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INSIGHT

COVID-19: Policy Options for Commercial Real Estate and Commercial Mortgage-Backed Securities Markets

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Recently, some Members of Congress have raised concerns over the commercial real estate (CRE) and commercial mortgage-backed securities (CMBS) markets and have called on Treasury and the Federal Reserve (Fed) to address potential liquidity issues. Challenges in those markets are discussed in CRS Insight IN11427, *COVID-19 Impact on Commercial Real Estate and Commercial Mortgage-Backed Securities*, by Andrew P. Scott. This Insight examines a few policy options for addressing these issues.

Why Residential and Not Commercial?

Conditions facing residential and commercial mortgage markets have numerous similarities; however, significant differences arise from the federal government's involvement in these markets. For instance, for both residential and commercial tenants, many are struggling to make payments to either their landlords or lenders. This in turn has created pressures on mortgage servicers who are supposed to advance payments from borrowers to lenders and investors. Additionally, investors may perceive more risk in mortgage markets and be less willing to buy securities backed by mortgages, making it more difficult to finance new projects.

The protections in the CARES Act (P.L. 116-136) for borrowers of consumer loans and residential mortgages, as well as assistance programs for companies to retain employees, were facilitated by existing federal government roles in these markets: federal agencies and government-sponsored enterprises are heavily involved in the residential mortgage market; the Small Business Administration (SBA) backs loans to businesses; financial regulators regulate banks; and the Fed serves as a lender of last resort. Additionally, regulators have provided regulatory relief for banks, and the Fed has established various liquidity facilities for financial institutions.

By contrast, the federal government has a more limited footprint in the CRE and CMBS markets, both before the Coronavirus Disease 2019 (COVID-19) pandemic and in the pandemic responses. While the CARES Act provides relief to residential (including multifamily) borrowers by allowing them to defer payments for up to a year, this could cause strain on landlords, residential mortgage lenders, and servicers

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by reducing their cash flow. In response, federal agencies have taken actions to assuage concerns over residential servicer liquidity issues. In contrast, in the CRE market, the federal government has not intervened in such a manner, and the stresses facing lending markets are more directly linked to borrowers' ability to repay rather than a statutory allowance to defer payments. This is an important distinction, as the normal market procedures for resolving delinquency (foreclosure, special servicing, bankruptcy) are all still available to commercial lenders and borrowers.

If similar relief efforts made in residential markets were extended to CRE markets, this could create a similar type of stress. For example, Section 110601 of the HEROES Act (H.R. 6800, passed the House on May 15, 2020) would limit some small businesses' and nonprofits' obligations to pay their commercial mortgages.

Current Federal Support to CMBS and CRE

Although there is currently no Fed or Treasury relief program dedicated to CRE, the broad policy response to COVID-19 includes support to CMBS markets. The Fed's response to the pandemic directly supported CMBS markets in two ways. First, as part of its "quantitative easing," the Fed has directly purchased CMBS that comprise federally backed multifamily mortgages. (Current holdings presented here.) Second, private CMBS are eligible for purchase through the Term Asset Backed Securities Liquidity Facility (TALF), a program to support the asset-backed securities market generally. While these actions boost demand for CMBS, they do not directly address the losses or funding strains faced by the industry.

CRE may also benefit from the Fed's broadly-based emergency programs. For example, if an eligible CRE company issued commercial paper or corporate bonds, it could benefit from Fed programs that purchase them. However, only large CRE companies are likely to be active issuers in securities markets. The Fed also created the Main Street Lending Program (MSLP) to offer loans with repayment deferment for smaller companies. Likewise, some small CRE businesses may already have access to the SBA's Paycheck Protection Program (PPP). In addition, PPP may enhance other small businesses recipients' ability to make rental payments to CRE businesses.

Policy Options for Augmenting Federal Assistance

While legislative options to assist CRE or CMBS markets are broad, two options would extend support modeled on previous COVID-19 policies.

Congress could provide federal loans or loan guarantees to CRE market participants (renters, borrowers, lenders, servicers, and/or investors) similar to those offered to small businesses and the airline industry in the CARES Act through Treasury. This may raise the question of whether other industries, such as CRE, are deserving of targeted assistance or whether broadly-based relief would be more effective or appropriate. For example, CMBS and CRE may indirectly benefit from policies that improved the financial condition of tenants.

Congress could also provide access to liquidity funding by creating a new Fed program. For example, the HEROES Act would require the Fed to make low-cost, long-term loans to creditors affected by the bill's debt repayment restrictions. Alternatively, the Fed could create such a program under existing authority subject to approval—and potentially backed by CARES Act funding—by the Treasury Secretary. However, Fed Chair Jerome Powell recently testified "we don't do facilities that are designed for individual industries. We do facilities of broad applicability, and anybody who meets those requirements can borrow." Creating a program dedicated to supporting one industry could lead to criticism that the Fed was "picking winners," which could be challenging for a politically independent agency.

Short of opening a new facility, the Fed could make its existing programs' terms more attractive to boost their take up or broaden eligibility, thus increasing the existing indirect support they provide to CRE markets. Doing so would likely increase the potential future losses of the programs; but, if desired, CARES Act funding would still be available to absorb such losses. Because TALF and the MSLP are just getting started, it may be premature to judge whether take up is sufficiently robust.

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