

Horace Mann Educators Corporation NYSE:HMN

FQ2 2023 Earnings Call Transcripts

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S&P Global Market Intelligence Estimates

| | -FQ2 2023- | | | -FQ3 2023- | -FY 2023- | -FY 2024- | |
|-----------------------|------------|--------|---|------------|-----------|-----------|----------|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | CONSENSUS | GUIDANCE |
| EPS Normalized | 0.02 | 0.03 | ▲ 50.00 | 0.52 | 1.34 | NA | NA |
| Revenue (mm) | 373.53 | 356.40 | ▼ (4.59 %) | 382.85 | 1489.15 | NA | NA |

Currency: USD

Consensus as of Aug-02-2023 8:16 PM GMT

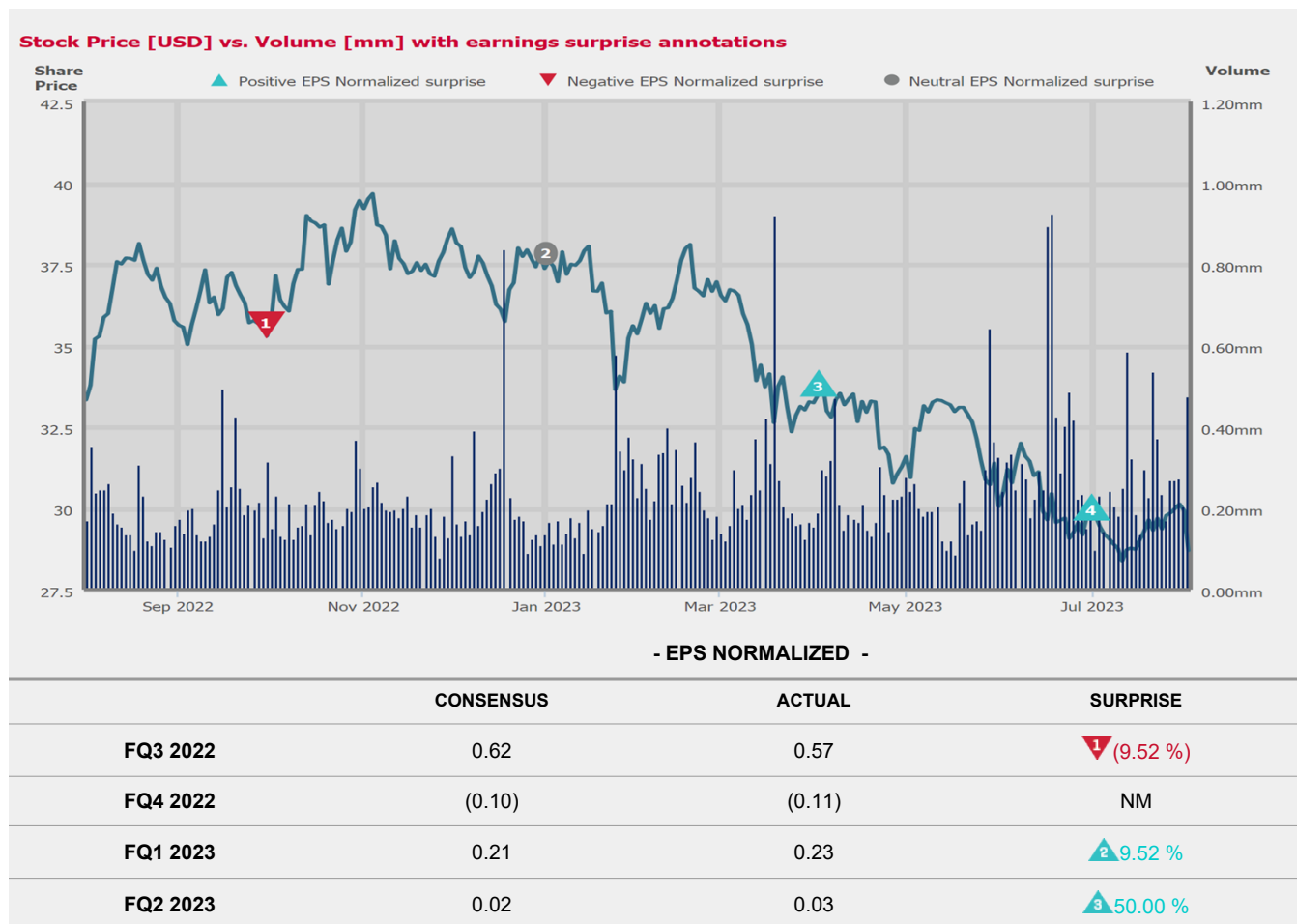


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Call Participants

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Presentation

Operator

Hello, and welcome to the Horace Mann Educators Q2 2023 Investor Call. [Operator Instructions] Please note today's event is being recorded.

I'd now like to turn the conference over to Heather Wietzel, Vice President, Investor Relations. Please go ahead, ma'am.

Heather J. Wietzel

Vice President of Investor Relations & Enterprise Communications

Thank you, and good morning, everyone. Welcome to Horace Mann's discussion of our second quarter results. Yesterday, we issued our earnings release, investor supplement and investor presentation. Copies are available on the Investor page of our website. Marita Zuraitis, President and Chief Executive Officer; and Bret Conklin, Executive Vice President and Chief Financial Officer, will give today's formal remarks. With us for Q&A, we have Matt Sharpe, Mark Desrochers, Mike Weckenbrock, Ryan Greenier and Steve McAnena.

Before turning it over to Marita, I want to note that our presentation today includes forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. The company cautions investors that any forward-looking statements include risks and uncertainties and are not guarantees of future performance. The forward-looking statements are based on management's current expectations, and we assume no obligation to update them. Actual results may differ materially due to a variety of factors, which are described in our news release and SEC filings. In our prepared remarks, we use some non-GAAP measures. Reconciliations of these measures to the most comparable GAAP measures are available in our investor supplement.

I'll now turn the call over to Marita.

Marita Zuraitis

President, CEO & Director

Thanks, Heather, and hello, everyone. Last night, we reported second quarter core earnings of \$0.03 per share, in line with our preannouncement. Despite the severe weather losses, Horace Mann continues to see the benefits of the earnings and revenue diversification efforts we've completed over the past 5 years. Both the supplemental and Group Benefits in the Life and Retirement segments provided solid core earnings contributions again this quarter.

Before we start, I want to welcome our new Chief Operating Officer, Steve McAnena, to the call. Steve joined us in May, bringing his more than 25 years of experience overseeing large personal lines, financial services and worksite businesses to Horace Mann. In his first months with us, he has already been an asset to the team as we look to build on our growing momentum in household acquisition and market share expansion.

Back to the quarter. As Bret will discuss in more detail later in the call, we now expect full year core EPS of \$1.20 to \$1.45, primarily due to higher catastrophe losses. Our confidence in our long-term business strategy and the results Horace Mann can deliver remains unchanged. We continue to expect 2024 core ROE near 10%.

We believe educators deserve a partner who is looking out for their financial wellness, one that will help them protect what they have today and prepare for a successful tomorrow. And we believe educators want a partner that has solutions tailored to educators' needs, delivered through knowledgeable distribution and built on customer-friendly infrastructure. Our multiline approach sets us apart not only for customers, but as a business as well. Our business diversification allows us more flexibility as a larger entity when challenges arise in one of the segments. Before I talk about the actions we are taking to address external factors facing the property and casualty industry, I would like to talk about how our multi-line approach is enabling us to serve more educator households with more products through more channels.

Our worksite division, which encompasses our employer-sponsored products as well as our worksite direct products, allows us to reach educators through their school district employers. We're expanding on the infrastructure that we gained with the NTA Life and Madison National acquisitions to support accelerated growth. Including a unified product platform we introduced this year in our employer-sponsored lines alone, we offer coverage to more than 750,000 employees. The division continues to perform above our expectations. In the first half of the year, worksite direct product sales doubled while employer-sponsored product sales increased by 50%.

We are actively introducing an enhanced group supplemental product line this fall, bringing to bear the strengths of both acquired businesses. The products are chosen by the employer and underwritten at the group level to provide employees options for purchase. Employers appreciate our long-standing reputation in the educator niche and educators value our solutions orientation. To accelerate the pace of growth in this segment, we are also investing in expanding our distribution reach, recruiting agents to support the Worksite Direct business and expanding our relationships with benefit brokers that brings solutions to employers. We're making strides in both fronts and continue to build brand recognition in this space.

Turning to the retail side of the business. We're also seeing successful agent recruiting with new agents reaching key milestones at a pace we haven't seen since before the Pandemic. Sales growth in our Life and Retirement segment remains encouraging with net annuity contract deposits increasing 8% for the quarter and life sales up year-to-date. We continue to see a nice contribution to life sales from the Worksite direct agents, an early indicator of the cross-sell potential across divisions. The value of our diversification is clear. Horace Mann can remain profitable in 2023 despite the unprecedented pressure on the personal lines P&C industry.

Our Life and Retirement earnings continue to be solid, and we are benefiting from growing contributions from the worksite business. With that context, let me give you an update on the actions we're taking to address the challenging loss cost environment affecting the property and casualty industry.

In auto, the rate plan we have been implementing since the beginning of 2022 to address inflation and the return to pre-pandemic levels of frequency is proceeding as we planned. with up to 25 points of cumulative rate expected by year-end 2023. As a result, the underlying loss ratio is approaching the inflection point we anticipated. And based on this trajectory, we will generate an underwriting profit during 2024 on our path to a long-term combined ratio target of 97% to 98%.

We have filed and are continuing to file for rate as needed to address anticipated loss cost trends. For example, we have filed for a California auto rate increase of 20%, reflecting our loss experience in that state for the past 3 years. We are hopeful that we'll be able to put that rate into use in the first half of 2024.

We are pleased that retention is holding across our auto and property books, but we also know that pricing changes can have an impact on our customers. We will continue to be thoughtful about balancing customer impact with the reality of current loss cost trends. We have equipped our agents with the data and resources for discussions with policyholders.

For property, the increase in adverse weather frequency, intensity and geographic reach means we need to take a multifaceted approach. We are addressing the increased loss costs associated with the more severe weather events in 3 ways: additional filed rate, product changes and enhanced modeling. First rate, we expect to meet our rate plan of 12% to 15% increases nationwide by the end of the year. In addition, we continue to implement inflation guard increases that allow us to make adjustments for higher home coverage values at renewal. So the impact on average renewal premium through year-end is closer to a 17% to 20% increase. As we evaluate the impact of continued elevated weather losses, we've already doubled our planned rate increases for property for 2024.

We now expect the impact on average written premiums next year, will be approaching this year's levels. One important example is the property rate increase of about 25% we have pending in California. We'll work closely with the department to bring that filing to resolution with the impact expected on renewals in 2024.

Second, we are looking to modify policy terms and conditions to mitigate the cost of damages. For example, in several key states, we are implementing an age of roof loss settlement process that will result in significant savings to offset higher loss costs and catastrophe volatility in those states. Lastly, we are continually updating and enhancing our modeling sophistication. We have brought in new tools specifically to help us better understand the impact of severe convective storms, and we will integrate that data into our future rate and underwriting actions. These actions to further address severe weather will start to contribute in 2024, but the full benefit can be expected in 2025. As Bret will discuss, these actions keep us on track to our combined ratio targets and we'll respond with further actions if external factors require.

As our business grows more diversified, the Property & Casualty segment becomes a smaller part of the larger business, but retains its strategic importance. For example, as the most broadly purchased personal lines product, auto remains a key entry point to educate our households.

Turning to the current financial concerns facing educators, Student loan repayments will resume this fall after a 3-year federal pause. This milestone disproportionately affects teachers who often have higher educational requirements for their jobs and lower salaries than workers in the private sector. And while some borrowers may have counted on \$10,000 or \$20,000 onetime loan forgiveness assistance, that isn't likely to be broadly available anytime soon. To be clear, the Biden administration's plan that was blocked by the Supreme Court is completely separate from the public service loan forgiveness program that is the bedrock of our student loan solutions program.

We're in the midst of an awareness campaign to encourage educators who may have been counting on one-time forgiveness to engage with us instead. Our free online accounts connect educators with resources and support to navigate the often confusing process of obtaining the public service loan forgiveness that they deserve. To date, we've helped educators identify more than \$600 million of loan forgiveness, solidifying our value as a true partner to the education community. Back-to-school preparations are underway across the company. We are engaging with our agents, both in person and online to prepare for the school year.

Last month, I traveled to South Carolina to meet with many of our worksite agents. And I was encouraged by the amount of enthusiasm from veteran and new agents alike. Before I turn the call over to Bret, I want to take a step back to reiterate our confidence in our long-term strategy to gain market share and achieve a sustained double-digit return on equity. On occasion, external challenges may slow our progress, but we are clearly building a more resilient company with a more diversified earnings profile. This has clear benefits for investors, employees, agents and most importantly, our educator customers.

And with that, I'll turn the call over to Bret.

Bret Alan Conklin
Executive VP & CFO

Thanks, everyone, for joining our call today. Marita provided a solid overview of the value of our diversification as well as the ways we are addressing the unprecedented pressures on the P&C personal lines industry, so let me turn to the details of the segment performance starting with P&C. Catastrophe losses in the quarter were in line with our pre-announcement at \$41.5 million, leading to the segment's quarterly loss. Segment net investment income was approximately 40% above the prior year with limited partnership portfolio returns at targeted levels compared with declines last year.

Although there were 19 catastrophe events in this year's second quarter, including multiple severe convective storms across the Midwest and Texas in June, the impact of catastrophe losses on our results was actually 4.2 points lower than last year. As we continue to address post pandemic loss trends, our analysis confirms that we took the appropriate reserve actions throughout 2022.

Turning to the results. Total written premiums rose again this quarter by 8.2%, reflecting the accelerating impact of the rate actions that we have implemented to date. With the rate environment rising across the industry, we're pleased to see very stable retention. The sales growth we're seeing is coming largely from states where we're most confident in the outlook for pricing. Marita covered the rate and non-rate underwriting actions we are taking in both auto and property, but let me add a few details on each business.

For auto, the rate we've implemented translated into a year-over-year increase in average written premiums of 11.4%, up from 8.1% in the first quarter and 4.8% in the fourth quarter. Largely due to weather-related frequency, the auto combined ratio for the full year is now expected to be above the 107 we had originally targeted, but we expect to return to an underwriting profit in 2024. We continue to take rate actions that are designed to get us to our long-term target level of 97% to 98%.

Turning to property. Second quarter average written premiums were also up 11.4% year-over-year. Rate increases countrywide continue to be bolstered by inflation adjustments to coverage values. The property underlying loss ratio was 49.8%, in line with the first quarter. Due to the severe weather, we've doubled our rate plan for 2024. The additional contribution from those actions keep us on track to achieve our long-term combined ratio target of 92% to 93% in this business. Taking into account the impact of cat losses, the P&C segment core loss is now expected to be between \$27 million and \$32 million for the full year. We adjusted our full year cat loss contribution to \$95 million to \$100 million or about 15.5 points to the combined ratio, acknowledging the potential for continued outsized weather losses through the second half. The longer-term combined ratio target for this segment remains at 95% to 96%.

Turning to Life and Retirement. The segment performed largely as expected, with adjusted core earnings at \$17.5 million. Net investment income was negatively impacted by lower limited partnership portfolio returns. As a result, the annualized net interest spread on our fixed annuity business was 203 bps for the second quarter, down from 303 bps last year. Year-over-year, the net contribution from our FHLB funding agreements remain stable, although net investment income reflected higher earnings from the floating rate investments backing the program. Interest credited similarly reflected offsetting higher interest expense.

For the segment, total benefit expenses, the total of mortality costs and change in reserves declined again this quarter as favorable market risk benefit adjustments for retirement more than offset a marginal increase in life mortality experience. For the retirement business, net annuity contract deposits were up 8.3% to \$113 million for the second quarter. Cash value persistency was down a bit to 92.2%, largely outside of our core 403(b) accounts. We had another good quarter for Retirement Advantage, the fee-based mutual fund platform that we believe creates long-term opportunity for this business segment.

Life annualized sales were flat for the quarter, but up 10% year-to-date, with persistency remaining strong. We continue to look for life sales as a way to initiate and solidify educator relationships, and we are very pleased with the progress. We updated our core

earnings guidance for this segment to \$63 million to \$65 million to reflect the lower-than-anticipated fixed annuity spread in the first half. The longer-term targeted range for the spread remains at 220 to 230 bps.

Now let me turn to the supplemental and Group Benefits segment where we are reaping the rewards of the investments we have made and will continue to make in diversifying into this higher growth, higher ROE and less capital-intensive business. For the segment, second quarter core earnings were \$11.8 million with a blended benefit ratio at 40.9%, remaining ahead of our long-term target of 43%. The benefit ratio for the worksite Direct product line again moved toward our target for that business, although utilization remains below historical levels. The benefit ratio for the employer-sponsored product line, which is normal seasonal fluctuations, increased from last year's relatively low results for this period and remains in line with expectations.

Second quarter premiums and contract charges earned were \$66 million, with segment sales at \$4.4 million. Sales levels in our worksite direct business, the supplemental products acquired in the NTA transaction in 2019 have reached the pre-pandemic run rate, and we're looking forward to growing from here. Sales of employer-sponsored products are seasonal, typically highest in the first and third quarters when benefit years begin. We continue to gain traction with our distribution partners and are pleased with the momentum we are seeing.

As we noted last quarter, seasonal fluctuations in sales patterns and the benefit ratio are anticipated in our full year guidance for worksite. But based on the strong first half, we again raised our guidance for this segment to the range of \$47 million to \$50 million. We continue to expect the segment will represent about 25% of total premiums and contract charges earned for the year.

Total net investment income on the managed portfolio rose 3.9% to \$82.5 million as floating rate investments benefit from the higher rate environment, including our commercial mortgage loan funds. Pre-tax investment yield on the portfolio, excluding limited partnership interest, was 4.52% with new money yields continuing to exceed portfolio yields in the core fixed maturity securities portfolio. The A+ rated core portfolio remains concentrated in investment-grade corporates, municipals and highly liquid agency and agency MBS securities, positioning us well for a potential recessionary environment later in 2023.

In fact, we've recently seen opportunities to buy AA+ rated agency securities, at yields above 5%. Following the valuation adjustments taken last year, the higher rate environment is also benefiting from commercial mortgage loan fund returns. This is offsetting lower limited partnership portfolio returns compared with the last year's second quarter.

Due to the elevated interest rate environment, the net unrealized investment loss position of the fixed maturity securities portfolio rose to \$501 million pre-tax at quarter end compared to \$453 million at the end of the first quarter. As you'll recall, unlike a pure-play P&C peer, nearly 90% of our asset portfolio supports longer-term liabilities in the L&R and S&GB segments with asset durations around 7 years. We don't expect to realize many of those unrealized losses as the portfolio is high quality, we have steady cash flow and our liability profile doesn't typically require us to monetize those positions from either a claim or surrender activity standpoint.

As a corollary, this is the primary reason we focus more on adjusted book value, the metric that adjusts for both unrealized investment losses and net reserve remeasurements attributable discount rates. At June 30, adjusted book value per share was \$35.55. This is the book value we use when we talk about core return on equity. We also had \$17 million in net investment losses in the second quarter as we again took opportunities to reposition the portfolio to improve book yield. Our net investment income guidance is unchanged as we continue to expect full year net investment income from the managed portfolio to be between \$325 million and \$335 million and approximately \$26 million quarterly from the deposit asset on reinsurance.

In closing, despite the challenges facing the P&C industry, I want to reiterate how clearly first half results demonstrate the progress we are making to leverage the stronger and more diverse organization that Horace Mann has become. We remain confident in our path to sustainable double-digit ROEs -- our Life and Retirement and supplemental and Group Benefits segments provide earnings and capital to mitigate volatility in P&C, the growth we anticipate over the next several years will lead to an increasing share of the education market, and we see a clear path to our longer-term profitability targets in P&C. As a result, we believe 2024 core ROE will be near 10%, which is now the equivalent of about \$3.50 in core EPS.

We continue to target 10% average annual EPS growth in 2025 and beyond. At our targeted profitability across the segments, we know Horace Mann is capable of generating approximately \$50 million in excess capital above what we pay in shareholder dividends. We remain committed to maintaining our financial leverage and capital ratios at levels appropriate for our current financial strength ratings but continue to expect to use excess capital in line with our priorities. First, to support growth; second, for shareholder dividends; and third, for opportunistic share repurchases. We continue to expect our progress toward our objectives will accelerate over the coming quarters as we remain focused on providing strong returns to shareholders. Thank you. And with that, I'll turn it back to Heather.

Heather J. Wietzel

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Vice President of Investor Relations & Enterprise Communications

Thank you, operator. We're ready for questions.

Question and Answer

Operator

Yes. At this time, we will begin the question-and-answer session [Operator Instructions] And the first question comes from Matt Carletti with JMP.

Matthew John Carletti

JMP Securities LLC, Research Division

Marita and Bret, you both touched on a bit about market share growth and kind of picking up share as we go forward. And I was hoping you could expand on that a little bit. Just -- you've spent a good chunk of the last several years, really growing your product set. And when you think about that and the kind of the geographies you're in and what you're doing with distribution, can you give us a little bit of an idea as you look forward like a reasonable investable time frame, 3 to 5 years, maybe something like that. Where do you think that I think got 15-ish percent market share today of the 7.5 million K-12 educators, -- where do you think that could be what the current kind of strategy of Horace Mann supports longer term?

Marita Zuraitis

President, CEO & Director

Matt, I really appreciate you asking the question because this quarter for us, really wasn't anything new other than I think it solidifies the strategy that we've laid out. And this was a weather quarter that the entire P&C industry saw not only cats, but underlying weather as well. So really nothing new or nothing in the numbers that take us away from that strategy that we've had now for a very long period of time. We built the products relevant to our educator space. We feel really good about the distribution momentum that we have, recruiting's back on track.

Our agents are excited about the future and feel really good about a lot of the modernization efforts we put into place in our infrastructure. So we're more confident than ever on our ability to build market share in the educator space and also thinking about others who serve that community. In the script, we talked about how many individual supplemental and group benefits customers that we gained with Madison National and NTA and certainly new business since that point in time and building on the cross-sell momentum that we started. When you think about Madison National and NTA certainly was about earnings diversification. We saw that in this quarter. We're not a monoline P&C carrier. We're an educator company, and we've built a resilient multiline company that helps us in times like this.

We talk a lot about insulated but not immune. We're not immune from the P&C industry trends that are out there. I think we manage them well, but we also have other businesses that are working really well for us and provide that ballast. But product expansion in the K-12 niche, which we did with the acquisitions and continue to do as we expand what we can bring to that educator niche, not only products, but the solution orientation. We said it in the script, how many student loan conversations we have had that drove that \$600 million of student loan forgiveness for those educators, that solidifies that relationship.

And I think we're seeing that work. I mean think about the trends in P&C right now. Any actuary would expect with those kind of trends with that much rate, we would see our retention going down. We're not Obviously, here and there, you'll see it. These are big numbers. We don't assume that will hold exactly the way it is. But during these types of times, our retention in P&C in our retirement deposits, it's pretty sticky. Our customers stick with us because of the types of things that we do for them and with them. So I am very confident in our strategy and where we're going and feel good about that market expansion, you say 15%, you say how we think about that growth. I think we're just scratching the surface of what we can do with educators and then how we expand that to other groups that look very similar to our educator niche.

Matthew John Carletti

JMP Securities LLC, Research Division

That's super helpful. And then just kind of just digging into one of the numbers a little bit. So I'm looking at Slide 18 in the presentation and you break down some industry numbers or the 7.5 million K-12 educators and how many are teachers versus kind of a structural and support staff. It's kind of even a little more teachers, but pretty even split. I'm curious, would Horace Mann current book of business look similar to that split? Or do you lean more heavily to a teacher versus a support staff or an administrator? Or does your book look like the industry?

Marita Zuraitis

President, CEO & Director

Yes. I would say our -- and we know that our split would lean more towards the teacher space. A lot of our research, a lot of our outreach a lot of where our agents came from, a lot of them from the principal and superintendent ranks. I would say that when you look at our teacher base, it would be skewed towards the teachers themselves, but also the administrators. We have a fair amount of principal, a fair amount of superintendents in our book. We certainly don't dissuade our agents from talking to support staff. But I think the models that we bring to bear the financial planning, the student loan solutions, the donors choose and classroom grants, a lot of our solutions really gear more towards the teacher and the administrator vertical.

Operator

And the next question comes from John Barnidge with Piper Sandler.

John Bakewell Barnidge

Piper Sandler & Co., Research Division

Thank you for the opportunity today. Question about the core EPS for '24. So I would ask what's the run rate catastrophe loss load? I know run rates and catastrophe losses really don't seem to go hand in hand anymore. But how do you think about that as we look forward to next year?

Marita Zuraitis

President, CEO & Director

Yes. Obviously, it would probably be premature to answer that question for '24. You saw what we did in our estimates for the second half and how we thought about second half catastrophes. The only thing you know about this number when you put it out there, John, is it's going to be wrong. You're either going to be too high or too low. So you got to rely on the math, right? You take recency, you take 5-year 10-year averages, you run it out. Everybody is doing the same thing right now. This second quarter was I won't say biblical, but it was certainly historic in many ways, right? So we look at that and we say it's probably prudent for us to assume in the second half of this year that those weather patterns will continue, but we haven't said yet how we think about what we will put in our plans for 2024.

But it's real. So I think the real question is what's everybody doing about it? And I think we were very clear in our script that it's about rate-rate and more rate. The days of a \$700 homeowner policy are gone, right? It's about sophisticated models and taking advantage of every piece of science that's out there in your underwriting, and it's about coverage changes. This issue has become certainly an affordability issue in many places. And as you know, when you read, it's becoming an availability issue in some of the more problematic states as well. So I think the industry is very concentrated on this, and we will figure this out. We will get the right coverage. We will get the right price. But make no mistake, this is something that we are and everybody is focused on.

Bret Alan Conklin

Executive VP & CFO

Yes. And John, this is Bret. I would add. I think you've been tracking us long enough to know that over the -- even the past few years, I think it's not too far looking back that you could see a 7.5% load, then I think we took it to 9. And this year, we guided to 10. So it's something we always factor in to our year-end guidance that will include like we always do in our fourth quarter earnings release.

John Bakewell Barnidge

Piper Sandler & Co., Research Division

And then on the follow-up, is there a level of the expense ratio that's elevated that we should be thinking about if we do get normal cat that might go away? Or how should we think about expense ratios as a result?

Bret Alan Conklin

Executive VP & CFO

John, this is Bret again. I mean our expense ratio is actually running at what we would expect, I believe, for both the quarter and the full year, we're up about 4%, and that's consolidated. We've guided to around 27% to 27.5% historically and really don't see any significant changes there. So we're -- the increase we're seeing in the expenses as a corporation are consistent with inflation.

Operator

And the next question comes from Meyer Shields with KBW.

Meyer Shields

Keefe, Bruyette, & Woods, Inc., Research Division

A similar question, and I'm not looking for a number, but more in terms of how you're thinking about this. I guess, it's a little less than 10 years, and we had a -- the unexpected frequency spike in about 2015 and now severity spiking. And I'm wondering how -- maybe there's a question for Mark. How do you think about the profit and contingency provision in rates. Does that need to go up completely because it seems like there are [indiscernible] out there?

Marita Zuraitis

President, CEO & Director

Yes. I don't know if you have a specific answer to that, Mark. I think it's an interesting way to ask the questions since everything has to be factored in. I mean on the expense side of it, and then I'll turn it over to Mark on the trends because I think there might be a more general trend to answer to that question. On the expense side, keep in mind that we've got a fair amount of strategic growth built into our thought process going forward. We didn't do the acquisitions that we did. We didn't build the product. We didn't pay for the infrastructure. We didn't build out the distribution to not grow. So our plans clearly are around growing this place, and you expect the structure reflects that. I mean I'm very proud of the fact that we were able to hold our expenses relatively flat while we did a lot of heavy lifting and building this place, so it was ready for the growth that we're very confident will come. But I'll turn it over to Mark and let him answer anything around the trend question there.

Mark Richard Desrochers

Chief Corporate Actuary & SVP of Property and Casualty

Yes. I mean Meyer, I think we -- I mean, we already do to some extent, factor in a higher profit and contingencies load in the property side to address this. But I think you do make a good point. It's something that we need to continue to look at as an industry because I believe and I think Marita believes as well, and she said this several times that if we look at auto, auto has been clearly a severity issue. It's a short-tailed line. I think everyone is eventually going to catch up to the severity side there. But on the property side, there is this question about the long-term impact of weather.

And are we taking enough rate to keep up with our profit targets are high enough vis-a-vis our combined ratio targets low enough. I think that's a legitimate question that we all need to answer as an industry. And I think as we said in the script and Marita reiterated that we will take an aggressive look at property rates, we've already doubled our expectation for next year in terms of rate. So we're looking at another year in 2024 similar to this year because we're trying to address, I think, some of the issues that we're all experiencing throughout the industry with the continued impact of weather.

Meyer Shields

Keefe, Bruyette, & Woods, Inc., Research Division

Okay. That's very helpful. Second question, maybe this is a little bit more yes or no. But can you talk about the tools that you have to ensure that if you're implementing these necessary rate increases in P&C that you're able to retain customers that have policies in the other segments that are doing pretty well.

Marita Zuraitis

President, CEO & Director

Yes. That's -- it's not just a yes or no. But if you want to, yes or no, I'll give you a yes, but I'll go a little bit further. I think that's where our third-party strategy comes into play. We know that our retention is stronger when we have a multiline customer. The majority of our customers are multiline customers when it makes sense for us to place a particular line of business with another carrier, we have a stable of many strong third-party relationships that we've had now for some time, and they like our educator business as much as we do. I mean we understand that it's a little bit more difficult in a harder market because we may all be thinking the same things at the same time. But make no mistake, we have a fair amount of business with third parties, and that works out quite well for us. So with or without a third party, our retention numbers, I think, speak for themselves. And I said that earlier that we're continuing to see those numbers hold.

Operator

And the next question comes from Greg Peters with Raymond James.

Sidney Schultz

Raymond James & Associates, Inc., Research Division

This is Sid on for Greg. We hear commentary on the difficult states in personal auto, but just curious outside of the difficult states, if you could give us a sense on how you feel about where the rest of your book is? Or if there's anything you can give us on how much of the book you feel is closer to the longer-term combined ratio target?

Yes. I mean I can turn that over to Mark, but we think about all the states the same way, right? You're going to price to a combined ratio target and work with the department to get the rate you need to get there. So in that respect, they're not all that different. It's just some states are more difficult to get that rate than other states. But I'll see if Mark has anything to add to that.

Mark Richard Desrochers

Chief Corporate Actuary & SVP of Property and Casualty

Yes. I think a couple of points here. I think when we look at what we've been able to achieve and what we think we can achieve, we have a very high level of confidence to the path of getting the right rate level in just about every state. California is the one that does stand out there for everybody. I think we have seen very recently that the Department of Insurance has been more proactive in working with carriers on their rate need, which is why we have both on the property side and the auto side, made recent filings that are substantially more than we have historically done.

And we are hopeful and somewhat confident in our ability to get that rate over the next 6 to 9 months and get that into the book, which will make us feel a lot better about that particular problem state. The other problem states that I hear a lot of the competitors talking about are just places that we don't have any presence or a little presence. So New York and New Jersey, we don't have presence there. Florida has been particularly problematic for many in the industry. It is, I think, driving or at least others have commented on its impact on prior year development.

Our Florida book for all intents and purposes is almost inconsequential at this point. It was at 6, 7, 8 years ago, maybe 10-plus percent of our auto book, it's now far less than 1%. So really, outside of California, which, again, I'm more optimistic about than I probably would have been 6 months ago, we have a fairly high degree of confidence in our ability to get to the level we need to get at to be profitable.

Marita Zuraitis

President, CEO & Director

That was very helpful, Mark. Thank you for that. And I would say we're growing in the right places. We said it in the script, and more states are falling into that bucket as we get to rate adequacy in those states. And I think it's also important to remember that we've got control over our distribution. We have captive distribution. So when we want to tighten the underwriting wheel when we want to put underwriting changes in place when we want to put any of those levers to drive non-rate underwriting actions, it's immediate. We can go out to our agency plant and say, this is how we're managing this particular issue in this state, and that's what they do. We're not in an independent agent world where that time line might be a little bit longer to control behavior. So that's helpful as well.

Operator

A question -- and we do have a follow-up question with Matt Carletti with JMP.

Matthew John Carletti

JMP Securities LLC, Research Division

I just had a question probably for Ryan, maybe for Bret. This has this been focus in the market kind of year-to-date on commercial real estate and so forth. And I was hoping maybe you can give us an update on your guys' investments there. I know you've been very thoughtful and have a very good view of the market. And maybe while at it touch on the limited partnership funds as well.

Ryan Edward Greenier

Deputy Chief Financial Officer & Chief Investment Officer

This is Ryan. So when I think about total real estate exposure in the portfolio, it's about 12%, and the vast majority of that, over 80% of it is senior commercial mortgage loan exposure. And if we want to dive right into the asset class, the exposure to office that folks tend to be the most concerned about right now, that total exposure across our entire portfolio is less than 3%. So it's under \$200 million, and it's mainly in your commercial mortgage loan funds. The average LTV on those office properties is 68%. We've got a strong debt service coverage ratio on them as well. And we're doing monitoring. We know what's in the portfolio.

We know line by line, building by building, lease roll by lease roll, and we feel pretty confident in our exposure there. The bulk of the portfolio is skewed towards multifamily, which historically has performed very well through various economic cycles. And you saw some pressure in our commercial mortgage loan funds last year, which is the function of the fact that the majority of our commercial

mortgage loan exposure is equity method of accounting. It's in funds. That's a little bit different than peers. But we took our valuation adjustments early. We marked that portfolio to market basically quarterly. And so you can see the rebound in returns this year, this quarter's annualized return for our CML funds for Q2 alone was over 6%. And these are mainly floating rate securities, and they're going to serve us well in the rate environment we're in.

Stepping back and looking at the limited partnership portfolio, again, the second quarter was a nice rebound from the negative returns we saw in the first quarter. LPs by nature of what they are, will be lumpy, the quarter-to-quarter performance will be somewhat volatile, but we put up a mid-high 5% return this quarter. And when I dissect that, our private credit and our infrastructure strategies continue to deliver solid, steady returns. This past quarter, they were low double digits, and that offset some of the valuation pressure that you're going to get from the more volatile equity investments.

And so when I think about LP returns for the full year, we're guiding to being under our historic 8.5% level for that portfolio, and that's really reflective of the first half performance. But to sum it up, we feel confident. We like our exposure, and we feel pretty good about the prospects as we move through this economic cycle.

Operator

And this concludes the question-and-answer session. I would like to return the floor to Heather Wietzel for any closing comments.

Heather J. Wietzel

Vice President of Investor Relations & Enterprise Communications

Thank you, and thank you, everyone, for joining us today. We realize it's a very busy day, and I will be available to arrange additional follow-up conversations as people -- there's something we want to touch base on. Just also flagging, we will be at the KBW conference in September, and we'll be in Chicago the following week on for a day that Raymond James is helping us put together. And then looking at into November, there's a number of conferences and other trips with Piper, JMP, Dowling, lots on the road, lots of chances to talk to people. So I look forward to connecting and I wish everyone a good day.

Operator

Thank you. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines.

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