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CBRE Group, Inc. (CBRE)

Q3 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the CBRE Third Quarter 2022 Earnings Conference Call. At this time, all participants are on a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Brad Burke, Senior Vice President of Investor Relations and Strategic Finance. Thank you. Please go ahead.

Brad Burke

Senior Vice President Investor Relations, CBRE Group, Inc.

Good morning, everyone, and welcome to CBRE's third quarter 2022 earnings conference call. Earlier today, we issued a press release announcing our financial results, which is posted on the Investor Relations page of our website, cbre.com. There you will also find a presentation deck that you can use to follow along with our prepared remarks and an Excel file that contains additional supplemental materials.

Before we kick off today's call, I'll remind you that our presentation contains forward-looking statements that involve a number of risks and uncertainties. Examples of these statements include our expectations regarding CBRE's future growth prospects, including our 2022 outlook, operations, market share, capital deployment strategy, investments, and share repurchases, financial performance, foreign exchange impacts, cost management, the business environment, and any other statements regarding matters that are not historical fact.

We urge you to consider these factors and remind you that we undertake no obligation to update the information contained on this call to reflect subsequent events or circumstances. For a full discussion of the risks and other

factors that may impact these forward-looking statements, please refer to this morning's earnings release and our most recent annual and quarterly reports filed on Form 10-K and Form 10-Q respectively.

We have provided reconciliations of the non-GAAP financial measures discussed on our call to the most directly comparable GAAP measures, together with explanations of these measures in our presentation deck appendix.

I'm joined on today's call by Bob Sulentic, our President and CEO, and Emma Giamartino, our Chief Financial and Investment Officer.

Now, please turn to slide 5, as I turn the call over to Bob.

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

Thank you, Brad, and good morning, everyone. Lower core EPS in the third quarter reflected a sharp deterioration in the macro environment, particularly with regard to capital availability for transactions. Nevertheless, core EPS was well-above any third quarter in our history, except for last year's especially strong result, even in light of a \$0.07 drag in this year's quarter from foreign currency effects. This underscores the resiliency we built into the business.

In contrast with last year's strong third quarter, the capital markets environment weakened materially as the quarter progressed. Property sales performed in line with expectations in July and August. However, most debt and equity capital sources moved to the sidelines after Labor Day, causing both sales and loan originations to fall sharply. In addition, as expected and previously communicated, we completed far fewer development asset sales this year than in last year's strong third quarter, mostly driven by the front-end loading of asset sales this year.

We also delayed selling some assets during the third quarter. As we noted last quarter, when market dislocations caused transaction activity to decline, those transactions are typically paused and returned to the market, when the uncertainty passes.

We took advantage of the temporary market dislocation to continue repurchasing shares at an elevated clip. In contrast with sales and financing, leasing performed very well. Revenue was up across all property types, led by office. In addition, as we discussed previously, many parts of our business are either cyclically resilient or benefit from secular tailwinds. These businesses, including occupier outsourcing, valuations, property management, loan servicing, investment management and project management posted solid results for the quarter.

We plan to further capitalize on our balance sheet to invest in secularly favored parts of our business that add differentiated capabilities. Over the last two years, project management, flex office space, renewable energy and industrial and multifamily assets have been at the forefront of those efforts.

Going forward, in addition to those areas, we are particularly focused on both enterprise and local facilities management, investment management and the more cyclically resilient Advisory business lines, while also continuing our share repurchase program.

As we prepare for a tougher operating environment, Emma will discuss how we have already been identifying cost savings while aiming to continue investments that will sustain long-term growth. Many economists, including our own, have cautioned that the market outlook is especially difficult to forecast right now because of an unusual confluence of high inflation, coupled with strong consumer spending, resilient employment growth amid a tightening credit cycle, and residual pandemic and Ukraine war-related challenges.

With this caveat in mind, we have updated our full year core EPS growth expectations to be up mid-single digits compared with 2021. Absent the challenging foreign currency comparisons, we expect our 2022 core EPS growth would achieve low-double-digit growth over 2021. While economic downturns are never welcomed, they present opportunities to consolidate our position as global occupiers and investors gravitate to the industry leader. We fully intend to make the most of these opportunities.

With that, I'll hand the call to Emma for deeper commentary on the quarter and our outlook.

Emma Giamartino

Global Group President, Chief Financial Officer & Chief Investment Officer, CBRE Group, Inc.

Thank you, Bob. As Bob noted, global economic sentiment has deteriorated since our last quarterly update. More specifically, and as you've all been following closely, since we last reported, the 10-year treasury rate has spiked 140 basis points. The S&P 500 has declined by 7% and public rate prices have fallen by 16%. The futures market is now indicating that the Federal Reserve will raise rates more steeply and use them less quickly, resulting in a harsher and longer downturn than when we last reported.

It is worth reiterating that this has all happened in just the last 90 days. This more negative backdrop began to impact our business late in the third quarter, and there will be more impacts in the fourth quarter. CBRE's core EPS fell 19% from the prior year to \$1.13. And as Bob noted, the drivers were weakening capital market conditions, the timing of development asset sales, and a foreign currency headwind. Our results were, however, supported by the continued growth in the lines of business that, as Bob noted earlier, we see as cyclically resilient or secularly favored.

Net revenue from these businesses collectively increased 12% in local currency, excluding the contribution from Turner & Townsend; and 24% in local currency, including Turner & Townsend's \$284 million of net revenue in Q3.

Finally, our GAAP EPS grew by 7% in the quarter due to a \$183 million mark-to-market gain on our investment in Altus Power, which continues to benefit from demand for renewable energy solutions and its synergy with our CBRE businesses.

I'll discuss results for each business segment, starting with Advisory on slide 6. Total Advisory revenue rose 1% in the quarter or 5% in local currency, though performance diverged across business lines. Capital markets weakness emerged immediately following Labor Day, which historically has been a time of heightened sales activity. The decline was most pronounced in our Americas region where property sales revenue fell 16% during the quarter. While Americas' capital markets revenue, which includes sales and debt origination, was relatively flat for July and August, September revenue fell by 43%.

Outside the Americas, property sales rose 3% or 17% in local currency for the quarter. The decline in US property sales reflects sharply reduced credit availability. Typically, credit spreads have tightened as rates rise. However, higher rates have been accompanied over the past three months by credit spread expansion. Many capital sources have tightened underwriting standards considerably and set pricing at levels that are uneconomical for borrowers.

Against this backdrop, our mortgage origination revenue declined by 28% versus last year's Q3, while the value of loans originated fell 34%. Revenue declined less than loan volumes because more financing in the quarter came from the government-sponsored enterprises, which we had expected to occur during periods of market weakness.

The declining credit availability was broad-based, with only regional banks lending more than in last year's Q3. Difficult comparisons further impacted year-over-year growth. Our combined property sales and debt origination businesses grew by 79% in last year's third quarter, driven by a resurgence of activity following the brief 2020 recession.

We were encouraged to see our leasing revenue increase 14% or 17% in local currency, driven by large office and industrial transactions in major markets. Globally, leasing revenue increased across all major property types, with offers growing mid-teens off a low base, and industrial up high-single digits. Property management, valuation and loan servicing all proved to be resilient, as expected, collectively realizing net revenue growth of 2% or 8% in local currency.

Advisory Services segment operating profit declined by 19% or 15% in local currency. Overall, Advisory margins on net revenue declined by 4.2 percentage points, including the decline in loan origination-related OMSRs.

Slide 7 illustrates the drivers of Advisory's lower margin versus prior year. Just over half the decline in Advisory segment operating profit margin is attributable to higher cost of services, with Advisory gross margins declining [ph] 2.2 percentage points (11:20) year-over-year, or 1.9%, excluding OMSRs. Approximately 80 basis points of the gross margin decline is due to higher broker commissions. Strong growth in the front half of the year resulted in an outsized number of brokers achieving higher splits earlier than we've seen historically. This will also impact the fourth quarter, albeit to a lesser degree, before the annual reset next year.

For context, approximately one-third of our US brokers had historically reached higher tranches by the third quarter. For 2022, the percentage of US brokers reaching higher tranches is almost 50%. It is important to note that our average commission expense naturally increases during strong years and declines during soft years. For example, in 2020, only a quarter of producers had reached a higher tranche for the third quarter.

The remainder of the gross margin decline is due to investments to support growth, broker recruitment costs, and revenue mix, as revenue erosion was steepest in debt origination, our highest margin line of business. Additionally, Advisory operating expenses increased by \$47 million or 10% with the majority of the increase due to hirings that occurred in late 2021 or early 2022 as we prepared for a more robust growth environment and higher employee compensation reflecting a tight labor market.

While we have and will continue to invest in target areas of growth in our business, we've also undertaken an equally targeted cost-cutting program, which I'll discuss shortly. While we began reducing operating expenditures during the third quarter, which showed the lowest year-over-year growth in OpEx since Q1 2021, only a fraction of our cost-cutting program was implemented during Q3 and thus did not fully reflect the impact of those reductions. We expect our cost programs to result in a single digit year-over-year decline in Advisory segment OpEx in the fourth quarter.

On slide 8, our GWS segment posted strong net revenue growth up 8% or 13% in local currency excluding the contribution from Turner & Townsend and 32% in local currency, including the contribution from Turner & Townsend. Both facilities management and project management net revenue grew organically by double digits in local currency. We also remain pleased with Turner & Townsend, which is performing in line with expectations.

Facilities management growth was supported by significant expansion work with our existing client base, particularly with technology clients. And project management growth was driven by space redesigns and fit-outs, often tied to our clients' changing use of office space. Our GWS new business pipeline is on pace to end the year

above the prior year's fourth quarter, with our opportunities coming from new and existing clients across a range of industries.

GWS' segment operating profit margin on net revenue was 11%, excluding the impact of Turner & Townsend, down from an unusually strong third quarter of last year. The 11% margin represents a sequential improvement, and was in line with our expectations, as margins continue to normalize from COVID-related highs.

Turning to our REI segment on slide 9. Segment operating profit of \$59 million represents an \$88 million decline from the prior year. You'll remember last quarter we told you 75% of the REI segment's total operating profit would be realized in the first half of the year, due to the cadence of our development asset sales. The segment operating profit decline is predominantly due to this anticipated deal timing.

Within REI, investment management realized operating profit of \$44 million, down 12% from last year. In local currency, the decline was 4%. Beyond FX, prior quarter results were bolstered by an \$11 million positive mark-to-market on our \$335 million co-investment portfolio, versus a negligible mark-to-market in the current quarter.

The overall decline masked continued growth of asset management fees, which increased by 19% in local currency, even though adverse currency movement reduced AUM to \$143.9 billion. Our development business realized \$17 million of operating profit, against \$100 million in the prior year, reflecting Even though adverse currency movement reduced AUM to \$143 billion.

Our development business realized \$17 million of operating profit against \$100 million in the prior year, reflecting fewer asset sales during the third quarter. While we expected most of this decline when we provided our last quarterly update, we elected to pause on selling certain assets as we await for capital markets sentiment to improve. And as we noted last quarter, our development business utilizes highly flexible financing, which enables us to monetize assets when market conditions are accommodating and to pause when appropriate.

Please turn to slide 10. While we cannot dictate the macroeconomic environment, we can control our costs and how we allocate our capital. We are targeting over \$400 million of cost reductions due to management actions. This is in addition to the naturally flexible cost reductions when business declines, such as discretionary bonuses, incentive compensation, profit sharing and commissions. As discussed last quarter, CBRE can ramp up cost reduction activities as market conditions necessitate.

Our current cost reduction program is driven by our [indiscernible] (16:56) economic assumptions, which, as we've discussed, envision a more challenging economy than we communicated last quarter. Approximately \$300 million of targeted cost reductions will be permanent in nature, with the vast majority coming from head count reductions. Beyond head count reductions, we also anticipate permanent reductions to our cost basis for third party and occupancy spending. The balance of the savings, approximately \$100 million is more temporary in nature, but we will continue them until market conditions improve.

These cost savings will come from reduced travel and entertainment, promotion and marketing spending and reductions to discretionary compensation plan. And to be clear, the planned reductions to discretionary compensation are above and beyond the natural flexibility of these plans that are already tied to financial performance.

Against our \$400 million cost target, we have identified \$175 million to be completed by the end of the year with the significant majority of the remainder to be completed by the end of Q1 2023. Only a small percentage of the

cost reductions taken to-date are reflected in [ph] Q2 (18:05) results due to a slight lag between taking action on head count reductions and having those cost savings reflected in financial results.

Given the nature of our cost structure, almost all of the planned reduction will be reflected in our operating expenditures, although we do anticipate achieving targeted reductions to some of the more fixed costs within our cost of services. While we are addressing our costs, you can expect us to invest more aggressively, utilizing our balance sheet during market weakness.

In the third quarter, CBRE repurchased 5.1 million shares for \$408 million, bringing our share repurchases through Q3 to nearly \$1.4 billion. We expect share repurchases to increase sequentially in the fourth quarter, ranging between \$500 million and \$700 million. We also continue to remain an increasingly robust pipeline of M&A opportunities. Current market conditions are increasing the likelihood that we'll be able to act on them. For now, though, buybacks remain the best use of capital, but that may change as we get into next year.

Please turn to slide 11. As we've discussed today, the broader economic outlook has worsened since our last update, necessitating that we revise our expectations for full-year performance. As Bob indicated, we now expect full-year core EPS growth to be up by mid-single digits compared with 2021. Our guidance most notably assumes that the capital markets remain under pressure.

We expect leasing to remain more resilient than property sales, albeit with more muted growth than we saw in the third quarter. Due to the headwinds in our transactional businesses, we expect full year Advisory segment operating profit to decline by mid- to high-single digits with FX driving 3 to 4 percentage points of the decline.

We expect our GWS segment will achieve low- to mid-20% segment operating profit growth for the full year, buoyed by continued strength in the fourth quarter. Absent foreign currency headwinds, we project segment operating profit growth for the full year in GWS would be 7 percentage points higher.

Within our REI segment, we believe we have realized approximately 90% of our full year segment operating profit, largely due to the expectation of few development asset sales in the fourth quarter. As noted previously, our outlook has been negatively impacted by the continued strength in the US dollar. At mid-year, we forecasted a \$100 million full year negative impact to core EBITDA from FX.

We've now raised the expected FX drag to \$125 million for the full year, with \$50 million hitting in Q4. Absent FX, we anticipate the core EPS growth would have been in the low double-digits for the full year.

We remind investors that it is difficult to forecast macro conditions and certain components of our business, notably capital markets. The timing of development sales and, to a lesser extent, leasing are subject to fluctuations in overall economic sentiment.

In closing, while near-term headwinds are intensifying, we remain as energized as ever about our long-term prospects and are committed to using our scale, balance sheet and cash flow to accelerate long-term growth and value creation.

With that operator, we'll open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. The floor is now open for questions. [Operator Instructions] The first question today is coming from Chandni Luthra of Goldman Sachs. Please go ahead.

Chandni Luthra

Analyst, Goldman Sachs & Co. LLC

Q

Hi. Good morning. Thank you for taking my question. So I understand, look, it's too early for 2023 outlook at this point, but if you could please perhaps give us some parameters to frame 2023, like what would you need to see engines in capital markets to get restarted? Is there a way to frame capital market activity in terms of first half versus second half? Like when do you think the outlook really starts to get better?

Emma Giamartino

Global Group President, Chief Financial Officer & Chief Investment Officer, CBRE Group, Inc.

A

Chandni, it's something that we're very focused on and we're working through our budgets right now to really determine what we're expecting in 2023. But from a macro level, if you look back to what we said 90 days ago, we view that we would be in a mild recession and that it would raise to peak in Q1 of 2023 and they would start to alleviate through 2023.

Our position now is that things have materially changed. We've seen that impacting our capital markets business directly. We are getting hit harder and faster than we were expecting 90 days ago and we're expecting the recession to impact our business for longer than we did 90 days ago. And so looking to next year, we do expect the capital markets to come back likely in the second half of the year. But that return is going to be more muted than what we initially expected when we talked to you in Q2.

Chandni Luthra

Analyst, Goldman Sachs & Co. LLC

Q

That's actually helpful color, thank you for that. Switching gears to margins a little bit, so 13% margins in the quarter down 450 bps, it's better than 3Q 2019, but then, of course, the worst is still ahead of us. So, help us frame margins in the context of 2019. Given that the macro is about to get much tougher and what you framed in your answer just recently, how should we think about margins in the context of 2019? Is there a scenario, do you think, we go all the way or do you think there is some recourse in the cost cutting plans that you laid out?

Emma Giamartino

Global Group President, Chief Financial Officer & Chief Investment Officer, CBRE Group, Inc.

A

Yeah. And Chandni, I'm going to talk about Advisory specifically because that's the most relevant piece [indiscernible] (24:20) what you're speaking to. And hopefully, it's clear what happened in Q3, but I just want to go through that.

In Q3, and we have this on slide 7 as you all saw, I think it's always important to look at our Advisory margin excluding OMSRs, so 30 basis points of the decline. That OMSRs are pure margins, and when they grow, they're adding margin. And when they decline, 100% of that margin comes out.

The second is we are in – because of the phenomenal first half of the year we had and the exceptional growth we delivered, our producers entered higher tranches much earlier than they ever have before. So, that was 80 basis

points of the margin decline. And those tranches reset at the end of the year. So, we don't expect that to be a headwind in 2023.

And then, the two remaining pieces are producer recruiting, where we are investing in our future growth. In the first half, we delivered again exceptional growth and we were investing in our costs to support that growth going forward. And then, on the operating expense side, again, we also were investing in new hires. We underinvested in 2021 simply because revenue accelerated faster than we can pick up our investments. And then, we also increased – we had wage inflation, just as every other company had.

So going forward, what we're seeing and looking into Q4, we should expect that operating expense growth to continue to come down. You look at the first half of the year, our operating expense in Advisory was up about over 19%. In Q3, our operating expenses came down to 10% growth year-over-year. And in Q4, that should – our operating expense should decline year-over-year and this is within Advisory.

And there's two components to how those costs are coming out. One is our discretionary cost levers that we can pull; pulling back on travel and entertainment, continuing to pull back on new hires, pulling back on new hires takes longer for that to come into our cost savings and then our discretionary bonuses. You'll also see some impact from our \$400 million cost savings program but that is going to be a meaningful lag there. Most of those savings you'll see in 2023 and that's because we take action on reducing head count and there is a lag in terms of when those costs come out of the system.

So net where we expect to end the year in Advisory, we expect our margins to be over 19% within Advisory. Excluding OMSRs, our margins should be over 18%. And that's an important number because that is a record margin excluding 2021 when our margins were inflated because our costs had not caught up to our revenue growth.

Chandni Luthra
Analyst, Goldman Sachs & Co. LLC

Q

Thank you for that detail.

Operator: Thank you. The next question is coming from Anthony Paolone of JPMorgan. Please go ahead.

Anthony Paolone
Analyst, JPMorgan Securities LLC

Q

Thank you and good morning. And, Emma, maybe just sticking on this margin discussion in Advisory. So if I'm understanding this right, on that page 7, that 190 basis point drag in the third quarter from OpEx, that actually flips and becomes a little bit of a benefit in 4Q. And so, if I'm kind of understanding and putting some narrative around this, is it just that come 4Q, you lose some of the drags on the cost side and the margin side, but you're more impacted by maybe the drawdown on the revenue side?

Emma Giamartino
Global Group President, Chief Financial Officer & Chief Investment Officer, CBRE Group, Inc.

A

Yes. And so, in Q4, across Advisory, we're expecting net revenue year-over-year to decline roughly 20%. And so – but we're also expecting margin expansion because of the cost. So, you're right.

Anthony Paolone
Analyst, JPMorgan Securities LLC

Q

Okay. Got it. And then, just within Advisory in the quarter, just to kind of understand mortgage originations and loan servicing a bit better. I'm just – I would have thought mortgage originations would be a little bit more insulated because people kind of have to refinance and do things, whereas investment sales, they maybe don't have to sell the asset. But that didn't seem to be the case. Like any thoughts on just maybe why that was or if that, like, reverts?

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Yeah. Yeah. Tony, that is just a function of the fact that we had two things go on. Rates went up and spreads went up. Typically, when you see rates go up the way they did, spreads will come down a little. But both of them went up and it – and people just avoided refinancing because it was so expensive. It's that simple. And we had that circumstance play out in a way that was beyond what we would have expected.

Now, here's what I'll say about that. It's going to – we think in the fourth quarter that you will see financing perform better than new sales. People are just not going to come back and trade assets until interest rates go down and until they think they can get the pricing they want, which will happen after – in our view, after the Fed starts to go the other direction with interest rates, which we – which, as Emma said in her prepared remarks, we think may happen later next year. But that's really what you saw happen in Q3 and especially what you saw happen in September.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

Okay. Got it. And then, just last one for me on the leasing side. You pointed out office as having been pretty strong. It's also a fairly cyclical property type. Like, how much more runway do you think is left there to get back to normal when you kind of net that against maybe, perhaps, activity slowing because of the more macroeconomic factors?

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Tony, when you say how much runway, is it till that gets back to normal, give a little more on that. I want to make sure I understand what you're asking there.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

Yeah, sure. I was under the impression, like, office maybe looked particularly good because you were still having some of the post-COVID recovery and just decision making, but maybe that's off.

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

No, no. What's going on is, in fact, that there was – and we talked about this last quarter. There were abundance of renewals in the marketplace to be done. We'll see that continue this year and into next year. But what we also expect to see now is some downward pressure as we go into a recession. There's always downward pressure on leasing in a recession because people are looking around trying to find ways to defer cost, save money. And so, what they – you have this dynamic that goes on where they extend for a short period of time, et cetera.

So, we expect to see some of that come in and leasing to be more flattish in the fourth quarter. But we still expect some of the benefit from the built-up number of renewals that need to be dealt with to occur in the fourth quarter and into next year.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

Okay. So, it sounds like maybe it's a net kind of flattish number between sort of the renewals getting cleared and the headwind from the macro.

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

That's what we think. It may be a little down, but that's how we think it's going to play out.

Emma Giamartino

Global Group President, Chief Financial Officer & Chief Investment Officer, CBRE Group, Inc.

A

Yeah. And, Tony, for Q4 specifically, we're expecting leasing to be flat.

Anthony Paolone

Analyst, JPMorgan Securities LLC

Q

Okay. Great. Thank you.

Operator: Thank you. The next question is coming from Steve Sakwa of Evercore ISI. Please go ahead.

Steve Sakwa

Analyst, Evercore ISI

Q

Great. Thanks. Just a couple. Emma, just on that last point, you said Q4 leasing to be flat in office. Is that – I just want to be clear. Is that year-over-year?

Emma Giamartino

Global Group President, Chief Financial Officer & Chief Investment Officer, CBRE Group, Inc.

A

To be clear, that's flat globally across all product types, and that's year-over-year.

Steve Sakwa

Analyst, Evercore ISI

Q

Okay. Thanks. I was wondering if you'd just provide any comments on the industrial sales market. I know that's an area that you guys have been fairly active in. It's obviously been one of the more favored asset types within REIT land. But we have seen a pullback in that leasing market as well, so I'm just curious if you have any comments on kind of industrial cap rates and the appetite today.

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Yeah. Industrial cap rates, like all cap rates, have gone up. Industrial fundamentals have remained very strong. They've backed off a little bit. We've seen a little bit of downward pressure on rental rates in some areas. We've seen slightly more vacancy, although the fundamentals are very, very strong. The market's held up very well and the major markets, very little vacancy. Strong demand still. So, that has created a circumstance where there are

buyers for the assets, and there are owners of assets and developers – investors and developers that want to sell. But they're just not going to sell in the current environment because cap rates have ticked up and finances is expensive. And in our own portfolio as a developer, we've made the choice to defer sales for some of our assets, some of our industrial assets.

And I think what happened, as we've already commented – or what will happen, as we've already commented, when that circumstance eases, and we think that likely will be the second half of next year, those assets in the pipeline will get sold. Pipelines are very strong. The pipelines of assets that sellers want to sell and buyers want to buy are strong. And we think starting in the second half of next year, you'll see all of that free up to a degree and start to – that market activity start to happen again.

Steve Sakwa

Analyst, Evercore ISI

Q

Great. Just – I guess, one more question. If you could provide any comments around sort of the Industrious and office kind of leasing business that you guys have. And I'm just curious, what uptake you've seen in that business in just kind of the short-term office leasing business.

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Well, office leasing and Industrious, they share some dynamics, but they're different. Industrious provides a capability in the marketplace that's unique. You can get in and out quickly. You can get in and out without capital expenditure. You can adjust the amount of space you have very quickly. You can go into places that you don't intend to be long term. And with all the uncertainty around the use of office space and where it's going to go, Industrious' business has done quite well and we believe it will continue to do quite well and we're very excited about that investment and the performance of that investment.

We've already commented today on office space. There's – there is – what you're seeing in the leasing on office space is at a pent-up amount of renewal activity, and uncertainty about what's going to happen long-term with offices. There's also a big bifurcation in how different parts of the office market are performing, with the best buildings, the premier buildings doing quite well, with rents up and the less quality, less favored buildings suffering much more.

Steve Sakwa

Analyst, Evercore ISI

Q

Yeah. Sorry, Bob. My question wasn't clear. I wasn't trying to follow-up on Tony's question, I was really asking specifically about the trends in Industrious. And just what maybe market share you're seeing the WeWorks, the Regis', the Industrious is taking in the office leasing business, against, kind of, traditional office leasing?

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Yeah. And that was my comment, that's where I started with Industrious. The trends that Industrious is seeing in the marketplace are very positive. We would characterize it as a record level of interest in that type of space. And it's being subjected to some different dynamics than regular office space. It creates flexibility, it creates the opportunity to get in and out of office space without capital expenditure. It creates the opportunity to get into a smaller amount of space in more convenient locations that you may not want to commit to long-term. And as a result, it's doing extremely well.

Steve Sakwa

Analyst, Evercore ISI

Great. Thanks. That's it for me.

Q

Operator: Thank you. The next question is coming from Jade Rahmani of KBW. Please go ahead.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Thank you very much. What are you seeing in the GSE multifamily lending business? Historically, they've been countercyclical providers of capital. They don't price through a securitization exit, at least private label. And so, their spreads may not be as wide, and they do have ample capacity on the FHFA-governed lending caps. Are you seeing them step up in this point of time?

Q

Emma Giamartino

Global Group President, Chief Financial Officer & Chief Investment Officer, CBRE Group, Inc.

Jade, we are seeing the GSEs pick up in this past quarter. They've contributed a larger portion of our volume than they did in the prior quarter, so picked up from 20% of our volume to 25% in this quarter. So, they are offsetting some of the declines from the private lenders, but the entire market is down. And so, even though they are picking up, it's not as material as you might expect.

A

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Thank you. In terms of REI's prospects, how sensitive is the outlook to where interest rates are, meaning if projects once stabilized need to finance at a mortgage [indiscernible] (38:28), is that going to inhibit sales out of that segment for potentially a longer-than-expected period?

Q

Emma Giamartino

Global Group President, Chief Financial Officer & Chief Investment Officer, CBRE Group, Inc.

And, Jade, are you asking through the remainder of this year?

A

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Say for next year. I mean, the timing of the outlook isn't that important. But I'm more concerned about if mortgage rates were stickier at, say, something in the 6% range, would that really inhibit a lot of those projects that are waiting to be sold? Would that inhibit the ability to sell those?

Q

Emma Giamartino

Global Group President, Chief Financial Officer & Chief Investment Officer, CBRE Group, Inc.

Yeah. So, the way we think about development, and we provided a range of conversion in that we take our in-process portfolio, which is currently over \$19 billion and, typically, that converts to SOP in the range of 1% to 2% in any given 12-month period.

A

Going into recession, and this is what we've said last quarter, going into 2023, we'd expect that in a mild recession, we should get to the bottom end of that range into the 1% range. And that's driven by two pieces: one,

cap rate expansion so that we're monetizing the assets at a lower return, but also the ability for us to choose to wait to sell the assets until the environment improves.

We have a really strong balance sheet. We have really flexible financing, so that allows us to make the decision that we don't want to monetize in a challenging environment and we don't want to wait to sell. And so, it'll be at the low end of the 1%. And then, if the environment is very challenging, it could dip slightly below that 1%. But I want to remind everyone that that doesn't mean those asset sales and monetizations are going away. Those should then appear in 2024 or whenever the market recovers.

[indiscernible] (40:23)

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Go ahead. Sorry.

Q

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

Yeah. I'm going to add to that. That's true of our portfolio and that's true of everybody else's portfolio in general. Those asset sales will happen eventually. The assets are there. They're ready to be moved from one party to another. But the parties aren't going to do that until they feel like they're confident in the fairness of the pricing on the sell side and the buy side and the availability of financing that works.

A

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Thank you. Just more broadly speaking on investment management, I mean, as long as I've covered this space, the theory has been institutionalization, increased allocations to real estate from LPs, sovereign wealth funds, et cetera. And for the first time, we're starting to hear chatter that's in the opposite direction that there's an over allocation because of the decline in equity markets and fixed income and that LPs are getting nervous about allocating to CRE. Has anything really changed on that long-term secular trend in your view?

Q

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

Not on a long-term sense, nothing at all has changed in that regard. In the short term, you're describing the denominator effect, which we haven't seen it for a long time, but we have seen it before. And – and it'll – I think we will revert back to the trends we saw previously over the last decade. We're quite confident that will be the case. That's what we – we're very actively engaged with capital sources around the world, and that's where their head is at. But we do have this short-term circumstance that's precipitated by the debt markets and also the denominator effect. And that's really what we're seeing here and hearing about.

A

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Thank you very much.

Q

Operator: Thank you. The next question is coming from Stephen Sheldon of William Blair. Please go ahead.

Stephen Sheldon

Analyst, William Blair & Co. LLC

Q

Hi. Good morning. First, wanted to dig in more on the GWS new business pipeline. I think you said it increased significantly in the third quarter. Is there anything specific, I guess, driving that? And is macro uncertainty having any impact there in terms of delaying decision making? Or could it actually be creating more urgency to outsource to vendors like CBRE in this type of environment? Just love some more detail on what you're seeing there.

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Yeah. Stephen, there's a number of factors at play there. Whenever you go into periods of financial stress, companies everywhere look for opportunities to save costs. Our outsourcing offering helps them save costs. It's demonstrably able to do that. And so, that's helping that capability sell in the marketplace right now.

The other thing in times of economic uncertainty is sometimes decision-making is slower. And so, while we have this – our large pipeline, you may see some slower decision-making. The third thing that's going on is we are continually adding to our capability in that area. Our procurement capability is getting better, the data that we can provide clients to help them make decisions is getting much better. We have a product called Vantage Analytics that they like a lot that helps them make decisions that causes them to be attracted to us. Our ability to connect our offering around the world and serve them in a way that's consistent is getting better. So that is all playing to our favor and that's some of what you've seen come through this year in the build-up of the pipeline and the landing of new business. But the cost factor is always at the top of the list, when you dig into that business and figure out what clients really want.

Stephen Sheldon

Analyst, William Blair & Co. LLC

Q

Got it. That's really helpful. And then, the follow-up, I guess, I just wanted to ask, as we kind of think about FX, headwinds, I think you report your currency exposures in the SEC filings for revenue, but just curious if your expenses would also – your expense exposure would also closely correlate to that? Or would you call out anything there where there's a material mismatch?

Emma Giamartino

Global Group President, Chief Financial Officer & Chief Investment Officer, CBRE Group, Inc.

A

It's generally aligned. Our cost is being impacted in a very similar way to our – into our revenue.

Stephen Sheldon

Analyst, William Blair & Co. LLC

Q

Okay. Great. Thank you.

Operator: Thank you. The next question is coming from Patrick O'Shaughnessy of Raymond James. Please go ahead.

Patrick O'Shaughnessy

Analyst, Raymond James

Q

Hey. Good morning. After the global financial crisis, it took, I think probably seven or eight years for industry sales activity to rebound to peak levels. And then after the pandemic, it obviously just took one year. Given kind of what

you're seeing in the macro right now, how are you think about the pace of recovery of the sales outlook? And whether we're seeing deals just delayed? Or whether deals get canceled?

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Well, Patrick, one thing that's interesting is how long it's been now since the financial crisis. The cycles that we had previous to that were shorter. And so, that, kind of, impacts people's thinking. The other thing that impacts people thinking is they forget how deep the financial crisis was, and how unusual it was compared to other downturns. But I can tell you, what we're seeing now, and we've used this term multiple times on this call, pipelines, there is a definitive identifiable pipeline of projects across property types that want to be sold by the owners.

And there is a lot of capital out there that wants to buy. And neither of them think this is the right time to transact, that's what you're really seeing. We believe that when interest rates start to go the other direction, when the Fed reverses course because they think that the economy has gotten to a point where continued upward pressure on interest rates goes from being a problem solving circumstance to a problem creating circumstance, that we will see that pipeline start to transact and it'll recover. I mean, we can't give an exact number of years, but it'll recover considerably more rapidly than it did coming out of the financial crisis.

Patrick O'Shaughnessy

Analyst, Raymond James

Q

Great. That's helpful. Thank you. And then as to your expense reductions, obviously, you guys took some expense actions during the pandemic. How much more room do you have to cut before you get into the muscle? And maybe you start potentially losing market share?

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Yeah. Well, Emma commented on the \$400 million number, that's the number we believe we can cut, without impacting our ability to grow the business and serve our clients in the future. A lot of work went into, from the grassroots level up and from top down to identify that \$400 million number. And I want to stress again something Emma said. We have a massive amount of our cost basis that flexes automatically when revenues go down, commissions, profit sharing and development, and investment management, incentive, equity, bonuses, all of that is completely independent of this \$400 million, \$300 million of which we think will be permanent and \$100 million of which we think will come back when things get better. And we don't think that that \$400 million will create problems for our business at all.

Patrick O'Shaughnessy

Analyst, Raymond James

Q

Great. Thank you.

Operator: Thank you. Our next question is a follow-up coming from Jade Rahmani of KBW. Please go ahead.

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you very much. A question investors often ask is where are commercial or let's just say capital markets overall versus some prior period, say, 2018, 2017. But I know that you all are constantly hiring producers. So,

could you give any sense for what the growth rate in number of producer head count has been on the brokerage side relative to some past period so that we could adjust for that? And, also, I think even if commercial real estate prices decline, the absolute nominal dollar of commercial real estate value is probably significantly higher than it was in 2017. So, hard to compare next year versus 2017, but any color on that would probably be helpful. Thank you very much.

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

A

Yeah, Jade. We'll give a conceptual answer to that. We don't have specific numbers on brokers. But we have had a strong year for brokers recruiting, and it was intentional because we believe that the opportunity to grow that business in the long term is there, and we believe it was the right time to get into the market and bring some new brokers on. So, relative to history, it would stack up well relative to our good brokerage recruiting years in the past. But we don't have specific numbers for you on that.

Operator: Sir, did you have any other questions?

Jade Rahmani

Analyst, Keefe, Bruyette & Woods, Inc.

Q

No. Thank you very much for taking the questions.

Operator: Thank you. This brings us to the end of the question-and-answer session. I would like to turn the floor back over to Mr. Sulentic for closing comments.

Robert E. Sulentic

President, Chief Executive Officer & Director, CBRE Group, Inc.

Thanks, everyone, for being with us. And we look forward to talking to you again when we report our year-end results.

Operator: Ladies and gentlemen, thank you for your participation and interest in CBRE. This concludes today's event. You may disconnect your lines and log off the webcast and enjoy the rest of your day.

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