



August 2, 2010

**VIA ELECTRONIC FILING**

Mr. Michael S. Barr  
Assistant Secretary  
Attention: President's Working Group on Financial Markets Public Comment Record Room  
1417 MT  
Department of the Treasury  
1500 Pennsylvania Avenue, N.W.  
Washington, DC 20220

**Re:** President's Working Group on Financial Markets: Terrorism Risk Insurance  
Analysis, Docket No. 4810-25-P

Dear Mr. Barr:

The Commercial Real Estate (CRE) Finance Council appreciates this opportunity to provide comments on terrorism risk insurance to the President's Working Group on Financial Markets.<sup>1</sup> The CRE Finance Council is the collective voice of the entire commercial real estate ("CRE") finance market, including investors such as insurance companies, pension funds, and money managers; commercial and investment banks; ratings agencies; accounting firms; servicers; and other service providers.

Because our membership consists of all constituencies across the entire CRE finance market, the CRE Finance Council has been able to develop comprehensive responses to policy questions to promote increased market efficiency and investor confidence. For example, our members provide practical advice to policymakers at all levels on measures designed to restore liquidity and facilitate lending in the commercial mortgage market such as the Term Asset-Backed Securities Loan Facility, and CRE Finance Council members have testified multiple times at Congressional hearings on the state of the CRE market and on financial regulatory overhaul measures.

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<sup>1</sup> Notice, Request for Comments, Analysis by the President's Working Group on Financial Markets on the long-term availability and affordability of insurance for terrorism risk, 75 Fed. Reg. 34530 (June 17, 2010) (hereafter, "PWG Notice").

Thus, we have a distinct perspective on the tremendous challenges facing the \$3.5 trillion market for commercial real estate finance and the need to craft policy measures that support, rather than undermine, the recovery of the commercial real estate sector and that of the nation's economy as a whole.

## **I. OVERVIEW**

The financing of commercial mortgages fosters market liquidity and broader expansion of capital available to the real estate industry. Without terrorism risk insurance, however, commercial borrowers' loans are unable to qualify for either traditional financing or securitization, as lenders and investors in commercial loans and securitizations generally view exposures that lack such protection to be unacceptably risky. The CRE Finance Council's members are not end-users of terrorism risk insurance. Rather, our members are lenders whose clients (the policyholders) need the insurance to comply with prudent underwriting guidelines for loans eligible for portfolio investment or securitization; and investors in securitized products who require a certain degree of confidence that the value of their investment will not be wiped out in a terrorist attack.

The September 11 terrorist attacks created severe disruption in insurance markets and a critical shortage of terrorism insurance that threatened the viability of the nation's economy. But since its 2002 enactment, the Terrorism Risk Insurance Act (TRIA) program has filled the void that would otherwise exist in the market, ensuring the availability of terrorism risk insurance coverage to policyholders at virtually no cost to the federal government.

There have been improvements in the availability and cost of terrorism risk insurance, and the capacity of the stand-alone market has grown since TRIA's inception. However, we believe these strides are due to the presence of TRIA, and that the market is not ready for withdrawal of the program. The CRE finance sector, in particular, is struggling to recover from the effects of an historic economic recession. The unavailability or reduced availability of terrorism risk insurance would threaten the recovery of the CRE finance market, and could bring a halt to the securitization of commercial mortgages – a market that is just beginning to show signs of life after being virtually frozen in 2008-2009. Therefore, the CRE Finance Council believes TRIA, which has given commercial borrowers access to this insurance, should remain in place unaltered not only for the protection of their properties, but for the stability and continued recovery of the capital markets as a whole.

## **II. BACKGROUND**

The terrorist attacks of September 11<sup>th</sup>, 2001 resulted in horrible loss of life and insured damages of approximately \$35 billion. The attacks also created tremendous uncertainty in the insurance market, which was further exacerbated by the threat of future terrorist attacks and the inability to price for terrorism risks. Consequently, reinsurers stopped writing coverage, and primary insurers withdrew, or tried to withdraw, from the terrorism coverage market, causing dramatic increases in the price of commercial property-casualty insurance. Commercial policyholders soon faced exclusions for terrorism in standard insurance policies, and coverage became extremely expensive and altogether unavailable in certain areas. The unavailability of terrorism insurance threatened the economic security of the United States, from existing infrastructure to future construction and commercial real estate development.

The impact of this insurance crisis was particularly problematic in the commercial finance sector for the commercial mortgage-backed securities (CMBS) market, which provides significant capital and liquidity. The smooth functioning of the commercial mortgage and CMBS market depends upon the availability of “all risk” insurance coverage, including terrorism insurance. Investors and rating agencies demand terrorism insurance coverage, while lenders require that such coverage be in place in the loan documents. If terrorism coverage is not available or affordable, CRE borrowers face the threat of being in default; ratings agencies may downgrade related bond ratings; and investors who see the value of their investment fall may be required to divest if the bonds no longer satisfy the mandatory investment parameters. Despite the overall growth in CRE financing, the consequences were especially evident after 9/11 when the lack of terrorism insurance caused negative growth in the market. In fact, new CMBS issuance declined almost 25% from 2001 to 2002 before Congress took action.

Fortunately, TRIA was enacted into law on November 26, 2002, and has served as the structure for the program that exists today. Importantly, the program includes a requirement that insurers “make available” terrorism insurance coverage as a separate offer in commercial property-casualty policies. Overall, TRIA has filled a critical void in the market and ensured that the private market is able to provide the much needed coverage to policyholders at virtually no cost to the federal government. The availability of terrorism risk insurance, in turn, makes financing commercial mortgages viable, which ultimately fosters market liquidity and the availability of much-needed capital for investment in commercial real estate.

### **III. POSITIVE IMPACT OF TERRORISM RISK INSURANCE ACT FROM THE CRE MARKET PERSPECTIVE**

The PWG Notice seeks comment regarding the impact of TRIA, demand for terrorism risk insurance and pricing.<sup>2</sup> Since TRIA’s enactment, the availability of terrorism coverage has grown and premium prices have generally declined. The importance of terrorism risk insurance is highlighted by the fact that its take-up rate has steadily increased, even in 2008 and 2009, when it was expected that the economic downturn would prompt companies to cut back on terrorism insurance to generate cost savings. Indeed, in 2003 the take-up rate was 27 %; over the subsequent years, the number of companies purchasing terrorism insurance increased steadily to 61% in 2009.<sup>3</sup> And the take-up rate for the real estate sector is even greater, at 76%.<sup>4</sup>

Moreover, with the support of TRIA, the overall cost of property terrorism insurance has become more affordable since 2003, particularly in the last year. The median premium rate for terrorism insurance was down from \$37 million in 2008 to \$25 million in 2009.<sup>5</sup> It should be noted, however, that real estate companies were among several sectors that paid a larger percentage of their total insurance premiums for terrorism coverage in 2009 (10%) than in 2008 (6%), which indicates that without the TRIA backstop, the cost of this coverage could easily return to the realm of unaffordable for many companies, if the coverage would be available at all.

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<sup>2</sup> See *id.* at 34532.

<sup>3</sup> Marsh, Inc., *The Marsh Report: Terrorism Risk Insurance 2010* (2010), at 10, *available at* <http://www.insurancemarketreport.com/Registration/tabid/7470/sbmt/1/fmmid/17044/fdid/8868/Default.aspx> (hereafter, “Marsh Report”).

<sup>4</sup> *Id.* at 11.

<sup>5</sup> *Id.* at 12.

#### IV. NOW IS NOT THE TIME TO RECONSIDER TRIA

Commercial real estate is a lagging indicator, and the market is facing an unprecedented combination of challenges as a result of the prolonged recession:

- **Severe U.S. Recession.** – With a prolonged recession (first housing-led, and then consumer-driven) and unemployment at 9.7% (as of May 2010), there is no greater impact on CRE than jobs and the economy, as commercial and multifamily occupancy rates, rental income and property values have subsequently been severely impacted and perpetuate the downturn. Those impacts persist even as the recession has abated.
- **“Equity Gap.”** – The biggest challenge today is the reality that CRE assets have depreciated in value by 30% to 50% since 2007, creating an “equity gap” between the loan amount and the equity needed to extend or re-finance a loan, which impacts even “performing” properties that continue to support the payment of monthly principal and interest on the underlying loans.
- **Significant Loan Maturities.** – Approximately \$1 trillion in CRE loans mature over the next several years, but perhaps most significantly, many of those loans will require additional “equity” to refinance given the decline in CRE asset values.
- **CMBS Restarting – Slowly.** – Even in normal economic conditions, the primary banking sector lacked the capacity to meet CRE borrower demand. That gap has been filled over the course of the last two decades by securitization (specifically, commercial mortgage-backed securities (CMBS) which utilizes sophisticated private investors – pension funds, mutual funds, and endowments, among others – who bring their own capital to the table and fuel lending. CMBS accounts, on average; for approximately 25% of all outstanding CRE debt, and as much as 50% at the peak, while readily identifiable properties funded by CMBS exist in every state and Congressional district. However, the volume of new CRE loan originations and thus of new CMBS has plummeted from \$240 billion in 2007 (when CMBS accounted for half of all CRE lending) to \$12 billion in 2008, \$2 billion in 2009, and \$2.4 billion through June 2010. While there is revitalized activity in the CMBS space, there is a mismatch between the types of loans that investors are willing to finance and the refinancing that existing borrowers are looking for to extend their current loans.

Clearly, in an environment where consumers, legislators and financial regulators are striving to improve the quality of loan underwriting and investor protections, the absence of a stable market for terrorism insurance would create a significant obstacle to the return of a healthy real estate capital market.

The PWG Notice seeks comment regarding the availability and pricing of terrorism risk insurance in the absence of the TRIA program.<sup>6</sup> The CRE Finance Council believes that in the absence of the program, terrorism risk insurance will once again be limited in availability and prohibitively expensive where it is available. This belief is supported by insurance industry

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<sup>6</sup> PWG Notice at 34533.

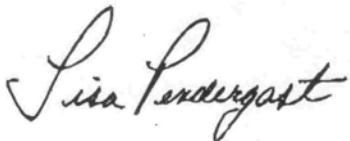
research concluding that even with the program, “commercial insurers continue to avoid accumulating high-profile urban exposures due to the residual risk for terror events retained by insurers below the triggers and retentions levels set by [the program], coupled with the relatively high cost of reinsurance in key exposure zones.”<sup>7</sup> It stands to reason, therefore, that the situation will not get any better without the program.

Although some observers have opined that the insurance marketplace should have recovered and evolved to the point of being able to deal with future terrorism losses without a government backstop, this view was succinctly rebutted by an industry expert that recognized, as we do, that the argument “takes little account of the pressures faced throughout the commercial property and casualty insurance industry as a result of heightened catastrophe losses[.]”<sup>8</sup> Furthermore, the assumption that TRIA is no longer needed also does not take into account the challenges confronting the CRE finance market, described above, which would be unnecessarily compounded by any alteration to the terrorism risk insurance market. Should terrorism risk insurance become significantly more expensive or unavailable – which is the likely result – there is a significant risk of destabilizing the CRE finance market, given that terrorism risk insurance is effectively a requirement for securitization. Such a destabilization would come at a critical juncture in the market’s recovery effort, and could very well bring recovery to a halt. In even more stark terms, the industry study mentioned above concluded that “[t]here is a real potential for an economic downturn should terrorism insurance not be readily available.”<sup>9</sup> For these reasons, the CRE Finance Council supports the continuation of the TRIA program as it currently is constituted.

## V. CONCLUSION

The CRE Finance Council recognizes and appreciates the efforts of the President’s Working Group on Financial Markets to ensure that TRIA continues to have a positive impact on American markets. As the CRE market recovers from a worldwide recession, the stability and certainty TRIA provides is imperative. We urge the President’s Working Group on Financial Markets to allow TRIA to continue facilitating a robust CRE market, and stand ready to provide any additional assistance that may be helpful.

Sincerely,



Lisa Pendergast  
Managing Director  
Jeffries & Company; and  
President  
CRE Finance Council



Dottie Cunningham  
Chief Executive Officer  
CRE Finance Council

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<sup>7</sup> Marsh Report at 4.

<sup>8</sup> Id. at 33.

<sup>9</sup> Id.