The NAIC's Capital Markets Bureau monitors developments in the capital markets globally and analyzes their potential impact on the investment portfolios of U.S. insurance companies. A list of archived Capital Markets Bureau Special Reports is available via the INDEX.

Lodging Exposure in U.S. Insurer Commercial Mortgage-Backed Securities (CMBS) Investments, Year-End 2019

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Executive Summary

- Total U.S. CMBS outstanding was about $490 billion according to Trepp as of March 2020, with more than $86 billion in outstanding balances collateralized by hotel/lodging properties across the U.S.
- Due in part to the economic impact of COVID-19, lodging loan defaults are expected to peak at 10% by the end of 2021, as 'extreme cash flow disruption" is likely due to massive hotel cancellations.
- For U.S. insurers, about $125 billion CMBS in book/adjusted carrying value (BACV) out of a total $173.5 billion modeled by the NAIC included CMBS collateralized by conduit and single asset/single borrower (SASB) lodging loans as of year-end 2019; about $96 billion of the $125 billion was in senior, high credit quality tranches.
- Life companies accounted for about 75% of the U.S. insurance industry's total exposure to CMBS, followed by 22% with property/casualty (P/C) companies and 3% with health companies.

Overall CMBS Market & Lodging/Hotel Loan Collateral

As of March 2020, U.S. CMBS outstanding was about $489.2 billion according to Trepp, a data source for securitized mortgages. Trepp data also shows that about 3,000 CMBS loans, totaling over $86 billion in outstanding balances, were collateralized by hotel—i.e., lodging—properties across the U.S., with more than 25% collateralized by lodging properties/hotels in multiple states.[1] The largest state exposures

[1] Trepp, *Spotlight on the Lodging Sector: $86.0 Billion in Hotel CMBS Exposure*, March 2020.

were California and Florida, each accounting for more than 10% of the outstanding balance of lodging/hotel loans as of March 24.

While originations of new CMBS have slowed almost to a halt due to market disruption, according to Credit Suisse research dated March 2020, there was a renewed interest by investors for senior CMBS tranches the week after the recent "…[the] Fed's policy actions, a rally in competing products (including corporates and equities) a drop in volatility and [the] $2 trillion congressional stimulus package."[2]

FitchRatings research cited that it has placed all CMBS with hotel, or lodging, exposure on Rating Watch Negative, as they are anticipating "extreme cash flow disruption" due to massive hotel cancellations and some even closing for the foreseeable future.[3] Consequently, some hotel/lodging loans are expected to default, estimated to peak near 10% by the end of 2021 according to Trepp and other sources). S&P Global Ratings research cited that between 2015 and 2018, about 15–17% of CMBS conduit collateral was collateralized by lodging, but it dropped to 12% in 2019.[4] Lodging collateral for Single Asset/Single Borrower (SASB) CMBS peaked at 40% in 2017 and 2018, but it decreased to 16% year-to-date in March 2020. Also, according to S&P Global, the lodging sector tends to react to changes in the economy before any other property sector, regardless as to whether it is a positive or negative impact, due in part to not having long-term leases, which makes it more volatile than others; it is susceptible to global events that affect travel.

U.S. Insurer CMBS Investments – Lodging Exposure

As of year-end 2019, U.S. insurers held approximately $190 billion in book/adjusted carrying value (BACV) CMBS investments; $173.5 billion of this total was modeled by the NAIC for the purpose of assigning NAIC designations (the remainder did not meet modeling requirements). U.S. insurer exposure to CMBS with lodging loans totaled $124.9 billion, which includes CMBS collateralized by conduit and SASB loans (see Table 1) and represents about 72% of total CMBS modeled by the NAIC. Mitigating concern, about 77% of the industry's total CMBS exposure with lodging loans, or $96.3 billion, was in Senior, high credit quality tranches.

[2] Credit Suisse, *CMBS Market Watch*, March 2020.
[3] FitchRatings, *Scanning North American CMBS for Coronavirus Vulnerability*, March 2020.
[4] S&P Global Ratings, *U.S. Lodging-Backed CMBS Bracing For The Impact of COVID-19*, March 2020.

Table 1: Total U.S. Insurer CMBS Investments*, Year-End 2019 ($BACV)

Industry Type & Tranche	Conduit with Lodging Exposure	Single Asset Single Borrower with Lodging Exposure	No Lodging Exposure	Total	% of Total
Life	***93,688,712,554***	***1,733,888,804***	***34,630,761,766***	***130,053,363,124***	***75%***
Senior	70,051,538,397	609,019,996	14,664,757,412	85,325,315,805	66%
Mezz	23,102,380,512	955,219,972	17,791,917,106	41,849,517,590	32%
Sub	534,793,645	169,648,836	2,174,087,248	2,878,529,729	2%
P/C	***25,352,271,970***	***731,657,089***	***12,230,956,447***	***38,314,885,506***	***22%***
Senior	22,356,067,395	249,868,800	6,716,138,940	29,322,075,135	77%
Mezz	2,933,592,373	376,851,091	5,189,190,429	8,499,633,893	22%
Sub	62,612,202	104,937,198	325,627,078	493,176,478	1%
Health	***3,337,233,549***	***113,377,163***	***1,658,447,393***	***5,109,058,105***	***3%***
Senior	2,985,467,072	52,809,749	976,133,759	4,014,410,580	79%
Mezz	347,284,698	59,009,444	678,860,465	1,085,154,607	21%
Sub	4,481,779	1,557,970	3,453,169	9,492,918	0%
Total Industry	**122,378,218,073**	**2,578,923,056**	**48,520,165,606**	**173,477,306,735**	**100%**
% of Total Industry	71%	1%	28%	100%	

*Includes CMBS investments modeled by the NAIC.

Life companies accounted for about 75% of the U.S. insurance industry's total exposure to CMBS (based on tranches modeled by the NAIC), followed by 22% with property/casualty (P/C) companies and 3% with health companies.

The $124.9 billion of CMBS lodging exposure within the U.S. insurance industry was to 472 CMBS deals with a total deal balance of $377.8 billion. Within U.S. insurers' total CMBS with lodging exposure, there was about $75 billion in lodging loans (see Table 2), representing 60% of total U.S. insurer CMBS exposure with lodging loans, at year-end 2019. Almost all lodging loans were issued post-2008 financial crisis, and about two-thirds were held within conduit CMBS (with SASB accounting for the remaining third for the most part, or $28.1 billion). As the lodging/hotel sector is expected to be severely affected by the current COVID-19 pandemic, concern is mitigated somewhat by relatively conservative underwriting, evidenced by an average debt service coverage ratio (DSCR) of 2.6x, and a loan-to-value (LTV) of 59% for U.S. insurer CMBS lodging loan exposure.

Table 2: Total U.S. Insurer CMBS Lodging Loans Exposure, Year-End 2019

Deal Type	Vintage	Lodging Loan Balance ($MM)	Deal Lodging %	Avg Lodging Loan Count	Total Lodging Loan Count	Remaining Term (Months)	DSCR	LTV %
Conduit	Pre Crisis	280	14.2%	1	15	18	1.3	133
Conduit	Post Crisis	46,464	13.5%	7	2,744	67	2.0	60
Sngle Asset/Borrower	Post Crisis	28,167	100.0%	1	70	14	3.5	58
Large Loan	Post Crisis	666	40.2%	2	12	21	3.8	48
Other	Post Crisis	155	14.0%	2	7	60	2.0	55
Total		**75,732**	**20.0%**		**2,848**	**46**	**2.6**	**59**

Source: BlackRock Solutions

Summary

Concluding, while the lodging/hotel industry is expected to experience double digit defaults due to major cash flow disruption over the next two quarters, concerns regarding U.S. insurer exposure to CMBS collateralized by lodging loans is mitigated by the high credit quality of the majority of the investments; i.e., they are mostly senior tranches with high credit quality ratings, and the total BACV of exposure is less than 3% of U.S. insurer total cash and invested assets. Still, U.S. insurers with thin capital buffers and high relative exposure to financial market volatility are most at risk of potential credit deterioration, and they should be monitored accordingly.

The NAIC Capital Markets Bureau will continue to monitor financial market trends with U.S. insurer investments and report as deemed appropriate.