

Life Insurance Companies Indirectly Anticipate Market Bottom

By: Michael Murray, Mortgage Bankers Association

Life insurance companies appear ready to invest in **commercial real estate** in a more indirect method until market values hit bottom.

Steve Collins, managing director of the international capital group in the Washington, D.C. office of **Jones Lang LaSalle**, said more life insurance companies are taking a stance resembling **Japanese** life companies.

"They're moving all to indirect," Collins said. "It's against the law for Japanese life insurance companies to own direct real estate. They all have to invest in it indirect. I think you see **MetLife** is moving toward indirect—moving the debt. I think you will see more of that."

"I'm hearing the same thing," said **Ross Moore**, executive vice president and director of market and economic research at **Colliers International**, Boston. "The argument, of course, goes—why would I lend at **6.5 percent** or **7 percent**, albeit to my best clients, when I can go in and buy [commercial] mortgage-backed securities at 1,100 basis points over 10-year swaps? You're looking at an **11 percent** to **12 percent** return. Do I go into that market and get a 12 percent return—AAA—or do I stick with my base model and lend to decline?"

Life insurance companies **Prudential**, **Metropolitan**, **The Hartford** and others appeared to provide commercial real estate loan facilities last year, primarily because they were in a better financial position without subprime and securitization concerns that led to bank capital, credit quality and liquidity issues across a number of market sectors, said **Theodore Sprink**, senior vice president and national marketing director in the UCC risk management program at the Carlsbad, Calif. office of **Fidelity National Financial Inc.**

However, low lender confidence in the market drove up loan costs, often LIBOR plus 600 to 800 basis points, and drove down LTV ratios to the 50 percent to 60 percent range, making life insurance companies more risk-averse toward lending.

Moore said life insurance companies, as well as banks, are "very, very selective" and all indications point to a sluggish year.

"It's affecting them as much as it anybody else in the financial industry," Moore said.

"For awhile there, it became too competitive," Collins said. "[Life companies] weren't in the game, lending-wise, because they were too expensive. They have a strong balance sheet and they are in a position to get a nice return if they lend, but they are going to lend on their own terms right now. For their equity side, it's hard to stay in the [ballgame] with the business they're in...Going forward, I think they are going to do less direct and more indirect."

For many industry observers, capital sources for commercial real estate markets now appear to come from a combination of local entities: community, state-chartered and regional banks, which could include five or more lenders in a syndicated transaction.

"Obviously this provides for a pooling of capital and a sharing of risk, to fill the void of the departed money center banks and life insurance companies," Sprink said. "This trend is likely the result of a better comfort level associated with local projects and well-known local borrowers, and the fact that these smaller lenders probably did not participate in the subprime and securitization markets that wiped out liquidity and the ability of the traditional commercial real estate lenders to remain active."

Sprink said bank and life insurance company's primary concern now could be a fear of a "false bottom" in the commercial real estate market and that today's **60 percent LTV** may wind up tomorrow's **80 percent LTV**.

"Today, it appears that life insurance companies have become extremely sensitive to underwriting and risk management factors, and because of more conservative loan-to-value restrictions, together with plummeting value associated with commercial real estate projects, loans from this source appear to have diminished significantly as well," Sprink said. "Traditional lenders, and now the life insurance companies, seem to be waiting for the 'real' bottom to reveal itself."

Purchasing distressed CMBS would become another strategy for life insurance companies, but Moore said markets still have to hit bottom.

"It would help but everybody's playing that game," Moore said.

"It is clearly an indication that traditional lenders, and certainly astute life insurance companies focused on managing risk, do not have confidence that the commercial real estate market has bottomed out," Sprink said.