National Association of Insurance Commissioners & The Center for Insurance Policy and Research

Capital Markets Special Report

The NAIC's Capital Markets Bureau monitors developments in the capital markets globally and analyzes their potential impact on the investment portfolios of U.S. insurance companies. A list of archived Capital Markets Bureau Special Reports is available via the INDEX.

U.S. Insurers' Exposure to Mortgage Loans Continues to Steadily Increase Through Year-End 2019

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Executive Summary

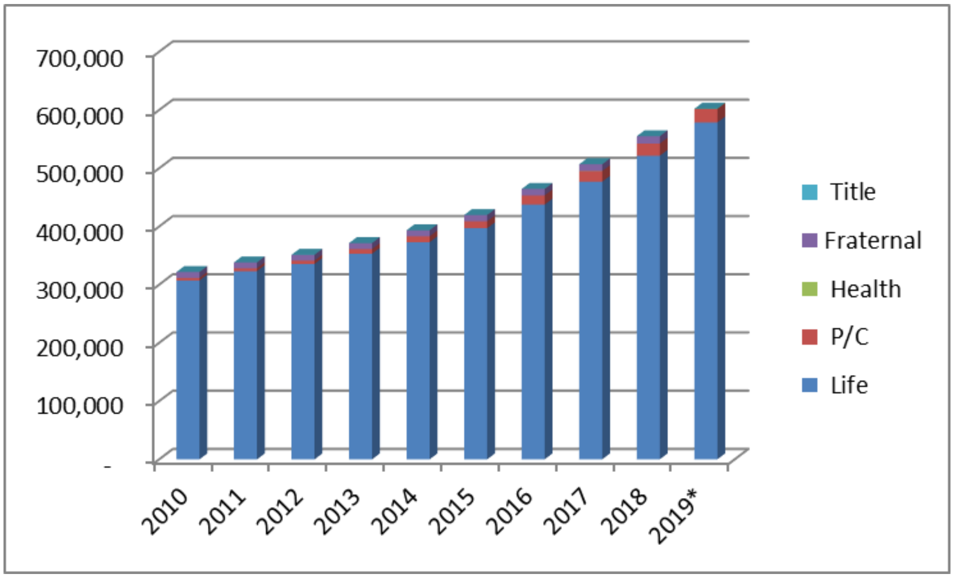
- Mortgage loans reported by U.S. insurers at year-end 2019 (in Schedule B) totaled about $602 billion in book value (BV), representing an 8.5% increase from year-end 2018 and almost 9% of total cash and invested assets. Within this total, $536 billion, or almost 90%, were commercial mortgage loans.
- Life insurance companies held the majority, or 96%, of the industry's mortgage loans, as they match well with the longer-term nature of their liabilities.
- About one-quarter of U.S. insurers' exposure to mortgage loans was in multifamily/apartment properties, which so far have not been severely affected by the COVID-19 pandemic.
- Life companies accounted for about 15% of the market's commercial mortgage loans outstanding at year-end 2019.
- Commercial mortgage loan origination volume through the first quarter of 2020 was down 2% versus the first quarter of 2019 due in part to the impact of COVID-19.
- Commercial mortgage loans with exposure to the retail and lodging sectors continue to be susceptible to price volatility and lower valuations due to COVID-19.

U.S. Insurers' Mortgage Loan Exposure

The U.S. insurance industry's exposure to mortgage loans has been on a steady incline over at least the last nine years, as shown in Chart 1, with life companies consistently accounting for a significant share. As of year-end 2019, U.S. insurers' exposure to mortgage loans backed by real estate as reported in

Schedule B was about $602 billion in BV; i.e., the statutory BV/recorded investment excluding accrued interest.

Chart 1: U.S. Insurers' Exposure to Mortgage Loans, 2009 – 2019 ($BACV mil)



*Life and fraternal companies reported together beginning with year-end 2019 data.

U.S. insurers' exposure to mortgage loans grew by 8.5% at year-end 2019, from about $555 billion BV at year-end 2018. Life companies accounted for approximately 96% of total Schedule B investments, with the remainder held predominantly by property/casualty (P/C) companies (see Table 1).

Table 1: U.S. Insurers' Mortgage Loan Exposure by Industry Type, Year-End 2019

Industry Type	BV ($mil)	BV % of Total
Life*	578,682.6	96%
Property/Casualty	23,218.4	4%
Health	175.1	0%
Title	43.0	0%
Total	**602,119.2**	**100%**

*Life companies includes fraternal companies' reported exposure as of year-end 2019.

Within U.S. insurers' mortgage loan exposure at year-end 2019, multifamily/apartment accounted for the largest property type, at about $154.5 billion, or 25.7% of total mortgage loan exposure (see Table 2). As multifamily/apartment properties have not yet been significantly affected by the COVID-19 pandemic, concern regarding potential losses in this sector is mitigated. However, the retail and lodging sectors have been significantly affected by loss of revenues due in part to lockdowns across the U.S. Exposure to retail property mortgage loans totaled $107.8 billion in BV among U.S. insurers at year-end 2019, representing about 18% of the total, and lodging properties totaled about $23.7 billion, representing 3.9% of the total. Concentrations of retail and/or lodging mortgage loans within individual insurers' portfolios could become a source of risk, particularly in terms of the percentage of an insurer's total capital and surplus.

Table 2: U.S. Insurer Mortgage Loan Exposure – By Property Types – Year-End 2019

Property Type	BV ($mil)	BV % of Total	Average LTV
APARTMENT/MULTIFAMILY	154,515.7	25.7%	44.3%
OFFICE	143,372.5	23.8%	39.5%
RETAIL	107,851.9	17.9%	43.5%
OTHER	84,286.3	14.0%	43.6%
INDUSTRIAL	75,782.0	12.6%	46.1%
LODGING	23,779.0	3.9%	30.4%
MIXED USE	10,013.4	1.7%	42.4%
MEDICAL/HEALTH CARE	2,518.2	0.4%	44.2%
Grand Total	**602,119.2**	**100.0%**	**42.3%**

The average loan-to-value (LTV) for the industry's overall mortgage loan portfolio was 42.3%. For loans in the retail and lodging sectors, LTV was 43.5% and 30.4%, respectively. While the current market environment anticipates the possibility for poor performance of retail and lodging loan properties, perhaps the risks will be mitigated by the relatively sound credit quality of the portfolio, evidenced by a relatively low average LTV. In addition, historically, mortgage loan portfolios of life insurance companies have performed well and experienced minimal losses, including through the 2008 financial crisis.

At year-end 2019, approximately 5% of the U.S. insurance industry's mortgage loans, or almost $30 billion, were pledged as collateral to the Federal Home Loan Banks (FHLBs) or coded as loaned or leased, such as for securities lending. As such, the exposure is considered to be a restricted asset in that it is not under the exclusive control of the reporting entity.

In view of the long-term nature of mortgage loans and their significant size, it is not surprising that over 90% of the total was with large life companies, or those whose assets under management exceeded $10 billion, as shown in Table 3. Small insurers, or those with less than $1 billion in assets under management, accounted for less than 1% of the U.S. insurance industry's total mortgage loan exposure at year-end 2019.

Table 3: Mortgage Loan Exposure by U.S. Insurer Assets Under Management, Year-End 2019, ($mil BV)

Asset Under Management	Life	P/C	Title	Health	Total	% of Total
Greater Than $10B	539,637.57	13,590.61	-	-	553,228.18	91.9%
Between $5.0B and $10.0B	19,386.12	4,820.75	-	62.55	24,269.41	4.0%
Between $2.5B and $5.0B	9,755.26	3,381.97	-	-	13,137.23	2.2%
Between $1.0B and $2.5B	6,734.45	1,091.66	4.04	20.87	7,851.02	1.3%
Between $500MM and $1.0B	1,727.66	89.01	3.23	32.32	1,852.22	0.3%
Between $250MM and $500MM	897.40	135.82	-	36.79	1,070.01	0.2%
Less Than $250MM	544.15	108.60	35.75	22.60	711.10	0.1%
Total	**578,682.60**	**23,218.41**	**43.02**	**175.12**	**602,119.15**	**100.0%**

Life insurance companies have a long history as lenders to the commercial real estate market since real estate and real estate lending are commonly viewed as long-term investments, which match well with the longer liabilities of life companies. Also, as an alternative asset class, commercial real estate loans are considered a suitable source of risk diversification in life company portfolios. As such, U.S. insurers' exposure to commercial real estate loans was almost 90% of total mortgage loan exposure (see Table 4), at $536 billion as of year-end 2019.

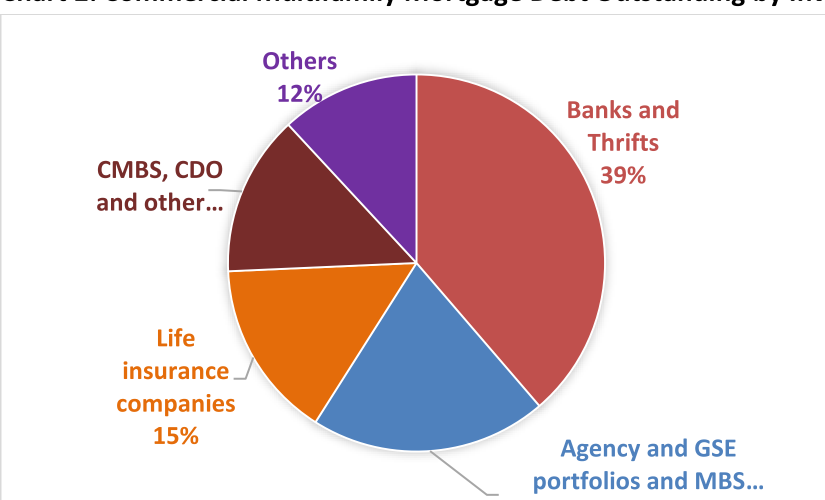
Table 4: U.S. Insurers' Mortgage Loan Exposure by Loan Type, Year-End 2019

Loan Type	BV ($mil)	% of Total
Commercial Mortgage	536,053.6	89%
Residential Mortgage	32,438.7	5%
Farm Mortgages	23,225.9	4%
Mezzanine Loans	10,400.9	2%
Total	**602,119.2**	**100%**

Commercial Mortgage Loan Market Trends

Commercial and multifamily mortgage debt outstanding as of year-end 2019 reached $3.6 trillion, a 7% increase from 2018, according to the Mortgage Bankers Association (MBA). Within this total, commercial mortgage debt alone accounted for about $2 trillion. The MBA estimates that commercial and multifamily mortgages provided by life insurance companies account for approximately 15% of commercial and multifamily mortgage debt outstanding as of year-end 2019 (see Chart 2), consistent with their share of the overall market as of year-end 2018.[1]

Chart 2: Commercial Multifamily Mortgage Debt Outstanding by Investor Group, Fourth Quarter 2019



Source: MBA

[1] Mortgage Bankers Association, *Commercial/Multifamily Quarterly Databook, Q4 2019*

Also, according to the MBA, new origination volume for commercial mortgage loans for the first quarter of 2020 was down 2% compared to origination volume for the first quarter of 2019. In particular, new origination volume for hotel loans was down 42% for the same time period—the largest decline across all property types. Retail loans were down 37%.

The economic fallout from the COVID-19 outbreak has significantly affected the retail and lodging sectors. Therefore, exposure to the retail and lodging sectors in commercial mortgage loans will likely result in greater susceptibility to price volatility and lower valuation of these investments and potential defaults. According to Trepp, a leading provider of commercial mortgage-backed securities (CMBS) and commercial real estate information, analytics and technology, in April 2020, 27 lodging loans, totaling $1 billion, were reported as delinquent compared to just 12 loans totaling $121 million in March 2020.[2] In addition, Trepp cites that retail was the worst performing commercial real estate property sector, with a 3.8% delinquency rate in April 2020. While the magnitude and distribution of expected defaults and losses within the lodging and retail sectors are uncertain going forward, as fallout continues, they are expected to increase sharply.

Conclusion

Mortgage loans have consistently represented a significant investment for the U.S. insurance industry, increasing steadily over the years, particularly for large life companies. From year-end 2018 to year-end 2019, U.S. insurer exposure to mortgage loans increased by 8.5% to approximately $602 billion in BV, of which about 90% was attributable to commercial mortgages. The performance of some mortgage loans, such as those to retail and lodging, has been adversely affected by the COVID-19 pandemic. In turn, U.S. insurers' mortgage portfolios are exposed to related risks. However, the risks are mitigated in that one-quarter of U.S. insurers' mortgage loan exposure is in multifamily/apartment properties, which have not experienced the pandemic-related stresses of the aforementioned property sectors. In addition, U.S. insurers' mortgages have a relatively modest average LTV, which could partially offset any impact by the current economic slowdown. Mortgage loans were about 9% of U.S. insurers' total cash and invested assets at year-end 2019 and have represented an attractive alternative to traditional bond investments over at least the last nine years.

The NAIC Capital Markets Bureau will continue to monitor financial market trends with mortgage loans and report as deemed appropriate.

[2] Trepp, *Lodging Sector Takes Hardest Hit from COVID-19; Increase in Distressed Hotels Across the U.S.*, May 2020.

Useful Links

NAIC Capital Markets Special Reports:

Retail Exposure in U.S. Commercial Mortgage-Backed Securities Investments, Year-End 2019, April 2020.
Lodging Exposure in U.S. Commercial Mortgage-Backed Securities Investments, Year-End 2019, April 2020.
U.S. Insurers' Retail Commercial Mortgage Exposure as of Year-End 2019, May 2020.

NAIC Capital Markets Primers:

Commercial Mortgage Loans, June 2019.

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