

Citizens Property Insurance Corporation

Financial Statements

December 31, 2014 and 2013

Citizens Property Insurance Corporation
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December 31, 2014 and 2013

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Independent Auditor's Report

To the Board of Governors and Management
Citizens Property Insurance Corporation

Report on the Financial Statements

We have audited the accompanying statements of net position of Citizens Property Insurance Corporation ("Citizens"), a component unit of the State of Florida, as of December 31, 2014 and 2013, and the related statements of revenue, expenses and changes in net position, and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Citizens as of December 31, 2014 and 2013, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information – Management’s Discussion and Analysis and Supplemental Revenues, Expenses and Claim Development Information

Accounting principles generally accepted in the United States of America require that the management’s discussion and analysis on pages 3–11 and the Supplemental Revenues, Expenses and Claim Development Information on page 42 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information – Supplemental Combining Statements

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Company’s basic financial statements. The supplemental combining statements of net position and of revenues, expenses and changes in net position are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The supplemental statements referred to above are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report on dated May 29, 2015 on our consideration of Citizens internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance, and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company’s internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "Johnson Lambert LLP". The signature is written in a cursive, flowing style.

Jacksonville, Florida
May 29, 2015

Citizens Property Insurance Corporation

Management's Discussion & Analysis

This discussion provides an assessment by management of the current financial position and results of operations for Citizens Property Insurance Corporation (Citizens). Management encourages readers to consider the information presented here in conjunction with additional information included in the accompanying financial statements, notes to the financial statements and supplemental financial information.

Financial Highlights

- The assets of Citizens exceeded its liabilities at the close of the most recent year by \$7.5 billion.
- Citizens' total net position increased by \$329.6 million. This increase is largely attributable to net income as further explained below.
- Operating income decreased \$305.5 million during 2014 compared to 2013. This decrease is primarily the result of a decrease of \$502.9 million in net earned premiums due to significant depopulation activity.
- Operating expenses decreased \$197.4 million during 2014 compared to 2013. This decrease is primarily the result of the overall decrease in premiums written and earned as compared to 2013.
- Non-operating expenses decreased \$21.2 million during 2014 compared to 2013 primarily as a result of a net increase in net investment income of \$43.7 million. Interest expense on outstanding debt also decreased by \$19.9 million during 2014 as compared to 2013.

Overview of Financial Statements

This discussion and analysis is intended to serve as an introduction to Citizens' basic financial statements, which consist of the statements of net position, statements of revenues, expenses and changes in net position and the statements of cash flows. This report also contains other supplementary information in addition to the basic financial statements.

The *statements of net position* present information on all of Citizens' assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indication of whether the financial position of Citizens is improving or deteriorating.

The *statements of revenues, expenses and changes in net position* present information illustrating changes to Citizens' net position during the most recent fiscal year as well as the prior year. All changes in net position are reported when the underlying events giving rise to the changes occur, regardless of the timing of related cash flows.

Citizens Property Insurance Corporation

Management's Discussion & Analysis

Overview of Financial Statements (Continued)

The *statements of cash flows* present information concerning cash receipts and cash payments during the year. The statements illustrate the cash effects of operating, noncapital financing, capital financing and investing activities during the fiscal years presented.

The *notes to the financial statements* provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements immediately follow the statements of cash flows.

In addition to the basic financial statements and accompanying notes, this report also presents certain *supplementary information* concerning Citizens' revenues, expenses and claims development information for the last ten policy years and combining financial statements.

Reclassifications and Change in Accounting Principle

During the first quarter of 2014, Citizens discontinued the practice of reclassifying certain invested assets between cash and cash equivalents, short-term investments and long-term investments based on remaining maturity at the balance sheet date. Citizens now categorizes all such investments based on remaining maturity at the date of acquisition. The balances within the three categories of invested assets have been reclassified as of December 31, 2013 in order to provide comparability to the presentation within the December 31, 2014 statement of net position. A summary of the effect of the reclassification is included in the exhibit on the following page as of December 31, 2013.

During 2014, Citizens adopted Governmental Accounting Standards Board (GASB) Statement No. 65. In summary, Statement No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows or inflows of resources, certain items that were previously reported as assets and liabilities. In doing so, the statement disallows the recognition of certain line items that have historically been reported within Citizens' statements of net position. Transition guidance provides that the effects of the statement be applied retroactively by restating financial statements for all periods presented, with the cumulative effect of the statement reported as an adjustment to net position within the earliest period presented. The effects on Citizens' December 31, 2013 financial statements are summarized in the exhibit below.

Citizens Property Insurance Corporation Management's Discussion & Analysis

Reclassifications and Change in Accounting Principle (Continued)

| | Original Balance 12/31/2013 | Change in Accounting Principle - GASB 65 | Reclassification of Investments | Restated as of 12/31/2013 |
|---|--------------------------------|---|------------------------------------|------------------------------|
| Cash and cash equivalents | \$ 1,180,598 | \$ - | \$ (1,251,524) | \$ (70,926) |
| Short-term investments | 1,690,797 | - | (35,139) | 1,655,658 |
| Deferred policy acquisition costs | 113,371 | (113,371) | - | - |
| Deferred financing costs | 67,432 | (67,432) | - | - |
| Long-term investments | 11,601,585 | - | 1,286,663 | 12,888,248 |
| Unearned assessment income | (67,313) | 23,712 | - | (43,601) |
| Assessment income | 56,442 | (14,229) | - | 42,213 |
| Other underwriting expenses * | (492,492) | 30,808 | - | (461,684) |
| Interest expense | (217,432) | 16,721 | - | (200,711) |
| Line of credit fees and note issuance costs | (6,575) | 6,575 | - | - |
| Net position | (7,333,278) | 157,091 | - | (7,176,187) |

* Includes servicing company fees, agent commissions, taxes and fees, processing and other fees and other underwriting expenses.

Certain other balances in the 2013 financial statements have been reclassified to conform to the 2014 presentation.

A summary of Citizens' Statements of Net Position is presented below (*in thousands*):

| | 2014 | 2013 | Change (%) |
|------------------------------------|----------------------|----------------------|-------------|
| Assets | | | |
| Current assets | \$ 2,063,533 | \$ 2,060,270 | 0% |
| Capital assets | 8,079 | 12,362 | -35% |
| Other noncurrent assets | 12,273,797 | 13,061,344 | -6% |
| Total assets | <u>\$ 14,345,409</u> | <u>\$ 15,133,976</u> | <u>-5%</u> |
| Liabilities | | | |
| Current liabilities | \$ 3,561,452 | \$ 3,513,931 | 1% |
| Noncurrent liabilities | 3,278,206 | 4,443,858 | -26% |
| Total liabilities | <u>6,839,658</u> | <u>7,957,789</u> | <u>-14%</u> |
| Net position | | | |
| Invested in capital assets | 8,079 | 12,632 | -36% |
| Restricted | 25,348 | 15,339 | 65% |
| Unrestricted | 7,472,324 | 7,148,216 | 5% |
| Total net position | <u>7,505,751</u> | <u>7,176,187</u> | <u>5%</u> |
| Total liabilities and net position | <u>\$ 14,345,409</u> | <u>\$ 15,133,976</u> | <u>-5%</u> |

Citizens Property Insurance Corporation

Management's Discussion & Analysis

Financial Analysis

Assets

Total assets decreased \$788.6 million, or 5%, during 2014 primarily due to repayments of principal on notes payable and a decrease in net premium receipts as compared to 2013. During 2013, total assets decreased \$773.3 million, or 5%, primarily due to repayments of principal on the 2007A, 2010A, and 2012A series debt obligations and payments for losses and loss adjustment expenses (LAE), partially offset by collections of net premiums during 2013. Certain investments, representing less than 1% of total cash and invested assets, continue to be held in legacy assets for which Citizens continues to receive payments of principal and interest.

Current assets include cash, cash equivalents, and short-term investments of \$1.5 billion and \$1.6 billion at December 31, 2014 and 2013, respectively. Long-term investments totaled \$12.3 billion and \$12.9 billion at December 31, 2014 and 2013, respectively. The decrease in invested assets of \$696.6 million is the result of repayments of principal on debt obligations, payments for losses and LAE and a decrease in net premiums collected of \$692.9 million, primarily as a result of depopulation. During 2013, invested assets decreased \$570.2 million as a result of principal and interest payments on outstanding debt in addition to loss and LAE payments of \$912.7 million.

Capital assets decreased \$4.3 million during 2014, primarily as a result of the recognition of depreciation expenses of \$6.6 million, partially offset by capital acquisitions. Capital assets decreased \$4.1 million, or 25%, during 2013. This decrease is primarily due to cyclical reduction in capital asset purchases as well as depreciation on capital assets purchased during prior years.

Liabilities

Total liabilities decreased \$1.1 billion, or 14%, during 2014. This decrease is largely the result of decreases in long-term debt as well as decreases in net loss and LAE reserves and unearned premiums. During 2013, total liabilities decreased \$1.4 billion, or 15%, primarily as a result of a decrease of \$871.5 million in debt obligations outstanding.

Current liabilities are comprised primarily of loss reserves, loss adjustment expense (LAE) reserves, unearned premium, and the current portion of long-term debt. Loss and LAE reserves decreased \$223.6 million during 2014. Loss and LAE reserves decreased \$393.5 million, or 11%, from 2012 to 2013. Net loss and LAE reserves related to the 2004 and 2005 hurricanes were \$45.6 million and \$68.2 million as of December 31, 2014 and 2013, respectively. It is expected that these loss and LAE reserves will continue to run-off into 2015 and likely beyond.

Loss and LAE reserves not related to hurricanes decreased by \$201 million to \$985.9 million as of December 31, 2014 from \$1.19 billion at December 31, 2013 (\$1.33 billion as of December 31,

Citizens Property Insurance Corporation

Management's Discussion & Analysis

Financial Analysis (Continued)

Liabilities (Continued)

2012). The decrease is the result of a decrease in exposure and the number of reported claims, partially offset by adverse development on reported sinkhole claims.

Unearned premiums decreased \$290 million and \$193 million as compared to the prior year end as of December 31, 2014 and 2013, respectively. These decreases are consistent with an overall decrease in direct premiums written as a result of successful depopulation and the implementation of the Clearinghouse Program.

Operating Revenue

A summary of Citizens Statements of Revenues, Expenses and Changes in Net Position and certain key financial ratios are presented below (*in thousands*):

| | <u>2014</u> | <u>2013</u> | <u>Change (%)</u> |
|--|-------------------|-------------------|-------------------|
| Operating revenue | | | |
| Premiums earned | \$ 1,377,841 | \$ 1,880,761 | -27% |
| Operating expenses | | | |
| Losses and loss adjustment expenses incurred | 640,090 | 750,426 | -15% |
| Other underwriting expenses | 374,600 | 461,684 | -19% |
| Total expenses | <u>1,014,690</u> | <u>1,212,110</u> | <u>-16%</u> |
| Operating income | 363,151 | 668,651 | -46% |
| Non-operating revenues (expenses) | <u>(33,190)</u> | <u>(54,382)</u> | <u>-39%</u> |
| Change in net position | <u>\$ 329,961</u> | <u>\$ 614,269</u> | <u>-46%</u> |
| | | | |
| Policies in-force | 661,161 | 1,021,694 | -35% |
| Policies serviced | <u>1,358,040</u> | <u>1,589,628</u> | <u>-15%</u> |
| | | | |
| Underwriting ratios | | | |
| Loss and LAE ratio (calendar year) | 46% | 40% | 6% |
| Expense ratio | 27% | 25% | 2% |
| Combined ratio | 73% | 65% | 8% |

Citizens Property Insurance Corporation

Management's Discussion & Analysis

Financial Analysis (Continued)

Operating Revenue (Continued)

Direct written premiums decreased approximately \$677.8 million, or 25%, for the year ended December 31, 2014 compared to 2013. The decrease is the result of a continued decrease in policies in-force (35%) due to successful depopulation during the last quarter of 2013 and in total for 2014. Direct written premiums decreased approximately \$419.1 million, or 13%, for the year ended December 31, 2013 as compared to the year ended December 31, 2012. This decrease is the result of a 22% decrease in policies in-force due to high depopulation during 2013, partially offset by the continued implementation of the glide path rate increase. Coverage reductions or removals implemented in mid-2012 have also contributed to an overall decrease in direct written premiums.

Premiums ceded to the FHCF decreased \$45.8 million for the year ended December 31, 2014 as compared to 2013 (\$345.1 million to \$390.9 million). This decrease is primarily the result of a decrease in exposure and policies in-force due to depopulation and the implementation of the Clearinghouse Program. Likewise, FHCF premiums ceded decreased \$84.3 million for the year ended December 31, 2013 as compared to 2012 as a result of a decrease in exposure for eligible risks.

Ceded premiums to private reinsurers increased \$22.8 million, or 8%, for the year ended December 31, 2014. This increase is primarily driven by an increase in the amount of coverage purchased through traditional and capital markets (\$3.2 billion vs. \$1.85 billion), partially offset by decreases in the relative cost of coverage purchased. For the year ended December 31, 2013, ceded premium to private reinsurers decreased \$53.0 million, or 16% as compared to 2012. Citizens entered into catastrophe excess of loss reinsurance treaties with private reinsurers in both 2013 and 2012. The amount of risk transferred in 2012 was \$1.5 billion as compared to the amount of risk transferred in 2013 of \$1.85 billion, reflecting an overall decrease in the cost of reinsurance purchased during 2013.

Ceded written premiums to takeout companies increased \$67.4 million and \$125.5 million during 2014 and 2013 as compared to their respective prior years. These increases were the result of record depopulation activity in which 416,623 and 365,767 policies were removed through depopulation in 2014 and 2013, respectively.

Operating Expenses

Losses and LAE incurred decreased \$110.3 million, or 15%, during 2014 as compared to 2013. This decrease is primarily the result of a significant decrease in exposure due to the removal of risks through depopulation in addition to modest favorable development on catastrophe related loss and LAE claims. Losses and LAE incurred decreased \$323.2 million, or 30%, during 2013 compared to 2012. A reduction in the number of reported sinkhole claims, minimal development of prior year sinkhole reserves, and a relatively modest storm season all contributed to the reduction in losses and LAE incurred.

Citizens Property Insurance Corporation

Management's Discussion & Analysis

Financial Analysis (Continued)

Operating Expenses (Continued)

Underwriting expenses, excluding losses and LAE incurred, decreased \$87 million and \$100.8 million during the years ended December 31, 2014 and 2013, respectively, as compared to the prior year. Certain underwriting expenses such as agent commissions and premium taxes, are incurred as a percentage of direct written premium and will increase or decrease proportionately.

Non-operating Expenses

Non-operating expenses consist mainly of assessment income (expense), net investment income, and interest expense. Non-operating expenses decreased \$21.2 million for the year ended December 31, 2014 as compared to 2013 and decreased \$165.3 million during 2013 compared to 2012. The decreases are primarily the result of changes in net investment income and assessment income (expense). For each 2014 and 2013, net investment income included a decrease in net unrealized gains, which represents the difference between fair value and amortized cost of all invested assets. Net decreases in unrealized holding gains were \$26 million and \$69 million for 2014 and 2013, respectively.

Economic Factors

Citizens' management performs an evaluation of pre-event liquidity needs in advance of each hurricane season. As a governmental entity, Citizens has the ability to issue municipal debt on a taxable or tax-exempt basis. Pre-event bond proceeds may be accessed as needed and as permitted by the bond documents. Bank credit lines may also be a component of the pre-event liquidity program. As described in Note 7 Citizens issued fixed rate tax-exempt debt in 2012, 2011, 2010, 2009, and 2008 to fulfill its liquidity needs.

Citizens' bond ratings are A1 / A+ / AA- from Moody's / Standard & Poor's / Fitch. Citizens' Short-Term ratings are MIG1 / SP-1+ / F-1+ from Moody's / Standard & Poor's / Fitch. In 2012, Moody's, Standard & Poor's and Fitch have Stable outlooks on Citizens' credit ratings for all business lines. The ratings reflect only the views of such organizations and any desired explanation of the significance of such ratings should be obtained from the rating agency furnishing the same, at the following addresses: Moody's, 7 World Trade Center at 250 Greenwich Street, New York, New York 10007; Standard & Poor's, 55 Water Street, New York, New York, 10041; and Fitch, Inc., One State Street Plaza, New York, NY 10004. Generally, a rating agency bases its rating on the information and materials furnished to it and on investigations, studies and assumptions of its own. There is no assurance such ratings will continue for any given period of time or that such ratings will not be revised downward or withdrawn entirely by the rating agencies, if in the judgment of such rating agencies, circumstances so warrant.

Citizens Property Insurance Corporation

Management's Discussion & Analysis

Economic Factors (Continued)

During 2014, management continued to administer programs designed to reduce the number of policies written by Citizens. Citizens' statutory mission includes providing property insurance to applicants who are in good faith entitled to obtain affordable insurance through the voluntary market but are unable to do so. Citizens' depopulation program is designed to return policies to the voluntary market. The private market has responded by removing policies from the Personal Lines Account, the Commercial Lines Account and the Coastal Account; depopulation tends to be most significant for the Personal Lines Account. During the last five years, policy counts removed from the PLA, CLA and Coastal Account were as follows:

| | PLA | CLA | Coastal Account |
|------|---------|-------|--------------------|
| 2014 | 323,167 | 2,493 | 90,963 |
| 2013 | 301,383 | - | 64,384 |
| 2012 | 252,968 | - | 24,034 |
| 2011 | 45,827 | - | 7,750 |
| 2010 | 57,561 | - | 2,231 |

Depopulation activity for the year ended 2014 exceeded that of any prior year on record for Citizens, with approximately 78% of the policies removed being in the PLA. The year ended December 31, 2014 was the first in recent history in which policies were removed from the CLA.

Citizens' enabling legislation and Plan of Operations established a process by which Citizens Board of Governors levies assessments to recover any deficits incurred in a given year. Citizens' determination of the amount of assessment is subject to the verification of the mathematical calculation by the Florida Office of Insurance Regulation (the OIR). Citizens' ability to assess provides some assurance of its financial stability.

Subsequent Events

Effective January 27, 2015, Citizens executed a legal defeasance of its 2007A post-event bonds. Authorization for the action was approved by Citizens' Board of Governors at its September 24, 2014 regular meeting. The defeasance, which is contemplated in the bond agreement, was effected by Citizens transferring future principal and interest of approximately \$400.5 million to a trustee escrow account, from which all remaining future principal and interest payments will be made. Citizens is no longer legally obligated to make any future principal and interest payments to the bondholders. The recognition of future interest expenses was accelerated and recognized as a loss on defeasance within the January 2015 financial statements. The net effect on net position, as a result of the defeasance, is an increase of approximately \$1.6 million

Citizens Property Insurance Corporation

Management's Discussion & Analysis

Subsequent Events (Continued)

Effective March 5, 2015, the Office issued an order terminating the 2005 Emergency Assessment thereby requiring all insurers that are required to collect the 2005 Emergency Assessment (including Citizens) to cease collections by July 1, 2015 on both new and renewal policies. This order was issued following the decision by Citizens' Board of Governors to terminate the assessment in connection with the legal defeasance of Citizens' 2007A post-event bonds.

Citizens Property Insurance Corporation
Statements of Net Position

| | December 31, | |
|--|-----------------------|----------------------|
| | 2014 | 2013 |
| | <i>(in thousands)</i> | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ (57,179) | \$ (70,926) |
| Short-term investments | 1,559,730 | 1,655,658 |
| Restricted cash and cash equivalents | 25,348 | 15,339 |
| Investment income due and accrued | 74,222 | 81,873 |
| Prepaid reinsurance premiums | 308,957 | 201,275 |
| Reinsurance recoverable on paid losses and LAE | 923 | 2,351 |
| Premiums receivable | 117,842 | 147,567 |
| Premiums receivable from assuming companies | 32,654 | 27,133 |
| Other current assets | 1,036 | - |
| Total current assets | 2,063,533 | 2,060,270 |
| Noncurrent assets: | | |
| Long-term investments | 12,263,861 | 12,888,248 |
| Capital assets | 8,079 | 12,362 |
| Assessments receivable | 67 | 165,181 |
| Other assets | 9,869 | 7,915 |
| Total noncurrent assets | 12,281,876 | 13,073,706 |
| Total assets | <u>\$ 14,345,409</u> | <u>\$ 15,133,976</u> |

See accompanying notes to financial statements.

Citizens Property Insurance Corporation
Statements of Net Position

| | December 31, | |
|---|-----------------------------|-----------------------------|
| | 2014 | 2013 |
| | <i>(in thousands)</i> | |
| Liabilities and net position | | |
| Current liabilities: | | |
| Loss reserves | \$ 736,602 | \$ 951,703 |
| Loss adjustment expense reserves | 294,920 | 303,444 |
| Unearned premiums | 1,005,043 | 1,295,266 |
| Current portion of unearned assessment income | 11,839 | 20,379 |
| Reinsurance premiums payable | 125,517 | 140,985 |
| Advance premiums and suspended cash | 48,961 | 70,440 |
| Interest payable | 22,540 | 25,846 |
| Taxes and fees payable | - | 3,143 |
| Current portion of long-term debt | 1,188,163 | 574,402 |
| Other current liabilities | 127,867 | 128,323 |
| Total current liabilities | <u>3,561,452</u> | <u>3,513,931</u> |
| Noncurrent liabilities: | | |
| Unearned assessment income | 7,487 | 23,222 |
| Long-term debt | 3,232,473 | 4,420,636 |
| Reserve for future assessments | 38,246 | - |
| Total noncurrent liabilities | <u>3,278,206</u> | <u>4,443,858</u> |
| Total liabilities | <u>6,839,658</u> | <u>7,957,789</u> |
| Net position: | | |
| Invested in capital assets | 8,079 | 12,632 |
| Restricted | 25,348 | 15,339 |
| Unrestricted | 7,472,324 | 7,148,216 |
| Total net position | <u>7,505,751</u> | <u>7,176,187</u> |
| Total liabilities and net position | <u><u>\$ 14,345,409</u></u> | <u><u>\$ 15,133,976</u></u> |

See accompanying notes to financial statements.

Citizens Property Insurance Corporation
Statements of Revenues, Expenses and Changes in Net Position

| | Years Ended December 31, | |
|---|---------------------------------|---------------------|
| | 2014 | 2013 |
| | <i>(in thousands)</i> | |
| Operating revenue: | | |
| Premiums earned | \$ 1,377,841 | \$ 1,880,761 |
| Operating expenses: | | |
| Losses incurred | 441,155 | 502,376 |
| Loss adjustment expenses incurred | 198,935 | 248,050 |
| Service company fees | 5,891 | 8,792 |
| Agent commissions | 169,764 | 224,042 |
| Taxes and fees | 27,829 | 41,323 |
| Processing and other fees | 760 | 1,335 |
| Other underwriting expenses | 170,356 | 186,192 |
| | <u>1,014,690</u> | <u>1,212,110</u> |
| Operating income | 363,151 | 668,651 |
| Nonoperating revenues (expenses): | | |
| Net investment income | 155,984 | 112,333 |
| Interest expense | (180,835) | (200,711) |
| Assessment (expense) income | (12,771) | 42,213 |
| Other income (expense) | 4,432 | (8,217) |
| Total nonoperating expense | <u>(33,190)</u> | <u>(54,382)</u> |
| Change in net position | 329,961 | 614,269 |
| Net position, beginning of year | 7,176,187 | 6,757,925 |
| Cumulative effect of a change in accounting principle (Note 2) | - | (196,966) |
| Net position, adjusted | <u>7,176,187</u> | <u>6,560,959</u> |
| Other changes in net position | (397) | 959 |
| Net position, end of year | <u>\$ 7,505,751</u> | <u>\$ 7,176,187</u> |

See accompanying notes to financial statements.

Citizens Property Insurance Corporation

Statements of Cash Flows

| | Years Ended December 31, | |
|---|---------------------------------|--------------|
| | 2014 | 2013 |
| | <i>(in thousands)</i> | |
| Cash flows from operating activities | | |
| Premiums collected, net of reinsurance | \$ 967,196 | \$ 1,660,111 |
| Net losses and loss adjustment expenses paid | (862,287) | (921,033) |
| Payments for underwriting expenses | (346,003) | (457,560) |
| Net cash (used in) provided by operating activities | (241,094) | 281,518 |
| Cash flows from noncapital financing activities | | |
| Debt redemption | (535,275) | (871,530) |
| Interest paid | (223,269) | (250,385) |
| Assessment income received | 128,068 | 177,393 |
| Net cash used in noncapital financing activities | (630,476) | (944,522) |
| Cash flows from capital and related financing activities | | |
| Capital assets acquired | (2,359) | (2,290) |
| Net cash used in capital and related financing activities | (2,359) | (2,290) |
| Cash flows from investing activities | | |
| Proceeds from investments sold, matured or repaid | 19,463,189 | 16,708,483 |
| Investments acquired | (18,842,252) | (16,386,776) |
| Interest income received | 276,748 | 314,903 |
| Change in restricted cash | (10,009) | (4,227) |
| Net cash provided by investing activities | 887,676 | 632,383 |
| Net change in cash and cash equivalents | 13,747 | (32,911) |
| Cash and cash equivalents: | | |
| Beginning of year | (70,926) | (38,015) |
| End of year | \$ (57,179) | \$ (70,926) |

See accompanying notes to financial statements.

Citizens Property Insurance Corporation
Statements of Cash Flows

| | Years Ended December 31, | |
|---|---------------------------------|-------------------|
| | 2014 | 2013 |
| | <i>(in thousands)</i> | |
| Reconciliation of operating income to net cash (used in) provided by operating activities: | | |
| Operating income | \$ 363,151 | \$ 668,651 |
| Adjustments to reconcile net cash (used in) provided by operating activities: | | |
| Depreciation expense | 6,651 | 6,437 |
| (Increase) decrease in operating assets: | | |
| Prepaid reinsurance premiums | (107,682) | 14,288 |
| Reinsurance recoverable | 1,428 | (6,700) |
| Premiums receivable | 28,692 | 14,699 |
| Other assets | (1,950) | 1,643 |
| Increase (decrease) in operating liabilities: | | |
| Loss and loss adjustment expense reserves | (223,625) | (163,908) |
| Unearned premiums | (290,223) | (192,943) |
| Reinsurance premiums payable | (15,468) | (48,549) |
| Advance premiums and suspended cash | (21,478) | (15,384) |
| Taxes and fees payable | (4,179) | (2,846) |
| Other current liabilities | 23,589 | 6,130 |
| Net cash (used in) provided by operating activities | <u>\$ (241,094)</u> | <u>\$ 281,518</u> |

See accompanying notes to financial statements.

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 1 – GENERAL

Citizens Property Insurance Corporation (Citizens) was established on August 1, 2002, pursuant to Section 627.351(6), Florida Statutes (the Act), to provide certain residential and non-residential property insurance coverage to qualified risks in the State of Florida under circumstances specified in the Act. The original intent of the legislation was that property insurance be provided through Citizens to applicants who are in good faith entitled to procure insurance through the voluntary market but are unable to do so. Citizens results from a combination of the Florida Residential Property and Casualty Joint Underwriting Association (the FRPCJUA) and the Florida Windstorm Underwriting Association (the FWUA). The FRPCJUA was renamed Citizens and the FWUA's rights, obligations, assets, liabilities and all insurance policies were transferred to Citizens. Unlike private insurers offering coverage through the admitted market, Citizens is not required to obtain or to hold a certificate of authority issued by the Florida Office of Insurance Regulation (the Office). For purposes of its tax-exempt status, Citizens is considered a political subdivision and an integral part of the State of Florida. As such, Citizens' operations may be affected by the legislative process. In 2007, the Act was amended to recognize Citizens' status as a governmental entity and to add affordability as an element of Citizens' statutory mission.

Citizens operates pursuant to a Plan of Operation (the Plan) approved by the Financial Services Commission (the Commission) of the State of Florida. The Commission is composed of the Governor, the Chief Financial Officer, the Attorney General and the Commissioner of Agriculture of the State.

Citizens is supervised by a Board of Governors (the Board) which consists of nine individuals who reside in the State of Florida. The Governor appoints three members, and the Chief Financial Officer, the President of the Senate and the Speaker of the House of Representatives each appoint two members of the Board. At least one of the two members appointed by each appointing officer must have a demonstrated expertise in the insurance industry. The Chief Financial Officer designates one of the appointees as the Board's chair. All Board members serve at the pleasure of their appointing officers.

Citizens' President and Chief Executive Officer (Executive Director) and senior managers are engaged by and serve at the pleasure of the Board. The Executive Director is subject to confirmation by the Florida Senate.

Criteria for defining the reporting entity are identified and described in the Governmental Accounting Standards Board's Codification of Governmental Accounting and Financial Reporting Standards, Sections 2100 and 2600. Application of these criteria determines potential component units for which the primary government is financially accountable and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the primary government's financial statements to be misleading or incomplete. Based on the application of these criteria, Citizens is a component unit of the State of Florida, and its financial activity is reported in the state's Comprehensive Annual Financial Report by discrete presentation.

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 1 – GENERAL (CONTINUED)

The financial statements presented herein relate solely to the financial position and results of operations of Citizens and are not intended to present the financial position of the State of Florida or the results of its operations or its cash flows.

Citizens has determined that it has no component units that should be included in its separately reported financial statements. However, the Florida Market Assistance Plan (FMAP) is a financially related entity. FMAP is a 501(c)(6) entity created by Section 627.3515, Florida Statutes. FMAP was created for the purpose of assisting in the placement of applicants who are unable to procure property or casualty insurance coverage from authorized insurers when such insurance is otherwise generally available. As provided in FMAP's enabling legislation, each person serving on the Board of Citizens also serves on the Board of FMAP. In addition, Citizens is required to fund any deficit incurred by FMAP in performing its statutory purpose.

Pursuant to the Act, all revenues, expenses, assets and liabilities of Citizens shall remain divided into three separate accounts: the Personal Lines Account, the Commercial Lines Account and the Coastal Account. A brief history of each account follows:

Personal Lines Account History – The Florida Residential Property and Casualty Joint Underwriting Association (FRPCJUA) began operations on January 21, 1993, after Hurricane Andrew, pursuant to Section 627.351(6), Florida Statutes, to provide certain residential property insurance coverage to qualified risks in the State of Florida for applicants who were in good faith entitled to procure insurance through the private market but were unable to do so. Residential property coverage consists of the types of coverage provided to homeowners, mobile homeowners, tenants, condominium unit owners, and similar policies. The policies provide coverage for all perils covered under a standard residential policy, subject to certain underwriting requirements. Such policies may exclude windstorm coverage on property within eligible areas. This portion of the FRPCJUA's activities became the Personal Lines Account under Citizens.

Commercial Lines Account History – The Florida Property and Casualty Joint Underwriting Association (FPCJUA) was activated in early 1994 to provide commercial residential coverage (i.e., coverage for condominium associations, apartment buildings and homeowner associations) to organizations unable to obtain such coverage from a private insurer. During 1995, legislation was enacted to transfer all obligations, rights, assets, and liabilities related to commercial residential coverage from the FPCJUA to the FRPCJUA. The legislation required that the premiums, losses, assets and liabilities be accounted for separately from the FRPCJUA's personal residential business. This portion of the FRPCJUA's activities became the Commercial Lines Account under Citizens. In 2006, the FPCJUA was re-activated to provide commercial non-residential wind-only coverage. In 2007, legislation was enacted which resulted in the transfer and assumption of the FPCJUA's commercial non-residential policies by Citizens. These policies were added to the Commercial Lines Account.

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 1 – GENERAL (CONTINUED)

Coastal Account History – The Florida Windstorm Underwriting Association, which was a residual market mechanism for windstorm and hail coverage in select areas of the State, was created by an act of the Florida Legislature in 1970 pursuant to Section 627.351(2), Florida Statutes. FWUA was a Florida unincorporated association, the members of which were all property insurance companies holding a certificate of authority to provide property insurance coverage in the State. FWUA provided policies of windstorm insurance for property owners within the eligible areas who were unable to obtain such coverage from private insurers. Insured properties include personal residential, commercial residential and commercial non-residential properties. This portion of the FWUA's activities became the High-Risk Account under Citizens. In 2007, Citizens received authority to issue multi-peril policies in the High-Risk Account. Pursuant to legislative changes during 2011, the High-Risk Account was renamed the Coastal Account.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accounting policies and practices of Citizens conform to accounting principles generally accepted in the United States applicable to a proprietary fund of a government unit. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. Citizens applies all applicable GASB pronouncements as well as Financial Accounting Standards Board (FASB) statements, interpretations and codification, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. Citizens' has also elected to apply all FASB statements and interpretations issued after November 30, 1989 except for those that conflict with or contradict GASB pronouncements.

GASB Statement No. 34 established standards for financial reporting for all state and local governmental entities, which includes a Statement of Net Position, a Statement of Revenues, Expenses, and Changes in Net Position, and a Statement of Cash Flows. It requires net assets to be classified and reported in three components: invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt – This component of net position consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net position component as the unspent proceeds. As of December 31, 2014 and 2013, Citizens did not

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Presentation (Continued)

have any outstanding debt that was attributable to capital assets.

- Restricted net position – This component of net position includes assets subject to external constraints imposed by creditors (such as through debt covenants), grantors, contributors, laws or regulations of other governments, or constraints imposed by law through constitutional provisions or enabling legislation.
- Unrestricted net position – This component of net position consists of assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

Use of Estimates

The preparation of the financial statements in accordance with generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Measurement Focus

The financial statements of proprietary funds are prepared using the economic resources measurement focus and the accrual basis of accounting. All assets and liabilities associated with the operations of Citizens are included in the statements of net position. The Statements of Revenues, Expenses and Changes in Net Position presents increases (revenues) and decreases (expenses) in total net position. The Statements of Cash Flows provides information about how Citizens finances and meets the cash flow needs of its activities.

Reclassifications and Change in Accounting Principle

During the first quarter of 2014, Citizens discontinued the practice of reclassifying certain invested assets between cash and cash equivalents, short-term investments and long-term investments based on remaining maturity at the balance sheet date. Citizens now categorizes all such investments based on remaining maturity at the date of acquisition. The balances within the three categories of invested assets have been reclassified as of December 31, 2013 in order to provide comparability to the presentation within the December 31, 2014 statement of net position. A summary of the effect of the adjustment is included in the exhibit below as of December 31, 2013.

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Reclassifications and Change in Accounting Principle (continued)

During 2014, Citizens adopted Governmental Accounting Standards Board (GASB) Statement No. 65. In summary, Statement No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows or inflows of resources, certain items that were previously reported as assets and liabilities. In doing so, the Statement disallows the recognition of certain line items that have historically been reported within Citizens’ statements of net position. Transition guidance provides that the effects of the statement be applied retroactively by restating financial statements for all periods presented, with the cumulative effect of the statement reported as an adjustment to net position within the earliest period presented. The effects on Citizens December 31, 2013 financial statements are summarized in the exhibit below.

| | Original Balance 12/31/2013 | Change in Accounting Principle - GASB 65 | Reclassification of Investments | Restated as of 12/31/2013 |
|---|--------------------------------|---|------------------------------------|------------------------------|
| Cash and cash equivalents | \$ 1,180,598 | \$ - | \$ (1,251,524) | \$ (70,926) |
| Short-term investments | 1,690,797 | - | (35,139) | 1,655,658 |
| Deferred policy acquisition costs | 113,371 | (113,371) | - | - |
| Deferred financing costs | 67,432 | (67,432) | - | - |
| Long-term investments | 11,601,585 | - | 1,286,663 | 12,888,248 |
| Unearned assessment income | (67,313) | 23,712 | - | (43,601) |
| Assessment income | 56,442 | (14,229) | - | 42,213 |
| Other underwriting expenses * | (492,492) | 30,808 | - | (461,684) |
| Interest expense | (217,432) | 16,721 | - | (200,711) |
| Line of credit fees and note issuance costs | (6,575) | 6,575 | - | - |
| Net position | (7,333,278) | 157,091 | - | (7,176,187) |

* Includes servicing company fees, agent commissions, taxes and fees, processing and other fees and other underwriting expenses.

Certain other balances in the 2013 financial statements have been reclassified to conform to the 2014 presentation.

Cash, Cash Equivalents, and Investments

Cash and cash equivalents consists of demand deposits held with financial institutions, various highly liquid money market funds, other short-term corporate obligations and agency discount notes. Demand deposits and highly liquid investments with original maturities of three months or less at the time of acquisition are considered to be cash and cash equivalents. Cash and cash equivalents include amounts on deposit in excess of insured limits through the Federal Deposit Insurance Corporation. Management does not consider this to represent a significant credit risk to Citizens.

Short-term investments consist of various money market funds, commercial paper, short-term municipal securities, short-term corporate bonds and U.S. government agency notes. Short-term investments are classified as all securities with original maturities of twelve months or less at the time of acquisition.

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash, Cash Equivalents, and Investments (Continued)

Long-term investments consist solely of debt securities issued by municipal bodies, U.S. Treasury, U.S. government agencies, and corporate bonds with an original maturity greater than twelve months at the time of acquisition. Such investments are recorded at fair value, which is generally based on independent quoted market prices. If quoted market prices are not available, broker quotes or an estimation of the current liquidation values is determined through a collaborative process among various pricing experts and sources in the marketplace. Changes in fair value are reflected as a component of net investment income.

Capital Assets

Depreciation and amortization expense was \$6.7 million and \$6.4 million for the years ended December 31, 2014, and 2013, respectively. Furniture, fixtures and equipment are depreciated using the straight-line method over the assets' estimated useful life. The estimated useful lives, by asset class, are as follows:

| | |
|---|----------|
| Electronic data processing (EDP) equipment: | 3 years |
| Capitalized office equipment and automobiles: | 5 years |
| Furniture and equipment: | 7 years |
| Leasehold improvements: | 10 years |

Loss Reserves and Loss Adjustment Expense Reserves

Liabilities for loss reserves and loss adjustment expense (LAE) reserves are estimated based on claims adjusters' evaluations and on actuarial evaluations, using Citizens' loss experience and industry statistics. While the ultimate amount of losses and loss adjustment expenses incurred is dependent on future development, in management's opinion, the estimated reserves are adequate to cover the expected future payment of losses. However, the ultimate settlement of losses may vary significantly from the reserves provided. Adjustments to estimates recorded resulting from subsequent actuarial evaluations or ultimate payments will be reflected in operations in the period in which such adjustments are known or estimable. Citizens does not discount liabilities for loss reserves and loss adjustment expense reserves.

Premiums

Premiums written are recorded on the effective date of the policy and earned using the daily pro rata basis over the policy period. The portion of premiums not earned at the end of the period are recorded as unearned premiums.

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Premiums (Continued)

If anticipated losses, loss adjustment expenses, commissions and other acquisition costs exceed the Company's recorded unearned premium reserve, a premium deficiency is recognized by recording an additional liability for the deficiency. Citizens anticipates investment income as a factor in the premium deficiency calculation. At December 31, 2014 and 2013, management determined that no premium deficiency reserve was required.

Premiums receivable includes amounts due from policyholders for billed premiums. Billings are calculated using estimated annual premiums for each policy and are paid either through an installment plan offered by Citizens or in their entirety at the inception of the policy. An allowance for doubtful accounts is recorded for the estimated uncollectible amounts, and amounted to \$3.5 million and \$2.1 million at December 31, 2014 and 2013, respectively.

Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from premiums charged to policyholders. Operating expenses include incurred losses, loss adjustment expenses and necessary costs incurred to provide and administer personal and commercial property insurance coverage and to carry out programs for the reduction of new and renewal writings.

Guaranty Fund and Other Assessments

Citizens is subject to assessments by the Florida Insurance Guaranty Association (FIGA). For the property lines of insurance, FIGA collects assessments from solvent insurance companies operating in Florida to cover the costs resulting from insolvency or rehabilitation of other insurance companies. Assessments are charged to expense and a liability is accrued when Citizens is notified that an assessment will be levied. After paying the FIGA assessment, Citizens recoups the assessment from its own insureds. Citizens recognizes revenue for the amount of policy surcharges that are charged to policyholders on subsequent billings to recoup any assessment levied by FIGA.

Assessments are also levied by the Florida Hurricane Catastrophe Fund (FHCF), which are in turn payable by Citizens' insureds. Citizens collects the FHCF assessments from its insureds and remits them to the FHCF.

Citizens is also required to assess insurers and insureds in Florida for deficits incurred by Citizens. Assessments made pursuant to the Act and the Plan are recognized as revenue and recorded as receivable in the period approved by the Board of Governors and the Office and levied by Citizens (see Note 14). Assessment receivables are considered to be fully collectible.

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Reinsurance

Premiums ceded under reinsurance agreements are recorded as a reduction of earned premiums. Reinsurance recoverables on unpaid losses are recorded as a reduction to loss and LAE reserves in accordance with GASB. Reinsurance recoverables on paid losses and LAE are recorded as receivables. All catastrophe reinsurance payments are recorded as premiums ceded and are amortized over the life of the hurricane season for which the payments apply, while depopulation premiums ceded are earned pro-rata over the life of the underlying policies. Premiums ceded include both FHCF and private catastrophic reinsurance purchases and depopulation premiums.

Market Risk

Citizens underwrites residential and commercial property insurance policies in the State of Florida. Therefore, adverse economic changes or certain changes in the insurance laws of the State of Florida could have a significant impact on Citizens' future financial position and results of operations. Approximately 57.7% of Citizens' insurance coverage exposure lies in the Southeast Florida counties of Miami-Dade, Broward, Monroe and Palm Beach at December 31, 2014. Approximately 12.8% of Citizens' insurance coverage lies in Pinellas and Hillsborough counties at December 31, 2014. Severe storm activity in any of these counties, or throughout the State of Florida, could have a significant impact on Citizens' future financial position and results of operations. Unlike private insurers that are subject to liquidation in the event of insolvency, Citizens is able (and statutorily required) to levy surcharges and assessments in the event of a deficit in any or all of its accounts. See Note 14 for further information.

Concentration of Credit Risk

Financial instruments that potentially subject Citizens to concentrations of credit risk consist principally of cash and cash equivalents, and investments. Citizens' cash management and investment policies restrict investments by type, credit and issuer, and Citizens performs periodic evaluations of the credit standing of the financial institutions with which it deals. As of December 31, 2014, management believes Citizens had no significant concentrations of credit risk other than those disclosed in Note 4.

Income Taxes

Pursuant to a determination letter received from the Internal Revenue Service, Citizens is exempt from federal income tax as a political subdivision and integral part of the State of Florida and as such, is liable for income taxes only on business income unrelated to the purpose for which it is exempt. No federal or state income tax was incurred in 2014 or 2013.

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Subsequent Events

Effective January 27, 2015, Citizens executed a legal defeasance of its 2007A post-event bonds. Authorization for the action was approved by Citizens' Board of Governors at its September 24, 2014 regular meeting. The defeasance, which is contemplated in the bond agreement, was effected by Citizens transferring future principal and interest of approximately \$400.5 million to a trusteed escrow account, from which all remaining future principal and interest payments will be made. Citizens is no longer legally obligated to make any future principal and interest payments to the bondholders. The recognition of future interest expenses was accelerated and recognized as a loss on defeasance within the January 2015 financial statements. The net effect on net position, as a result of the defeasance, is an increase of approximately \$1.6 million.

Effective March 5, 2015, the Office issued an order terminating the 2005 Emergency Assessment thereby requiring all insurers that are required to collect the 2005 Emergency Assessment (including Citizens) to cease collections by July 1, 2015 on both new and renewal policies. This order was issued following the decision by Citizens' Board of Governors to terminate the assessment in connection with the legal defeasance of Citizens' 2007A post-event bonds.

Citizens has evaluated subsequent events for disclosure and recognition through May 29, 2015, the date on which these financial statements were available to be issued. With the exception of those items noted above, there were no additional events requiring disclosure.

NOTE 3 – FAIR VALUE MEASUREMENTS

Citizens' estimates of fair value for financial assets and financial liabilities are based on the framework established in the Fair Value Measurements and Disclosures accounting guidance. The framework is based on the inputs used in valuation and requires that observable inputs be used in the valuations when available. The disclosure of fair value estimates in the fair value accounting guidance includes a hierarchy based on whether significant valuation inputs are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest priority is given to unadjusted quoted prices in active markets and the lowest priority to unobservable inputs that reflect Citizens' significant market assumptions. The three levels of the hierarchy are as follows:

Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities traded in active markets.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and market corroborated inputs.

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 3 – FAIR VALUE MEASUREMENTS (CONTINUED)

Level 3 – Inputs to the valuation methodology are unobservable for the asset or liability and are significant to the fair value measurement, and includes broker quotes which are non binding.

At the end of each reporting period, Citizens evaluates whether or not any event has occurred or circumstances have changed that would cause an instrument to be transferred between Levels 1 and 2. This policy also applies to transfers into or out of Level 3. During the current reporting period, no such transfers occurred.

At December 31, 2014, all investments held by Citizens are categorized as Level 2. Citizens has no assets that are financial instruments categorized as Level 3 and Citizens has no liability-based financial instruments.

NOTE 4 – INVESTMENTS

Citizens' invested assets are governed by four investment policies, two for taxable operating funds and two for tax-exempt bond proceeds:

- Liquidity Fund (Taxable): generally this policy will govern the investment of funds and surplus that, in addition to internally managed cash, will be the first monies used to pay claims after an event, and that can be used to pay operating expenses on an ongoing basis.
- Liquidity Fund (Tax-exempt): generally this policy will govern the investment of tax-exempt pre-event bond proceeds and other monies required to be invested in tax-exempt instruments. Citizens will use these monies to pay claims after an event or to pay principal and / or interest payments on an as needed basis.
- Claims-Paying Fund (Taxable): generally this policy will govern the investment of funds that will be used to pay post-event claims after Citizens has expended all monies in the Liquidity Fund. Only monies eligible for investment in taxable instruments will be deposited in this fund.
- Claims-Paying Fund (Tax-exempt): generally this policy will govern the investment of tax-exempt pre-event bond proceeds and other monies required to be invested in tax-exempt instruments. Citizens will use these monies to pay claims after an event, typically after all funds in the Liquidity Fund have been expended.

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 4 – INVESTMENTS (Continued)

Citizens investment policy for bond proceeds is at least or more restrictive than the bond documents require.

- Credit Risk Disclosure** - Credit risk exists when there is a possibility the issuer or other counterparty to an investment may be unable to fulfill its obligations. All long-term and short-term securities held in the investment portfolio are rated by two of the three nationally recognized rating agencies. The following table presents the fair value by rating classification as reported by Moody's at December 31, 2014. (See discussion of rating agencies in "Economic Factors" under "Management's Discussion & Analysis").

| Rating | Fair Value (in thousands) |
|--------|------------------------------|
| A1 | \$ 1,181,116 |
| A2 | 1,730,099 |
| A3 | 609,121 |
| Aa1 | 1,279,607 |
| Aa2 | 1,305,054 |
| Aa3 | 1,191,537 |
| Aaa | 4,986,529 |
| Baa1 | 239,845 |
| Baa2 | 20,505 |
| Baa3 | 3,808 |
| WR | 250 |
| NR | 1,276,120 |
| | \$ 13,823,591 |

- Custodial Risk Credit** - For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, Citizens would not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Citizens had no investments with custodial credit risk as of December 31, 2014 and 2013, respectively. All investments were held by Citizens or its agent in Citizens' name.
- Concentration of Credit Risk** – An increased risk of loss occurs as more investments are acquired from one issuer or a group of insurers with one industry which results in a concentration of credit risk. Excluding securities issued by U.S. Government & Agencies, Citizens does not hold any securities from any single issuer that exceeded 5% of the investment portfolio.

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 4 – INVESTMENTS (CONTINUED)

- **Interest Rate Risk** – Interest rate risk exists when there is a possibility that changes in interest rates could adversely affect an investment’s fair value. Citizens measures this risk by using the weighted average maturity method. Citizens’ investment policy requires that the weighted average maturity of the Liquidity Fund and Claims Paying Fund portfolios not exceed 365 days and 3.5 years, respectively. This policy takes interest rate reset dates, primarily related to tax-exempt variable rate demand notes and floating rate notes, into consideration.

- **Foreign Currency Risk** – Citizens had no investments with foreign currency risk at December 31, 2014 and 2013, respectively. All investments are settled in U.S. dollars.

The following tables provide a summary of investments by type as of December 31, 2014 and 2013 at fair value and amortized cost.

As of December 31, 2014:

| Description | Fair Value | Amortized Cost | Net Unrealized Gain (Loss) |
|--|----------------------|-----------------------|---------------------------------------|
| Financial Instruments - Assets | | | |
| U.S. treasury | \$ 1,557,106 | \$ 1,557,513 | \$ (407) |
| All other government | 56,126 | 56,012 | 113 |
| States, territories & possessions | 821,477 | 817,222 | 4,255 |
| Political subdivisions | 870,126 | 866,075 | 4,051 |
| Special revenue | 4,476,654 | 4,465,765 | 10,889 |
| Industrial & miscellaneous | 5,632,103 | 5,627,477 | 4,625 |
| Asset backed securities: | | | |
| Residential & commercial mortgage backed | 252,224 | 250,699 | 1,526 |
| Industrial & miscellaneous | 157,775 | 105,657 | 52,118 |
| Total | \$ 13,823,591 | \$ 13,746,420 | \$ 77,170 |

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 4 – INVESTMENTS (CONTINUED)

As of December 31, 2013:

| Description | Fair Value | Amortized Cost | Net Unrealized Gain (Loss) |
|--|----------------------|----------------------|----------------------------|
| Financial Instruments - Assets | | | |
| U.S. treasury | \$ 1,532,329 | \$ 1,536,436 | \$ (4,107) |
| All other government | 23,775 | 23,775 | - |
| States, territories & possessions | 1,079,076 | 1,070,691 | 8,385 |
| Political subdivisions | 1,014,183 | 1,006,772 | 7,411 |
| Special revenue | 5,032,776 | 5,016,339 | 16,437 |
| Industrial & miscellaneous | 5,477,924 | 5,465,424 | 12,500 |
| Asset backed securities: | | | |
| Residential & commercial mortgage backed | 187,007 | 186,181 | 826 |
| Industrial & miscellaneous | 196,836 | 135,068 | 61,768 |
| Total | \$ 14,543,906 | \$ 14,440,686 | \$ 103,220 |

The following tables summarize unrealized losses on investments by the length of time that the securities have continuously been in unrealized loss positions as of December 31, 2014 and 2013 (*in thousands*).

| As of December 31, 2014: | Less than 12 months | | More than 12 months | | Total | |
|-------------------------------------|---------------------|-------------------|---------------------|-------------------|---------------------|--------------------|
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. Treasury & Agency | \$ 461,613 | \$ (679) | \$ 230,054 | \$ (1,364) | \$ 691,667 | \$ (2,043) |
| All Other Government | 16,682 | (68) | - | - | 16,682 | (68) |
| States, Territories and Possessions | 123,826 | (522) | 15,275 | (55) | 139,101 | (576) |
| Political Subdivisions | 154,137 | (527) | 11,802 | (13) | 165,939 | (540) |
| Special Revenue | 1,023,529 | (2,367) | 388,413 | (2,816) | 1,411,942 | (5,183) |
| Industrial & Miscellaneous | 1,443,311 | (4,687) | 712,428 | (4,628) | 2,155,739 | (9,315) |
| Mortgage-backed Securities | 54,331 | (111) | 19,055 | (12) | 73,386 | (123) |
| Total | \$ 3,277,429 | \$ (8,961) | \$ 1,377,027 | \$ (8,888) | \$ 4,654,456 | \$ (17,848) |

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 4 – INVESTMENTS (CONTINUED)

| As of December 31, 2013: | Less than 12 months | | More than 12 months | | Total | |
|--|---------------------|--------------------|---------------------|-------------------|---------------------|--------------------|
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. Treasury & Agency | \$ 659,796 | \$ (5,736) | \$ 21,632 | \$ (315) | \$ 681,428 | \$ (6,051) |
| All Other Government States, Territories and Possessions | 5,922 | (68) | - | - | 5,922 | (68) |
| Political Subdivisions | 167,930 | (736) | 20,265 | (104) | 188,195 | (840) |
| Special Revenue | 110,850 | (460) | 53,005 | (274) | 163,855 | (734) |
| Industrial & Miscellaneous | 1,114,202 | (4,914) | 258,555 | (4,259) | 1,372,757 | (9,173) |
| Mortgage-backed Securities | 1,513,649 | (16,776) | 59,751 | (641) | 1,573,401 | (17,416) |
| Total | \$ 3,628,036 | \$ (29,032) | \$ 442,843 | \$ (5,671) | \$ 4,070,880 | \$ (34,702) |

The fair value and amortized cost of securities at December 31, 2014, by contractual maturity, are shown below (*in thousands*). Actual maturities may differ from contractual maturities because borrowers may have the right to call or repay obligations with or without call or prepayment penalties.

| Maturity: | Fair Value | Amortized Cost |
|----------------------------|----------------------|----------------------|
| In 2015 | \$ 2,901,859 | \$ 2,858,765 |
| 2016 - 2019 | 10,400,885 | 10,377,934 |
| 2020 - 2024 | 41,858 | 41,707 |
| After 2024 | 226,765 | 217,315 |
| Mortgage-backed securities | 252,224 | 250,699 |
| Total | \$ 13,823,591 | \$ 13,746,420 |

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 4 – INVESTMENTS (CONTINUED)

Sources and uses of investment income for the years ended December 31, 2014 and 2013 were as follows (*in thousands*):

| | 2014 | 2013 |
|--|------------------|------------------|
| Income earned | | |
| Bonds | \$133,341 | \$132,298 |
| Cash, cash equivalents, and short-term investments | 1,687 | 2,809 |
| Total gross investment income earned | 135,028 | 135,107 |
| Capital gains | | |
| Bonds | 31,514 | 32,515 |
| Cash, cash equivalents, and short-term investments | 21,987 | 20,313 |
| Total realized gains on sales | 53,501 | 52,828 |
| Market value adjustment | (26,052) | (68,937) |
| Investment expenses | (6,493) | (6,665) |
| Net investment income | \$155,984 | \$112,333 |

NOTE 5 – LIABILITY FOR LOSS RESERVES AND LOSS ADJUSTMENT EXPENSE RESERVES

Activity in the net liability for loss reserves and loss adjustment expense reserves for the years ended December 31, 2014 and 2013 were as follows (*in thousands*):

| | 2014 | 2013 |
|---|---------------------|---------------------|
| Direct loss and loss adjustment expense reserves, beginning of year | \$ 1,267,302 | \$ 1,434,337 |
| Less reinsurance recoverables on reserves | (12,155) | (15,282) |
| Net loss and loss adjustment expense reserves, beginning of year | 1,255,147 | 1,419,055 |
| Incurred related to: | | |
| Current accident year | 525,725 | 684,549 |
| Prior accident years | 114,365 | 65,877 |
| | 640,090 | 750,426 |
| Paid related to: | | |
| Current accident year | 272,398 | 352,354 |
| Prior accident years | 591,478 | 560,353 |
| | 863,876 | 912,707 |
| Change in retroactive reinsurance reserves ceded | 161 | (1,627) |
| Net loss and loss adjustment expense reserves, end of year | 1,031,522 | 1,255,147 |
| Add reinsurance recoverables on reserves | 7,090 | 12,155 |
| Direct loss and loss adjustment expense reserves, end of year | \$ 1,038,612 | \$ 1,267,302 |

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 5 – LIABILITY FOR LOSS RESERVES AND LOSS ADJUSTMENT EXPENSE RESERVES (CONTINUED)

As a result of changes in estimates of insured events in prior years, primarily due to the re-estimation of costs within the PLA relating to accident years 2010 and 2011 litigated sinkhole and water loss claims, the provision for loss and LAE increased by approximately \$114.4 million and \$65.9 million, net of reinsurance, in 2014 and 2013, respectively. Increases or decreases of this nature occur as a result of claim settlements during the current year, and as additional information is received regarding individual claims, causing changes from the original estimates of the cost of these claims.

For both catastrophic and non-catastrophic claims, the loss adjusting function is performed by Citizens through its employees and through contracted independent adjusting firms. Citizens compensates independent adjusting firms, depending upon the type or nature of the claims, either on per-day rate or on a graduated fee schedule based on the gross claim amount. Such costs are included as loss adjustment expenses.

NOTE 6 – REINSURANCE AGREEMENTS

Citizens has entered into various contracts with reinsurers for the purpose of reducing its net exposure to qualifying losses should such losses occur. These contracts provide for the recovery of amounts above specified retention levels, subject to contractual limits, under per occurrence and aggregate catastrophe excess of loss arrangements. Reinsurance coverage is purchased separately for the Coastal Account and combined for the PLA and CLA. As required by statute, Citizens participates in the FHCF. Coverage provided by and premium ceded to the FHCF as respects the Coastal Account is considered as a separate participating insurer with its own exposures, reimbursement premium and loss reimbursement. Likewise, the PLA and CLA are considered together as a single, separate participating insurer with its own exposures, reimbursement premium and loss reimbursement. Reinsurance coverage purchased through the FHCF was \$2.849 billion and \$1.699 billion in the Coastal Account and PLA/CLA, respectively, for 2014, and \$3.043 billion and \$2.203 billion in the Coastal Account and PLA/CLA, respectively, for 2013. Reinsurance coverage purchased in the Coastal Account through traditional and capital markets totaled \$3.269 billion and \$1.851 billion for 2014 and 2013, respectively.

The effect of reinsurance on premiums written and earned is as follows (*in thousands*):

| | 2014 | | 2013 | |
|-----------------|-------------------|---------------------|---------------------|---------------------|
| | Written | Earned | Written | Earned |
| Direct premiums | \$ 2,083,870 | \$ 2,374,093 | \$ 2,761,638 | \$ 2,954,580 |
| Ceded premiums | (1,103,934) | (996,252) | (1,059,530) | (1,073,819) |
| Net premiums | <u>\$ 979,936</u> | <u>\$ 1,377,841</u> | <u>\$ 1,702,108</u> | <u>\$ 1,880,761</u> |

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 6 – REINSURANCE AGREEMENTS (CONTINUED)

Ceded premiums include premiums ceded to companies that assume policies pursuant to a depopulation program (see Note 10), as well as premium ceded under 100% private quota share arrangements. Ceded losses and LAE incurred were (\$2.5) million and \$2.3 million during 2014 and 2013, respectively.

Amounts recoverable from reinsurers on unpaid losses and loss adjustment expenses are estimated based on the allocation of estimated unpaid losses and loss adjustment expenses among Citizens' coverage lines. Actual amounts recoverable will depend on the ultimate settlement of losses and loss adjustment expenses. Reinsurance contracts do not relieve Citizens from its obligation to policyholders. Citizens remains liable to its policyholders for the portion reinsured to the extent that any reinsurer does not meet the obligations assumed under their reinsurance agreements.

NOTE 7 – LONG-TERM DEBT

Citizens has issued multiple Senior Secured Bonds for the purpose of funding losses in the event of a future catastrophe. The bonds are secured by pledged revenues which consist of monies and investments held in accounts established under the trust indenture, proceeds from any surcharges, regular and emergency assessments, and/or reimbursements received from the FHCF. The following table provides pertinent information regarding each issuance of the Senior Secured Bonds (*in thousands*):

| Bond Issue | Issuance Date | Face Value | Carrying Value | Stated Interest Rate | Current Year Principal Paid | Current Year Interest Paid |
|--|-------------------|---------------------|---------------------|----------------------|-----------------------------|----------------------------|
| Series 2007A Senior Secured Refunding Bonds (Post-event HRA) | February 26, 2007 | \$ 388,930 | \$ 392,832 | 3.750% - 5.000% | \$ 117,220 | \$ 20,379 |
| Series 2009A-1 Senior Secured Bonds (Pre-event HRA) | May 7, 2009 | 746,585 | 748,244 | 4.000% - 6.000% | 168,055 | 46,358 |
| Series 2010A-1 Senior Secured Bonds (Pre-event HRA) | April 6, 2010 | 1,240,000 | 1,252,182 | 3.000% - 5.250% | 100,000 | 63,207 |
| Series 2011A-1 Senior Secured Bonds (Pre-event HRA) | July 14, 2011 | 645,000 | 654,932 | 3.000% - 5.000% | - | 31,577 |
| Series 2011A-3 Senior Secured Bonds (Pre-event HRA) | July 14, 2011 | - | - | SIFMA plus 1.65% | 150,000 | 1,278 |
| Series 2012A-1 Senior Secured Bonds (Pre-event PLA/CLA) | June 21, 2012 | 1,100,000 | 1,172,446 | 3.000% - 5.000% | - | 54,779 |
| Series 2012A-3 Senior Secured Bonds (Pre-event PLA/CLA) | June 21, 2012 | 200,000 | 200,000 | SIFMA plus 1.25% | - | 2,606 |
| Total | | \$ 4,320,515 | \$ 4,420,636 | | \$ 535,275 | \$ 220,184 |

Citizens Property Insurance Corporation
Notes to Financial Statements

NOTE 7 – LONG-TERM DEBT (CONTINUED)

A schedule of bond maturities is as follows (*in thousands*):

| Years Ending December 31 | Series 2007 Bonds | Series 2009 Bonds | Series 2010 Bonds | Series 2011 Bonds | Series 2012 Bonds | Total |
|-----------------------------|--------------------------|--------------------------|----------------------------|--------------------------|----------------------------|----------------------------|
| 2015 | \$ 123,225 | \$ - | \$ 410,000 | \$ 80,000 | \$ 275,000 | \$ 888,225 |
| 2016 | 129,540 | 403,085 | 305,000 | 90,000 | 125,000 | 1,052,625 |
| 2017 | 136,165 | 343,500 | 525,000 | - | 130,000 | 1,134,665 |
| 2018 | - | - | - | 125,000 | 130,000 | 255,000 |
| 2019 | - | - | - | 175,000 | 160,000 | 335,000 |
| After | - | - | - | 175,000 | 480,000 | 655,000 |
| | <u>\$ 388,930</u> | <u>\$ 746,585</u> | <u>\$ 1,240,000</u> | <u>\$ 645,000</u> | <u>\$ 1,300,000</u> | <u>\$ 4,320,515</u> |

A schedule of debt service requirements, including principal and interest, is as follows (*in thousands*):

| Years Ending December 31 | Principal | Interest | Total |
|-----------------------------|----------------------------|--------------------------|----------------------------|
| 2015 | \$ 888,225 | \$ 189,633 | \$ 1,077,858 |
| 2016 | 1,052,625 | 141,663 | \$ 1,194,288 |
| 2017 | 1,134,665 | 84,491 | \$ 1,219,156 |
| 2018 | 255,000 | 54,483 | \$ 309,483 |
| 2019 | 335,000 | 39,480 | \$ 374,480 |
| After | 655,000 | 37,423 | \$ 692,423 |
| | <u>\$ 4,320,515</u> | <u>\$ 547,173</u> | <u>\$ 4,867,688</u> |

Unamortized premium at December 31, 2014 and 2013 was \$100.1 million and \$139.2 million, respectively.

NOTE 8 – AGENT COMMISSIONS AND SERVICING COMPANY FEES

Citizens has contracted with various insurance agents licensed in the State of Florida. These agreements provide for commissions to be paid to the agents at rates established by the Board and calculated as a percentage of direct written premiums, net of certain surcharges and assessments. Agent commissions were \$169.8 million and \$224 million during 2014 and 2013, respectively.

Additionally, Citizens is a party to an agreement with a servicing company to provide underwriting and policy management services. The agreement provides for monthly compensation to the company based on a “Per Transaction Fee” applied to the number of transactions processed in a monthly cycle. These services are for both Citizens’ Commercial Lines and Personal Lines business. The amount per transaction ranges from \$3.50 to \$50.00, depending on the complexity and volume of each transaction. Servicing company fees included in other underwriting expenses incurred were \$5.9 million and \$8.8 million, during 2014 and 2013, respectively.

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 9 – RETIREMENT PLAN

Deferred Compensation Plan

Citizens sponsors a 457(b)/401(a) defined contribution employee savings plan for qualified employees (the Savings Plan). The Savings Plan qualifies as a deferred salary arrangement under Section 401(a) of the Internal Revenue Code. Under the Savings Plan, participating eligible employees may defer a portion of their pretax earnings, up to the Internal Revenue Service annual contribution limit. Citizens matches 100% of each employee's contributions, up to a maximum of 8% of the employee's pretax earnings. Citizens' matching contributions to the Savings Plan were \$4.2 million and \$3.8 million for the years ended December 31, 2014 and 2013, respectively.

NOTE 10 – DEPOPULATION

Pursuant to the Act, Citizens is authorized to adopt one or more programs, subject to approval by the Office, for the reduction of both new and renewal writings. Policies may be removed from Citizens as part of a bulk assumption (Assumption Agreement). In an assumption, the assuming insurer (Takeout Company) is responsible for losses occurring from the assumption date through the expiration of the Citizens' policy period (the assumption period). Subsequent to the assumption period, the Takeout Company will write the policy directly. In January 2007, Florida law was amended to state that assumed policies are the direct insurance of the Takeout Company, for the purpose of clarifying that FIGA is liable for assumption period losses occurring during the assumption period if a Takeout Company were liquidated and unable to meet its obligation to policyholders.

During 2014 and 2013, Citizens ceded \$455.0 million and \$387.6 million in premiums to Takeout Companies pursuant to Assumption Agreements.

Citizens provides policy administration services with respect to the assumed policies. All agreements provide for the Takeout Company to adjust losses. While Citizens is not liable to cover claims after the assumption (unless the assumed insured exercises its option to return to Citizens during the assumption period), Citizens continues to service policies for items such as policyholder endorsements or cancellation refunds. Should Citizens process and provide a refund to policyholders, such amount is subsequently collected from the Takeout Company. At December 31, 2014 and 2013, net assumed premiums receivable in the amount of \$32.7 million and \$27.1 million, respectively were due from certain Takeout Companies.

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 11 – OPERATING LEASES

Citizens leases office space and certain office equipment under various operating leases. Rental expense on operating leases amounted to \$7.3 million and \$8.5 million for the years ended December 31, 2014 and 2013, respectively. There are no contingent rental payments or unusual renewal options, escalation clauses or restrictions and there have been no early terminations of existing leases. Future minimum payments under operating leases are as follows (*in thousands*):

| | |
|--------------|-------------------------|
| 2015 | \$ 4,874 |
| 2016 | 2,578 |
| 2017 | 2,035 |
| 2018 | 1,122 |
| 2019 | 935 |
| Total | <u>\$ 11,544</u> |

NOTE 12 – COMMITMENTS AND CONTINGENCIES

Citizens is involved in certain litigation and disputes incidental to its operations. In the opinion of management, after consultation with legal counsel, there are substantial defenses to such litigation and disputes and any ultimate liability, in excess of reserves resulting there from, will not have a material adverse effect on the financial condition or results of operations of Citizens. Citizens is also involved in other potentially significant litigation described below. Due to the preliminary nature of the following litigation, the potential loss, if any, is not determinable at this time.

In September 2013, Citizens received a subpoena from the Securities and Exchange Commission (SEC) requesting information relating to catastrophe bonds issued by Everglades Re Ltd. in 2012 and 2013. Citizens is voluntarily cooperating with the SEC and is of the belief that any action by the SEC will not materially affect the financial condition of Citizens.

A summary of potentially significant litigation follows:

Davis & Hernandez v. Citizens. This is a putative class action. The court has not certified the class. Potential class members are Citizens' policyholders who presented a claim for damage to their residential property from April 2006 to present. At issue is whether Citizens appropriately calculated and paid overhead and profit policy benefits. Citizens responded to Plaintiff's Third Amended Complaint on October 2, 2013 and litigation is moving forward. Following 10 months of inactive record activity, the court signed its Notice of Failure to Prosecute. In response, Plaintiff filed a Motion for Leave to Amend attaching a proposed 4th Amended Complaint. Citizens responded that it had no objection to the 4th amended complaint, but requested that the court order prohibit any further amendments.

Citizens Property Insurance Corporation
Notes to Financial Statements

NOTE 12 – COMMITMENTS AND CONTINGENCIES (CONTINUED)

Risk Management Programs

In addition to claims under the insurance policies it issues, Citizens is potentially exposed to various risks of loss, including those related to torts; theft of, damage to, and destruction of assets, errors and omissions, injuries to employees, and natural disasters. As a state government entity, Citizens has immunity from certain claims. For the years ending December 31, 2014 and 2013, Citizens had insurance protection in place from various commercial insurance carriers covering various exposures, including workers' compensation, property loss, employee liability, general liability, and directors and officers' liability. Management continuously reviews the limits of coverage and believes that current coverage is adequate. There were no significant reductions in insurance coverage from the previous year.

NOTE 13 – RECONCILIATION OF SAP TO GAAP

A reconciliation of Citizens' 2014 and 2013 statutory basis net income and accumulated surplus to its GAAP basis (as determined by the Governmental Accounting Standards Board) is as follows (*in thousands*):

| | <u>2014</u> | <u>2013</u> |
|--|-------------------|-------------------|
| Net income - statutory basis | \$ 351,122 | \$ 665,346 |
| Adjustments: | | |
| Change in allowance for doubtful accounts | (1,359) | 1,814 |
| Change in FIGA assessment income | 6,250 | 16,046 |
| Change in net unrealized gain on investments | <u>(26,052)</u> | <u>(68,937)</u> |
| Change in net position - GAAP basis | <u>\$ 329,961</u> | <u>\$ 614,269</u> |

| | <u>2014</u> | <u>2013</u> |
|---------------------------------------|---------------------|---------------------|
| Accumulated surplus - statutory basis | \$ 7,384,028 | \$ 7,008,208 |
| Adjustments: | | |
| Nonadmitted assets | 49,460 | 74,590 |
| Provision for reinsurance | 556 | 1,881 |
| FIGA assessment recoverable | (5,463) | (11,714) |
| Net unrealized gain on investments | <u>77,170</u> | <u>103,222</u> |
| Net position - GAAP basis | <u>\$ 7,505,751</u> | <u>\$ 7,176,187</u> |

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 14 – ASSESSMENTS

Citizens' enabling legislation and the Plan establish a process by which Citizens is required to levy assessments to recover deficits incurred in a given plan year for any of its three accounts. Deficits are calculated separately, and assessments are accordingly levied separately, for each of the three accounts. The Plan provides for deficits to be determined in accordance with GAAP, adjusted for certain items.

In the event of a Plan Year Deficit in any Account, Citizens must first levy an assessment against the premium of each Citizens policyholder (the Citizens Policyholder Surcharge) in each of Citizens' Accounts, as a uniform percentage of the premium of the policy of up to 15% of such premium. Citizens Policyholder Surcharges are not subject to commissions, fees, or premium taxes; however, failure to pay a Citizens Policyholder Surcharge will be treated as failure to pay premium. If the Citizens Policyholder Surcharge is insufficient to eliminate the deficit in an Account, Citizens would then levy a Regular Assessment on assessable insurers and assessable insureds, each as defined herein. The Regular Assessment is applied as a uniform percentage of the policy premium up to 2% of such premium of the Coastal Account only. Effective July 1, 2012, the Regular Assessment was eliminated for the PLA and CLA accounts and was reduced from 6% to 2% for the Coastal Account.

Regular Assessments are levied on assessable insurers, as defined in Section 627.351(6), Florida Statutes, based upon each assessable insurer's share of direct written premium for the subject lines of business in the State of Florida for the calendar year preceding the year in which the deficit occurred. Regular Assessments on assessable insurers, collectively, are based on the ratio of the amount being assessed for the Coastal Account to the aggregate statewide direct written premiums for the subject lines of business for the preceding year.

If the deficit in any year in any Account is greater than the amount that may be recovered through Citizens' Policyholder Surcharges and Regular Assessments, Citizens is required to levy any remaining Plan Year Deficit as an Emergency Assessment. An Emergency Assessment is to be collected by all Assessable Insurers, Surplus Lines Agents and Citizens from policyholders upon the issuance or renewal of policies for Subject Lines of Business for as many years as necessary to cover the Plan Year Deficit in the Account. The primary difference between the assessment base for Regular Assessments and Emergency Assessments is the inclusion of Citizens' direct written premium in the assessment base for Emergency Assessments.

For purposes of Regular Assessments and Emergency Assessments, the "Subject Lines of Business" are all lines of property and casualty insurance, including automobile lines, but excluding accident and health, workers' compensation, and medical malpractice insurance, and also excluding insurance under the National Flood and Federal Crop insurance programs. The Regular Assessment base excludes Citizens policies (while the Emergency Assessment base includes Citizens policies). Prior to the enactment of the 2007 Legislation, the Regular Assessment base for each Account included only property lines of business.

Citizens Property Insurance Corporation

Notes to Financial Statements

NOTE 14 – ASSESSMENTS (CONTINUED)

The Legislature, in Section 44 of 2006 SB 1980, appropriated \$715 million to reduce Citizens' 2005 plan year deficit. The appropriation first eliminated the deficits in the Personal and Commercial Lines Accounts of \$87.2 million and \$4.6 million, respectively. The balance of \$623.2 million then partially reduced the High Risk Account deficit and Regular Assessment. The remaining \$163.1 million High Risk Account Regular Assessment and the \$887.5 million Emergency Assessment were approved in 2006. Subsequent to the issuance of the 2007A post-event note, an additional \$496.9 million of financing costs were added to the balance of the assessment for a total of \$1.384 billion.

Effective March 5, 2015, the 2005 Emergency Assessment was terminated for all policies with effective dates on or after July 1, 2015. The 2005 Emergency Assessment was anticipated to be collected over a ten year period commencing July 1, 2007. However, as of December 31, 2014, Citizens collected approximately \$38.2 million in excess of the original Emergency Assessment receivable. Any current or remaining excess collections have been categorized as "Reserve for future assessments" and are included in the accompanying statements of net position until such time as Citizens' Board of Governors approves a change to direct these excess collections to be used for any lawful purpose available within Citizens' Plan of Operation.

In November 2012, Citizens received a notice of assessment from the Florida Insurance Guaranty Association (FIGA) amounting to \$27.8 million. In December 2012, Citizens remitted payment for this assessment and subsequently obtained approval from the Office of Insurance Regulation for recoupment through future policy surcharges on new and renewal policies. No asset has been recorded within Citizens statements of net position for the periods ended December 31, 2014 and 2013, in accordance with applicable accounting guidance.

NOTE 15 - RESTRICTED CASH

Restricted cash and surplus represents assessments that were, in accordance with the Act, over-collected by the Florida Surplus Lines Servicing Office (FSLSO) from surplus lines insureds with respect to the 2004 Plan Year Deficit. Pursuant to a consent order, the Office, FSLSO and Citizens agreed that this cash would be included in Citizens restricted surplus until such time future regular and emergency assessments would otherwise be payable by surplus lines insureds. As amounts have been approved by FSLSO with respect to regular and emergency assessments for Citizens' 2005 Plan Year deficit, Citizens has transferred these funds to unrestricted surplus.

Citizens Property Insurance Corporation
Supplemental Combining Statement of Net Position

December 31, 2014

| | Combined | Personal Lines Account | Commercial Lines Account | Coastal Account |
|--|-----------------------|------------------------------|--------------------------------|---------------------|
| | <i>(in thousands)</i> | | | |
| Assets | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | \$ (57,179) | \$ (79,836) | \$ 15,188 | \$ 7,469 |
| Short-term investments | 1,559,730 | 247,303 | 175,729 | 1,136,698 |
| Restricted cash and cash equivalents | 25,348 | - | - | 25,348 |
| Investment income due and accrued | 74,222 | 22,948 | 6,812 | 44,462 |
| Prepaid reinsurance premiums | 308,957 | 155,951 | 27,967 | 125,039 |
| Reinsurance recoverable on paid losses and LAE | 923 | 556 | - | 367 |
| Premiums receivable | 117,842 | 38,234 | 5,789 | 73,819 |
| Premiums receivable from assuming companies | 32,654 | 19,622 | 4,878 | 8,154 |
| Other current assets | 1,036 | (366) | (216) | 1,618 |
| Total current assets | <u>2,063,533</u> | <u>404,412</u> | <u>236,147</u> | <u>1,422,974</u> |
| Noncurrent assets: | | | | |
| Long-term investments | 12,263,861 | 4,386,252 | 1,756,438 | 6,121,171 |
| Capital assets | 8,079 | 8,079 | - | - |
| Assessments receivable | 67 | 8 | 724 | (665) |
| Other assets | 9,869 | 9,724 | 16 | 129 |
| Inter-account receivable (payable) | - | 213,500 | (36,757) | (176,743) |
| Total noncurrent assets | <u>12,281,876</u> | <u>4,617,563</u> | <u>1,720,421</u> | <u>5,943,892</u> |
| Total assets | <u>\$ 14,345,409</u> | <u>\$ 5,021,975</u> | <u>\$ 1,956,568</u> | <u>\$ 7,366,866</u> |
| Liabilities and net assets | | | | |
| Current liabilities: | | | | |
| Net loss reserves | \$ 736,602 | \$ 530,398 | \$ 114,201 | \$ 92,003 |
| Net loss adjustment expense reserves | 294,920 | 212,232 | 32,115 | 50,573 |
| Unearned premiums | 1,005,043 | 451,805 | 74,855 | 478,383 |
| Current portion of unearned assessment income | 11,839 | - | - | 11,839 |
| Reinsurance premiums payable | 125,517 | - | - | 125,517 |
| Advance premiums and suspended cash | 48,961 | 19,625 | 4,222 | 25,114 |
| Interest payable | 22,540 | 4,207 | 577 | 17,756 |
| Current portion of long-term debt | 1,188,163 | 257,848 | 35,394 | 894,921 |
| Other current liabilities | 127,867 | 76,551 | 3,773 | 47,543 |
| Total current liabilities | <u>3,561,452</u> | <u>1,552,666</u> | <u>265,137</u> | <u>1,743,649</u> |
| Noncurrent liabilities: | | | | |
| Unearned assessment income | 7,487 | - | - | 7,487 |
| Long-term debt | 3,232,473 | 948,945 | 130,260 | 2,153,268 |
| Reserve for future assessments | 38,246 | - | - | 38,246 |
| Total noncurrent liabilities | <u>3,278,206</u> | <u>948,945</u> | <u>130,260</u> | <u>2,199,001</u> |
| Total liabilities | <u>6,839,658</u> | <u>2,501,611</u> | <u>395,397</u> | <u>3,942,650</u> |
| Net position: | | | | |
| Invested in capital assets | 8,079 | 8,079 | - | - |
| Restricted | 25,348 | - | - | 25,348 |
| Unrestricted | 7,472,324 | 2,512,285 | 1,561,171 | 3,398,868 |
| Total net positions | <u>7,505,751</u> | <u>2,520,364</u> | <u>1,561,171</u> | <u>3,424,216</u> |
| Total liabilities and net position | <u>\$ 14,345,409</u> | <u>\$ 5,021,975</u> | <u>\$ 1,956,568</u> | <u>\$ 7,366,866</u> |

See accompanying notes to financial statements.

Citizens Property Insurance Corporation
Supplemental Combining Statement of Revenues, Expenses and Changes in Net Position

Year Ended December 31, 2014

| | <u>Combined</u> | <u>Personal Lines Account</u> | <u>Commercial Lines Account</u> | <u>Coastal Account</u> |
|-------------------------------------|-----------------------|---------------------------------------|---|----------------------------|
| | <i>(in thousands)</i> | | | |
| Operating revenue: | | | | |
| Premiums earned | \$ 1,377,841 | \$ 772,059 | \$ 129,546 | \$ 476,236 |
| Operating expenses: | | | | |
| Losses incurred | 441,155 | 344,094 | 22,159 | 74,902 |
| Loss adjustment expenses incurred | 198,935 | 141,948 | 8,198 | 48,789 |
| Service company fees | 5,891 | 3,961 | - | 1,930 |
| Agent commissions | 169,764 | 65,462 | 18,165 | 86,137 |
| Taxes and fees | 27,829 | 12,676 | 2,542 | 12,611 |
| Processing and other fees | 760 | - | 672 | 88 |
| Other underwriting expenses | 170,356 | 87,652 | 10,572 | 72,132 |
| Total operating expenses | <u>1,014,690</u> | <u>655,793</u> | <u>62,308</u> | <u>296,589</u> |
| Operating income | 363,151 | 116,266 | 67,238 | 179,647 |
| Nonoperating revenues (expenses): | | | | |
| Net investment income | 155,984 | 59,369 | 21,863 | 74,752 |
| Interest expense | (180,835) | (33,665) | (4,621) | (142,549) |
| Assessment income | (12,771) | 3,172 | 404 | (16,347) |
| Other income | 4,432 | 2,856 | 231 | 1,345 |
| Total nonoperating income (expense) | <u>(33,190)</u> | <u>31,732</u> | <u>17,877</u> | <u>(82,799)</u> |
| Change in net position | 329,961 | 147,998 | 85,115 | 96,848 |
| Net position, beginning of year | 7,176,187 | 2,372,366 | 1,476,056 | 3,327,765 |
| Other changes in net position | (397) | - | - | (397) |
| Net position, end of year | <u>\$ 7,505,751</u> | <u>\$ 2,520,364</u> | <u>\$ 1,561,171</u> | <u>\$ 3,424,216</u> |

See accompanying notes to financial statements.

Citizens Property Insurance Corporation
Supplemental Revenues, Expenses and Claim Development Information
(in thousands)

| | <u>2005</u> | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>2009</u> | <u>2010</u> | <u>2011</u> | <u>2012</u> | <u>2013</u> | <u>2014</u> |
|---|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Net earned premiums and investment revenue | \$ 1,143,973 | \$ 2,289,760 | \$ 3,417,277 | \$ 2,268,368 | \$ 1,822,227 | \$ 2,088,293 | \$ 2,452,744 | \$ 2,526,541 | \$ 1,993,094 | \$ 1,533,825 |
| Unallocated expenses | 227,795 | 321,522 | 569,661 | 442,570 | 342,840 | 293,047 | 366,109 | 507,579 | 495,680 | 366,261 |
| Estimated incurred claims and expense, end of policy year | 2,138,004 | 339,770 | 692,583 | 839,708 | 674,431 | 786,223 | 1,236,012 | 1,049,647 | 684,549 | 525,725 |
| Paid (cumulative) as of: | | | | | | | | | | |
| End of policy year | 1,005,020 | 157,640 | 353,312 | 413,175 | 307,072 | 330,603 | 501,310 | 516,059 | 352,354 | 272,398 |
| One year later | 2,114,174 | 291,045 | 555,540 | 622,104 | 472,476 | 553,965 | 799,332 | 785,930 | 520,164 | |
| Two years later | 2,227,283 | 326,997 | 625,868 | 675,168 | 532,779 | 643,424 | 965,456 | 900,022 | | |
| Three years later | 2,286,765 | 341,906 | 661,758 | 698,220 | 553,356 | 702,357 | 1,120,696 | | | |
| Four years later | 2,328,746 | 350,721 | 677,041 | 709,550 | 566,641 | 798,270 | | | | |
| Five years later | 2,350,722 | 355,658 | 683,229 | 732,381 | 587,168 | | | | | |
| Six years later | 2,373,190 | 357,534 | 688,043 | 738,610 | | | | | | |
| Seven years later | 2,426,212 | 358,381 | 693,600 | | | | | | | |
| Eight years later | 2,446,868 | 360,091 | | | | | | | | |
| Nine years later | 2,469,607 | | | | | | | | | |
| Reestimated incurred claims and expense: | | | | | | | | | | |
| End of policy year | 2,138,004 | 339,770 | 692,583 | 839,708 | 674,431 | 786,223 | 1,236,012 | 1,049,647 | 684,549 | 525,725 |
| One year later | 2,205,877 | 354,194 | 678,130 | 753,244 | 651,058 | 876,415 | 1,237,713 | 1,068,384 | 648,934 | |
| Two years later | 2,374,726 | 359,950 | 693,332 | 750,380 | 624,955 | 886,308 | 1,259,076 | 1,045,511 | | |
| Three years later | 2,406,456 | 358,122 | 697,792 | 738,966 | 622,057 | 893,876 | 1,342,169 | | | |
| Four years later | 2,413,674 | 360,230 | 701,651 | 738,733 | 622,963 | 962,361 | | | | |
| Five years later | 2,406,633 | 360,996 | 700,302 | 747,942 | 634,117 | | | | | |
| Six years later | 2,476,606 | 360,694 | 702,670 | 749,604 | | | | | | |
| Seven years later | 2,494,017 | 361,555 | 705,898 | | | | | | | |
| Eight years later | 2,497,925 | 364,139 | | | | | | | | |
| Nine years later | 2,506,632 | | | | | | | | | |
| Increase (decrease) in estimated incurred claims and expense from end of policy year | 8,707 | 2,584 | 3,228 | 1,662 | 11,154 | 68,485 | 83,093 | (22,873) | (35,615) | 525,725 |

See accompanying notes to financial statements.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Board of Governors
Citizens Property Insurance Corporation

We have audited the basic financial statements of Citizens Property Insurance Corporation (Citizens), a component unit of the State of Florida, as of and for the year ended December 31, 2014, and have issued our report thereon dated May 29, 2015. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered Citizens' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Citizens' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Citizens' internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Citizens' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the Board of Governors, others within the entity, and Auditor General of the State of Florida and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Johnson Lambert LLP". The signature is written in black ink and is positioned above the typed text of the firm's name.

Jacksonville, Florida
May 29, 2015