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Retail Exposure in U.S. Insurer Commercial Mortgage-Backed Securities Investments, Year-End 2019

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Executive Summary

- Total U.S. commercial mortgage-backed securities (CMBS) outstanding was about $490 billion according to Trepp as of March 2020, with about $122.5 billion in outstanding balances (or 25%) collateralized by retail properties across the U.S.

- Retail loans placed in the category of either "late but within grace period" or "late beyond grace period" were 9.6% as of early April 2020, as many brick-and-mortar stores have closed resulting in a significant decrease in revenues.

- For U.S. insurers, about $136 billion CMBS in book/adjusted carrying value (BACV) out of a total $173.5 billion modeled by the NAIC had exposure to retail loans as of year-end 2019; about $125 billion of the $136 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 & Retail Loans

As of March 2020, U.S. CMBS outstanding was $489.2 billion according to Trepp, a data source for securitized mortgages. Trepp data also indicated that about 25% of mortgage debt outstanding is derived from commercial real estate loans backed by retail properties.[1] Rather than the 8–10% increase in CMBS new issuance that was initially expected for this year, market participants are expecting a

[1] Trepp, *The State of the Retail Market in Times of Global Pandemic*, March 2020.

double-digit decline for 2020, in stark contrast to 2019 new issuance, which was the strongest year since the last financial crisis.[2]

The outbreak of COVID-19 has adversely affected the retail sector of the real estate market. To slow the spread of the virus, social distancing guidelines have been put in place and nonessential businesses across the country have been forced to shut down. After several weeks of this countrywide shutdown, the performance of the already distressed retail sector started to take a toll. Not only have brick-and-mortar stores closed, but there are also several chains seeking rent reductions. According to Trepp, in April 2020, the loans placed in the category of either "late but within grace period" or "late beyond grace period" increased to 9.6% from about 1.7% in March 2020.[3] This trend will likely lead to an increase in the near-term delinquency rate.

FitchRatings, reflecting the near-term financial impact of the guidelines and enacted policies, expects the near-term retail delinquency rate to sharply increase to approximately 20%, surpassing its prior peak of 7.67%, and it expects bankruptcies to occur at weaker retail tenants.[4] Loans secured by lower tier malls and outlet properties are at risk of default due to a lack of access to capital and/or an inability to inject additional equity; however, loans from higher tier regional malls with strong sponsorship, along with retail properties that include “essential industries” such as supermarkets, pharmacies and banks as tenants, will be less affected.

FitchRatings research cited that it has placed 35 tranches of debt from five multi-borrower (conduit) CMBS on Ratings Watch Negative that have more than 25% exposure to retail collateral, and its outlook for the retail sector is negative. While it was “already under pressure from e-commerce, the pandemic will further add pressure … in already weak malls, leading to the potential for bringing forward [additional] retail bankruptcies.”[5]

U.S. Insurer CMBS Investments – Retail Exposure

As of year-end 2019, U.S. insurers held approximately $190 billion in 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 retail loans totaled $136.3 billion, which includes CMBS collateralized by conduit and Single Asset/Single Borrower (SASB) loans (see Table 1), and it represents about 78.5% of total CMBS modeled by the NAIC. Mitigating

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[2] S&P Global Ratings, *Coronavirus Jolts CMBS Pricing and 2020 Issuance Expectations*, April 2020.
[3] Trepp, *April CMBS Remittance Data Reveals 10x+ Increase In Non-Payment of Hotel Loans; Almost 5x For Retail Loans*, April 2020.
[4] FitchRatings, *U.S. CMBS Delinquencies Projected To Approach Great Recession Peak Due To Coronavirus*, April 2020.
[5] FitchRatings, *Scanning North American CMBS for Coronavirus Vulnerability*, March 2020.

concern, about 77% of the industry's total CMBS exposure with retail loans, or $103 billion, was in senior, high credit quality tranches.

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

Industry Type & Tranche	Conduit with Retail Exposure	Single Asset Single Borrower with Retail Exposure	No Retail Exposure	Total	% of Total
Life	**98,090,353,933**	**6,257,590,486**	**25,705,418,705**	**130,053,363,124**	75%
Senior	73,087,212,638	2,982,273,493	9,255,829,674	85,325,315,805	66%
Mezz	24,388,234,226	2,907,337,546	14,553,945,818	41,849,517,590	32%
Sub	614,907,069	367,979,447	1,895,643,213	2,878,529,729	2%
P/C	**26,490,197,516**	**1,849,503,649**	**9,975,184,341**	**38,314,885,506**	**22%**
Senior	23,192,457,600	1,209,666,380	4,919,951,155	29,322,075,135	77%
Mezz	3,235,127,714	572,739,084	4,691,767,095	8,499,633,893	22%
Sub	62,612,202	67,098,185	363,466,091	493,176,478	1%
Health	**3,513,604,537**	**151,935,049**	**1,443,518,519**	**5,109,058,105**	3%
Senior	3,098,777,874	95,722,610	819,910,096	4,014,410,580	79%
Mezz	409,385,622	56,212,439	619,556,546	1,085,154,607	21%
Sub	5,441,041		4,051,877	9,492,918	0%
Total Industry	**128,094,155,986**	**8,259,029,184**	**37,124,121,565**	**173,477,306,735**	**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 P/C companies and 3% with health companies.

The $136.3 billion of CMBS retail exposure within the U.S. insurance industry concerned 556 CMBS deals with a total outstanding deal balance of $393.8 billion, of which about 31.8%, or $125 billion of the underlying loans, were retail loans (see Table 2) at year-end 2019. Almost all retail loans were issued post-2008 financial crisis, and about 80% were held within conduit CMBS (with SASB accounting for almost all of the remainder, or $22.6 billion). As the retail sector has been severely affected by COVID-19, concern is mitigated somewhat by relatively conservative underwriting, evidenced by an average debt service coverage ratio (DSCR) of 2x and a loan-to-value (LTV) of 62% for U.S. insurer CMBS retail loan exposure.

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

Deal Type	Vintage	Current Retail Loan Balance ($MM)	Retail Loan (%)	Avg. Retail Loan Count	Total Retail Loan Count	Remaining Term (Months)	DSCR	LTV (%)
Conduit	Pre Crisis	2,976	45.8%	4	306	8	1.2	153
Conduit	Post Crisis	97,976	27.2%	19	7,687	63	1.9	61
Single Asset/Borrower	Post Crisis	22,601	99.8%	1	63	49	2.7	53
Large Loan	Post Crisis	930	57.6%	3	18	19	2.8	55
Other	Post Crisis	556	23.2%	20	195	60	1.5	57
Total		**125,040**	**31.8%**		**8,269**	**59**	**2.0**	**62**

Source: BlackRock Solutions

Summary

While the retail loan industry is expected to experience double digit delinquency rates due to a severe impact on brick-and-mortar revenues, concerns regarding U.S. insurer exposure to CMBS collateralized by retail 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 appropriate.