CAPITAL MARKETS
Special Report

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U.S. Insurance Industry's Commercial Real Estate Investments Near $1 Trillion as of Year-End 2023, Led by Mortgage Loans

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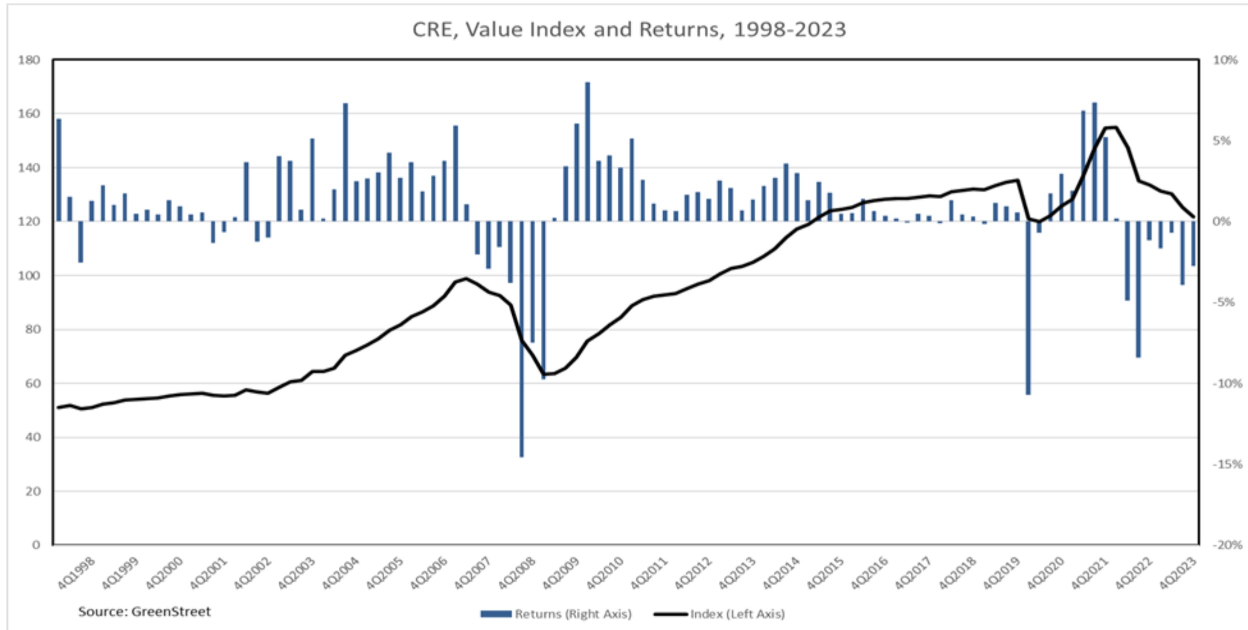
Executive Summary

- The U.S. insurance industry's exposure to commercial real estate (CRE) totaled $995 billion as of year-end 2023, or 11.7% of the industry's total cash and invested assets.
- Life insurance companies are the third largest lender to the CRE market, accounting for 15.7% of outstanding commercial mortgages.
- As of year-end 2023, U.S. insurance companies' exposure to mortgage loans increased 5.9% compared to the prior year to $770 billion, with 84% of the total in commercial mortgage loans.
- Mortgage loans accounted for 9.4% of the U.S. insurance industry's total cash and invested assets and approximately 13.8% of life companies' cash and invested assets.
- Challenges in CRE are largely concentrated in the office sector, as the lodging and retail sector have experienced improvements from prior pandemic-related difficulties, and supply dynamics in the multifamily and industrial sectors are well-balanced.
- The share of office and retail properties in U.S. insurers' commercial mortgage loan portfolio decreased to 20% and 15%, respectively, with both sectors facing challenges due to paradigm shifts.
- Refinancing risk in the commercial mortgage loan portfolio has risen when compared to a year ago with approximately 51% of commercial mortgages maturing in the next five years.

As is now widely appreciated, commercial real estate (CRE) is firmly entrenched as a core asset class for many investors, particularly U.S. insurance companies. Nonetheless, it is not immune to disruptions particular to the sector, and it is very cyclical and linked to the state of the economy. Since 2000, the CRE asset class has enjoyed generally positive returns, with values increasing approximately 72% since the end of the prior century. However, the great financial crisis of 2008–2009 resulted in a loss of about 40% of CRE value overall in only three years. (Refer to Chart 1.)

Chart 1:



CRE values largely recovered to prior levels by 2013, and they continued to rise by 45% through 2020 until the onset of the COVID-19 pandemic. The effects of the pandemic have been mixed across sectors. Lodging and retail properties were initially hit hardest, but they recovered fairly quickly as business travel rapidly returned to normal, and consumers continued normal shopping habits. Multifamily properties, a longtime investor favorite, enjoyed continued high valuations, which in turn inspired significant additional construction. As a result of the widespread adoption of online commerce, industrial properties (i.e., storage and distribution warehouses) have enjoyed significant favor by investors with elevated valuations.

By far, the most problematic CRE sector has been office, both in central business districts (CBDs) and suburban areas, but the former has been affected most significantly. Although the pandemic caused the flight of workers from on-site at the office to home, nominal financial performance did not immediately suffer, as long-term leases (i.e., three to 10+ years) supported leased space calculations and rental payments despite the dearth of workers on-site. However, the in-office paradigm has shifted as workers resist returning to the office full-time, and two to three days in the office has become the accepted norm. With approximately half of all current leases predating the pandemic, and as these and prior leases expire, this new paradigm has had monumental effects on office sector performance. CBD-located properties, especially B- and C-class properties, have been particularly challenged, while properties in suburban areas have fared better.

Commercial Real Estate Exposure Across Asset Classes

The U.S. insurance industry has been a consistent and reliable lender to the CRE market for decades. U.S. insurance companies are exposed to CRE through various investments, including commercial mortgage loans, commercial mortgage-backed securities (CMBS), wholly owned real estate, and unsecured bonds issued by real estate investment trusts (REITs). While real estate provides portfolio diversification, it is a relatively illiquid investment that generally has less credit and pricing transparency, and it is, therefore, subject to greater price volatility, especially during market stress.

The U.S. insurance industry's total exposure to CRE—specifically commercial mortgage loans, CMBS, REITs, and real estate—totaled $995 billion in book/adjusted carrying value (BACV) as of year-end 2023, or 11.7% of the industry's total cash and invested assets. (Refer to Table 1.) Commercial mortgage loans are the largest CRE exposure by a significant margin, representing approximately 65% of the total. CMBS accounted for the second largest exposure at almost 29%, and REITs and real estate rounded out the exposure.

Table 1: U.S. Insurance Industry Commercial Real Estate Exposure, Year-End 2023 (BACV$ in Millions)

	Life	P/C	Health	Title	Total	% of Total
Mortgage Loans	614,288	29,764	749	1	644,802	64.8%
CMBS	196,827	75,805	11,725	129	284,485	28.6%
REITs	34,899	8,504	1,575	69	45,047	4.5%
Real Estate	16,613	4,177	148	2	20,940	2.1%
Total	**862,626**	**118,250**	**14,196**	**201**	**995,273**	**100.0%**
% of Total	86.7%	11.9%	1.4%	0.0%	100.0%	

Note: Numbers in the table have been rounded.

Life insurance companies held the greatest exposure to CRE, with 87% of the industry's exposure, while property/casualty (P/C) insurance companies accounted for nearly 12%. While life companies' CRE exposure increased by only 0.5% year over year, CRE as a percentage of life insurers' cash and invested assets declined to 15.8% from 16.1% as of year-end 2022.

The mortgage loans category in Table 1 includes commercial mortgage loans and excludes residential, farm, and mezzanine mortgage loans. CMBS includes both private-label and agency-backed CMBS, and REITs include bond investments but exclude equity investments. The real estate category represents properties held for income as reported by U.S. insurers on Schedule B; it does not include properties held for sale or owner-occupied properties.

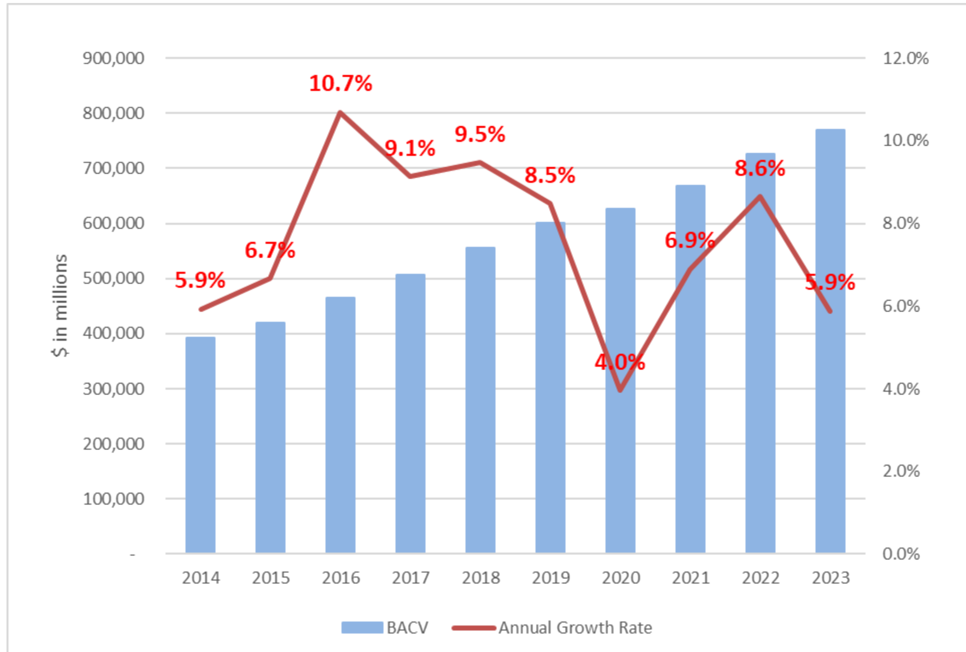
A Deeper Dive Into Insurers' Mortgage Loan Exposure

Mortgage loans account for the U.S. insurance industry's largest CRE exposure. Life insurance companies, in particular, are large investors in mortgage loans, as they are long-term assets that match well with their longer-duration liabilities. P/C companies also invest in mortgage loans, but to a lesser extent because they provide portfolio diversification that can potentially reduce investment risk. U.S. insurers' mortgage

loan investments include commercial mortgages, residential mortgages, farm mortgages, and mezzanine loans.

As of year-end 2023, U.S. insurance companies reported $770 billion BACV of mortgage loans, an increase of 5.9% from the prior year. Despite the continued rise in exposure, the year-over-year growth rate in 2023 was a slowdown from the previous year and marked the second smallest percentage increase over the 10-year period analyzed. (Refer to Chart 2.)

Chart 2: U.S. Insurance Industry Mortgage Loans, Year-End 2014–2023



Total U.S. insurer investments in mortgage loans have increased each year since at least 2010, and they have nearly doubled since year-end 2014 when insurers reported $393 billion in mortgage loan exposure. Mortgage loans represented approximately 9.4% of the industry's total cash and invested assets as of year-end 2023, compared to 6.8% of total cash and invested assets as of year-end 2014.

Commercial properties accounted for the majority, or 83.8%, of U.S. insurers' mortgage loan exposure at year-end 2023. (Refer to Table 2.) Residential loans were the second largest type at 11.1%, and they were the primary driver of total mortgage loan growth in 2023, with BACV increasing approximately 38% compared to the prior year. In contrast, commercial mortgage loans increased a modest 3% compared to year-end 2022. Farm loans and mezzanine loans rounded out the industry's exposure and together represented approximately 5% of total mortgage loan exposure.

Table 2: Total U.S. Insurance Industry Mortgage Loans by Type, Year-End 2023 (BACV$ in Millions)

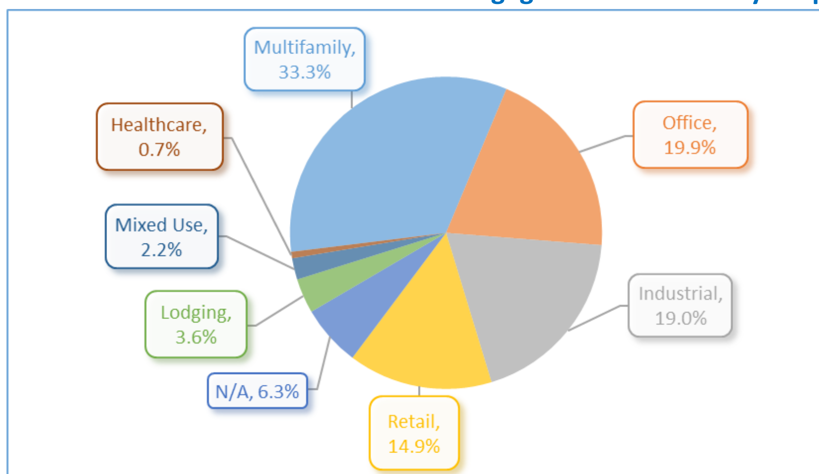
Mortgage Loan Type	Life	P/C	Health	Title	Total	% of Total
Commercial	614,288	29,764	749	1	644,802	83.8%
Residential	82,723	2,791	-	6	85,520	11.1%
Farm	26,774	246	-	-	27,020	3.5%
Mezzanine	11,464	809	-	-	12,274	1.6%
Total	**735,250**	**33,610**	**749**	**7**	**769,616**	**100.0%**
% of Total	95.5%	4.4%	0.1%	0.0%	100.0%	

Note: Numbers in the table have been rounded.

Life companies continued to account for the overwhelming majority of the industry's mortgage loan investments, or 95.5%, at year-end 2023. P/C, health, and title companies represented less than 5% of the exposure. As of year-end 2023, mortgage loans accounted for approximately 13.8% of life companies' cash and invested assets, having steadily increased from 10% at year-end 2014. For P/C, health, and title companies, mortgage loans represented approximately 1% or less of respective cash and invested assets for each insurer type.

U.S. insurance companies' portfolio of commercial mortgage loans totaled $645 billion as of year-end 2023 and remains well-diversified across property types. Based on reporting by insurers in annual statement filings, multifamily properties represented the largest share of the portfolio at approximately 33%, followed by office properties at nearly 20%. Industrial and retail properties were the third and fourth largest components, respectively, at approximately 19% and 15%. (Refer to Chart 3.) The share of multifamily and industrial properties increased from 32% and 17%, respectively, while the share of office and retail properties decreased from 22% and 16%, respectively, at year-end 2022.

Chart 3: U.S. Insurers' Commercial Mortgage Loan Portfolio by Property Type (Year-End 2023)



The CRE markets, particularly the CRE debt markets, are also affected by the level of interest rates. Interest rates serve as the foundation for both pricing commercial mortgages and valuation of commercial properties; that is, as they rise, so do mortgage loan interest rates, with values moving (down) inversely. Commercial mortgages typically have significant balloon payments due at maturity (i.e., they are generally

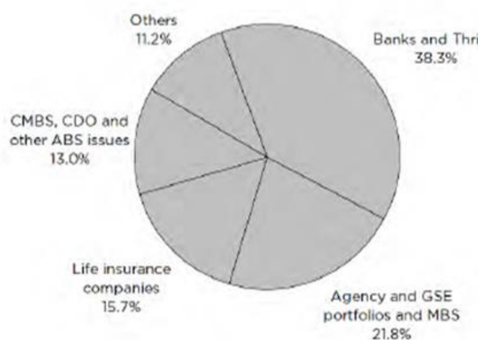
not fully amortizing) and thus, at maturity, they must be refinanced with a new mortgage. When interest rates are at high levels, the new debt requires a significantly higher payment. This may not be affordable, especially if income (and valuations) has also declined. In the extreme, new debt may not even be available, and borrowers would then be faced with the requirement to infuse additional capital or relinquish the property to the lender.

Furthermore, refinancing risk in the U.S. insurance industry's commercial mortgage loan portfolio has risen when compared to a year ago, as a greater percentage of the portfolio will be maturing in the coming years. That is, approximately 31% of commercial mortgages are expected to expire in the next three years, 51% in the next five years, and almost 82% in the next 10 years. The higher interest rate environment also contributes to a greater level of refinancing risk.

Life Insurance Companies Are Key but Conservative Mortgage Lenders

According to Mortgage Bankers Association (MBA) data, commercial mortgage loans outstanding as of the second quarter of 2024 totaled $4.7 trillion. Life insurance companies were an important and significant source of funding in CRE financing, accounting for 15.7% of commercial mortgages held by all lenders. They were the third largest lender, after banks/thrifts and agency/government-sponsored entity (GSE) mortgage-backed securities, which represented 38.3% and 21.8%, respectively, of outstanding commercial mortgages. (Refer to Chart 4.)

Chart 4:



Source: Mortgage Bankers Association

Note that because of asset/liability considerations, insurance companies prefer to invest primarily in the safest, most conservative assets. Life insurance companies, in particular, have historically invested in mortgages with low loan-to-value ratios and high-debt service coverage ratios. As a result, commercial mortgage holdings of insurance companies are generally the most secure of the various investor groups, and the default and loss rates of these mortgages are among the lowest in the CRE lending sector. MBA data shows that commercial mortgage default rates at life companies were 0.43% as of the second quarter

of 2024, comparing favorably to 1.15% at banks and thrifts and 4.82% for CMBS transactions. (Refer to Table 3.)

Table 3:

Commercial Mortgage Default Rates
(%)

	YE2022 %	YE2023 %	2Q24 %
Banks & Thrifts (90+ day)	0.45	0.94	1.15
GSEs			
Freddie Mac (60+ day)	0.12	0.28	0.38
Fannie Mae (60+ day)	0.24	0.46	0.44
Life Insurance Cos. (60+ day)	0.11	0.36	0.43
CMBS (30+ ,REO)	2.90	4.30	4.82

Source: Mortgage Bankers Assn.

Natural catastrophe risks have become an additional consideration in real estate investments. Commercial mortgage investments, in particular, expose life insurance companies to the physical as well as the transitional risks of natural catastrophes. A report titled *Climate Risks in the Commercial Mortgage Portfolios of Life Insurers: A Focus on Sea Level Rise and Flood Risks* explores this topic. The report is a *Journal of Insurance Regulation* Spencer L. Kimball Writing Award winner, and it will be honored by the Center for Insurance Policy and Research (CIPR) at the 2024 NAIC Fall National Meeting.

Commercial Real Estate Outlook

Although expected to decelerate, economic growth should remain positive in 2024 and support CRE markets. However, the effects on the different sectors and individual properties will likely be uneven, depending on the particular market, location, vintage, etc. Currently, real estate fundamentals are reasonably stable. At year-end 2023, the 10-year Treasury rate remained elevated at approximately 4% from its previous low in 2020 of less than 1%. While higher interest rates have inhibited refinancing and sales, the Federal Reserve has begun to ease its monetary policy, and it cut interest rates by 50 basis points in the second quarter of 2024. Another similar-sized cut is anticipated by year-end, and there are already signs of the CRE markets loosening. Additionally, while CRE returns remained negative through the end of 2023, initial data indicates that they have since turned positive, and prices have increased by approximately 3% in the first half of 2024. Thus, signs are beginning to point to at least a stabilization of CRE markets, if not a turnaround.

Still, results will differ by sector. Office is expected to remain the most troubled, particularly CBD properties of B and C quality and earlier vintage. The current office vacancy rate is 13.8%. Although employers are encouraging workers to return to the office at least a few days per week, employees are resistant because the paradigm has shifted. As the remaining pre-pandemic leases expire, employers' ultimate space needs are yet to be determined.

Due to a boom in construction over the last several years, deliveries of new multifamily inventory have dramatically increased and have resulted in moderate oversupply, especially in the South. This is mitigated

by demand from potential single-family buyers who have been priced out of the market, especially due to elevated interest rates. Both of these markets, however, should find equilibrium as markets smooth out the imbalances. In addition, industrial properties are facing a similar situation as recent completions have outpaced absorption.

Retail remains the most solid of the major sectors. The overall sector is relatively balanced, as prior difficulties in the mall sector have largely been digested, and consumer spending has supported non-mall, grocery-anchored retail, and higher-end strip centers.

The NAIC Capital Markets Bureau will continue to monitor trends in the U.S. insurance industry's CRE and mortgage loan investments and report as deemed appropriate.

Questions and comments are always welcome. Please contact the Capital Markets Bureau at CapitalMarkets@naic.org.

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