

# Commercial Mortgage Loans: A Core Allocation for Life and Annuity Investment Portfolios

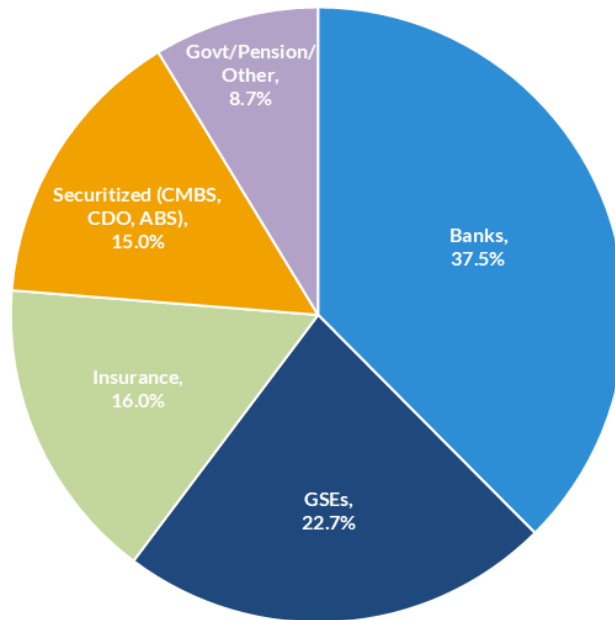
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Commercial Mortgage Loans (CMLs) represent a core allocation for insurance portfolios, offering a compelling combination of incremental yield, strong historical credit performance, favorable capital treatment, and alignment with backing annuity and life liabilities. Recent fixed annuity sales trends indicate a shift to more capital efficient investments, such as Commercial Mortgage Loans. Despite these advantages, adoption lags for smaller insurers, which can create a meaningful opportunity to enhance the yield profile of insurer investment portfolios and support life & annuity sales.

## The CRE Debt Market Landscape

The U.S. Commercial Real Estate (CRE) debt market is a large and diverse asset class, with approximately \$5 Trillion of outstanding debt. Core property sectors include multi-family, retail, office, and industrial properties, alongside specialized segments such as self-storage facilities, hospitality, student housing, and data centers.

**Exhibit 1: U.S. CRE Debt by Lender Type**  
**Share of Total Outstanding CRE Debit Balances by Lender Type 4Q25**



Source: Trepp, Federal Reserve

**Banks** - Local and regional banks are the largest originator of CRE debt, typically focusing on their regional markets. Loans may also include construction loans and bridge loans, and generally carry shorter term structures and floating rates of interest.

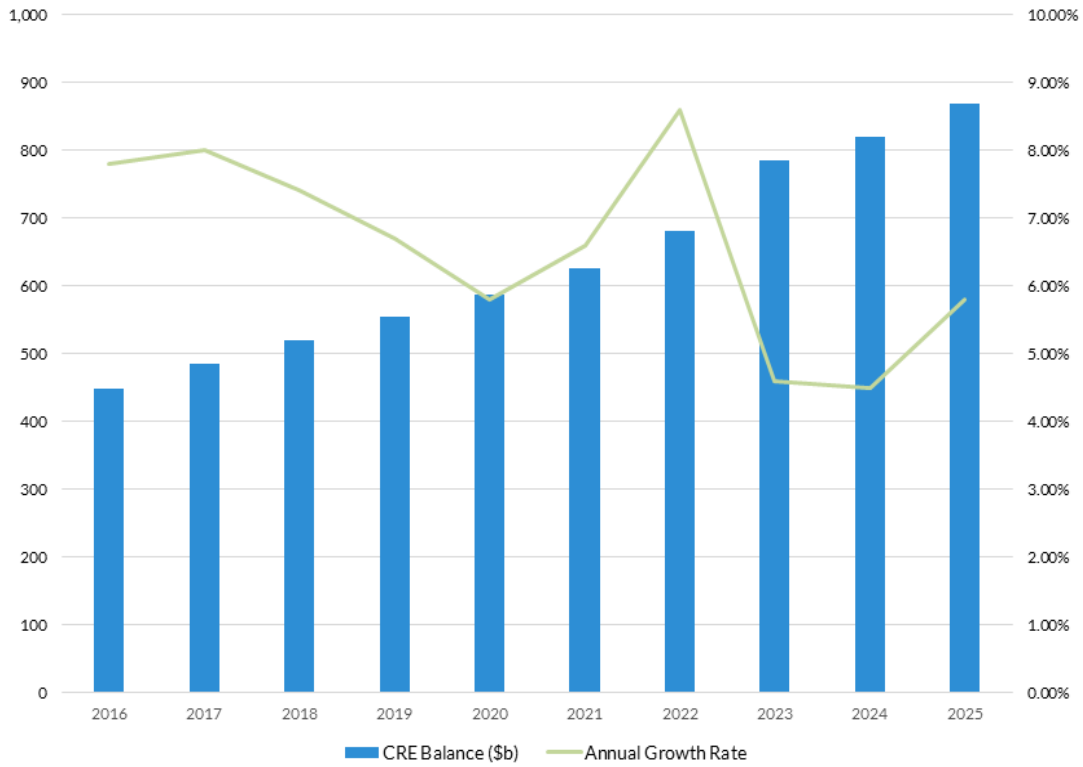
**Government-Sponsored Enterprises (GSEs)** - GSE lending is concentrated in multifamily housing, supported by federal programs aimed at promoting housing affordability. Freddie Mac’s K-Series program is the dominant platform in this segment.

**Securitized (CMBS, CDO, ABS)** - Structured CRE exposure is primarily delivered through Commercial Mortgage-Backed Securities (CMBS), which can include large single-asset/single-borrower (SASB) or conduit transactions. Conduits provide a diversified pool of commercial loans with embedded bondholder protections to achieve desired credit ratings. Commercial real estate CDOs are similar to CMBS conduit securities, but allow for the replacement of properties within the structure.

**Insurance** - The insurance industry is a long-time investor in CRE debt that plays a significant role, focusing on long-duration, fixed-rate loans secured by high-quality assets. Origination is facilitated through an established correspondent network, enabling disciplined underwriting and competitive pricing. The insurance industry has been a major CRE lender for over 100 years.

Insurance companies currently hold approximately 16% of total U.S. CRE debt, up from roughly 10% over the past decade. Growth in the insurance channel reflects changes in regulation and a retrenchment of bank lending to higher risk segments such as construction lending, and the disruption of the CMBS market following the Global Financial Crisis.

**Exhibit 2: Insurance CRE Debt Balance & Annual Growth Rate**



Source: 2025 NAIC Capital Markets Bureau Year-End Asset Mix Report

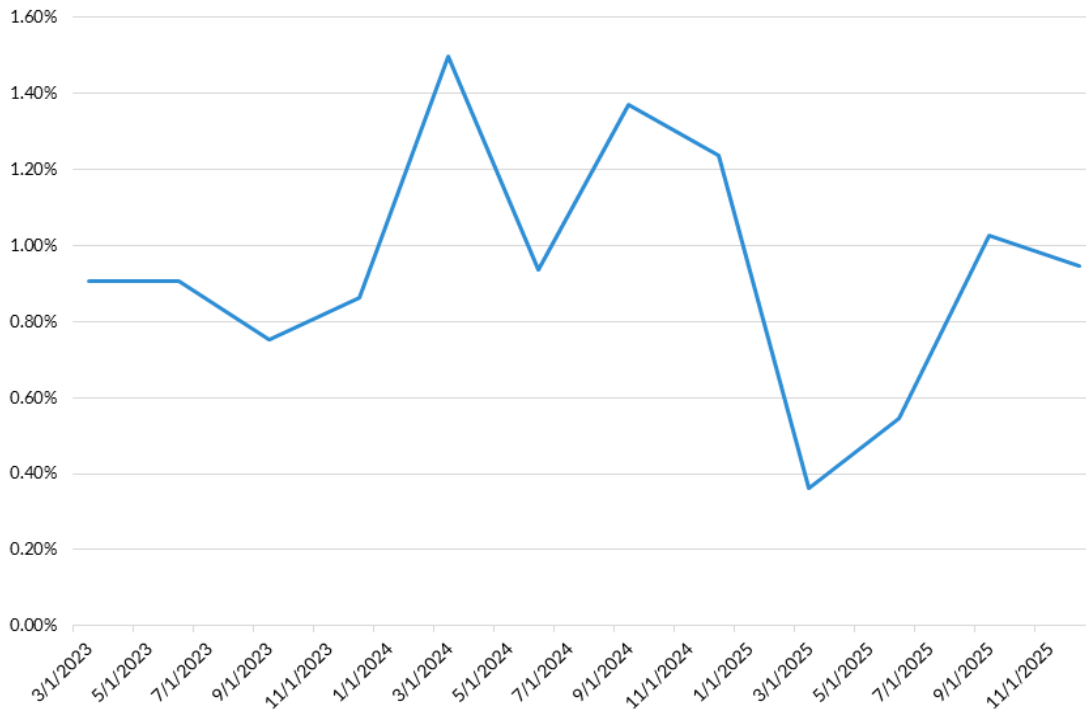
## Investment Rationale for Commercial Mortgage Loans (CMLs)

There are clear reasons why the insurance industry has allocated a growing share of capital to commercial mortgage loans.

### 1) Incremental Yield Advantage

CMLs have historically delivered a yield premium relative to highly rated corporate bonds. Over the past three years, newly originated loans have provided an average yield pickup of approximately 95 basis points over 7-10 year A-rated corporates. This yield premium compensates investors for the asset class's relative illiquidity, and the insurance industry has demanded this premium over several decades.

**Exhibit 3: Life CML Yield vs 7-10yr A Corp Field**



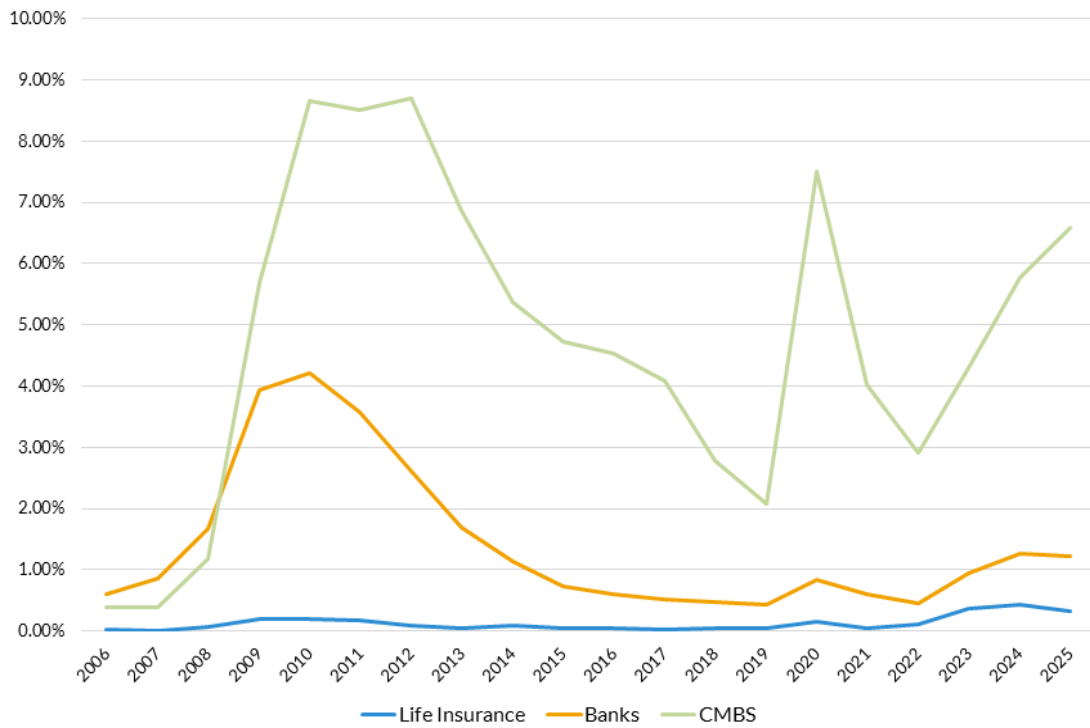
Source: NAIC, S&P Capital IQ

Beyond CMLs, additional yield enhancement opportunities exist through adjacent CRE strategies for insurance companies – including mezzanine lending, bridge loans, and construction financing – while maintaining a disciplined risk profile.

## 2) Strong Credit Performance and Low Loss Rates

CMLs have demonstrated strong credit performance over long time horizons, supported by conservative underwriting, structural protections, and collateral backing. A low default profile means that insurance companies have realized all of the excess spread relative to corporate bonds - with no extra drag from losses.

**Exhibit 4: Historical Delinquency Rates**



Source: Mortgage Bankers Association

In addition to lower default rates by the insurance industry versus banks and the CMBS market, recovery rates on foreclosed Insurance CMLs have also been favorable, typically exceeding 75%. When you combine the low insurance default rate and high recovery rates, indicates an implied average annual loss rate of 5 basis points or less. This compares favorably to commercial loan loss rates for banks. According to FDIC data, over the past 20 years, the bank charge-off rate for all commercial loans was 24 basis points. This indicates a more conservative underwriting standard and better loss experience by the insurance industry.

Based on Moody’s 20 year cumulative default and recovery rates, the average annual loss rate for A rated Corporate bonds is 6-12 basis points, and 3-6 basis points for AA Corporates. The possibility for materially higher yields, while maintaining comparable or better long term loss rates versus Corporates, reinforces the asset class attractiveness on a risk-adjusted basis.

### 3) Favorable Capital Treatment

The consistently low loss history of CMLs is reflected in the RBC capital framework. For life insurers, NAIC capital charges for CMLs are broadly aligned with those applied to high-quality fixed income securities. The distinction between CML categories is formulaic and driven by LTV and DSC Ratios, with CM1 and CM2 considered Investment Grade. Loans in these two rating categories make up the vast majority of insurance company purchases.

**Exhibit 5: Life Company RBC Charges**

Bond Code	Credit Equivalent	Base RBC Factor	CML Code	Base RBC Factor
1.A	AAA	0.158%		
1.B	AA+	0.288%		
1.C	AA	0.370%		
1.D	AA-	0.490%		
1.E	A+	0.617%		
1.F	A	0.738%		
1.G	A-	0.916%	CM1	0.900%
2.A	BBB+	1.258%		
2.B	BBB	1.543%	CM2	1.750%
2.C	BBB-	2.012%		
3.A	BB+	3.141%	CM3	3.000%
3.B	BB	3.890%		
3.C	BB-	4.764%		

Source: NAIC

Growth in annuity products has led to pressure in the insurance industry to achieve a higher yield to remain competitive. These dynamics have led to a deterioration in credit quality to many insurers. Recent commentary from AM Best indicates that annuity writers are facing increased pressure on capital ratios, partly due to increased allocation to higher yielding, but riskier assets. Much of the recent regulatory scrutiny has focused on asset classes with untested long-term loss histories, such as private credit, or ones with higher tail risk such as subordinated CLOs.

CMLs provide a means of enhancing portfolio yield without materially increasing capital strain. CMLs are unaffected by increased regulatory scrutiny, and offer a long history of favorable loss experience.

**4) Call Protection**

Call protection is an important consideration when designing an investment portfolio to support life and annuity policy benefits. Annuity policies, such as MYGA, need fixed-rate yield certainty over the life of the policies. Unlike Residential Mortgages, which can be prepaid when interest rates decline (thus callable), commercial real estate loans have prohibitive prepayment penalties. CMLs typically feature fixed maturities of 5-12 years.

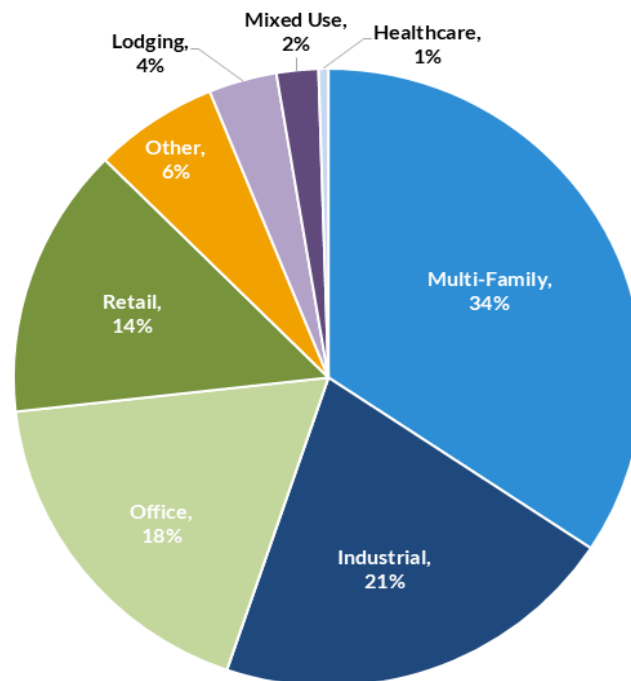
CML characteristics align well with intermediate-to-long duration insurance liabilities, and are suitable for annuity products. Insurers retain flexibility to construct portfolios that closely match duration targets across various liability profiles.

### 5) Diversification Benefits

Many Insurance general accounts remain concentrated in corporate credit. According to the NAIC, corporate bonds have represented the largest percentage of Fixed Income investments at over 60% over the past several years. This makes broad diversification more challenging with increasing corporate issuer concentrations, and in light of long term declines to average corporate credit quality. This diversification away from corporate bonds can be particularly valuable in periods of corporate credit market volatility.

CML portfolios offer exposure to real asset collateral, and can be diversified by vintage, geographic location, and property type. Below is the diversification by property type across the insurance industry.

**Exhibit 6: US Insurer Commercial Mortgage Loan Portfolio by Property Type (12/31/24)**

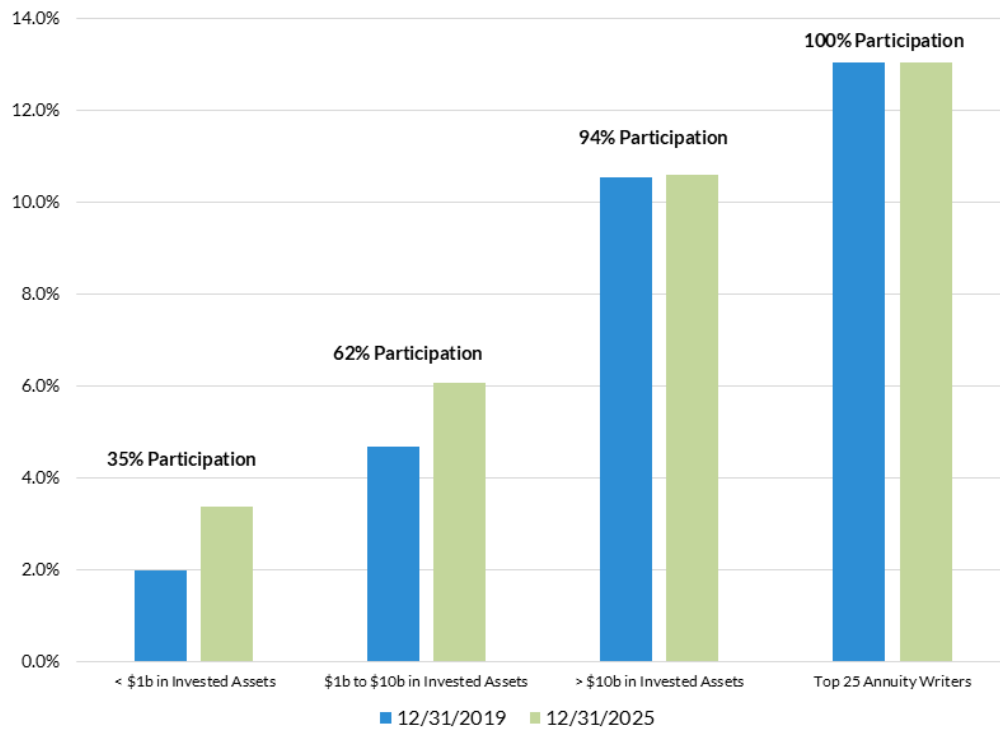


Source: NAIC

## Underutilization Among Smaller Life Insurers

We compiled the entire Life Insurance universe asset allocation set and grouped CML exposure by general account asset size (<\$1 billion, \$1-10 billion, and >\$10 billion), and compared to 12/31/19.

**Exhibit 7: CML % of Life Assets**



Source: S&P Capital IQ

Observations from the data show that Life insurers with less than \$1 billion in assets allocate just 3.4%, with only 35% investing in the asset class. Mid-sized insurers (\$1-10 billion) have increased allocations but remain well below large company levels. Nearly all large Life insurers (>\$10 billion) participate in CMLs, and consider it a core asset class with over 10% allocated. The largest annuity writers are by far the most active participants with 13% allocated to CMLs and 100% participation. This is due to the competitive annuity landscape to achieve capital efficient yield.

Despite the clear advantages of CMLs, participation and allocation is correlated to size. This is due to the overhead involved for smaller insurers to develop in-house expertise to originate, appraise, and service a well-diversified portfolio of commercial mortgage loans. This can be overcome by loan participations.

Loan participation programs allow smaller insurance companies to co-invest with a lead lender, often a large insurance company, and participate in smaller position sizes to develop instant diversification. Programs can be tailored to match yield requirements, credit quality, and duration profile. Loan participations are reported on Schedule B, with identical capital treatment as a 100% owned direct loan.

## Conclusion

Commercial Mortgage Loans represent a core, institutional-quality asset class that can offer a differentiated combination of yield, credit stability, capital efficiency, and liability alignment.

While alternative private credit strategies have gained traction, many introduce incremental credit risk, complicated structures, and limited performance history. In contrast, CMLs are grounded in tangible collateral, transparent underwriting, and decades of proven performance.

For insurers – especially smaller life companies and annuity writers – greater allocation to CMLs can:

- Enhance portfolio yield without materially increasing credit risk
- Strengthen competitive positioning in annuity markets
- Adhere to asset-liability matching
- Maintain capital efficiency in an environment of regulatory scrutiny

CMLs can be viewed as a foundational component of a well-constructed investment portfolio supporting life and annuity policies.

### **For author biography please visit [www.aamcompany.com](http://www.aamcompany.com)**

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