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INSIGHT

COVID-19 Impact on Commercial Real Estate and Commercial Mortgage-Backed Securities

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The economic turmoil resulting from Coronavirus Disease 2019 (COVID-19)—particularly business interruptions and the decline in consumer activity—has negatively affected commercial real estate in numerous ways, leading to a sharp increase in delinquencies among commercial mortgage-backed securities (CMBS) borrowers in the past month. This Insight provides a brief overview of the commercial real estate (CRE) market, as well as some policy issues that may be of interest to Congress.

Overview of Commercial Real Estate Financing

The CRE market is large and complex. Because private companies own or lease most of the properties, valuing the market is difficult—but industry analysis suggests that outstanding CRE debt is around $3 trillion. As seen in **Figure 1**, banks are the largest lenders of CRE mortgages, but nonbank financial institutions, such as life insurance companies and CMBS lenders, also play a significant role. The general distinction between CRE mortgages and residential mortgages is the commercial use of CRE properties, meaning that they will be used for generating income rather than being used as a residence. Borrowers can be individuals or corporations looking to buy space to rent out to retailers or use for their own small businesses; corporations that want office space for their employees or factories for production; or investors buying multifamily apartment complexes with the hope of generating rent from the buildings' residents. CRE comprises many subsectors, including office and industrial space, retail storefronts, apartments, hotels, health care facilities, and other specialty properties (e.g., sports venues, storage units, and data centers).

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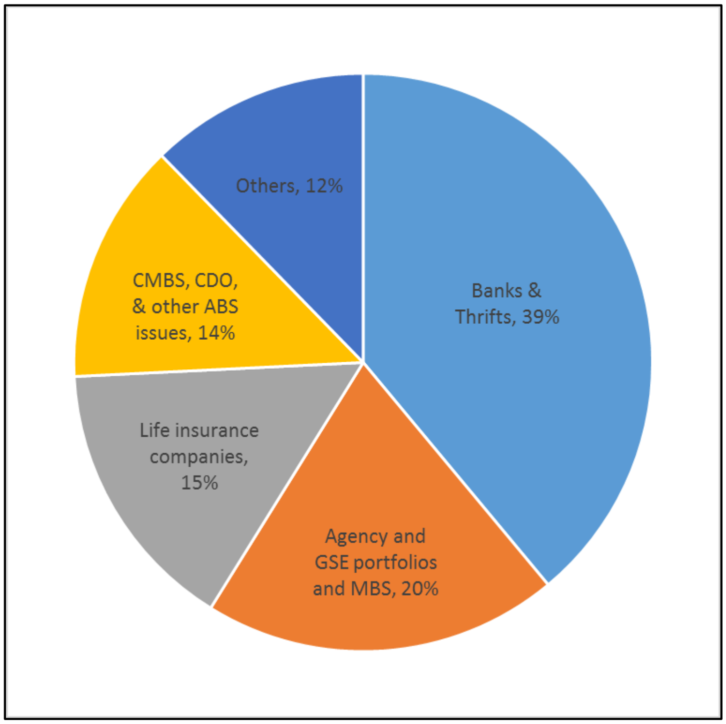
Figure 1. Outstanding Commercial Real Estate Debt

by lending institution share



Source: Mortgage Bankers Association, *Role of CMBS in the Financing of Commercial and Multifamily Real Estate in America*, October 2019, p. 11.

What Is the Role of Commercial Mortgage-Backed Securities?

One way borrowers can access funding for CRE is through a CMBS loan (known as a "conduit" loan), which is a CRE mortgage designed to be securitized and sold in the secondary market. CMBS loans are attractive to borrowers because they can carry lower rates than traditional CRE mortgages and allow borrowers flexibility in transferring or prepaying their mortgage. Some financial institutions specialize in making CMBS loans to borrowers and selling them to investors. Typically, life insurance companies, pension funds, money managers, mutual funds, and commercial banks invest in CMBS products.

Figure 1 shows that private securities backed by commercial mortgages and real estate comprise around 14% of the total CRE lending market. Mortgage-backed securities (MBS) for CRE constitute over a third of the market after adding the multifamily (i.e., properties with five or more residential units) portfolios and securitized issuances from Fannie Mae and Freddie Mac (collectively referred to as the government-sponsored enterprises, or GSEs) and Ginnie Mae.

What Is the Federal Role in Commercial Real Estate Finance?

Some federal agencies guarantee, insure, or securitize certain types of CRE loans. For example, the U.S. Small Business Administration (SBA) has programs that guarantee repayment of portions of eligible small commercial loans designed for fixed asset investments—which can include machinery or CRE. The Federal Housing Administration (FHA) insures certain multifamily loans. The U.S. Department of Agriculture (USDA) guarantees (and can issue) rural multifamily loans. Ginnie Mae securitizes these FHA and USDA loans. Additionally, the GSEs have lending programs focusing on multifamily housing.

Policy Issues for Congress

Commercial Real Estate Mortgage Servicer Liquidity

Federal bank regulators have issued considerable guidance and statements on how banks that service consumer loans and residential mortgages can work with customers during the pandemic, including by offering forbearance to those having trouble meeting their financial obligations. Under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act; P.L. 116-136), borrowers with federally-backed mortgages are given the right to request temporary forbearance on their loans. Multifamily residential loans securitized by the GSEs and Ginnie Mae are considered "federally-backed loans" under the CARES Act. This has placed some strain on mortgage servicers, which are responsible for remitting payments to lenders and investors regardless of whether they receive payments from borrowers. In April, the Federal Housing Finance Agency (FHFA) issued a statement that limited the obligation of servicers to advance up to four months of payments on loans in forbearance; this applies to single-family housing and does not include multifamily units. (Ginnie Mae implemented provisions to provide liquidity to servicers for both single- and multifamily properties.) Additionally, the Health and Economic Recovery Omnibus Emergency Solutions Act (HEROES Act; H.R. 6800), which passed the House on May 15, 2020, would expand access to the Federal Reserve's liquidity facilities to mortgage servicers of federally-backed loans, including multifamily loans.

CMBS mortgage servicing is more complex than residential mortgage servicing, with multiple servicers having sometimes competing interests. CMBS loan servicing duties are divided among three types of servicers: the master servicer responsible for executing the contracts of the CMBS; subservicers responsible for ensuring payments from the underlying mortgage borrowers; and special servicers appointed to manage defaults and loss-mitigation procedures. Policies aimed at liquidity for CRE and CMBS mortgage servicing may need to take into account this fragmentation.

Commercial Real Estate Market Intervention

Nonresidential CRE policy considerations differ from those pertaining to residential mortgages, where a primary policy goal is often to reduce the number of families who lose their homes. In the CRE market, the policy questions focus more on to what extent federal intervention should mitigate losses that would otherwise be borne by the private sector, in the hopes of avoiding potential future systemic risks. The Federal Reserve is purchasing federally-backed CMBS and supporting other CMBS through the Term Asset Backed Securities Loan Facility, as part of its response to COVID-19. However, a prolonged economic downturn resulting from depressed economic activity in retail space, restaurants, hotels, and other key parts of the CRE market may result in greater losses that these initiatives can addressed, raising the question of whether further policy intervention is needed.

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