What are CRE CLOs?

CRE CLOs are CLOs that are collateralized by CRE loans that are transitional, or short-term and floating rate. Income earned on the underlying CRE loans—i.e., principal and interest payments—is utilized to make debt service payments to noteholders. Due in part to the strong U.S. economy and investor appetite for higher yields, the CRE CLO market experienced substantial growth in 2019. Some sources cite the first CRE CLOs having been issued around 2012 or 2013. CRE CLOs are structured with reinvestment periods (usually one to three years), during which time the collateral manager, which manages the underlying portfolio of loans, may buy and sell loans in and out of the underlying portfolio. In addition to having a collateral manager to manage the portfolio, CRE CLOs may have a servicer to service the underlying CRE loans.[1]

Characteristics of the Underlying CRE Collateral

Collateral for CRE CLOs primarily consists of bridge loans (short-term loans) on CRE properties that are in transition, such as renovations, expansion, or repositioning. They are "transitional" loans on properties that will have more value in the future and are not seeking long-term financing. The transitional loans typically have a duration of three to five years and are floating rate. In addition, they are predominantly whole loans and pari passu participation whole loans secured by first-mortgage liens on CRE assets.[2]

In contrast, CMBS are structured finance transactions collateralized by stabilized property loans; i.e., those that have achieved an occupancy rate of at least 80%. Chart 1 shows the difference in collateral and structural characteristics between a CRE CLO and CMBS, including statistics from 2020.

[1] Commercial Real Estate CLOs: Features That Make Them an Attractive Asset Class, *Journal of Structured Finance*, Fall 2014.

[2] What Institutional Investors need to Know About CRE CLOs, *pionline.com*, August 2018.

coverage tests and collateral quality tests that must be satisfied as loans are substituted within the portfolio during the reinvestment period.

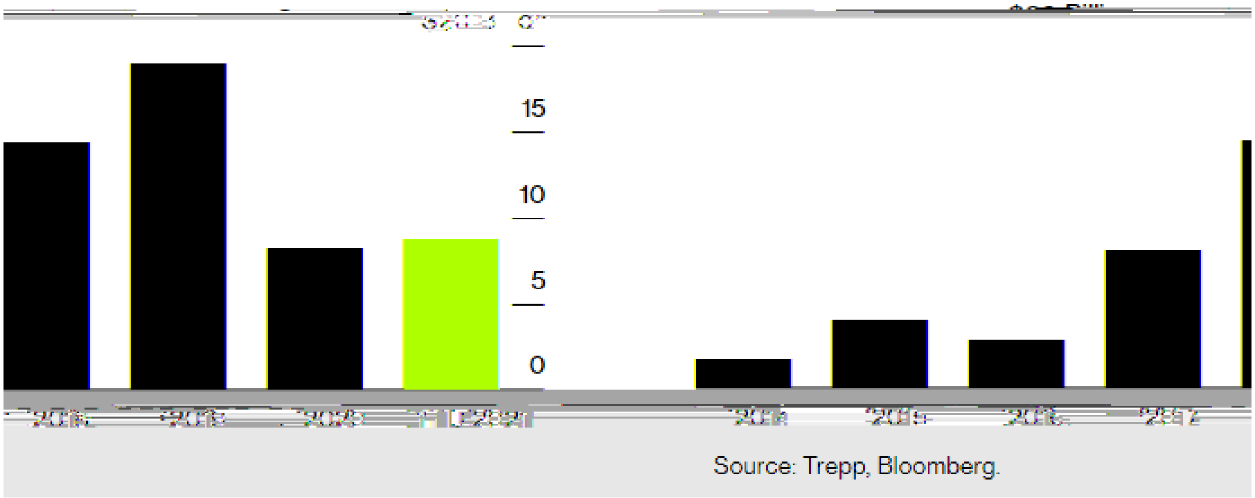
A

(issuer) established by a sponsoring organization. According to the *Accounting Practices and Procedures Manual* (AP&P Manual), "loan-backed securities are defined as securitized assets not included in structured securities…for which the payment of interest and/or principal is directly proportional to the payments received by the issuer from the underlying assets, including but not limited to pass-through securities, lease-backed securities, and equipment trust certificates." If a CRE CLO is defined as an LBASS, then it follows the guidance of *Statement of Statutory Accounting Principles (SSAP) No. 43R—Loan-Backed and Structured Securities.* SSAP No. 43R securities are reported on Schedule D, Part 1: Long-Term Bonds, and the measurement method for the investment depends on the reported NAIC designation. For U.S. insurers that maintain an asset valuation reserve (AVR) (life and fraternal companies), CLOs that are LBASS are to be reported at amortized cost, except for those with an NAIC designation of 6, which are to be reported at the lower of amortized cost or fair value. For U.S. insurers that *do not* maintain an AVR (non-life or fraternal companies), CLOs that are defined as LBASS designated that the highest quality and high quality (NAIC designations 1 and 2, respectively), are to be reported at amortized cost. CRE CLOs defined as LBASS with NAIC designations 3 through 6 are to be reported at the lower of amortized cost or fair value.

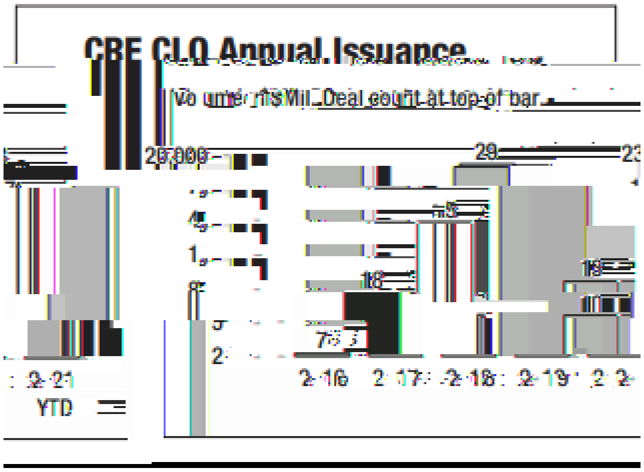
LBASS meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets*, and they are admitted assets to the extent that they conform to the requirements of SSAP No. 43R. CRE CLOs have typically been a relatively small subset of the U.S. insurance industry's overall CLO exposure, which has predominantly been to CLOs securitized by BSLs. Also similar to insurers' BSL CLO investments, CRE CLO investments have been high credit quality.

Appendix:

CRE CLO Issuance (YTD = April 2021)



Source: Trepp, Bloomberg.



Source: Commercial Mortgage Alert, May 28, 2021.

Amortization Period

Once the reinvestment period has ended, the CRE CLO manager pays down the

Special Purpose Vehicle (SPV)

Trusts whose operations are limited to the acquisition and financing of specific assets into the pool that collateralizes the structured securities (in this case, CRE CLOs); an SPV is the actual issuer of the CRE CLO notes.

Tranche

Class of debt within a securitization's capital structure.

Transaction Sponsor

Issuer of the transaction, often the collateral manager or originator.

Transitional Loans

CRE loans to properties that are short-term or bridge loans on CRE properties, whose value is yet to be maximized; loans on properties in a transitional phase such as expansion, renovation, or repositioning.