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U.S. Insurance Industry's Mortgage Loan Exposure Rises at Year-End 2022 as Commercial Real Estate Trends Deteriorate

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Executive Summary

- U.S. insurance companies reported \$727 billion in mortgage loans at year-end 2022, an increase of 8.6% compared to year-end 2021.
- Mortgage loans represented 8.9% of the U.S. insurance industry's total cash and invested assets, and approximately 13% of life companies' cash and invested assets.
- Commercial mortgage loans totaled \$626 billion at year-end 2022, or 86.1% of U.S. insurers' mortgage loan exposure.
- Multifamily properties represented the largest share of U.S. insurers' commercial mortgage loan portfolio at approximately 32%, followed by office properties at almost 22%.
- The office sector of the commercial real estate (CRE) market continues to be under pressure as a result of occupancy and usage issues continuing from the COVID-19 pandemic.
- The commercial real estate market is also facing potential financial issues arising from increased interest rates affecting existing commercial mortgages that are due for refinancing, as well as mortgages for the financing of new projects.
- Life insurance companies' mortgage loan investments have historically been conservative with low loan-to-value ratios and high debt service coverage ratios, resulting in the lowest default and loss rates in the commercial real estate finance industry.

The U.S. insurance industry is exposed to commercial real estate (CRE) through various investments—including primarily through direct commercial mortgage loans, commercial mortgage-backed securities (CMBS), wholly-owned real estate, and unsecured bonds issued by real estate investment trusts (REITs). This special report focuses on commercial mortgage loans, which account for the largest CRE exposure because life insurance companies have been reliable lenders to the CRE market for many years. Real estate and real estate lending are commonly viewed as long-term investments, which match well with the longer liabilities of life companies. They also provide diversification to the risk of investment

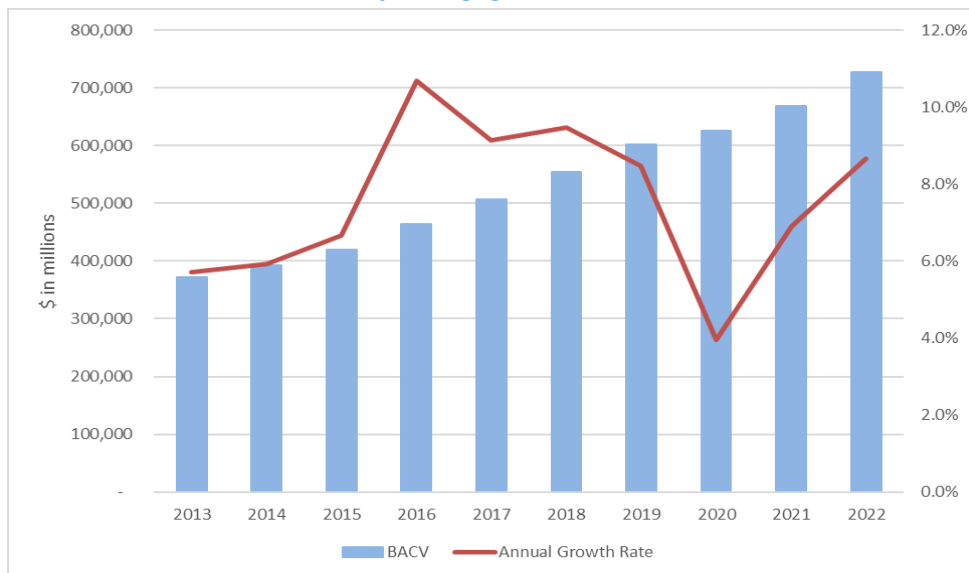


portfolios. Commercial mortgage loans, however, are relatively illiquid investments that generally have less credit and pricing transparency. Therefore, they are subject to greater price volatility.

Total Mortgage Loan Exposure Continues to Climb

Total U.S. insurer investments in mortgage loans have increased since at least 2013, with year-over-year growth rates of approximately 6% or greater each year except 2020. As of year-end 2022, U.S. insurance companies reported \$727 billion in book/adjusted carrying value (BACV) in mortgage loans, an increase of 8.6% from the prior year. This year-over-year growth rate was the largest increase since 2019, when mortgage loans increased 9.5%. (Refer to Chart 1.) Furthermore, over the 10-year period between 2013 and 2022, the U.S. insurance industry’s BACV exposure to mortgage loans has almost doubled.

Chart 1: U.S. Insurance Industry Mortgage Loans, Year-End 2013–2022



As of year-end 2022, mortgage loan exposure represented 8.9% of the industry’s total cash and invested assets. The share of mortgage loans relative to total cash and invested assets has increased from 6.7% as of year-end 2013.

Commercial properties accounted for the majority, or 86.1%, of U.S. insurers’ mortgage loan exposure. (Refer to Table 1.) Residential loans were the second largest type, with farm and mezzanine loans rounding out the industry’s exposure.

**Table 1: Total U.S. Insurance Industry Mortgage Loans by Type, Year-End 2022 (BACV\$ in Millions)**

Mortgage Loan Type	Life	P/C	Health	Title	Total	% of Total
Commercial	598,339	27,230	468	5	626,042	86.1%
Residential	59,645	2,387	46	7	62,085	8.5%
Farm	26,647	241	-	-	26,888	3.7%
Mezzanine	11,238	638	-	-	11,876	1.6%
Total	695,868	30,496	514	12	726,890	100.0%
% of Total	95.7%	4.2%	0.1%	0.0%	100.0%	

Note: Numbers in the table have been rounded.

Similar to previous years, life companies accounted for the overwhelming majority of the industry's mortgage loan investments, or 95.7%, at year-end 2022. Property/casualty (P/C), health, and title companies represented less than 5% of the exposure. As of year-end 2022, mortgage loans accounted for approximately 13% of life companies' cash and invested assets, steadily increasing from 10% in 2013. At P/C, health, and title companies, mortgage loans represented 1% or less of the respective cash and invested assets for each insurer type.

In recent decades, life insurance companies have been the premiere source of permanent commercial real estate debt. They have commanded the lowest (most conservative) loan-to-value ratios and the highest debt service coverage ratios, resulting in the lowest delinquency rates in the CRE finance industry.¹

Overall Commercial Real Estate Exposure Approaches \$1 Trillion

U.S. insurance companies' overall exposure to commercial real estate—encompassing commercial mortgage loans, CMBS, real estate, and REITs—totaled \$982 billion as of year-end 2022. (Refer to Table 2.) The industry's commercial real estate exposure represented 12% of total cash and invested assets. Approximately two-thirds of the exposure was attributed to commercial mortgage loans and almost one-third to CMBS. Life companies had the greatest exposure to CRE, with 87% of the industry's exposure, while P/C companies accounted for 11%.

Table 2: U.S. Insurance Industry Commercial Real Estate Exposure, Year-End 2022 (BACV\$ in Millions)

Asset	Life	P/C	Health	Title	Total	% of Total
Mortgage Loans	598,339	27,230	468	5	626,042	63.7%
CMBS	205,849	75,518	12,038	92	293,497	29.9%
REITs	37,111	3,916	510	42	41,578	4.2%
Real Estate	16,613	4,177	148	2	20,940	2.1%
Total	857,911	110,841	13,163	141	982,057	100.0%
% of Total	87.4%	11.3%	1.3%	0.0%	100.0%	

Note: Numbers in the table have been rounded.

¹ Fitch Ratings, [U.S. Life Insurers' Commercial Mortgage Update \(Diversified Exposures, Underwriting Quality Support Ratings Despite Challenges\)](#), June 28, 2023.



The mortgage loans category only includes commercial mortgage loans and excludes residential, farm, and mezzanine mortgage loans. CMBS includes both private-label and agency-backed CMBS. REITS includes bond investments and excludes equity investments. Finally, 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 occupied properties.

Commercial Real Estate Market Faces Significant Headwinds

As of the first half of 2023, there were two main concerns for the CRE industry:

- Continuing effects of the COVID-19 pandemic on CRE.
- Increasing interest rates on CRE debt, especially maturing debt.

Prior to 2020, the chief risk to CRE was online shopping, which primarily affected the retail mall sector as consumers began shifting their shopping preference from brick-and-mortar stores. However, this situation was largely stabilized, with much of retail—i.e., grocery-anchored retail centers—remaining unaffected. On the other hand, regional (second and third tier) malls took and continue to take significant hits to valuation as the revised paradigm in favor of online shopping has solidified. Moreover, the industrial sector, previously a relatively minor segment of the life insurance company market, rapidly became a favored sector as warehouse space was needed to support the revamped shopping habits.

Beginning in 2020, the emergence of the COVID-19 pandemic had two primary effects on CRE. First, with travel restrictions and COVID-19 precautions, travel almost came to a halt, severely affecting both business and leisure travel. (Although, as of the first half of 2023, this sector has largely recovered.) Second, virtually overnight, workers stopped going to the office every day, so that much office space, even though leased (and with rent being paid), was not physically occupied. Office space, particularly in central business districts (CBDs), is leased for terms ranging from two to 10 (or more) years. From 2020 through 2022, the effect of the pandemic on nominal office occupancy, rental rates, and valuations was muted, as the continuing rental payments under existing leases supported payments on underlying commercial mortgage debt and valuations of the buildings themselves. However, leases expiring during this period were either not renewed or renewed under restructured terms.

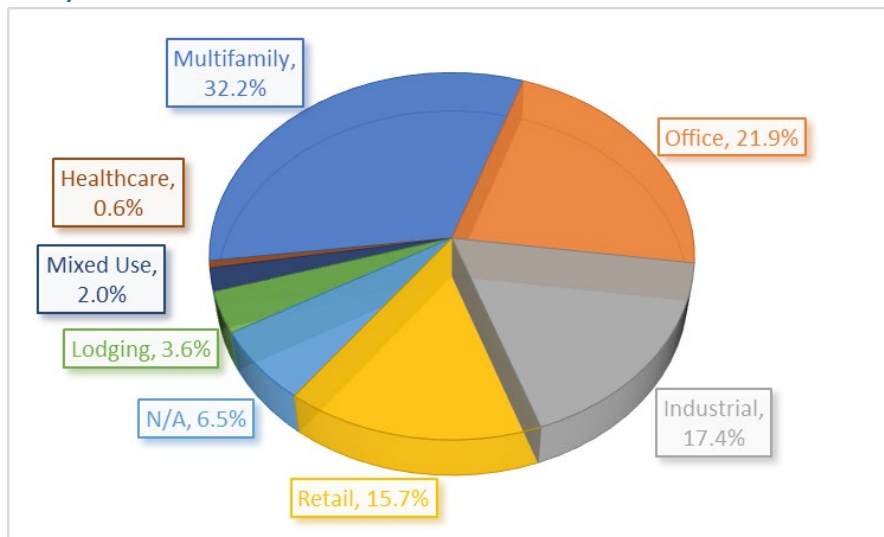
It seems clear, though, that through 2022 and into 2023, the office leasing paradigm has changed, as many employees have embraced the work-from-home model using online remote capabilities. Employers have also responded by accepting this model via the adoption of hybrid work schedules, office sharing, and other means. Therefore, the demand for office space may continue to decline as employers—i.e., office space renters—and employees continue to respond to this new reality and demonstrate limited inclination to return to the prior model. As a result, as existing office leases expire and are not renewed at previous rates, building incomes will deteriorate, thus making continued debt payment streams problematic. In addition, ultimate building valuations will likely be significantly reduced with corresponding effects on CRE performance.



Overall, challenges in CRE going forward appear largely in the office sector, as the retail sector (except regional malls) seems to have experienced improvements from prior pandemic-related difficulties, and the industrial sector has shown much-improved performance. The hospitality sector has also largely recovered, and the multifamily sector remains a stronghold.

U.S. insurance companies' portfolio of commercial mortgage loans totaled \$626 billion as of year-end 2022 and was relatively well-diversified across property types. As reported by insurers in annual statement filings, multifamily properties represented the largest share of the portfolio at approximately 32%, followed by office properties at almost 22%. Industrial and retail properties were the third and fourth largest components, respectively, at approximately 17% and 16%. (Refer to Chart 2.)

Chart 2: U.S. Insurance Industry's Commercial Mortgage Loan Portfolio by Property Type (Year-End 2022)



In addition, about 30% of the U.S. insurance industry's \$21 billion in real estate properties held for income were reported as office properties.

The CRE markets, particularly the CRE debt markets, are also affected by rising interest rates. The Federal Reserve (the Fed) had maintained the federal funds rate at historically low levels since the financial crisis of 2008–2009, at virtually zero from 2010 through 2015 with a minor increase to 2.5% from 2015 to 2019. The Fed then pivoted to ease again with rates going back to almost zero from April 2020 to February 2022. Beginning in March 2022, however, the Fed began to raise the federal funds rate to tame persistent and high inflation, increasing rates in 11 instances. As of July 2023, the federal funds rate target was set at 5.25%–5.50%, with two additional increases possible by year-end, depending on inflation and other economic datapoints over this time frame.

Together with Treasury securities, these 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 significantly increase, the new debt requires a significantly higher payment. This may not be affordable, especially if incomes (and valuations) have 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.

The U.S. insurance industry's commercial mortgage loan portfolio carries significant refinancing risk in today's rising interest rate environment. Approximately 25% of commercial mortgages are expected to expire in the next three years, 45% in the next five years, and 79% in the next ten years.

There is also speculation for a recession in the U.S. economy, possibly sometime during the second half of 2023 at the earliest, which could adversely affect the CRE sector and its performance in insurance company investment portfolios.

Summary

The CRE sector continues to face significant headwinds, particularly the office sector, first as a result of occupancy and usage issues continuing from the COVID-19 pandemic, and second from financial issues arising from increased interest rates affecting existing commercial mortgages due for refinancing and the financing of new projects. These issues have the potential to adversely affect the credit performance of commercial mortgages through reduced income streams supporting both current debt service and anticipated new debt service on potential new financing; property values also are being revised to reflect this deteriorated income stream. In addition, a recession in the U.S. economy could adversely affect insurance companies' CRE investments.

The NAIC Capital Markets Bureau will continue to monitor trends in the U.S. insurance industry's CRE 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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