Gallagher | Research Centre

Commercial Real Estate Investments

A macroeconomic outlook and recessionary scenarios for insurers

By Professor Ricardo Reis

Executive summary

Amid growing geopolitical tensions and recent global inflation, there were concerns at the beginning of 2024 that the Commercial Real Estate (CRE) market could be heading for a major downturn. Given the importance of housing and real estate more broadly in the economy, this downturn would likely spread to the overall economy and cause a recession.

Insurance companies are major investors in CRE, with insurers having an average of between 9% and 12% of their investment portfolios invested in this sector. In Europe and the US specifically, insurers have 7% and 12% invested respectively.

This paper considers the current social and macroeconomic trends that are impacting the CRE market across different regions. While there is some potential for many countries to experience a recession in 2024, the data and current forecasts suggest that it is more likely that CRE will remain largely stable. Productivity in the US is thriving, even if there is stagnation in the EU. China's housing market raises concerns that are connected to CRE. At the heart of CRE trends there are also deeper forces concerning employment, including the post-COVID-19 pandemic shift to increased remote working that has led to increasing office vacancies in the center of cities. Despite this, data from the construction sector remains resilient, driven by rising productivity, property prices, and continued low unemployment figures.

While figures do not indicate signs of an imminent deep recession, trends suggest a probable downward revaluation of insurers' legacy assets that could make insurers want to reevaluate their strategy on relative exposures to CRE.

In the last section of this report, we consider three recessionary scenarios for insurers to consider, each tied to significant price adjustments in CRE. The scenarios are intended to help insurers consider their own CRE investment strategies across diverse geographic regions.

Key takeaways

- Globally, insurers have between 9%–12% exposure to the commercial real estate (CRE) market through both direct and indirect investments in mortgages, bonds, and directly owned real estate.
- COVID-19 and the rise in working from home has resulted in a dramatic increase in city center commercial real estate availability. This trend shows no sign of reversing.
- Recessionary headwinds remain light with a healthy US economy and an EU that is stagnant but not contracting. China remains strong in absolute terms despite a decline in growth relative to the recent past.
- Banks have steadily been increasing their investment and extending lines of credit to commercial real estate. This has helped explain how the sector has remained buoyant through challenging times.

1. Insurer investments in Commercial Real Estate (CRE)

Insurers invest in CRE for its diverse benefits, including its role as an inflation hedge, a stable income source, and portfolio diversification. CRE offers diversification across assets and geographies, helping reduce risk. Favorable tax treatment and regulatory incentives further drive insurers to allocate capital to this sector. The dynamic nature of real estate allows for value-enhancing strategies such as redevelopment and lease renegotiation, mitigating risk and maximizing profitability.

Another attraction of CRE is that by taking long-term positions in this market, insurers can take advantage of the long-tail liabilities of life products. This provides diversification of risk and healthy returns within an investment portfolio. However, these assets are relatively illiquid and have less pricing transparency than other investments, often resulting in greater pricing volatility.

Insurers' exposure to CRE is influenced by both their geographic location and line of business, with life insurers being more exposed to this sector.[1]

Different ways insurers are invested in CRE

There are multiple direct and indirect ways that insurers can be exposed to the CRE market. The most direct is through the acquisition of entirely owned real estate. Other exposure includes direct mortgages on commercial real estate properties as well as mortgage-backed securities, loans, and investment trusts.

Figure 1 shows the typical investment portfolio of a US insurer, and how these investments are connected to CRE exposure. The inset chart shows the proportional breakdown of different forms of investments in CRE for a US carrier.

An insurer's exposure to Commercial Real Estate within their investment portfolio

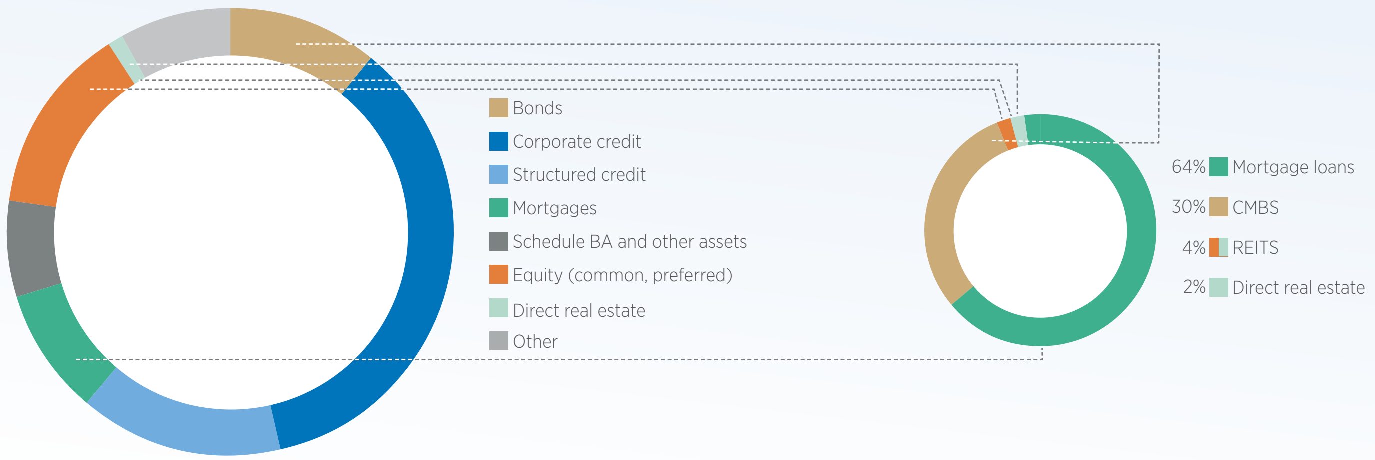

Figure 1. Typical investment portfolio of a US carrier across all investment types. Right: Breakdown of total CRE exposure of a US carrier within the wider investment portfolio (data source: NAIC). For a US carrier, total exposure to CRE within the wider investment portfolio is around 12%[1]

The relative exposure of an insurer to CRE is typically through one or more of the following investment options.

- Direct commercial mortgage loans: This is the largest share of exposure to CRE for US insurers, with approximately 64% of their CRE interests being in long-term loans on commercial properties.
- Commercial mortgage-backed securities (CMBS): Within the bond investments of an insurer, this will include both private-label and agency-backed CMBS. These investments constitute 6% of the bond portfolio, 30% of CRE total exposure, and an overall exposure to the insurer of approximately 4% of their entire portfolio.
- Wholly owned real estate: Around 0.5% of their total investment portfolio (and 2% of their CRE share) is in directly owned real estate.
- Unsecured bonds issued by real estate investment trusts (REITs): Considered a good counterbalance to stocks, bonds, and cash, REITs are based on income-producing commercial estate, whether it's from the properties themselves or the mortgages on those properties. This forms approximately 4% of overall CRE exposure to insurers.

Life vs. non-life exposure

Life insurers and non-life insurers diverge not only in the risks they cover but also in their investment approaches. Life insurance primarily mitigates risks related to an individual's life, prioritizing long-term investments such as annuities, whole life plans, and endowment plans, including assets like bonds and dividend-paying stocks. CRE plays a more significant role in life insurer asset and liability management (ALM) given its suitability to being a longer term, less liquid investment class. Conversely, the short-tail focus of non-life insurance risks unrelated to human life require more liquid investment within the portfolio to accommodate shorter-term and unpredictable liabilities.[2]

As **Figure 2** highlights, due to the more significant investment portfolio size, life insurers are more exposed to changes in the CRE market than non-life insurers due to their respective investment in direct mortgages, mortgage-backed securities, and direct real estate. Proportionally, a non-life US carrier's greatest exposure to CRE is within the CMBS investment class, whereas for life insurers, it is through mortgage loans.

Life and Non-Life Investments in the CRE Market (2022)

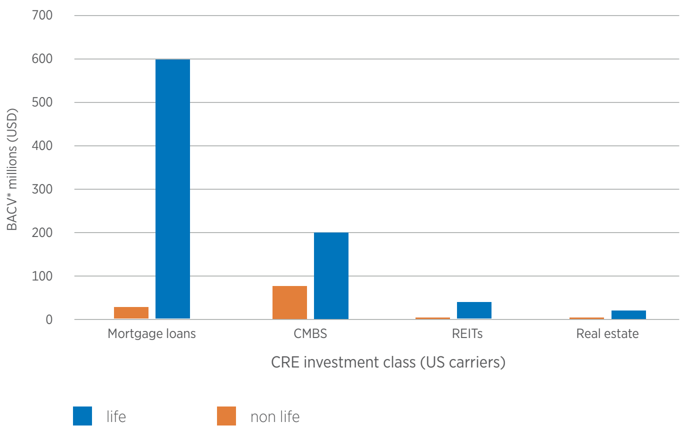

Figure 2. Life and non-life investments by US insurers by asset type exposed to CRE
*Book-adjusted carrying value (BACV) (data source: NAIC)

2. Regional Differences in Commercial Real Estate Investment

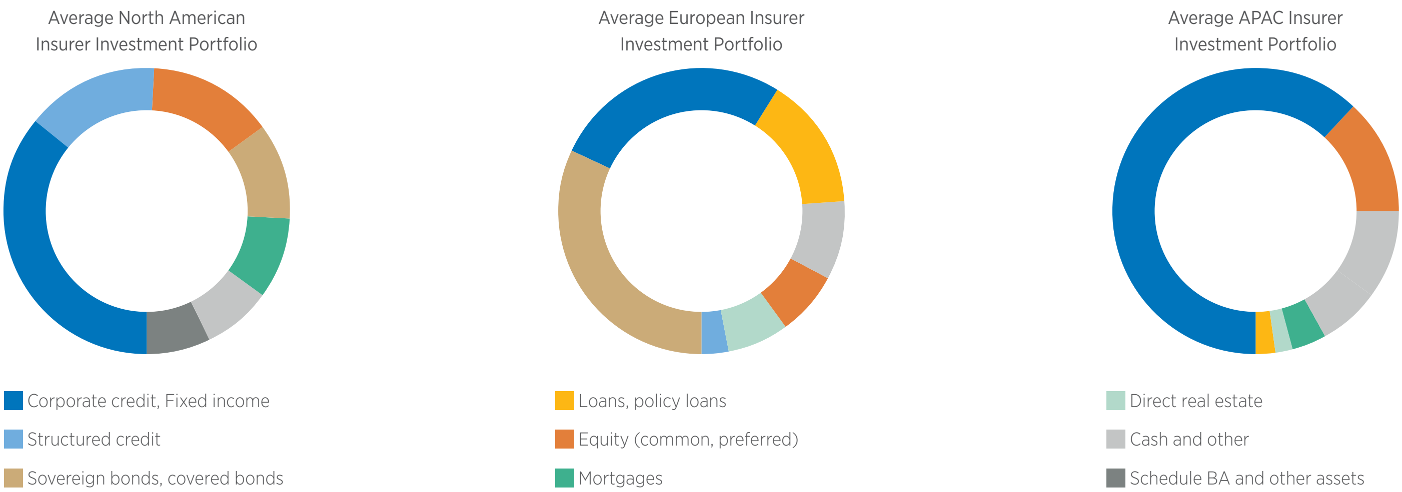

Figure 3. Average regional differences in insurers' investment portfolios (2022) (data sources: NAIC (US data) Autonomous Research (Europe data), AM Best (APAC data))

North America

Insurers in the US allocate approximately 12% of their investment portfolios to CRE. Within this CRE exposure, 94% is indirect through mortgage loans and commercial mortgage-backed securities (CMBS), 4% in Real Estate Investment Trusts (REITs), and 2% in direct real estate.[3]

CRE has remained a steadfast allocation among institutional portfolios, particularly given the US CRE market's valuation of approximately $21 trillion, approximately half the size of the US stock market.[1]

Correspondingly, insurers in the United States have shown a consistent preference for commercial mortgage loans, with exposure steadily increasing since the 2007–2008 financial crisis.

Europe

Overall, European insurers have roughly 9% of their investment portfolio within CRE exposure classes.[4]

Within their exposure to real estate more generally, commercial mortgages (13%) and commercial real estate direct investments (20%) are large components. Commercial mortgage-backed securities (CMBS) form only 4% of European composite CRE exposure.[4] This is a lower investment proportional terms than US counterparts in the CMBS market. In contrast though, European carriers invest more in direct real estate than US insurers.

Rest of the world

Beyond North America and Europe, insurers in the rest of the world are also investing in CRE although local market practice appears to vary greatly. According to AM Best data, insurers in the Asia Pacific region allocate 1.4%, 2.2%, and 4.3% of their investment portfolios to direct real estate, policy loans, and mortgages, respectively.[5] On average, these allocations are lower than those of insurers in the US and Europe.

However, it's important to note that different markets around the world face unique challenges and opportunities in CRE investment due to local regulatory frameworks, market dynamics, and economic conditions. Financial disclosures detailing specific CRE investments in many jurisdictions are also not always readily available.

3. Macroeconomic conditions and the prospects of a recession in 2024

This section looks at the current uncertainty in macroeconomic conditions in the EU, US, and China.

EU

The European economy is in a peculiar state, unlike anything we've seen in quite a long time.

On the one hand, the unemployment rate is at 6.4%, still the absolute lowest level since the start of the single currency. Total employment has been growing fast for three years and shows no signs of slowing down.

On the other hand, economic growth during 2023 was flat, with current noisy estimates of a -0.1% growth rate in real GDP per capita and an expected growth rate for 2024 of 0.6%–1.0%. This disconnect could mean that either employment or economic activity figures could start moving in the direction of the other.

It is hard to know which direction it will go, but there are some encouraging signs in the data that activity should improve, so the economy is healthier than many analysts think.

US

In the US, labor markets are equally tight, but economic growth is much higher than in the EU: 2.6% in 2023 in real GDP per capita and a forecast of 2.0%–2.4% in 2024. Productivity is booming in the US, while it is stagnant in the EU.

The news of the past three months has, for the most part, been positive. The chances of a recession in 2024 are small in the US. The financial fragilities exposed by the Silicon Valley Bank (SVB) crisis seem to have been absorbed by the system through a mix of mergers, and some restructuring among small and regional banks.

The median sales price of a house sold in the United States was 12.9% lower at the end of 2023 relative to one year earlier, but this has not shown up as any noticeable financial instability. The nexus between banks and housing, a traditional weak spot in the US economy, has held up well so far.

China

China is the region in best shape of the three in absolute terms, yet conversely the worst shape in relative terms.

Growth in 2023 was 5.2%, against a very low base of activity in a pandemic-locked-down economy in 2022. Relative to its trend until 2020, the Chinese economy is still well below par, while the US, for instance, has now fully recovered.

Moreover, after rapid growth until the start of 2022, real estate development investment shrank by 12% by the end of 2023, and many banks have impaired balance sheets linked to the housing sector.

Recessions and the insurance sector

By its very nature, a recession affects all sectors in the economy, and insurance is no exception.

From an earnings resilience perspective, the main sensitivity for insurers tends to come from financial market volatility, pressures related to uncertainty, and a deteriorating economic outlook.

On the consumer side, hard times can result in a shortfall for demand for life and health products, resulting in policy lapses. Recessions that occur when monetary policy is tight and interest rates are high can be especially hard. The last couple of years have seen a rise in interest rates coincide with an economy that was fast recovering from a pandemic, so performance was good overall, but a turn in the economy in 2024 is something to look out for.

Looking at the asset side of balance sheets, the returns on different asset classes have different correlations with the state of the economy. For instance, stock prices only weakly co-move with GDP. So, even though insurers by the nature of their business hold large asset positions, the impact of asset revaluations often does not coincide with an impact on business income.

The special role of commercial real estate

Given insurers' investment positions in CRE, any losses in that sector would translate into quick losses on their assets. Moreover, this is one sector where economic activity and asset returns are strongly tied together. Interest rates are an important consideration as real estate benefits from liquidity infusion by central banks or in periods of ultra-low interest rates. In a weakened economy, interest rates are cut to support the economy, which can potentially soften the pain from an economic downturn. CRE is an especially volatile sector within the business cycle, as well as a sector where asset prices can move quickly.

4. Fundamental drivers of the current real estate market

Working from home is here to stay

Figure 4 shows the share of job vacancies posted in the US and the UK that explicitly allow for remote working. There was an almost tripling of these vacancies relative to before the COVID-19 pandemic in 2020, which has been well documented and much discussed.

Somewhat less appreciated is that the share has kept rising until the start of 2023. Even the slight decline then is more indicative of a flattening than of a reversal. From 3%–4% of all job openings allowing for remote work, the new normal seems to be around 10%–12% in the US and 15%–17% in the UK.[6]

In Europe the numbers are lower. While in the UK and US, people are spending 1.5 and 1.4 days working from home, respectively, in Greece that average is 0.5 days, in France it is 0.6, and in Germany it is 1.0.

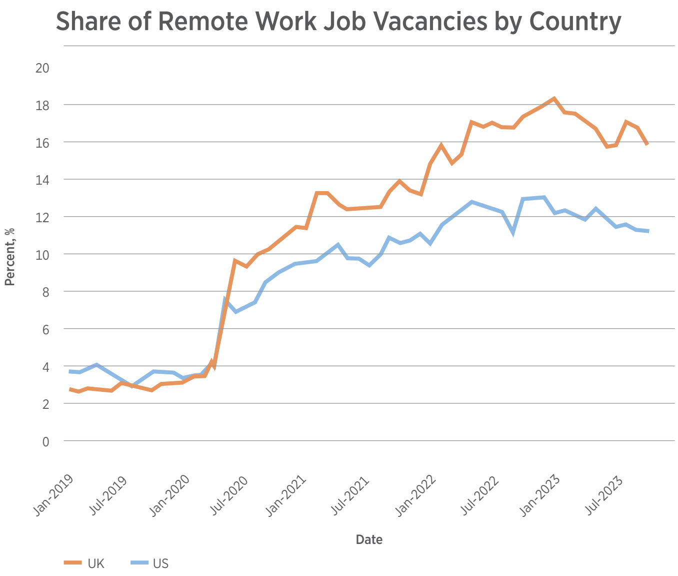

Figure 4. Work-from-home shares in the US and the UK (data source: National Bureau of Economic Research)

Office vacancies are still high

Offices becoming vacant between 2020 and 2021 was not a surprise. After all, with a pandemic of unknown duration, many companies were not willing to keep that expense and let leases expire.

As Figure 5 shows though, for the case of London (New York looks quite similar, as do other cities in the UK and the US), even as the economy started recovering rapidly in 2022 and 2023, the vacancy rate never fell.

As there is a housing shortage, especially in the UK but also in many densely populated urban areas of the US, a seemingly obvious solution is to convert office space into residential units.

However, reconverting office spaces does not happen overnight and poses substantial challenges. As a result, this has not happened in the last few years.

The cost of doing the conversions and the regulatory barriers have proven to be very high, and the availability of significant credit to the sector is not there. A recent report by Goldman Sachs argued that a residential conversion would only make financial sense if there was a discount price of 50% on commercial real estate.[7] Of course, offering such a discount would be unrealistic in most locations.

Figure 5. Office vacancy rates are at an all-time high (data source: CoStar)

The construction sector has gone through a productivity slump, but the pandemic turned a corner

Figure 6 shows two measures of productivity. The first is labor productivity, or how much value added is generated by workers. The second is total factor productivity (TFP), which is an econometric measure of how much more output all factors, including capital, are able to generate. The figures show results for the overall economy and for construction, for the US, ending in 2020 (the same points, made below, apply to the UK economy).

Especially in the last 20 years, productivity in the construction sector has consistently declined every year, and the gap relative to the rest of the economy has widened.

However, the pandemic seems to have caused a change. In the US, productivity increased by 1.5% between 2019 and 2022 in building single-family or multiple-family homes, and by 4.8% in constructing industrial buildings. This reversal reflects in great part the economic rebound and housing shortages, together with the tight labor market.

The new world and the transition to it

In London in October of 2023, 9.3% of offices were vacant, an all-time high. Work from home is here to stay and reconversions have not happened.

There were many forecasting a crisis in commercial real estate that never came. Is it just around the corner?

Perhaps, but a more optimistic (and rarely heard) side is that the vacancy rate in offices may be just turning the corner, as the economy is only now getting back on trend, and that the increases in productivity in construction will allow reconversions to start happening this year. A crisis in real estate triggering a recession is far from being a given.

Either way, crisis or not, recession or not, these are stranded illiquid assets in balance sheets. For investors in the sector like insurance companies, this remains a risk. The lack of surplus labor for the expensive (and low productivity) conversion of offices and retail spaces in cities creates a disconnect between new activity versus legacy assets, which the commercial real estate sector will have to absorb.

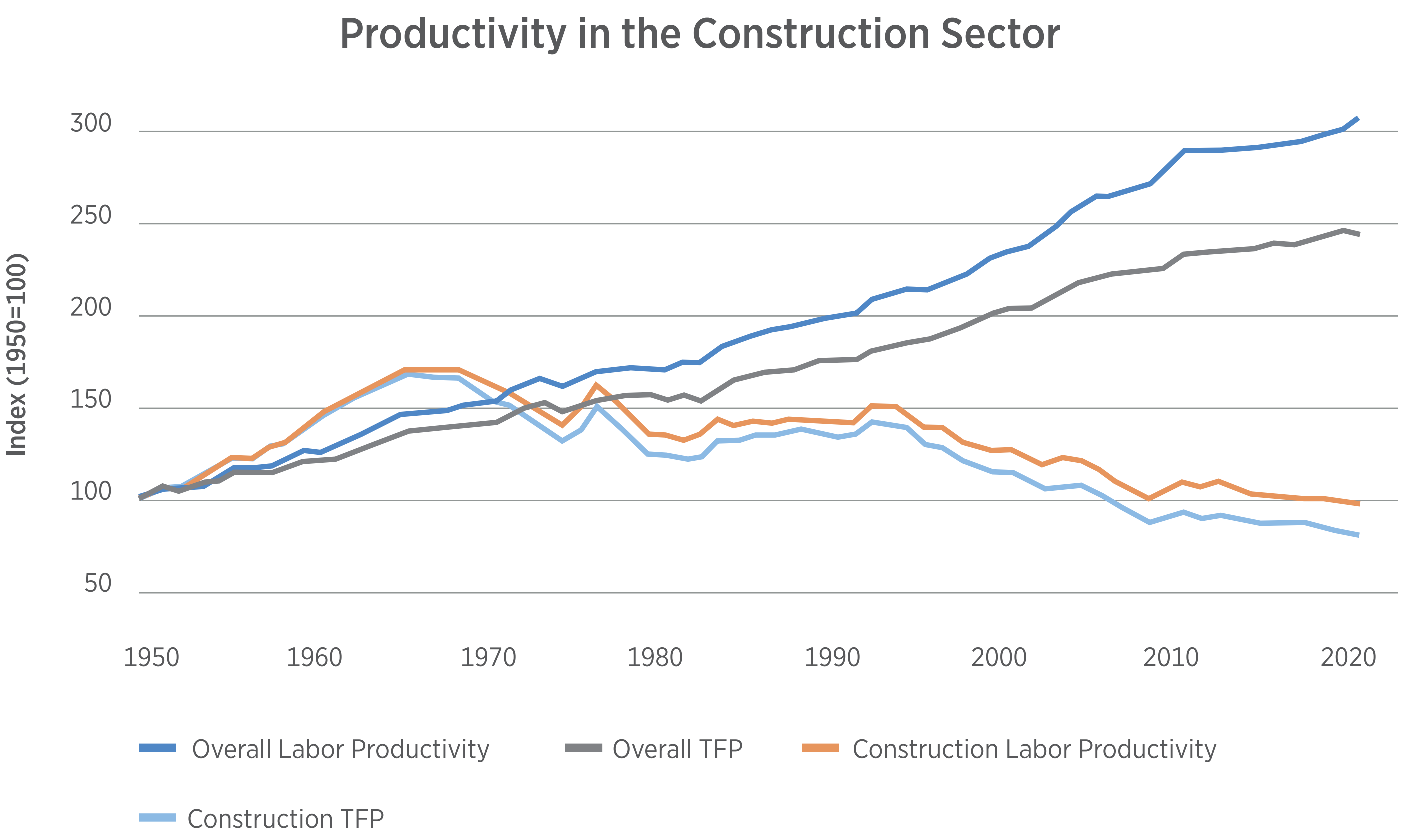

Figure 6. Productivity in the construction sector (data source: Bureau of Economic Analysis)

The Exposure of the Banking Sector to Commercial Real Estate

The share of credit to commercial real estate has grown in banks' portfolios

Figure 7 shows loans that explicitly finance real estate acquisitions as a share of total assets for the average US bank. This does not include mortgages, and so mostly captures credit for commercial real estate as well as, possibly, for industrial buildings. There is a well-known trend that the share of mortgages in bank assets has been continuously falling, as other financial intermediaries have started taking a bigger role originating mortgages. What this picture shows is that there has been a trend in commercial real estate in the opposite direction. While this is relatively small as a share of assets, it uncovers some of the reason as to why the sector has not faced a crash post-pandemic, in spite of the poor fundamentals just described. Banks have supplied plentiful credit to the sector, keeping it steady through rough times.

Smaller banks are more indirectly exposed to real estate these days

It is a commonly stated fact that smaller banks are more exposed to real estate, mostly because a larger chunk of their activity is in providing mortgages. Yet, this forgets the large structural transformation in the mortgage sector, where more non-bank financial institutions have grown to be dominant in the mortgage market. As a result, as **Figure 8** shows, the share of assets backed by real estate collateral for small banks has fluctuated over the past 15 years in the US, reaching a high point of 0.6 in 2014 before falling to nearly 0.2 in 2021.

However, inferring from this that banks are more immune to real estate would be a mistake. The financing companies issuing mortgages, packaging them, and selling them as asset-backed securities are all connected to banks. Some of the largest buyers of these MBS are banks themselves. Moreover, during the securitization process, the financing companies must borrow capital, and most of it comes from bank loans. Combining the two factors, the exposure of banks to real estate has not fallen much, if at all.

Loans to Finance Real Estate, compared to Banks' Total Assets

Figure 7. Bank loans for financing real estate activities (data source: FFIEC Call Reports)

Real Estate Loans Compared to Total Assets, for Small and Large Banks

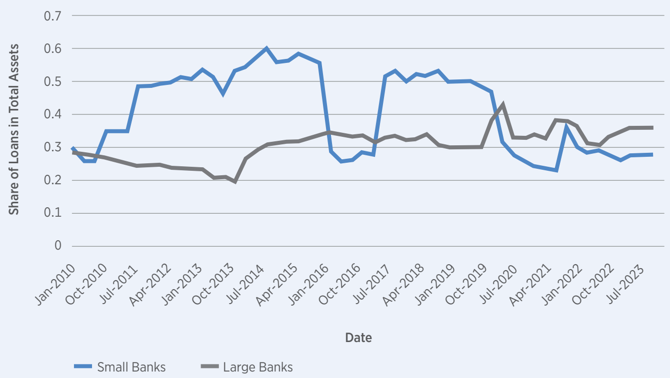

Figure 8. Bank loans (by size of bank) secured to real estate collateral (data source: FFIEC Call Reports)

Larger banks have become more exposed to commercial real estate after the pandemic

Figure 8 also shows the share of loans backed by real estate for larger banks. Since the pandemic, this has grown in the US compared to exposure of small banks. This might seem odd, given the overall backdrop of somewhat tight credit conditions (caused by central banks tightening policy to control inflation).

But we are talking here about stocks of credit, not flows. While banks may have scaled back on new real estate lending lately, there are still plenty of older real estate loans on their balance sheets. This is what **Figure 8** shows. In an environment where the flow of new credit is slowing down, legacy assets become a larger proportion of the stock. Changes in the price of these older loans, or any that become non-performing, are a weak spot for bank balance sheets right now.

Disconnect between activity and legacy assets

Looking at banks' balance sheets reinforces the idea that one must look at economic activity and legacy assets separately. When it comes to activity, real estate has continued to enjoy access to credit. There are no signs this will revert, therefore, from this link, there are little signs of a recession driven by commercial real estate in 2024.

Yet, as the Silicon Valley Bank episode showed right away, the underlying problem was one of solvency, not liquidity. SVB and the other banks that failed had losses in their government bond portfolios. With bond prices rising right now, this is likely not a source of new losses moving forward. However, the data here suggests that the risk in bank balance sheets may well be instead in their loans to real estate.

Implications for insurance companies

Insurance companies have large exposure to real estate assets. Like banks, it is the risk in these legacy assets that should be the source of focus. These are variable across different companies and portfolios, and a careful attention to their risks is important. Moreover, as the subprime crisis of 2007–2008 taught us, often risk models are not well calibrated to deal with sudden movements in prices of real estate as they get amplified through the whole financial sector.

Finally, note that if nonperforming loans rise in commercial real estate, this inevitably leads to some loans being called and some fire sales of properties repossessed by the banks. We know from banking crises that this quickly spreads into significant losses to anyone holding these assets, whether they are banks or not. Therefore, if for reasons other than real estate, we do enter a recession, then commercial real estate will play a role. Even if not the cause of the recession, it will be a propagator. Paying attention to the nexus between real estate conditions and bank credit is central to understand the risk in the commercial real estate holdings of insurance companies.

5. Financial links from real estate to the economy

The usual link between real estate and real activity

Traditionally, the housing cycle is a large part of the business cycle. Recessions almost always come at times when house prices fall and vice versa, as recessions can trigger house prices to drop. As a result, when household wealth falls, consumption is cut. Recessions are also times when credit to construction falls, and employment and production in that sector falls, driving many other sectors with it. This traditional link between a recession and real estate does not need further elaboration. It is well known.

The weight of real estate on balance sheets

Figure 9 shows the weight of real estate in the total assets of households and non-financial corporations since 2000 in the US.

The house price boom of the early 2000s clearly had an effect on the valuation of real estate. By 2011 though, after the crash, the weight was back to its usual number at around 25% of the value of all assets for households and 30% for companies.

Since the pandemic, there has been not much of a change when it comes to companies. The household share has risen though until the end of 2022. Also looking at these numbers, there do not seem to be any alarm bells from real estate foreshadowing a recession.

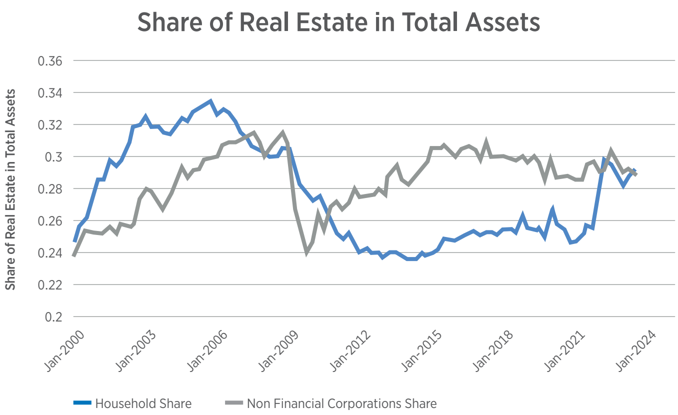

Figure 9. The weight of real estate assets on assets outside of the financial sector (data source: Board of Governors of the Federal Reserve System (US), Release: Z.1 Financial Accounts of the United States)

Are property prices collapsing or recovering?

Figure 10 shows recent indices for US commercial property prices. All of them seemed to have turned a corner in the second half of 2023 and are now growing. Again, despite some of the media commentary on the impending doom coming from housing and real estate, the sector seems to now be rebounding. Figure 11 shows figures for Europe as a comparison and the story is similar.

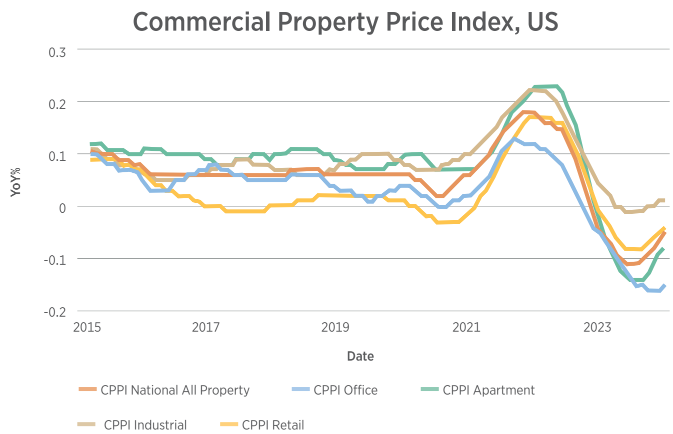

Figure 10. US commercial property prices (CPPI) (data source: Bloomberg)

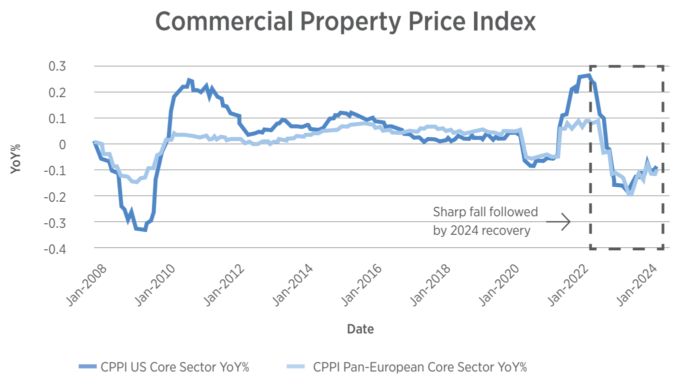

Figure 11. Commercial property prices in the US and Europe (data source: Green Street Advisors)

At the same time, it is important to note a difference: offices stand out as the ones that are recovering the least, if at all.

As outlined in Section 2, the problem, if there is one, is in legacy commercial real estate given working-from-home trends and the cost of reconversions.

This is a problem that should not be driving a recession, as the share of real estate in household wealth is tiny. It is rather a problem for investors in office commercial real estate, like insurance companies.

Zooming in on real estate and asset prices

What needs to be better understood is the link between real estate and the price of financial assets, as this is relevant for insurance companies given their asset holdings and the legacy asset problem discussed in the previous section. The asset price is the main channel through which problems with commercial real estate, driven by the fundamental sources described in Section 2, can quickly spread.

Figure 9 confirms the importance of asset prices. The increase in the share of real estate in wealth reflects the return in those assets relative to the price of bonds, or even equity. As the equity market rallied in 2023, and bond prices are rising, the share of housing in assets will likely fall back to its usual value.

There is a clear link between real estate and recessions working through household and firm balance sheets. Right now, though, it does not seem more elevated than usual, and therefore does not indicate that some correction in the system is about to happen. As always, a fall in house prices would have a strong recessionary impact by cutting wealth and consumption. But currently, there is little in the data to suggest that this is more relevant in 2024 than it usually is.

6. Financial returns and distress

Financial returns on real estate have been stable

Figure 12 shows the returns on Real Estate Investment Trusts (REITs) for the US and Europe. It also shows a specialized REIT on shopping centers for the US and returns on a stock market index comprising the 600 largest real estate companies in Europe. Financial returns on real estate have been relatively stable since 2009. After, understandably, returns fell below the average in 2020, we have seen a reversal back to close to historical averages by October 2023, albeit with quicker upticks in the US than in Europe.

Figure 12. Returns on real estate investment (data sources: NAREIT; STOXX Europe 600 Real Estate Price Historical Price Data)

The peculiarities of commercial real estate returns

A very important part of returns in the real estate sector is depreciation. Allowances for accounting depreciation in buildings are large. They are also often divorced from actual economic depreciation, because of the large changes in property prices. This implies that the typical commercial real estate holder, or a builder, can carry large depreciation tax allowances. They can, with some ease, transfer these across years or across companies in order to lower their tax burden. However, this implies that the earnings, or dividends, associated with commercial real estate can become divorced from the actual cash flows and earnings, and more tied down to the tax shield that they offer. Moreover, because of the illiquidity in some sectors of real estate, often pricing underlying assets is not the easiest. Leverage is also very high in this sector.

The danger from legacy assets

Combining distorted returns by tax accounting, illiquidity, and leverage creates a dangerous mix when it comes to legacy assets when there have been large fundamental shocks. Commercial real estate returns can look steady for more than a decade, as in Figure 12, then easily fall in a short period of time. Returns can look smooth over time because of accounting transfers and illiquid pricing. But when there is an inevitable downward adjustment in the price of the underlying asset because of a structural change, then there will be an inevitable period of negative returns. This will happen quickly. Leverage implies that fire sales follow, with crashes overall.

The usual advantage of insurance companies as investors is that, unlike banks, they are not subject to frequent withdrawals in normal times. Because of that, they can earn the premiums on illiquid assets, but also because of this tendency, regulations are tight on what they can invest in. In this tug of war between incentives and regulations, commercial real estate is a desirable asset. Because it can be marked to market and sold in indices (like REITs), it satisfies regulators.

However, the returns in those indices hide an underlying illiquidity of the assets, and the marking to market is contaminated by the accounting tax incentives. Therefore, while insurance companies should invest in commercial real estate, this is also one aspect of their portfolio to which to pay particular attention.

Given the uncertainty documented here, the amplification potential to the real economy and to banking, and the misleading impression from market returns, this is a source of risk to carefully consider. If a bad shock happens, losses can be catastrophic.

7. CRE scenarios and implications for insurer CRE exposure

In this final section we consider some potential trajectories for CRE in 2024 **(Figure 13)** and what the consequences could be for insurers in different regions regarding their exposure to CRE **(Table 1)**.

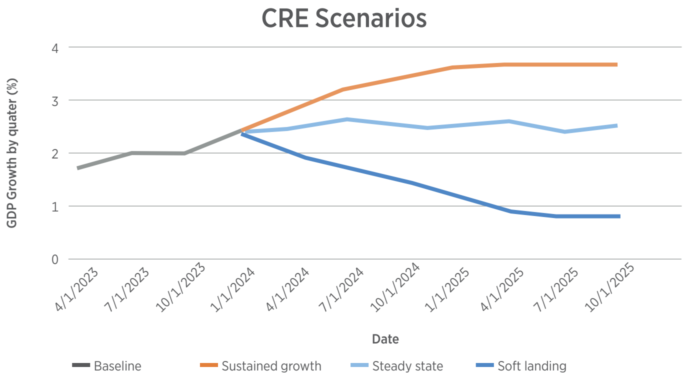

Figure 13. Conceptual recessionary scenarios based on changes from a US GDP baseline

Table 1. Macroeconomic scenarios and implications for insurers and CRE asset classes

Higher exposure

Scenario	Direct Commercial Mortgages	Commercial Mortgages Backed Securities (CMBS)	Wholly Owned Real Estate	Real Estate Investment Trusts (REITs)
Sustained growth: Early 2024 productivity continues to rise and drive sustainable economic growth through 2024 — CRE yields increase. Consequences may include: • Increased rental rates • Higher occupancy rates • Property appreciation • Increased investment	US — Noticeable increases in investment returns for insurers as rental rates and occupancy rates increase (particularly for life carriers).	US — Increased investment profits on an asset that represents 3.6% of their overall portfolio and 68% of non-life carrier CRE investments.	US — Increased returns as property values increase with rental yields. Represents only 0.4% of the overall portfolio, so returns would be modest compared to commercial mortgages and CMBS.	US — Increased rents, property valuations, and investment push yields up. Only represents marginal increases given their 0.5% overall portfolio investment.
	Europe — Healthy returns for many carriers as this represents approximately 3% of overall investment and 13% of explicit exposure to CRE.	Europe — Carriers in Europe are less invested in CMBS than US counterparts (<1% of total investment).	Europe — Good ROI as wholly owned assets account for 36% of all CRE.	Europe — Limited impact, since it represents only 0.7% of the overall investment portfolio and 4% of CRE exposure.
	RoW — Healthy returns as this is estimated to represent 4.3% of the investment portfolio of an average APAC insurer.	RoW — Scale of upside not certain as the detail on CMBS and RMBS investment exposure for RoW carriers is not always available.	RoW — Regional investment practices will be key as property valuations will be noticeably different across the world.	RoW — High occupancy and property valuations increase yields for insurers.
Steady state: Economy does not go into recession and growth is held steady across the CRE sector. Consequences may include: • Stable rental income • Limited valuation growth • Interest rate sensitivity	US — Continued returns on what is a long-term diversified investment.	US — Assuming central bank interest rate policies remain the same, solid returns would be expected.	US — Continued shareholder returns on what is a stable investment.	US — Cut in dividends to insurers' investment portfolios as REITs lose money due to lower occupancies and falling valuations.
	Europe — Stable returns as long as monetary policies on interest rates remain unchanged.	Europe — Marginal impacts given limited investment. Added upside from RMBS.	Europe — Will vary across Europe and returns will depend on whether valuations increase in line with rental income.	Europe — A positive return in a buoyant property market albeit in a minor investment asset.
	RoW — Steady, continued returns, more so for Life insurers than non-life. Life insurers hold five times the investment on mortgages than non-life.	RoW — Stable returns but unlikely to shift the balance sheet.	RoW — Stable returns, but unlikely to shift the balance sheet.	RoW — Some Asian countries restrict REIT investments for insurers, so impact would vary considerably.
Sharp downturn: Rising geopolitical and supply chain pressures, unemployment rises, productivity slows, and the global economy gradually slips toward a recession over the next 18 months. CRE is hit badly. Consequences may include: • Falling property values • Falling CRE occupancy • Interest rates near zero to stimulate economy	US — This is the biggest CRE risk to investment losses for US life carriers. This asset class represents around 70% of their CRE exposure (and 8% of the entire investment portfolio).	US — Not as exposed as direct mortgages but losses would impact 3.6% of insurer's investments.	US — Falling returns but limited as only 2% of CRE exposure and 0.4% overall. Primary concern would be on the US property market for US carriers. Life carriers are approximately two times as exposed as non-life carriers.	US — Cut in dividends to insurers' investment portfolios as REITs lose money due to lower occupancies and falling valuations.
	Europe — CRE losses would be noticeable but not as exposed as US counterparts.	Europe — Low exposure should limit investment losses on this asset class.	Europe — Could account for a sizeable impact given that exposures across commercial and residential real estate account for approximately 7% of the investment portfolio.	Europe — Insurers in Europe are slightly more exposed to this asset class than US counterparts in a property downturn scenario.
	RoW — Losses would likely be defined by geography.	RoW — Impact of losses will vary considerably as carriers are exposed to local property market variations.	RoW — Exposure to a downturn could be more sizeable for less diversified portfolios.	RoW — Shortfalls due to reduced rental income. However, the severity of impact may depend on the type of REIT. Investments in warehouses and data centers may likely prove more resilient than office space (as noted in the COVID-19 pandemic).

Data sources: NAIC (US data), Autonomous Research (Europe data), AM Best (RoW data).

How can we help?

Please contact Gallagher Re's Strategic and Financial Advisory team for further information on our business intelligence, capital advisory and modeling, ratings and regulatory advisory, and strategic advisory services.

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