EXECUTIVE INSIGHTS

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Real Estate Lending and Insurance Capital, Opportunities in a Reset Market

How real estate credit fits within insurance portfolios, the evolving risk landscape, regulatory considerations and where today's most compelling opportunities are emerging

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Panelist:

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Executive Summary:

As insurers navigate a volatile investment landscape and tighter spreads in traditional fixed income, private real estate lending is emerging as a critical tool for seeking to enhance yield, improve diversification, and optimize capital efficiency. The discussion highlights how insurers—particularly life carriers—are expanding beyond traditional core mortgage exposure and beginning to incorporate strategies aimed at higher-yield, such as value-add lending, while still maintaining a disciplined focus on downside protection and liability matching.

Panelist Pramit Mukherjee, Managing Director, Insurance Client Solutions at SLC Management, emphasizes that this evolution is being shaped by multiple forces: regulatory capital frameworks, asset-liability management requirements, and the need to generate stronger capital-adjusted returns. As insurers broaden their investment scope, success increasingly depends on balancing risk, liquidity, and return, while leveraging structural innovations and maintaining rigorous portfolio construction discipline.

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Highlights:

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01. The Growing Role of Real Estate Lending

Private real estate debt remains foundational, but insurers are becoming more strategic and selective in how they deploy it.

John: How are insurers currently incorporating private real estate lending into their overall portfolio strategy?

Pramit: John, private real estate lending has always been a part of insurance companies' core portfolios. If you think about it based on most recent NAIC data as of year-end 2024, insurance companies had a fairly good amount of exposure in commercial mortgage loans, mostly senior mortgage loans, what we call core mortgages, for example, in the life insurance world they're called CM1, CM2 mortgages.

Now, the exposure to higher-yielding mortgages has traditionally been very low on insurance company balance sheets. Now, we're going to get into more details as to why that could be and how that is a very important tool for insurance companies to consider.

Staying with your question, insurance companies historically have grown their exposure to mortgages, but the different cycles we have seen have made it imperative for insurance companies to be very focused from both a credit standpoint and a macro standpoint, building portfolios from both bottom-up and top-down perspectives. As part of the portfolio construction process, they need to ensure diversification across different asset classes. They also need to ensure a variety of factors, including matching their liabilities, matching rate volatility, or trying to cope with the liquidity profile these different investments can offer.

Again, we're going to get into all these details, but one key point to highlight is the importance of building a franchise with a strong data-science foundation, complemented by insights from the equity side of the business. To me, that is a strong template for managers looking to build a real estate debt platform that can support higher-yielding asset classes.

02. Diversification and Relative Value

Real estate credit offers structural advantages and diversification versus traditional corporate-heavy portfolios.

John: What role does real estate credit play alongside traditional fixed income and insurance portfolios today?

Pramit: If you think about a traditional insurance portfolio, it's very corporate-credit heavy. Core and core-plus fixed income form the majority of insurance portfolios. Now, what has that resulted in? As I talked about over the past decade, we have seen a couple of cycles and core and core-plus fixed income have become heavily correlated to these cycles.

It could be events like spread widening or a downgrade cycle where everything seems to move together and insurance companies are hold-to-maturity-type investors, so it's not like they have the ability to trade in and out of exposures at a moment's notice.

Coming back to my earlier point that creating diversification in the portfolio is of paramount importance. That's where real estate debt or what I talked about, higher-yielding real estate debt can be a very important asset class in the portfolio construction process.

Now, a few things to highlight here that are top of mind for insurance companies, at a super high level like credit. Most of the book is, think of it as senior unsecured credit, maybe some exposure to securitized. When you think about real estate mortgages across this credit spectrum, high quality as well as high yielding, they're all mostly senior secured loans.

From a security standpoint, they're high quality. Number two, from a relative value standpoint, we all know corporate credit is super tight right now. There is barely any risk premium present in corporate credit across investment grade or even in the below investment grade BB space.

That's where a strategy which focuses on high quality senior real estate debt lending and also down to a higher-yielding part of the spectrum offers strong relative value compared to corporate credit.

Lastly, I want to highlight that liquidity is very important for insurance companies because they need to forecast out liability cash flows and try to pay out claims using their asset portfolio. For example, for life insurance companies, they have a fair amount of allocation to illiquid securities.

The real estate debt across the spectrum, including higher-yielding real estate debt can be a very good fit within that illiquid bucket, offering a real value while maintaining strong credit protections. Swapping to the P&C and health side, through a similar lens, they have very large liquid credit portfolios. A little bit of exposure to illiquid strategies can actually enhance their portfolio yield and support their new business efforts with profitability, and capital and surplus generation.

03. Capital Considerations Shape Allocation

Regulatory frameworks play a central role in determining how insurers deploy capital into real estate credit.

John: How significant are regulatory capital considerations when allocating to real estate credit?

Pramit: It's very significant. Everything insurance-related is ultimately the capital it takes to access an asset class. Insurance companies, over decades, have been very prudent about capital preservation. Downside protection has always been the mantra.

The regulators have also been thoughtful about creating a credit box or limitations by applying penalties if certain asset classes were allocated to back liabilities or to an insurance portfolio via a very heavy capital charge.

As a result, insurance portfolio construction has evolved over the years, to focus on asset classes that will incur lower capital charges, rather than optimizing across asset classes, liquidity, and exposure to less correlated strategies like real estate value-add lending.

To take a step back and understand some of the regulatory considerations or the differentiation across types of insurers, for any type of real estate debt investments or mortgage investments, life insurance companies in the US, they get a look-through treatment. They get to take credit for every single mortgage in their portfolio based on the loan-to-value or LTV and the debt service coverage ratio or DSCR.

There is a grid called the commercial mortgage scale, and to reiterate, the value-add strategy that we are talking about here fits within the CM2 or CM3 on that scale, which is basically investment grade to just below investment grade. That actually consumes a pretty low capital charge. All the disclosures are publicly available on NAIC's website.

If you think about it from a portfolio construction standpoint, you're optimizing on a risk, on liquidity, on capital-adjusted returns. Value-add screams of optimizing and generating profitability and improving portfolio yields from that portfolio construction lens.

Shifting focus to the Mid Atlantic and Bermuda, under the Bermuda Capital Regime or the BSCR, commercial mortgages or real estate debt across core-plus and value-add are treated the same way on an unlevered basis. Their capital charge there is also fairly attractive for Bermuda-based insurers to consider.

The value-add lending strategy is actually a good fit for Bermuda-based insurers as well under their capital regime. It should be fairly high on a capital-adjusted return basis, definitely beating most core fixed income and private credit asset classes, while maintaining many of the attractive features from a credit standpoint.

04. Improving Capital Efficiency

Innovative structures are helping insurers maximize return per unit of capital deployed.

John: How do these investments help insurers improve capital efficiency?

Pramit: It's an interesting question. There are still a few parts to it. One is the opportunity cost. That's how I would like to put it. If not real estate debt, if not value-add bridge lending, what else?

Other forms of comparable private credit, or real estate equity-like strategies, are accessed, based on what we have seen in the industry, through a fund format, an SMA format, or sometimes through other forms like partnerships, JVs, REITs, and so on and so forth.

We've seen this over the years evolve in the industry. While delivering some yield, those vehicles may not always be as capital efficient. What we have seen in the industry is over the years within private markets, certain types of structures have evolved, and these industry structures we have seen include rated notes.

These can offer better capital treatment depending on the structure and other features and the capital regime as well, US versus Bermuda, versus other capital regimes.

Gaining access to more capital-efficient structures to ultimately get to value-add lending-like strategies is very attractive for insurers because that can save them in terms of capital or capital-adjusted return per capital spend or just a unit of yield or spread per capital spend. Again, insurers can come up with their own metrics to quantify the risk.

Another thing I would like to point out is a lot of insurers might be challenged in terms of the sheer manpower. They don't have an army of operations folks, analysts, or PMs looking at every single loan, every single CUSIP within a portfolio at all times. The operational complexity can also add up as insurers are moving more towards private markets, which we have seen as a trend over the years.

Gaining access to a strategy like rated notes can reduce such operational complexity because it synthesizes a loan portfolio into a couple of bonds, which are private bonds, CUSIPS, and a residual tranche. You are not dealing with individual loan-level line items, valuation, accounting. You are dealing with the structure.

Rated note structures offer insurers higher-capital adjusted returns, capital efficiency, as well as operational efficiency.

05. Supporting Asset-Liability Management

Real estate credit helps insurers align duration, liquidity, and yield within their portfolios.

John: What advantages does real estate credit offer in terms of asset liability management?

Pramit: Great question. Again, now we are pivoting to life insurers because it matters to them. All insurers care, but life insurers are required to provide ALM. One big aspect I want to point out is the entire spectrum of core, core-plus mortgages, then value-add, all the way down to construction loans. They all fit in different parts of a life insurance book.

If you look at a typical book, which is a long-duration life insurance book, you can think of a strategy where you have some longer-dated corporate credit investments on the public and private side. Now on the mid to shorter end, you have commercial mortgage loans - core and core-plus, and on the shorter end value-add or construction loans.

What that does is a little bit of liquidity barbelling. You are giving up some liquidity on the shorter end to get access to these higher-yielding downside, protected asset classes. On the longer end, when typically liabilities start paying off, your assets are also rolling off. Now, there is flexibility on the value-add side, through some of the structures discussed to perpetuate the tenor. What do I mean by that? Via reinvestment, you can extend the effective duration of that strategy. That gives life insurers more flexibility. Instead of being confined to a couple years, now they can think of a slightly longer-dated, mid-duration-type, note-like strategy. That's one way.

Now, the other thing I talked about is liquidity. I'll mention credit briefly as well. In terms of credit, you don't want to stay locked into, let's say, a construction loan portfolio for a long tenor because there could be credit events, there could be natural migration higher in the risk spectrum while value-add loans are somewhere in between construction and core. It's better to allocate to construction loans on the shorter end. On the longer end, you are better off having more higher-quality liquid public credit exposure. That way, you can manage both liquidity, credit and migration, and they all fit into a broader ALM policy.

06.Expanding Risk Appetite—Carefully

Insurers are moving down the risk spectrum, but with discipline and selectivity.

John: How are insurers adjusting their risk tolerance when evaluating commercial real estate exposures?

Pramit: Over the years, especially in a zero-rate regime, which was forever till over the last few years, insurers all of a sudden found that their book yield is lower than the risk-free, which is not acceptable. Now they are trying to cautiously explore other asset classes or adjacencies within real estate mortgages, going down the risk spectrum but in a very defensive fashion.

One example is value-add lending and how it can support that thesis. That's one big adjustment I've seen in insurance companies' risk offices or investment offices, that they have widened their scope. Another trend is, obviously, the corporate private credit market is much more advanced now versus, let's say, the counterpart on the real estate side.

The first dibs, if I may call that, was on the private credit side, allocation. We have seen some of the issues emerge there. Some of the late-cycle signals and technicals, including overallocation and fund flows, have created concerns in private credit, so insurers need to be very selective.

Insurers have the choice to be very nitpicky there, spend a lot of time and try to pick the good private credit managers, or they can look on the real estate side where there are a ton of opportunities and not enough technical pressure. The credit underwriting standards are still intact. It's that judgment or expansion in risk horizon that insurers are now considering.

07. Managing Concentration Risk

Diversification across markets, sponsors, and property types is essential to managing downside risk.

John: What should insurers be mindful of when managing concentration risk in real estate lending?

Pramit: The first thing that comes to mind is diversification across geography. As we say, real estate lending is location, location, location. That's the number one thing. Picking the right markets and submarkets, building a portfolio across different markets so that any shocks or headwinds in one area can be absorbed elsewhere.

These could include a climate risk event, like wildfires and hurricanes. You can think of insurance costs rising. You can think of an economic downturn which affects one part of the country versus another. Having diversification is a big source of downside protection.

The other aspect I'll point out is diversification across sponsor types. Having different sponsors, having many different names who hold equity in your portfolio rather than just a couple of names, even if they're big ones, because things can go wrong with the big guys too. That's another way to think about portfolio diversification and risk management.

The last one I'll point out, although this is a little bit nuanced, is property type diversification. There are some strong managers on the residential and industrial side. I'm not recommending that insurers go and put money in every single sector out there. That's not the right way to invest your portfolio. Pick the right spots within residential and industrial, and then selectively look into other asset classes that have shown a strong track record.

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