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on behalf of
Mortgage Bankers Association of America

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Committee on Financial Services

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Hearing:
"How Much Are Americans at Risk Until Congress Passes Terrorism Insurance Protection?"

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Good afternoon, Madam Chairwoman and Members of the Committee, I appreciate the opportunity to be here today to discuss the terrorism insurance issue and its consequent effects on the commercial real estate finance industry. My name is Kieran Quinn. I am the President and CEO of Column Financial, Inc., in Atlanta, Georgia, a subsidiary of Credit Suisse First Boston. I am here today on behalf of the Mortgage Bankers Association of America (MBA)[1].

First, I want to thank you for inviting the MBA into this very important discussion on a very urgent matter. I commend the Committee's leadership in calling for these hearings, as we believe that a full understanding of the issue is the only responsible way to finding solutions. The lack of terrorism insurance is a barrier to conducting business in the commercial real estate sector, and we urge Congress to work with industry to craft a workable solution to this problem. A failure to address this situation will have negative consequences for the economy.

[1] MBA is the premier trade association representing the real estate finance industry. Headquartered in Washington, DC., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership prospects through increased affordability, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate professionals through a wide range of educational programs and technical publications. Its membership of approximately 3,100 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies and others in the mortgage lending field.

During 2001, Column Financial closed 549 individual loans, totaling $5.8 billion. The smallest loan was approximately $1 million and the largest loan was $480 million. Today we will not consider any loans in excess of $50 million without full terrorism insurance coverage and we are scrutinizing all loans in excess of $20 million if they have any terrorism exclusions. Recently, I have turned down six loans valued at approximately $300 million, and have discouraged many more. My competitors are acting likewise, and the current situation is only going to get worse. High-rise office buildings in high profile cities such as New York, Washington, Chicago and Los Angeles would be extremely difficult to finance without terrorism coverage. If another attack occurs the markets will shut down.

To put the commercial real estate financial industry in perspective, total outstanding commercial mortgage debt equals $1.7 trillion. The real estate finance industry provides the strong tax base that allows communities to thrive. Property taxes alone provide almost half of all local government funding and more than 70 percent of the local tax base throughout the country. The construction and real estate industries create hundreds of thousands of jobs, which benefit local communities. The real estate industry contributes 11 percent of the gross domestic product, making it the fourth largest industry contributor after manufacturing, tertiary, and entire government sectors.

Undeniably, 2001 was a record setting year for commercial and multifamily real estate loan production. The reasons for this success are varied, but are tied to the historically low interest rate environment; the relatively shallow nature of the recession; and the lack of overbuilding. Furthermore, many loans were already in the pipeline before September 11, but more importantly, most lenders and originators continued to lend, based on their confidence that Congress would act and pass a terrorism reinsurance backstop.

Loan production volumes for 2002 will be at risk if terrorism insurance coverage remains unavailable. For example, during 2001, commercial real estate finance activity in Chicago was approximately $10 billion dollars; in New York it was $12 billion; and in Los Angeles it was $10 billion. This is not only a loss of business for lenders and developers--it also represents a loss of construction jobs, and a loss of transfer taxes to the locality. Furthermore, since pension funds and life insurance companies have a significant amount of their investors' money in commercial real estate holdings and commercial mortgage backed securities, if there is a downturn in the commercial real estate industry average Americans will be adversely affected.

Currently, there is a risk transfer occurring from the insurance industry to commercial businesses. Insurance commissioners in 45 states have approved exclusions for terrorism, war and military action, and the use of nuclear, biological or chemical materials. This risk is being transferred to borrowers and lenders, thus making the lenders the insurers of last resort. If this situation remains, lenders will not be able continue to make loans.

I am here today to say that lending capacity, in the industry as a whole, in 2002 is being dramatically affected by the lack of available terrorism insurance coverage. My company is not the only lending institution affected. The Mortgage Bankers Association of America (MBA), of which I am a member, has been conducting an industry-wide survey of its members and has collected anecdotal information regarding lost business opportunities and additional procedures now required as a consequence of the unavailability of terrorism insurance.

For example, several Manhattan high-rise projects, whose collective values equal about $1 billion, have lost funding because terrorism insurance could not be obtained. One of the nation's largest commercial and multifamily lenders has sent a company-wide memo stating that no loans should be made over $25 million without strict scrutiny of potential terrorism risk.

Many servicers of commercial mortgage backed securities (CMBS) have concerns about insurance coverage on existing issuances. If the same insurance coverage is not available when policies are renewed, there is a possibility that loan covenants have been violated because the required all risk coverage will not be provided. If this is case, the bondholders may have the option of selling back the bonds to the issuer. During 2001, new CMBS issuances totaled $97 billion. A massive sale back of these bonds could have a profound effect on the safety and soundness of the banking industry.

A major commercial mortgage lender with a $10 billion portfolio and who originates large loans for securitization has decided it must protect itself by requiring terrorism insurance on all its current and new loans. Borrowers frequently are unable to obtain the required terrorism insurance making it impossible for the lender to close the loan. This situation is creating strains on long-term lender-borrower relationships and requires hiring large numbers of additional staff to review insurance policies for required coverage. In addition, many borrowers appear to be in technical default on their mortgages because they cannot obtain adequate insurance coverage. Many hours of staff and legal time have been taken up on the question of what it might mean to throw so many properties into technical default.

Rating agencies are also reacting to the lack of available terrorism insurance. Fitch IBCA, Duff & Phelps and Moody's are in the process of creating new criteria to categorize risk. If Congress fails to pass legislation, these new guidelines would likely cause rating downgrades in new, outstanding and existing deals. Among the high-risk properties are trophy assets; large gathering venues, such as stadiums, arenas and major retail centers; infrastructure, such as bridges and tunnels; and energy providing structures. In addition, special scrutiny is being given to otherwise run of the mill properties that are in close proximity to such structures. Under these new guidelines, Moody's is factoring the extent of insurance coverage, the amount of the deductible, the prominence of the real estate and the likelihood that a property may be the target of a terrorist attack. Fitch has stated tall buildings located in densely populated central business districts or buildings with high-profile tenants may also be categorized as a high-risk property. These actions taken by the rating agencies will increase spreads and subordination levels that will result in diminishing returns to issuers.

I am a commercial real estate lender and that means that I am trained to assess and price risk. I do not get them all right, but I get enough right that I have been successful over the years. But I am trained to deal with certain types of risks. For example, K-Mart has announced that they are walking away from 335 major retail leases across the country, a significant potential loss for the properties and developers involved, but the commercial real estate industry is prepared to deal with this type of event.

The problem is that we have no training in how to assess and price the risk of terrorist acts. I can assess and price the risk of a K-Mart bankruptcy, or I can buy insurance against the risk of a building burning down. But if I cannot assess the risk, and borrowers are unable obtain insurance, I will not do the deal, particularly when various government officials continue to state that the chance of another terrorist attack is 100%.

I submit that the time to act is now, before another terrorist incident occurs. Act now while you have the luxury of being able to give careful consideration of how such a program should be crafted. Act now before the absence of terrorism has the profound effect of limiting new commercial and multifamily real estate financing which has been one of the sectors that has performed well during the recessionary period. I must underscore this is an economic issue. The need and purpose of a government reinsurance backstop is to stabilize the markets. If and when another attack occurs, a federal backstop will ensure against market disruption and panic.

Currently, the stalemate in the legislative process has created a hold on capital flow in the commercial real estate markets. Further economic growth is being held hostage to legislative indecision that will, in turn, create and prolong an economic downturn. Despite the volatility if the financial markets and the lack of growth in most sectors of the economy, the real estate industry remains vibrant. Moreover, I believe that real estate can serve as the engine for restoring our nation's economic health and vitality. Indeed, the entire real estate industry employs more than 8.5 million people. We need to preserve real estate's role in fostering economic growth, and also unleash its potential to do even more.

While I do not feel qualified to comment on specific legislative provisions, I urge Congress to pass terrorism reinsurance backstop legislation and I want to applaud the Financial Services Committee for taking the lead in this area.

Thank you for the opportunity to testify. I will be happy to answer any questions Members of the Committee may have.