NAIC 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 Retail Commercial Mortgage Loans at Year-End 2019

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Executive Summary

- Retail commercial properties represented 18% of the U.S. insurance industry's mortgage loan holdings as of year-end 2019, or a total of $602 billion in book value (BV).
- Life insurance companies hold the majority, or 96%, of the industry's mortgage loans, as they match well with the longer-term nature of their liabilities.
- With approximately 90% of the U.S. under some form of stay-at-home and social distancing orders and unemployment at record levels, commercial mortgage loans with exposure to the retail sector are susceptible to price volatility and lower valuations.
- Trepp's stress scenario results indicate that defaults on retail commercial mortgage loans will increase sharply to 3.6% by late 2021/early 2022 from less than 0.5% at the end of 2019.
- Commercial mortgage loan portfolios of life insurance companies have performed well and experienced minimal losses through previous economic and credit cycles.

The economic fallout from the COVID-19 outbreak has significantly affected the retail industry. As most U.S. states implemented necessary quarantines and social distancing practices to contain the pandemic, discretionary and non-essential retailers temporarily closed brick-and-mortar stores. While online platforms are still viable, consumers have sharply reduced their spending, as many have been unemployed or furloughed, resulting in record unemployment levels. U.S. consumer spending fell by 7.6% in first quarter of 2020, and U.S. retail sales declined by a record of 8.7% in March compared to the prior month. Therefore, exposure to the retail sector in commercial mortgage loans will likely result in greater susceptibility to price volatility and lower valuation of these investments.

U.S. Insurers' Investment Exposure

At year-end 2019, U.S. insurers reported approximately $602 billion in BV—i.e., the statutory BV/recorded investment excluding accrued interest—of exposure to mortgage loans backed by real estate in Schedule B. Commercial mortgage loans represented approximately 89% of the industry's mortgage loan exposure, or $536 billion. Within the commercial mortgage loan exposure, retail properties totaled $107.8 billion in BV, representing about 18% of total Schedule B assets. 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). Real estate and real estate lending are commonly viewed as a long-term investment; therefore, it matches well with the longer liabilities of life insurance companies, which have a long history as lenders to the commercial real estate market.

Table 1: Retail Commercial Mortgage Loan Exposure of Life and P/C Companies (BV, $mil), Year-End 2019

		Retail	Total	Pct. Of Total Schedule B
Life	Number of Loans	19,956	170,419	11.7%
	BV ($ bil)	104,355	578,683	18.0%
	Appraisal Value ($bil)	239,251	1,349,789	17.7%
	LTV (%)	43.6%	42.9%	
P/C	Number of Loans	11,288	32,905	34.3%
	BV ($ bil)	3,463	23,218	14.9%
	Appraisal Value ($bil)	8,681	74,700	11.6%
	LTV (%)	39.9%	31.1%	
Total	Number of Loans	31,244	203,324	15.4%
	BV ($ bil)	**107,818**	**601,901**	**17.9%**
	Appraisal Value ($bil)	247,932	1,424,489	17.4%
	LTV (%)	43.5%	42.3%	

The U.S. insurance industry provides mortgage loans secured by retail properties in a wide range of loan sizes. An analysis of the industry's exposure to mortgage loans indicates that the retail commercial mortgage loans in the portfolio of P/C companies have a different profile in terms of loan size than those held by life companies. Although P/C companies have relatively low BV exposure to mortgages, they tend to focus on smaller mortgage sizes—$10 million or less—and in large quantities; i.e., loan count. Only life companies reported mortgage loans in excess of $100 million in BV, which represented 19% of their retail commercial mortgage loans. Approximately 50% of P/C's retail commercial mortgage loans have a BV of $10 million or less, compared to 32% for life companies.

Almost all, or 98.8%, of the industry's retail commercial mortgage loans outstanding at year-end 2019 were in good standing; i.e., whereby all the original basic terms of the loan are being met by the borrowers.

The average loan-to-value (LTV) for commercial mortgage loans with exposure to the retail industry held by U.S. insurers was 43.5% compared to 42.3% for the overall commercial mortgage loan exposure of U.S. insurers. While the current market environment indicates the possibility for poor performance for investments with retail sector exposure, perhaps the risks will be mitigated by the relative sound credit quality of the portfolio—an average LTV of 43.5%, an estimated LTV at the 75th percentile of 60.7%, and all but 0.2% of retail property mortgages in good standing. Historically, commercial mortgage loan portfolios of life insurance companies have performed well and experienced minimal losses, even through the 2008 financial crisis.

Note that retail is the third largest industry exposure among commercial mortgage loans, as reported by U.S. insurers in Schedule B. At 25.7% of total Schedule B assets, multifamily/apartment was the largest industry exposure, followed by office at 23.8%.

At year-end 2019, approximately 6.5% of the U.S. insurance industry's commercial mortgage loans within the retail industry were pledged as collateral to the Federal Home Loan Banks (FHLB) or coded as loaned or leased, such as for securities lending.

Furthermore, U.S. insurers reported that 4.1% of total direct real estate exposure, or $1.8 billion out of a total of $42.5 billion as reported in Schedule A, were retail properties. The majority of direct real estate exposure was in office properties at 58.1% of total Schedule A assets.

Retail 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). The MBA estimates that life insurance companies own approximately 15% of the commercial and multifamily mortgage debt outstanding as of year-end 2019, consistent with their share of the overall market as of year-end 2018.[1]

Trepp, a leading provider of commercial mortgage-backed securities (CMBS) and commercial real estate information, analytics and technology, performed a COVID-19 economic and real estate forecast stress scenario analysis of a portfolio of $77.5 billion—12,500 in number—in commercial mortgage loans held by commercial banks. The loans span a broad range of size, geography and property type. Retail loans made up 20% of the total, or $5.55 billion in approximately 3,000 loans. The loan portfolio exhibited good credit quality metrics with an LTV of 40.9% and a debt service coverage ratio (DSCR) of 1.82x.[2]

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

[2] Trepp, *COVID-19 Impacts on Commercial Real Estate: Rising Defaults and Losses in the Loan Sector*, March 2020.

With consumers being “urged to stay at home” and social distancing practices in place, non-essential, discretionary retailers have closed physical stores. Consequently, defaults on retail commercial mortgage loans are expected to increase sharply. Trepp’s stress scenario analysis shows that retail defaults will reach 3.6% in late 2021/early 2022 from less than 0.5% at the end of 2019. This higher periodic default rate results in a cumulative five-year default rate of 16% and an expected loss of 5.3%.[2]

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

Questions and comments are always welcome. Please contact the Capital Markets Bureau at
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