Financial Statements

Citizens Property Insurance Corporation
Years Ended December 31, 2005 and 2004

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Audited Financial Statements

Years Ended December 31, 2005 and 2004

Contents

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Management’s Discussion and Analysis

December 31, 2005 and 2004

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

Citizens was created to provide certain residential property and casualty insurance coverage to qualified risks in the State of Florida under circumstances specified by Section 627.351(6) of the Florida Statutes. The intent of the legislation is 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 is the successor entity resulting 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 rights, obligations, assets, liabilities and all insurance policies were transferred to Citizens.

All revenues, expenses, assets and liabilities are divided into three separate accounts: the Personal Lines Account (PLA), the Commercial Lines Account (CLA) and the High-Risk Account (HRA). See Footnote 1 for a brief history of each account.

Financial Highlights

- The liabilities of Citizens exceed its assets at the close of the most recent year by $1.7 billion (*net deficit*).

- The Company’s total net assets decreased by $1.4 billion. This decrease is attributable to a decrease in available funds generated from operations due to increased claim payments.

- Operating revenues increased 4% primarily due to an increase in new business, in addition to, an increase in premium rates.

- Operating expenses increased 2% primarily due to an increase in other underwriting expenses and takeout bonus expenses.

- Nonoperating revenues increased 3,525% due to an increase in assessment income.

Overview of Financial Statements

Prior to January 1, 2003, Citizens prepared its financial statements in accordance with the accounting standards issued by the Financial Accounting Standards Board (FASB). In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "*Basic Financial Statements — and Management's Discussion and Analysis — for State and Local Governments*." This standard established financial reporting standards for state and local governments and certain funds of those governmental entities. The State of Florida elected to adopt the provisions of GASB Statement No. 34 for its fiscal year beginning July 1, 2001. To be consistent with State reporting practices, Citizens has elected to adopt the provisions of this standard effective January 1, 2003. Under the provisions of GASB Statement No. 34, Citizens is classified as an enterprise fund, which is a type of proprietary fund, and prepares its financial statements in accordance with the provisions of accounting standards issued by the GASB and only FASB pronouncements issued before December 1, 1989 that do not conflict with or contradict GASB pronouncements.

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

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

The *statements of revenues, expenses and changes in net assets (deficit)* presents information showing how the Company's net assets (deficit) changed during the most recent year. All changes in net assets (deficit) are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows.

The *statements of cash flows* presents information about the cash receipts and cash payments during the year. The statement shows the cash effect of operations, investing and financing transactions during a given period.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found beginning on page 8 of this report.

Overview of Financial Statements (continued)

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

Financial Analysis

A summary of Citizens' Statement of Net Assets (Deficit) is presented below (in thousands):

	2005	2004	% Change
Assets			
Cash and investments	$ 2,649,079	$ 4,186,489	(37)%
Interest due and accrued	19,418	23,848	(19)%
Premium receivable, net	16,729	6,027	178%
Other assets	303,685	144,963	109%
Total assets	$ 2,988,911	$ 4,361,327	(31)%
Liabilities and net assets			
Loss and loss adjustments expense reserves	$ 1,485,016	$ 1,607,050	(8)%
Unearned premiums	762,577	667,386	14%
Borrowed money	2,118,277	2,115,624	0%
Federal income taxes payable	54,899	54,899	0%
Taxes, licenses and fees payable	30,995	30,972	0%
Other, liabilities	212,748	136,429	56%
Total liabilities	4,664,512	4,612,360	1%
Net assets (deficit)	(1,675,601)	(251,033)	567%
Total liabilities and net assets (deficit)	$ 2,988,911	$ 4,361,327	(31)%

Assets

As shown above, total assets decreased $1.4 billion, or 31%, during 2005 primarily due to the payment of claims associated with the 2004 and 2005 hurricane seasons.

Financial Analysis (continued)

Long and short-term investments totaled $2.5 billion at December 31, 2005. Because the primary purpose of the investment portfolio is to fund future claim payments, the Company employs a conservative investment philosophy. The Company's portfolio consists of debt instruments such as: U.S. Treasury and U.S. government securities, corporate bonds, collateralized mortgage obligations and asset-backed securities. These securities decreased $270.6 million, or 10%, in 2005 due largely to debt service payments made during the year.

Cash and cash equivalents decreased $1.3 billion, or 89%, during 2005. This decrease is due to cash used in operations, primarily to fund hurricane losses. Approximately $596.6 million of the Company's operating funds are invested in a short-term portfolio managed by the Treasurer of the State of Florida and are invested, along with State funds, in securities which are rated in the highest category by a nationally recognized rating service.

Premium receivable increased $10.7 million, or 178%. This increase is attributed to an increase in written premiums and the timing of collections near year-end 2005 as compared to the prior year. Citizens does not anticipate any unusual collection problems with respect to the premium balances.

Other assets increased $178 million, or 123%. This increase is attributed primarily to prepaid reinsurance premiums. Prepaid reinsurance premiums increased due to an increase in assumption activity by takeout companies during 2005 as compared to the prior year. In addition, in 2005 Citizens purchased reinsurance in the Personal Lines Account on the aggregate level and per occurrence in the High Risk Account.

During the year, Citizens had no significant capital assets activity.

Liabilities

Total liabilities increased $52.2 million, or 1%, during 2005. The increase is due to increases in unearned premiums, notes payable, taxes licenses and fees payable, offset by a decrease in losses and LAE reserves.

Loss and loss adjustment expense (LAE) reserves are stated at the Company's estimate of the ultimate loss (as determined by an outside actuary) of settling all incurred but unpaid claims. Loss and LAE reserves are not discounted.

Financial Analysis (continued)

Activity with respect to unpaid losses and LAE for 2005 and 2004 is displayed below (in thousands):

Loss and LAE Reserve Summary	**2005**	**2004**
Unpaid at beginning of year	$ 1,607,050	$ 138,705
Losses and LAE incurred in current year:		
Current year losses and LAE	2,138,004	2,721,512
Prior year losses and LAE	590,167	(15,498)
	2,728,171	2,706,014
Losses and LAE paid in current year:		
Current year losses and LAE	1,005,019	1,145,602
Prior year losses and LAE	1,845,186	92,067
	2,850,205	1,237,669
Unpaid losses and LAE at end of year	$ 1,485,016	$ 1,607,050

Loss and LAE reserves decreased $122 million or 8%, as of the year ended 2005 compared to the prior year ended 2004. Reserves related to the 2004 and 2005 hurricanes were $1.2 billion as of December 31, 2005 as determined by our independent actuary.

Unpaid losses and LAE reserves not related to hurricanes increased from $187 million as of December 31, 2004 to $249 million as of December 31, 2005. This increase is due largely to an increase in the Company's overall exposure in 2005 compared to 2004 caused by growth in new policies.

Unearned premiums increased due to an increase in written premiums. Unearned premiums increased $95 million, or 14%, which correlates to a 15% increase in direct written premiums caused by increases in premium rates.

Borrowed money stayed substantially the same at $2.1 billion.

Financial Analysis (continued)

Security transactions are recorded on the trade date rather than the settlement date. Occasionally, securities are purchased and recorded in the Company's financial records, but the cash has not been disbursed as of the balance sheet date. At December 31, 2005 and 2004, the Company owed no amounts to brokers. This is due to the restrictions Citizens has placed on managers to avoid settlements over month end.

Federal income tax payable remains at $54.9 million, which reflects federal income tax refunds received in 2004 and 2003 on behalf of the FWUA. During 2002, FWUA transferred its assets and liabilities to the Company in accordance with Florida Statute 627.351(6)(1)(2). Subsequently, the FWUA filed amended state and federal income tax returns claiming refunds in excess of $182 million related to this transfer. Management anticipates the refund will be contested by the Internal Revenue Service and has recorded the proceeds as a liability until uncertainties surrounding the matter are resolved.

Taxes, licenses and fees payable stayed substantially the same at $31 million.

Financial Analysis (continued)

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

	2005	2004	% Change
Operating revenue:			
Net earned premiums	$ 1,055,746	$ 1,022,503	3%
Operating expenses:			
Losses and LAE incurred	2,728,171	2,706,014	(1)%
Other underwriting expenses	227,592	191,333	(19)%
	2,955,763	2,897,347	(2)%
Operating loss	(1,900,017)	(1,874,844)	(1)%
Nonoperating revenues (expenses)	475,524	(13,882)	3525%
Change in net assets (deficit)	$ (1,424,493)	$ (1,888,726)	(25)%
Policies in force, net of takeouts	810,017	873,996	(7)%
Underwriting ratios			
Loss and LAE ratio (calendar year)	258%	265%	2%
Expense ratio	22%	19%	(13)%
Combined ratio	280%	283%	1%

Earned premiums increased $33 million, or 3%, during 2005 primarily due to premium rate increases and growth of new business. This increase is partially offset by an increase in premiums ceded to the Florida Hurricane Catastrophe Fund (FHCF) and Takeout Companies.

Financial Analysis (continued)

Policies in force before Takeouts increased 102,440, or 10%, during 2005 compared to 2004. The increase in policies is due to the following factors;

- Insurers exiting the Florida Market in order to reduce their hurricane exposure,
- Continued growth in Florida's population,
- Insurers concern about frequency of mold and sinkhole claims, and
- Rate inadequacies

During 2005, Citizens' premium rates increased on average 19.7% and 11.8% for residential policies written in the Personal Line Account and High Risk Account, respectively. In addition, the Commercial Lines Account increased an average of 26.1%.

Premiums ceded to the FHCF totaled $193.9 million and $177.1 million during 2005 and 2004, respectively, and are included in net earned premiums. The increase in FHCF premium is attributed to an increase in exposure caused by growth in policies in force. The Company entered into excess of loss reinsurance agreements in 2005, but not in 2004, for both the PLA and HRA. The ceded excess of loss premiums in 2005 were $52.9 million.

During 2005 and 2004, premiums ceded to certain Takeout Companies totaled $232.5 million and $136 million, respectively.

Losses and LAE incurred increased $22 million, or 1%, due mainly to (1) losses incurred related to the four hurricanes and (2) increase in exposure caused by growth in new business.

Financial Analysis (continued)

Non-hurricane combined Loss and LAE Ratio was 26% for 2005 compared to 29% for 2004. The reason for the decrease in Loss and LAE ratios is due to the decrease in Non-Catastrophe claims.

Other underwriting expenses increased $36.3 million, or 19%, in 2005 primarily due to an increase in policies in force. Certain underwriting expenses, such as producer commissions and premium taxes, are determined based on written premiums. As written premiums increase, these expenses will increase proportionately. During 2005, commission and premium tax expenses consisted of 48% and 11% of total underwriting expenses, respectively. During 2004, commission and premium tax expenses consisted of 54% and 14% of total underwriting expenses, respectively. Furthermore, policies assumed by Takeout Companies increased to 293,684 policies compared to the 130,277 policies assumed in 2004.

Non-operating expenses consist mainly of assessment income, net investment income, and interest expense. During 2005, non-operating expenses increased $489.4 million, or 3,525%. This increase is due mainly to an increase in assessment income of $515.5 million, offset by a decrease in investment income, net of investment related expenses, of $18.4 million, or 17%. Approximately $.9 million of this variance relates to line of credit fees and note issuance costs.

Interest expense increased $6.8 million, or 6%, in 2005. The increase is a result of the variable rate increase on the 2004 HRA Auction Rate Securities. Debt outstanding as of December 31, 2005 and 2004 was $2.1 billion and $2.1 billion, respectively.

Economic Factors

Management continues to administer programs designed to reduce the number of polices written by Citizens. As a residual market mechanism, the mission of Citizens is to provide property insurance to applicants who are in good faith entitled to obtain insurance through the voluntary market but are unable to do so. Citizens' depopulation program is designed to reduce exposure by providing incentives to private insurers to remove policies from Citizens and to write these policies for their own account. The private market has responded by removing policies from the both the Personal Lines Account and the High-Risk Account. During 2005, 218,128 PLA policies and 75,556 HRA policies have been assumed by private insurers.

Citizens' rate development methodology is based on the highest average premium (calculated for each county in Florida) charged by other residential insurers. This method ensures that Citizens rates are among the highest for each county within Florida. During 2005, Citizens increased homeowner multiperil rates and residential fire/dwelling rates 23.2% and 5.1% respectively, and increased residential wind-only rates for the High-Risk Account 11.8%. Commercial Lines Account rate were also increased 26.1%. Rate increases were implemented to help fund rising losses and claim related expenses.

Citizens enabling legislation and Plan of operations established a process by which Citizens may levy assessments to recover deficits incurred in a given year. Citizens' determination of the amount of assessment is subject to the verification and approval by the Department of Financial Services.

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Report of Independent Certified Public Accountants

The Board of Governors
Citizens Property Insurance Corporation

We have audited the accompanying basic financial statements of Citizens Property Insurance Corporation (the Company), as of and for the years ended December 31, 2005 and 2004. These financial statements are the responsibility of the Company's management. 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Citizens Property Insurance Corporation at December 31, 2005 and 2004, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 17, 2006 on our consideration of Citizens Property Insurance Corporation's 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's discussion and analysis on pages i through x and the schedule of supplemental revenues, expenses and claim development information on page 32 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental statement of net assets (deficit) and statement of revenues, expenses and changes in net assets (deficit) are presented for purposes of additional analysis and are not a required part of the basic financial statements. The supplementary information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects in relation to the basic financial statements taken as a whole.

Ernst & Young LLP

May 17, 2006

Citizens Property Insurance Corporation

Statements of Net Assets (Deficit)

	December 31	
	2005	**2004**
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 155,531**	$ 1,422,375
Short-term investments	**462,312**	215,635
Deferred policy acquisition costs	**65,331**	63,981
Investment income due and accrued	**19,418**	23,848
Prepaid reinsurance premiums	**57,385**	36,300
Reinsurance recoverable	**16,202**	-
Premiums receivable, net	**9,083**	2,700
Premiums receivable from assuming companies	**7,646**	3,327
Assessment receivables	**96,644**	-
Total current assets	**889,552**	1,768,166
Noncurrent assets:		
Long-term investments	**2,031,236**	2,548,479
Deferred takeout bonus	**54,965**	36,742
Fixed assets, net	**11,633**	6,797
Other assets	**1,525**	1,143
Total noncurrent assets	**2,099,359**	2,593,161
Total assets	**$ 2,988,911**	$ 4,361,327

	December 31 2005	December 31 2004
	(In Thousands)	
Liabilities and net assets		
Current liabilities:		
Loss reserves	**$ 1,267,635**	$ 1,458,495
Loss adjustment expense reserves	**217,381**	148,555
Unearned premiums	**762,577**	667,386
Reinsurance premiums payable	**30,201**	-
Advance premiums and suspended cash	**76,193**	67,653
Federal income taxes payable	**54,899**	54,899
Interest payable	**37,178**	36,550
Taxes and fees payable	**30,995**	30,972
Other current liabilities	**69,176**	32,226
Total current liabilities	**2,546,235**	2,496,736
Noncurrent liabilities:		
Long-term debt	**2,118,277**	2,115,624
Total noncurrent liabilities	**2,118,277**	2,115,624
Total liabilities	**4,664,512**	4,612,360
Net assets:		
Invested in capital assets	**11,633**	6,797
Unrestricted	**(1,687,234)**	(257,830)
Total net assets (deficit)	**(1,675,601)**	(251,033)
Total liabilities and net assets (deficit)	**$ 2,988,911**	$ 4,361,327

See accompanying notes.

Citizens Property Insurance Corporation

Statements of Revenues, Expenses, and Changes in Net Assets (Deficit)

	Year Ended December 31	
	2005	**2004**
	(In Thousands)	
Operating revenue:		
Premiums earned	**$ 1,055,746**	$ 1,022,503
Operating expenses:		
Losses incurred	**2,401,939**	2,493,127
Loss adjustment expenses incurred	**326,232**	212,887
Service company fees	**8,086**	12,562
Producer commissions, net	**108,758**	104,041
Taxes and fees	**26,007**	26,482
Processing and other fees	**2,824**	1,753
Other underwriting expenses	**51,297**	38,458
Takeout bonus expense	**30,620**	8,037
Total operating expenses	**2,955,763**	2,897,347
Operating loss	**(1,900,017)**	(1,874,844)
Nonoperating revenues (expenses):		
Net investment income	**88,226**	106,589
Interest expense	**(124,390)**	(117,574)
Assessment income	**515,514**	-
Line of credit fees and note issuance costs	**(3,826)**	(2,897)
Total nonoperating revenues (expenses)	**475,524**	(13,882)
Change in net assets (deficit)	**(1,424,493)**	(1,888,726)
Net assets (deficit), beginning of year	**(251,033)**	1,637,693
Accumulated other comprehensive loss	**(75)**	-
Net assets (deficit), end of year	**$ (1,675,601)**	$ (251,033)

See accompanying notes.

Citizens Property Insurance Corporation

Statements of Cash Flows

	Year Ended December 31	
	2005	**2004**
	(In Thousands)	
Operating activities		
Premiums collected, net of reinsurance	**$ 1,111,488**	$ 1,088,465
Losses and loss adjustment expenses paid	**(2,850,205)**	(1,237,669)
Payments to employees for services	**(17,251)**	(13,977)
Payments for underwriting expenses	**(159,169)**	(187,025)
Net cash used in operating activities	**(1,915,137)**	(350,206)
Noncapital activities		
Debt issuance	**-**	750,000
Debt repayment	**-**	(275,000)
Interest expense paid	**(123,358)**	(124,588)
Assessment income received	**418,870**	-
Financing costs paid	**(1,578)**	(14,987)
Net cash provided by noncapital activities	**293,934**	335,425
Capital activities		
Fixed assets acquired	**(8,863)**	(4,483)
Net cash used in capital activities	**(8,863)**	(4,483)
Investing activities		
Proceeds from investments sold, matured or repaid	**4,384,082**	7,683,766
Investments acquired	**(4,143,358)**	(7,828,794)
Net investment income received	**122,498**	143,777
Net cash provided by (used in) investing activities	**363,222**	(1,251)
Net decrease in cash and cash equivalents	**(1,266,844)**	(20,515)
Cash and cash equivalents:		
Beginning of year	**1,422,375**	1,442,890
End of year	**$ 155,531**	$ 1,422,375

Citizens Property Insurance Corporation

Statements of Cash Flows (continued)

	Years Ended December 31	
	2005	**2004**
	(In Thousands)	
Operating activities		
Operating loss	$ (1,900,017)	$ (1,874,844)
Depreciation expense	4,027	3,319
Loss on disposal of fixed assets	-	(1)
Adjustments to reconcile net cash provided by operating activities:		
(Increase) decrease in operating assets:		
Deferred acquisition costs	(1,350)	2,416
Prepaid reinsurance premiums	(21,085)	(30,919)
Reinsurance recoverable	(16,202)	-
Premium receivable, net	(10,702)	(3,324)
Deferred takeout bonuses	(18,223)	(26,596)
Other assets	(382)	(925)
Increase (decrease) in operating liabilities:		
Loss and loss expenses reserve	(122,033)	1,468,345
Unearned premiums	95,191	96,386
Reinsurance premiums payable	30,201	-
Advance premium and suspended cash	8,540	3,819
Taxes and fees payable	23	8,198
Other current liabilities	36,950	3,920
Additional pension liability	(75)	-
Net cash used in operating activities	$ (1,915,137)	$ (350,206)
Noncash supplementary information		
Net unrealized loss on investments	$ 29,842	$ 36,905

See accompanying notes.

1. General

Citizens Property Insurance Corporation (Citizens) was established on August 1, 2002, pursuant to Section 627.351(6), Florida Statutes, to provide certain residential property and casualty insurance coverage to qualified risks in the State of Florida under circumstances specified in the Act. The intent of the legislation is 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 is the successor entity resulting 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 rights, obligations, assets, liabilities and all insurance policies were transferred to Citizens. Citizens is not required to obtain or to hold a certificate of authority issued by the Florida Department of Financial Services (the Department).

Citizens operates pursuant to a Plan of Operation (the Plan) approved by the Department and under the supervision of the Board of Governors which consists of eight individuals who reside in the state of Florida, from difference geographical areas of the state. The Governor, the Chief Financial Officer, the President of the Senate and the Speaker of the House of Representatives each appoint two members of the board. The executive director and senior managers of Citizens are engaged by the board, as recommended by the Chief Financial Officer, and serve at the pleasure of the board. Since the State of Florida exercises significant control over the appointment of the governing board, Citizens is considered a component unit of the State of Florida.

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 High-Risk Account. A brief history of each account follows:

> ***Personal Lines Account history*** - The FRPCJUA began operations on January 21, 1993, after Hurricane Andrew, pursuant to Section 627.351(6), Florida Statutes, to provide certain residential property and casualty insurance coverage to qualified risks in the State of Florida (on a statewide basis) to applicants who are in good faith entitled to procure insurance through the private market but are unable to do so. Residential property and casualty 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 exclude windstorm coverage on property within eligible areas. This portion of the FRPCJUA's activities became the Personal Lines Account under Citizens.

1. General (continued)

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. These policies excluded windstorm coverage on properties within eligible areas. This portion of the FRPCJUA's activities became the Commercial Lines Account under Citizens.

High-Risk Account history **–** The FWUA, which was a residual market mechanism for windstorm and hail coverage in selected areas of the State, was created by an act of the Florida Legislature in 1970 that enacted 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.

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. With respect to proprietary activities, the Board has adopted GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*. Citizens has elected to apply all applicable GASB pronouncements as well as FASB pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

2. Summary of Significant Accounting Policies (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 Department or the results of its operations or its cash flows.

Prior to January 1, 2003, Citizens prepared its financial statements in accordance with the accounting standards issued by the Financial Accounting Standards Board (FASB). In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "*Basic Financial Statements — and Management's Discussion and Analysis — for State and Local Governments*." This standard established financial reporting standards for state and local governments and certain funds of those governmental entities. The State of Florida elected to adopt the provisions of GASB Statement No. 34 for its fiscal year beginning July 1, 2001. During 2003, Citizens adopted the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, GASB Statement No. 34, GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*; and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. GASB Statement No. 31 establishes accounting and financial reporting for all investments held by governmental entities. GASB Statement Nos. 34 and 37 changed the reporting model for governmental entities and GASB Statement No. 38 modified certain note disclosure requirements for governmental entities.

GASB Statement No. 34 established standards for financial reporting for all state and local governmental entities, which includes a statement of net assets, a statement of revenues, expenses, and changes in net assets, 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 – The component of net assets 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 assets component as the unspent proceeds.

2. Summary of Significant Accounting Policies (continued)

- Restricted – This component of net assets includes asset 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 assets – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

The primary impact on Citizens of adopting GASB Statement Nos. 31 and 34 was the requirement to report all investments at fair value and to report the change in the fair value of investments as a component of nonoperating income on the statement of revenues, expenses and changes in net assets. The cumulative effect of this requirement was an immaterial increase in net assets at January 1, 2003. The adoption of GASB Statement Nos. 37 and 38 had no material effect on the financial statements.

Adoption of New Accounting Standards

On January 1, 2005, Citizens adopted the provisions of GASB Statement No. 40, *Deposit and Investment Risk Disclosures, an amendment of GASB Statement No. 3.* The new standard enhances the deposit and investment risk disclosures by updating the custodial credit risk disclosure requirements of GASB Statement No. 3 and addressing other common risks, including concentrations of credit risk, and foreign currency risk.

GASB Statement No. 40 is summarized as follows: The deposits and investments of state and local governments are exposed to risks that have the potential to result in losses. This Statement addresses common deposit and investment risks related to credit risks, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest risk, this Statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this Statement also should be disclosed.

2. Summary of Significant Accounting Policies (continued)

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 statement of net assets. The statement of revenues, expenses and changes in net assets presents increases (revenues) and decreases (expenses) in total net assets. The statement of cash flows provides information about how Citizens finances and meets the cash flow needs of its activities.

Cash, Cash Equivalents, and Investments

Cash consists of demand deposits held with financial institutions, various highly liquid money market funds, and amounts deposited with the State of Florida Chief Financial Officer's Special Purpose Investment Trust Account (the Special Purpose Account). The Special Purpose Account consists of pooled funds invested by the Chief Financial Officer of the State of Florida under the guidelines provided by Section 18.10, Florida Statutes. Deposits whose values exceed the limits of Federal depository insurance are entirely insured or collateralized pursuant to Chapter 280 of the Florida Statutes, "Florida Security for Public Deposits Act." For purposes of the statement of cash flows, highly liquid investments with original maturities of three months or less at the time of acquisition are considered to be cash.

Investments consist of relatively low-risk, highly liquid fixed-maturity securities and are recorded at market value, which is based on independent quoted market prices. Citizens considers all investments with remaining maturities of one year or less to be short-term.

Note Issuance Costs

Note issuance costs incurred in connection with acquiring notes payable (see Note 6) are deferred and amortized over the life of the note agreements.

Deferred Takeout Bonus

Takeout bonuses incurred in connection with the depopulation of Citizens (see Note 12) are deferred and amortized over the term of the related agreement under which the policy is removed from Citizens, which is generally a three-year period.

2. Summary of Significant Accounting Policies (continued)

Deferred Policy Acquisition Costs

Costs which vary directly with acquiring, renewing and servicing the business such as net commissions, servicing company fees and taxes and fees (see Note 7) are deferred and recognized over the term of the related policy. Amortization of deferred policy acquisition costs recognized for the years ended December 31, 2005 and 2004 was $145,902 and $145,577, respectively.

Fixed Assets

Fixed assets are stated at cost less related accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of three to seven years. Depreciation expense for fixed assets was $4,027 and $3,319 for the years ended December 31, 2005 and 2004.

Loss Reserves and Loss Adjustment Expense Reserves

Liabilities for loss reserves and loss adjustment expense reserves are based on claims adjusters' evaluations and on independent outside actuarial evaluations, using Citizens' loss experience and industry statistics. While the ultimate amount of losses incurred and loss adjustment expenses incurred is dependent on future developments, in management's opinion, these reserves are adequate to cover the future payment of losses. However, no assurance can be given that the ultimate settlement of losses may not vary significantly from the reserves provided. Adjustments, if any, 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 are recorded as earned on a daily pro rata basis over the policy period. The portion of premiums not earned at the end of the period is recorded as unearned premiums.

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.

2. Summary of Significant Accounting Policies (continued)

Assessments

Assessments made pursuant to the Act and the Plan are recognized as revenue in the period approved by the Board of Governors and the Department and levied by Citizens.

Reinsurance

Premiums ceded under reinsurance agreements are recorded as a reduction of earned premiums over the hurricane season covered by the agreement. Reinsurance recoverables on unpaid losses are recorded as a reduction of losses incurred and loss adjustment expenses incurred. Reinsurance recoverables on paid losses 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.

Use of Estimates

The preparation of the financial statements in accordance with 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.

Financial Instruments

The carrying value of cash and cash equivalents, premiums receivable, due from affiliates, producer commissions payable, reinsurance premiums payable and accounts payable and accrued expenses approximates fair value given their short-term nature.

2. Summary of Significant Accounting Policies (continued)

Market Risk

Citizens underwrites residential property and casualty 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 24%, 14%, 4% and 13% of Citizens' insurance coverage exposure lies in Miami-Dade, Broward, Monroe and Palm Beach counties, respectively, as of December 31, 2005. Severe storm activity in any of these counties could have a significant impact on Citizens' future financial position and results of operations.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, premiums receivable, and investments. The Company's cash management and investment policies restrict investments by type, credit and issuer, and the Company performs periodic evaluations of the credit standing of the financial institutions with which it deals. As of December 31, 2005, management believes the Company had no significant concentrations of credit risk.

Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from premiums charged to policyholders. Operating expenses include incurred losses and necessary costs incurred to provide and administer residential property and casualty insurance coverage and to carryout programs for the reduction of new and renewal writings.

(In Thousands)

3. Investments

GASB 40 Disclosure – Citizens implemented GASB Statement No. 40, *Deposit and Investment Risk Disclosures* ("GASB No. 40") which primarily amends existing accounting guidance under GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, ("GASB No. 3"), as of January 1, 2005. The new standard enhances the deposit and investment risk disclosures by updating custodial credit risk disclosure requirements of GASB No. 3 and addressing other common risks, including concentration of credit risk, and interest rate risk.

- ***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 one on of the three National Recognized Rating Agencies. Below is the Market Value by rating classification as reported by Moody's Rating Agency. This table includes debt securities of the US government and obligations of U.S. government agencies that are explicitly guaranteed, including U.S. Treasury & GNMA investments.

Rating	Market Value
A1	$ 116,474
A2	69,951
A3	60,108
AA1	23,143
AA2	50,416
AA3	97,552
AAA	1,170,375
BBB	626
P-1	382,863
Agency Mortgage Backed Securities	309,035
U.S. Treasury Strips	213,005
	$ 2,493,548

(In Thousands)

3. Investments (continued)

- ***Custodial Risk Credit –*** Disclosed in Note 3, Investments. Citizens investments at December 31, 2005 and 2004 are categorized in the following table to give an indication of the level of risk assumed. Category 1 includes investments that are insured or registered or for which the securities are held by Citizens or its agent in Citizens' name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in Citizens' name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty, or by its trust department or agent, but not in Citizens' name.

2005	**Risk Category**			**Carrying Amount/ Fair Value**
Type	**1**	**2**	**3**	
U.S. Government and Federally guaranteed obligations	$ 427,982	$ –	$ –	$ 427,982
Federal agency obligations	986,349	–	–	986,349
Commercial paper	23,133	–	–	23,133
Bonds and notes	1,056,084	–	–	1,056,084
	$ 2,493,548	$ –	$ –	$ 2,493,548

2004	**Risk Category**			**Carrying Amount/ Fair Value**
Type	**1**	**2**	**3**	
U.S. Government and Federally guaranteed obligations	$ 542,148	$ –	$ –	$ 542,148
Federal agency obligations	509,370	–	–	509,370
Commercial paper	82,823	–	–	82,823
Bonds and notes	1,629,773	–	–	1,629,773
	$ 2,764,114	$ –	$ –	$ 2,764,114

- ***Concentration of Credit Risk –*** An increase risk of loss occurs as more investments are acquired from one insurer which results in a concentration of credit risk. A detailed review of the company's investments showed that FHLB Government Agency was the only issuer to hold more than 5% of the company's invested assets, at 5.71%. No other single issuer exceeded 5%.

(In Thousands)

3. 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. Citizen's measures this risk by using the duration method to manage interest rate risk. Additionally, the company's investment policy requires each manager to have an average portfolio rating of AA, while keeping duration at 36 months or 1.2 times the benchmark. Currently, the Company uses two blended benchmarks 1) 75% Merrill Lynch 1-5 Year Corp/Govt Index and 25% Merrill Lynch 0-5 Mortgage Index and 2) 75% Merrill Lynch 1-3 Year Corp/Govt Index and 25% Merrill Lynch 0-5 Mortgage Index. Cash flows assumptions are obtained from Bloomberg for all mortgage backed and loan backed securities. The table below reflects the duration by security type at December 31, 2005.

	Market Value	Modified Duration
U.S. Government & Agency	$ 658,141	0.68 Years
Corporate	1,082,956	0.73 Years
U.S. Treasury Strips	213,005	0.14 Years
Mortgage Backed Securities	539,446	0.69 Years
	$ 2,493,548	2.24 Years

- **Foreign Currency Risk –** None.

(In Thousands)

4. Fixed Assets

A summary of changes in fixed assets and depreciation for the year ended December 31, 2005 follows:

	Beginning Balance	Additions	Reductions/ Adjustments	Ending Balance
Leasehold improvements	**$ 1,479**	**$ 501**	**$ -**	**$ 1,980**
Furniture and equipment	**7,134**	**4,705**	**(20)**	**11,819**
Other capital assets	**9,303**	**3,657**	**-**	**12,960**
Totals at historical cost	**17,916**	**8,863**	**(20)**	**26,759**
Less accumulated depreciation for:				
Leasehold improvements	**(349)**	**(73)**	**-**	**(422)**
Furniture and equipment	**(4,719)**	**(1,471)**	**20**	**(6,170)**
Other capital assets	**(6,051)**	**(2,483)**	**-**	**(8,534)**
	(11,119)	**(4,027)**	**20**	**(15,126)**
	$ 6,797	**$ 4,836**	**$ -**	**$ 11,633**

A summary of changes in fixed assets and depreciation for the year ended December 31, 2004 follows:

	Beginning Balance	Additions	Reductions/ Adjustments	Ending Balance
Leasehold improvements	$ 505	$ 974	$ –	$ 1,479
Furniture and equipment	5,513	1,732	(111)	7,134
Other capital assets	7,521	1,777	5	9,303
Totals at historical cost	13,539	4,483	(106)	17,916
Less accumulated depreciation for:				
Leasehold improvements	(246)	(103)	–	(349)
Furniture and equipment	(3,840)	(985)	106	(4,719)
Other capital assets	(3,820)	(2,231)	–	(6,051)
	(7,906)	(3,319)	106	(11,119)
	$ 5,633	$ 1,164	$ –	$ 6,797

(In Thousands)

5. Liability for Loss Reserves and Loss Adjustment Expense Reserves

Activity in the liability for loss reserves and loss adjustment expense reserves for the years ended December 31, 2005 and 2004 are as follows:

	2005	**2004**
Loss reserves and loss adjustment expense reserves, beginning of year	**$1,607,050**	$ 138,705
Incurred related to:		
Current year	**2,138,004**	2,721,512
Prior years	**590,167**	(15,498)
Total incurred	**2,728,171**	2,706,014
Paid related to:		
Current year	**1,005,019**	1,145,602
Prior years	**1,845,186**	92,067
Total paid	**2,850,205**	1,237,669
Loss reserves and loss adjustment expense reserves, end of year	**$1,485,016**	$1,607,050

As a result in changes in estimates of insured events in prior years, primarily due to the underestimation of costs relating to demand surge on hurricane losses, the provision for loss and loss adjustment expenses increased by $590,167 in 2005 and decreased by $15,498 in 2004.

The increase in loss and loss adjustment expenses incurred and paid is directly related to catastrophic losses sustained from hurricanes Dennis, Katrina, Rita and Wilma during the current year. Total incurred and paid losses and loss adjustment expenses related to the four storms were $2,915,479 for the year ended December 31, 2005.

Citizens entered into agreements with several companies that provide claim adjustment services. These agreements provide for compensation to the companies based on a graduated fee schedule, based on the cost and type of losses handled by the companies. Compensation for claim services performed during a catastrophe are paid based upon a fee schedule plus an additional amount based on a percentage of paid losses. The agreements are effective for one year, with provisions for automatic renewal for successive one-year periods. In the opinion of management, any additional liability that may ultimately result from unusual loss adjustment expenses will not have a material adverse effect on the financial position or results of operations of Citizens.

6. Notes Payable

Series 1997A issued August 25, 1997 and Series 1999A issued March 31, 1999 – In August 1997 and March 1999, the pre-merger FWUA issued $750 million and $1 billion of secured notes, respectively. The bonds were issued for the purpose of funding losses in the event of a future catastrophe. Repayment and annual debt service of the High-Risk Account bonds will be facilitated through premium and surcharge revenues, unused proceeds of the bonds, amounts available under the High-Risk Account line of credit, regular assessments and emergency assessments, as necessary.

The bonds bear interest ranging from 6.70% to 7.125% per annum. The interest on the bonds is payable semi-annually on February 25th and August 25th. The principal reduction on these notes during the years ended December 31, 2005 and 2004 was $0 and $150,000. Outstanding maturities on these notes were $1,300,000 at December 31, 2005 and 2004. The fair market value of these bonds approximate $1.467 billion.

Series 1997A, issued May 13, 1997 – In May 1997, the pre-merger FRPCJUA issued $500 million of Series 1997A Notes for the Personal Lines Account and Commercial Lines Account. The bonds were issued for the purpose of funding losses in the event of a future catastrophe. The bonds are secured by a security interest in emergency assessments. Under certain circumstances the bonds will also be secured by and payable by regular assessments or reimbursements received by or on behalf of Citizens from the Florida Hurricane Catastrophe Fund (FHCF - see Note 10). The trust indenture contains covenants that impose restrictions on Citizens' ability to sell, lease, pledge, assign or otherwise encumber or dispose of its security interest. The bonds are a direct and general obligation of Citizens and are secured ratably and without preference with Citizens' Personal Lines Account and Commercial Lines Account line of credit agreement (see Note 9).

The bonds bear interest ranging from 7.45% to 7.625% per annum. The interest on the bonds is payable semi-annually on January 1st and July 1st. The principal reduction on these notes during the years ended December 31, 2005 and 2004 was $0 and $125,000. Outstanding maturities on these notes were $100,000 at December 31, 2005 and 2004. The fair market value of these bonds approximate $100 million.

(In Thousands)

6. Notes Payable (continued)

Series 2004A through 2004I Bonds – During May 2004, Citizens issued $750 million of senior secured bonds for the purpose of funding losses in the High-Risk account in the event of a future catastrophe. The bonds were issued in multiple series and bear interest at variable, auctioned rates, based on 30-day LIBOR, for generally successive 28-day auction periods. These bonds are secured by pledged revenues which consist of moneys and investments held in accounts established under the trust indenture, proceeds from any regular assessment and/or reimbursements received from the FHCF. The fair market value of the bonds approximate $750 million.

A schedule of debt service requirements, including principal and interest, is as follows:

Year Ending December 30	Principal	Interest	Total
2006	$ -	$ 136,925	$ 136,925
2007	400,000	130,013	530,013
2008	-	113,250	113,250
2009	-	114,750	114,750
2010	-	116,250	116,250
2011-2015	-	581,250	581,250
2016-2020	1,400,000	426,250	1,826,250
2021-2025	350,000	42,000	392,000
Total	$ 2,150,000	$ 1,660,688	$ 3,810,688

The total interest expense on the notes for the years ended December 31, 2005 and 2004 was $126,419 and $120,372, including discount amortization of $405 and $552 and is included in "Interest expense" in the accompanying statements revenues, expenses and changes in net assets.

Total deferred financing costs related to all notes was $26,881 and $29,129 at December 31, 2005 and 2004 and is included in "Long term debt" in the Statement of Net Assets.

6. Notes Payable (continued)

Interest Rate Swap Agreements – Citizens had no interest rate exchange agreements outstanding at December 31, 2005 and 2004. However, in connection with the issuance of the Series 1997A Notes issued May 13, 1997, Citizens entered into interest rate exchange agreements with various counterparties for notional amounts of $500 million. The interest rate exchange agreements were terminated during 1998, 2001 and 2002, for which Citizens received termination payments of $7,304, $7,632, and $10,250, respectively. The gain on terminated interest rate swap agreements has been deferred and is being amortized over the remaining term of the terminated agreements using the effective interest method. The total amount of deferred gain and accrued interest amortized and recognized as a reduction of interest expense for the year ended December 31, 2005 and 2004 was $2,029 and $2,798.

Citizens is planning on issuing $3 billion of debt sometime during the summer of 2006.

7. Producer Commissions and Servicing Company Fees

Citizens contracted with various licensed producers in the State of Florida. These agreements provide for commissions paid to the producers at rates established by the Board and calculated as a percentage of direct written premiums, net of certain surcharges.

Additionally, Citizens entered into agreements with servicing companies to provide underwriting and policy management services. These agreements provide for monthly compensation to the companies based on a "Per Transaction Fee" based upon the number of policies processed in a monthly cycle. Service carrier fees expensed during 2005 and 2004 were $8,086 and $12,562.

8. Income Taxes

Pursuant to a determination letter received from the Internal Revenue Service, Citizens is exempt from federal income tax under Section 501(a) of the Internal Revenue Code and as such, is liable for income taxes only on business income unrelated to the purpose for which it is exempt.

8. Income Taxes (continued)

During 2002, FWUA transferred its assets and liabilities to Citizens in accordance with Florida Statute 627.351(6)(l)(2). Citizens filed federal income tax refund claims in excess of $182 million related to the transfer. During 2004 and 2003, Citizens received federal and state refunds for approximately $8 million and $69 million, respectively, related to the 2002 taxable year. The amount has been recorded as a liability in the accompanying statement of net assets (deficit). Citizens has not recorded any other anticipated refund as the claim for refund is being contested by the IRS due to the size of the refund and the refund's relationship to Citizens as the former FRPCJUA. The IRS has filed a counterclaim assessment of past due taxes and interest in the amount of approximately $93 million. The Company believes that it will prevail in this matter.

9. Line of Credit Agreements

***Line of Credit, Personal and Commercial Lines Accounts* –** Effective December 29, 2005 Citizens entered into a $600 million credit agreement (the Line of Credit) with a syndication of banks. The Line of Credit was secured by a security interest in anticipation of Revenues consisting of FHCF reimbursements and/or regular assessments. The expiration of the agreement is 364 days from December 29, 2005. Citizens is required to pay an annual Facility Fee of .10% on the unused portion of the facility. This rate is based on Moody's and S&P ratings of A and A2, respectively, on Personal and Commercial Lines Accounts long-term debt. The first Facility Fee payment will be March 31, 2006.

Effective May 13, 1997, the pre-merger FRPCJUA entered into a $1.5 billion credit agreement (the Line of Credit) with a syndication of banks. The Line of Credit was secured by a security interest in emergency assessments. Under certain circumstances, the Line of Credit was also be secured by and payable by regular assessments or reimbursements received by or on behalf of Citizens from the FHCF. Pursuant to the amendment dated March 25, 2003, the available borrowing amount was reduced to $675 million. The expiration date of the amended credit agreement was March 24, 2004. Citizens was required to pay an annual commitment fee of .37% of the daily amount by which the aggregate amount of the commitment exceeds the outstanding principal amount of the loan. The commitment fee percentage was based on Moody's and S&P ratings of A and A2, respectively, on the Personal and Commercial Lines Accounts' long-term debt. Annual commitment fees associated with this credit agreement were $591 for the year ended December 31, 2004. This agreement was not renewed after March 24, 2004.

(In Thousands)

10. Reinsurance Agreements

Citizens participates in the Florida Hurricane Catastrophe Fund (the FHCF). The FHCF will reimburse Citizens a specified percentage of losses incurred relating to a hurricane in Florida if a prescribed retention is reached. Premiums ceded to the FHCF, net of refunds received, totaled $193,633 and $177,075 during 2005 and 2004 and are included in "Premiums earned" in the accompanying statements of revenues, expenses and changes in net assets (deficit). The High-Risk Account is treated for all FHCF purposes as if it were a separate participating insurer with its own exposures, reimbursement premium and loss reimbursement. Likewise, the Personal and Commercial Lines Accounts are viewed together for FHCF purposes, as if the two accounts were one and represent a single, separate participating insurer with its own exposures, reimbursement premium and loss reimbursement. The FHCF coverages and retention amounts by account are as follows:

	2005		2004	
	Coverage Amounts	**Retention Amounts**	**Coverage Amounts**	**Retention Amounts**
Personal and Commercial Lines Accounts	$ 578 million	$ 178 million	$ 958 million	$ 283 million
High-Risk Account	3,375 million	1,041 million	3,404 million	1,007 million

Citizens purchased private reinsurance for the Personal Lines Account and the High Risk Account in 2005. The private reinsurance will reimburse Citizens a specified percentage of losses incurred relating to hurricanes in Florida if a prescribed retention is reached. Reinsurance is on the aggregate level for the Personal Lines Account and on per occurrence in the High Risk Account. Premiums ceded to private reinsurance, net of refunds received, totaled $52,897 during 2005 and are included in "Premiums earned" in the accompanying statements of revenues, expenses and changes in net assets (deficit). The private reinsurance coverages and retention amounts by account are as follows:

	2005	
	Coverage Amounts	**Retention Amounts**
Personal Lines Accounts	$ 175 million	$ 225 million
High-Risk Account	282 million	775 million

(In Thousands)

10. Reinsurance Agreements (continued)

The effect of reinsurance on premiums written and earned is as follows:

	2005		2004	
	Premiums		Premiums	
	Written	Earned	Written	Earned
Direct	**$ 1,609,085**	**$ 1,513,894**	$ 1,401,086	$ 1,304,700
Ceded	**(479,232)**	**(458,148)**	(313,118)	(282,197)
Net premiums	**$ 1,129,853**	**$ 1,055,746**	$ 1,087,968	$ 1,022,503

Citizens is entitled to $895,202 in FHCF reimbursements and $64,420 in the High Risk Account private reinsurance reimbursements related to losses incurred and paid as a result of hurricane Wilma in 2005. Citizens is also entitled to $91,458 in the Personal Lines Account private reinsurance reimbursement related to losses incurred and paid as a result of all four hurricanes (Dennis, Katrina, Rita and Wilma) in 2005. The losses incurred and the loss adjustment expenses incurred are presented net of these anticipated recoveries in the accompanying statements of revenues, expenses and changes in net assets (deficit). No recoveries were received as of December 31, 2005.

Amounts recoverable from reinsurers on unpaid losses and LAE are estimates based on the allocation of estimated unpaid losses and LAE among the Company's coverage lines. Actual amounts recoverable could significantly vary based on the ultimate settlement of losses and LAE.

Reinsurance contracts do not relieve the Company from its obligation to policyholders. The Company 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.

11. Retirement Plan

Deferred Compensation Plan

Citizens sponsors a 457(b)/401(a) deferred 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 $823 and $470 for the years ended December 31, 2005 and 2004, and are included in "Other underwriting expenses" in the accompanying statements of revenues, expenses and changes in net assets (deficit).

12. Depopulation

Pursuant to the Act, Citizens is authorized to adopt one or more programs, subject to approval by the Department, for the reduction of both new and renewal writings. Both of the pre-merger entities, the FRPCJUA and the FWUA, were also authorized to adopt and did enact such programs. However, the FRPCJUA was the only entity authorized to pay bonuses related to such programs. Agreements were entered into with various insurance companies (the Takeout Company or Companies) licensed in the State of Florida to remove policies from the FRPCJUA or the FWUA.

Policies may be removed from Citizens at policy renewal or as part of a bulk assumption (Assumption Agreement). If the Takeout Companies are unable to meet their obligations to policyholders, Citizens may be liable for losses incurred prior to the policy expiration date. In the opinion of management, any losses relating to these transactions will not have a material adverse effect on Citizens' financial position and results of operations.

During 2005 and 2004, Citizens ceded $232,472 and $136,042 in premiums to Takeout Companies pursuant to Assumption Agreements, which is included in "Premiums earned" in the accompanying statements of revenues, expenses and changes in net assets (deficit).

(In Thousands)

12. Depopulation (continued)

Citizens provides policy administration services with respect to the assumed policies. All agreements provide for the Takeout Company to adjust losses. The Takeout Company pays a ceding commission to Citizens to compensate Citizens for policy acquisition costs, which includes servicing company fees, producer commissions, and premium taxes. At December 31, 2005 and 2004, assumed premiums in the amount of $7,646 and $3,327 were due from certain Takeout Companies.

Certain agreements provide for a policy takeout bonus of up to 25% of policy premium to be paid to the Takeout Companies. Such takeout bonuses have been placed into escrow bank accounts pursuant to an escrow agreement. After three years, funds placed in escrow will be released to the Takeout Companies in accordance with the policy takeout agreement. As of December 31, 2005, $83,477 is held in escrow.

At the end of the three-year period, Citizens requires the Takeout Companies to have an independent audit of the policies for which they are claiming a bonus to determine if the policy is properly classified and is eligible for payment. Based upon results of that audit, Citizens evaluates the original amounts placed into escrow to determine if the escrow account is over or underfunded. During 2005, Citizens paid into escrow $0 for underfunded accounts and received $669 for overfunded accounts. These amounts are included in "takeout bonus income (expense)" in the accompanying statements of revenues, expenses and changes in net assets (deficit).

13. Operating Leases

Citizens leases office space and certain office equipment under various operating leases. Rental expense on operating leases amounted to $3,078 and $1,943 for the years ended December 31, 2005 and 2004. At December 31, 2005, future minimum payments under operating leases are as follows:

2006	$ 1,998
2007	2,455
2008	2,462
2009	2,235
2010	1,592
After 2010	4,017
Total	$ 14,759

14. Commitments and Contingencies

Citizens is involved in legal proceedings incidental to the conduct of its business. Management of Citizens does not believe that the outcome of any of these legal proceedings will have a material adverse effect on the financial condition or results of operations of Citizens.

ZIMMERMAN V. CITIZENS

This class action litigation was filed in the Broward County Circuit Court as a renewed challenge to windstorm insurance rate increases implemented between July 2000 and June 2002 by Citizens' predecessor, the Florida Windstorm Underwriting Association ("FWUA") pursuant to an arbitration hearing in February 2000. The court has failed to grant relief, directing the Plaintiffs to the Office of Insurance Regulation ("OIR").

On June 9, 2005, Plaintiffs filed a petition with the OIR requesting the relief they originally sought in the Broward County action. On June 24, 2005, OIR required the Zimmerman Plaintiffs to first seek relief from Citizens. Citizens reviewed the Plaintiff's petition and on February 9, 2006 denied the Petition. As such, the Petition is back at OIR for review. Plaintiffs have also served an Extraordinary Writ Petition on Citizens' counsel asking the First District Court of Appeal to assume jurisdiction over the matter. However, this Petition has not been filed with First District Court of Appeal. Citizens' management does not believe that an unfavorable outcome is likely.

SCYLLA V. CITIZENS

This case was filed in the Leon County Circuit Court as a putative class action brought by two property owners seeking damages arising from losses to their residences during the recent hurricane season. Summary Judgment was entered against Citizens and the case is currently pending on appeal at the First District Court of Appeal.

The First District Court of Appeals will decide if the *Mierzwa* case, which held that the valued policy law requires an insurer to tender full policy limits in the event of a total loss even if perils not covered under the insurance policy (i.e., flood) contributed to the total loss applies to Citizens or conflicts with its enabling legislation. Citizens Reply Brief was due on Monday, March 6, 2006. No date has been set for oral argument at the First District Court of Appeals at this time. The Company is unable to determine the outcome at this time.

14. Commitments and Contingencies (continued)

AIKENS V. CITIZENS

Brought by the same attorneys as the Scylla case, the Aikens putative class action seeks to certify all flood/wind total loss claims in the Fourth District which were carved out of the Scylla case.

CARL J. FERRO, D/B/A ITALIA, INC., ET AL. V. FLORIDA WINDSTORM UNDERWRITING ASSOCIATION

This case, originally brought against the FWUA, is a putative class action which claims coverage for wind driven rain.

A class certification hearing was held on February 3, 2006 and the Court has reserved ruling on the matter. Citizens believes that class certification is not warranted in this case.

PARADELA V. CITIZENS

Paradela, a Citizens policyholder, filed a putative class action complaint in Broward County Circuit Court seeking damages and declaratory relief against Citizens alleging that Citizens improperly applied a deductible to his claim for “Loss Assessment Coverage” under Citizens’ policy.

There is currently no hearing date for class certification. The potential financial exposure is yet undetermined.

SCHIRMER V. CITIZENS

These Citizens’ insureds have filed two proposed class actions in Pinellas County seeking, in companion cases, damages and declaratory relief arising from alleged breaches of their respective insurance contracts for Citizens’ alleged failure to pay general contractor’s overhead and profit (“O&P”) benefits in their claims. The potential financial exposure is currently undetermined.

15. Assessments

Citizens' enabling legislation and Citizens' Plan establish a process by which Citizens may levy assessments to recover deficits incurred in a given plan year by account. The Plan provides for deficits to be determined in accordance with accounting principles generally accepted in the United States adjusted for certain items. Deficits are calculated separately and assessments are levied separately for each of Citizens' three accounts.

When a deficit is incurred in any account in a given plan year, regular assessments are levied on assessable insurers, as defined in Section 627.351(6), Florida Statutes, based upon their 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, as reduced by any credits for voluntary writings for that year. Regular assessments on assessable insureds, collectively, are based on the ratio of the amount being assessed for an account to the aggregate statewide direct written premiums for the subject lines of business for the preceding year.

The adjusted GAAP deficit was $87,181, $4,564 and $1,673,836 for the Personal Lines Account, Commercial Lines Account and High Risk Account, respectively, for a combined adjusted GAAP deficit of $1,765,581 as of the year ended December 31, 2005. The Personal Lines Account and Commercial Lines Account deficits will be fully funded with a regular assessment. The High Risk Account will be fully funded with a regular and emergency assessment. Citizens' determination of the amount of regular assessments and emergency assessments to be levied is subject to verification and approval by the Citizens' Board of Governors and the Department of Financial Services, which has not occurred as of the audit report date.

Required Supplemental Information

Citizens Property Insurance Corporation

Supplemental Revenues, Expenses, and Claim Development Information
(In Thousands)

	Policy Year Ended									
	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Net earned premiums and investment revenue	521,530	648,109	680,546	480,933	462,207	575,853	754,581	929,691	1,129,092	1,143,973
Unallocated expenses	196,603	197,729	229,694	267,415	258,843	254,407	283,265	150,578	191,333	227,795
Estimated incurred claims and expense, end of policy year	240,074	174,388	326,199	112,544	35,855	64,812	97,373	243,767	2,721,512	2,138,004
Paid (cumulative) as of:										
End of policy year	133,797	102,805	206,255	69,471	19,544	41,602	44,863	123,943	1,145,602	1,005,019
One year later	208,297	141,554	302,455	104,241	27,795	59,874	77,758	200,635	2,952,024	
Two years later	217,780	149,491	314,598	111,348	28,941	63,625	82,694	215,997		
Three years later	222,366	151,905	318,920	113,198	29,830	64,809	85,512			
Four years later	224,779	153,608	321,162	112,419	30,089	68,315				
Five years later	226,806	154,427	318,455	112,798	31,186					
Six years later	227,814	155,088	318,921	120,661						
Seven years later	228,874	155,138	328,323							
Eight years later	228,959	155,730								
Nine years later	229,690									
Reestimated incurred claims and expense:										
End of policy year	240,074	174,388	326,199	112,544	35,855	64,812	97,373	243,767	2,721,512	2,138,004
One year later	238,049	157,638	318,084	116,215	31,832	67,838	87,937	222,519	3,285,721	
Two years later	230,753	156,317	326,602	118,408	31,698	66,654	87,011	227,916		
Three years later	227,558	159,193	327,268	119,342	30,932	66,564	88,085			
Four years later	230,742	158,343	328,721	117,406	30,652	69,337				
Five years later	229,829	157,470	324,993	114,217	31,648					
Six years later	229,682	155,805	319,452	121,705						
Seven years later	229,527	155,465	328,866							
Eight years later	229,113	156,071								
Nine years later	229,879									
Increase (decrease) in estimated incurred claims and expense from end of policy year	766	606	9,414	7,488	996	2,773	1,074	5,397	564,209	–

Supplemental Information

Citizens Property Insurance Corporation

Statement of Net Assets (Deficit)

December 31, 2005

	Consolidated	Personal Lines Account	Commercial Lines Account	High Risk Account
	(In Thousands)			
Assets				
Current assets:				
Cash and cash equivalents	$ 155,531	$ 269,149	$ 107,668	$ (221,286)
Short-term investments	462,312	12,354	1,028	448,930
Deferred policy acquisition costs	65,331	19,790	3,691	41,850
Investment income due & accrued	19,418	2,378	460	16,580
Prepaid reinsurance premiums	57,385	26,859	-	30,526
Reinsurance recoverable	16,202	15,881	321	-
Premiums receivable, net	9,083	8,377	(248)	954
Premiums receivable from assuming co's	7,646	7,410	-	236
Assessment receivables	96,644	-	-	96,644
Total current assets	889,552	362,198	112,920	414,434
Noncurrent assets:				
Long-term investments	2,031,236	93,085	7,744	1,930,407
Deferred takeout bonus	54,965	42,722	-	12,243
Fixed assets, net	11,633	11,633	-	-
Other assets	1,525	850	14	661
Inter-account receivable (payable)	-	165,903	(17,933)	(147,970)
Total noncurrent assets	2,099,359	314,193	(10,175)	1,795,341
Total assets	$ 2,988,911	$ 676,391	$ 102,745	$ 2,209,775
Liabilities and net assets				
Loss reserves	$ 1,267,635	$ 152,454	$ 40,849	$ 1,074,332
Loss adjustment expense reserves	217,381	58,053	17,462	141,866
Unearned premiums	762,577	307,026	29,035	426,516
Reinsurance premiums payable	30,201	18,614	-	11,587
Advance premiums and suspended cash	76,193	26,880	10,226	39,087
Federal income taxes payable	54,899	-	-	54,899
Interest payable	37,178	3,520	293	33,365
Taxes and fees payable	30,995	3,546	367	27,082
Other current liabilities	69,176	50,928	773	17,475
Total current liabilities	2,546,235	621,021	99,005	1,826,209
Noncurrent liabilities:				
Long-term debt	2,118,277	92,176	7,668	2,018,433
Total liabilities	4,664,512	713,197	106,673	3,844,642
Net assets:				
Invested in capital assets	11,633	11,633	-	-
Unrestricted	(1,687,234)	(48,439)	(3,928)	(1,634,867)
Total net assets (deficit)	(1,675,601)	(36,806)	(3,928)	(1,634,867)
Total liabilities and net assets (deficit)	$ 2,988,911	$ 676,391	$ 102,745	$ 2,209,775

Citizens Property Insurance Corporation

Statement of Revenues, Expenses, and Changes in Net Assets (Deficit)

Year Ended December 31, 2005

	Consolidated	Personal Lines Account	Commercial Lines Account	High Risk Account
		(In Thousands)		
Operating revenue:				
Premiums earned	$ 1,055,746	$ 408,098	$ 47,445	$ 600,203
Operating expenses:				
Losses incurred	2,401,939	460,738	57,194	1,884,007
Loss adjustment expenses incurred	326,232	103,338	16,907	205,987
Service company fees	8,086	8,086	-	-
Producer commissions, net	108,758	25,751	5,660	77,347
Taxes and fees	26,007	11,886	959	13,162
Processing and other fees	2,824	2,704	120	-
Other underwriting expenses	51,297	29,884	1,896	19,517
Takeout bonus expense	30,620	29,353	-	1,267
Total operating expenses	2,955,763	671,740	82,736	2,201,287
Operating loss	(1,900,017)	(263,642)	(35,291)	(1,601,084)
Nonoperating revenues (expenses):				
Net investment income	88,226	24,149	4,819	59,258
Interest expense	(124,390)	(5,166)	(430)	(118,794)
Assessment income	515,514	-	-	515,514
Line of credit fees and note issuance costs	(3,826)	(690)	(69)	(3,067)
Total nonoperating revenues (expenses)	475,524	18,293	4,320	452,911
Change in net assets (deficit)	(1,424,493)	(245,349)	(30,971)	(1,148,173)
Net assets, beginning of year	(251,033)	208,544	27,043	(486,620)
Accumulated other comprehensive income	(75)	-	-	(75)
Net assets (deficit), end of year	$ (1,675,601)	$ (36,805)	$ (3,928)	$ (1,634,868)

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Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements in Accordance With *Government Auditing Standards*

The Board of Governors
Citizens Property Insurance Corporation

We have audited the financial statements of Citizens Property Insurance Corporation as of and for the years ended December 31, 2005 and 2004, and have issued our report thereon dated May 17, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States 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 Property Insurance Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Citizens Property Insurance Corporation's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and responses.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness.

Compliance

As part of obtaining reasonable assurance about whether Citizens Property Insurance Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Governors, management 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.

Ernst & Young LLP

May 17, 2006

Citizens Property Insurance Corporation
Schedule of Findings and Management Responses
for the Year Ended December 31, 2005

Finding: The Company identified an error in the computation of the ceded unearned premiums related to take-out policies on the High Risk Account subsequent to December 31, 2005. Ernst & Young also noted that the eWind system was incorrectly calculating unearned premium amounts throughout the year for the High Risk Account on the eWind system.

Management's Response: Management has resolved both errors and has made the necessary changes to the eWind system so that it properly calculates unearned premium and ceded unearned premium amounts. The Company recorded an adjustment to properly state the High Risk Account ceded unearned premiums and earned premium amounts as of and for the year ended December 31, 2005.

Finding: We noted that IT general controls for program changes for the eWind system were deemed ineffective during 2005. Appropriate documentation of approval, testing and implementation of program changes to the eWind system was not maintained.

Management's Response: Management is currently addressing the operation of program change controls for the eWind system over the High Risk Account and will ensure that the controls are operating effectively on a prospective basis.

Finding : We noted an error in the computation of reinsurance expense on the Personal Lines Account private reinsurance contract as of December 31, 2005. The error occurred as a result of a miscalculation of the reinsurance contract provisions.

Management's Response: The Company recorded an adjustment to properly reflect the ceded premium expense and reinsurance payable balances as of and for the year ended December 31, 2005. Management is implementing changes to internal controls and the reinsurance process to properly account for its reinsurance contracts on a prospective basis.