Citizens Property Insurance Corporation
Management Discussion and Analysis for 2016
NAIC Group Code 0000 NAIC Company Code 10064

COMPANY BACKGROUND

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 (FRPCJUA) and the Florida Windstorm Underwriting Association (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. 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. As of the end of 2016, one of the nine Board member appointments was vacant.

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. 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 – The 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 (PLA) under Citizens.

Commercial Lines Account – 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 (CLA) 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 CLA.

Coastal Account **–** The FWUA, 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. The 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. The 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 (HRA) under Citizens. In 2007, Citizens received authority to issue multi-peril policies in the HRA. Pursuant to legislative changes during 2011, the HRA was renamed the Coastal Account.

During the 2013 legislative session, Citizens was authorized to create a Clearinghouse Program to confirm eligibility of new applicants to Citizens and to provide new applicants and existing Citizens policyholders enhanced access to offers of coverage from authorized insurers. Under the program, authorized insurers that have voluntarily agreed to participate in the program are able to make offers of coverage to new applicants and existing Citizens policyholders.

The Clearinghouse Program launched on January 27, 2014, and as of the end of 2016 had 14 authorized carriers participating in the program. Both Citizens' new business and renewal policies for HO-3, DP-1, DP-3, and HO-6 policy forms are currently processed through the clearinghouse. During 2016, approximately $4.8 billion ($11.3 billion since inception) in new business exposure and $498 million ($1.4 billion since inception) in renewing exposure was redirected to the private market through the clearinghouse. Since its inception, approximately 45,000 policies have been redirected to the private market prior to entering Citizens and more than 7,000 policies previously underwritten by Citizens have been placed in the private market. In 2017, Citizens expects to add certain wind-only policy forms to the Clearinghouse Program.

Policy types offered by Citizens, by account, are as follows:

Personal Lines Account	Commercial Lines Account	Coastal Account
Homeowners (HO-3) Modified Homeowners (HO-8) Dwelling Fire (DP-1 and DP-3) Condo Unit Owners (HO-6) Mobile Homeowners (MHO-3) Mobile Home Dwelling Fire (MDP-1) Tenant (HO-4) Mobile Home Tenants (MHO-4)	Commercial Residential Policies (excludes liability coverage) Commercial Nonresidential Policies (commercially operated nonresidential property)	All policy forms of the PLA and CLA within "Eligible Areas"** Personal Residential Wind-Only Homeowners (HW-2) Tenant (HW-4) Condo Unit Owners (HW-6) Dwelling (DW-2) Mobile Home (MW-2) Mobile Home Dwelling (MD-1) Commercial Wind-Only: Commercial Residential Commercial Nonresidential

***"Eligible Areas" currently include portions of 29 of Florida's 35 coastal counties, including all of Monroe County and the area within Port Canaveral; in Miami-Dade, Broward, and Palm Beach Counties, all of the areas east of I-95 are eligible (in some instances extends as far as five miles from the coast); elsewhere in the State, coverage is generally limited to a distance within 1,000 to 1,500 feet from the coast*

Net premiums earned by line of business for 2016 and 2015, are as follows:

Line of Business	2016 Net Premiums Earned	%	2015 Net Premiums Earned	%
	(in thousands)		*(in thousands)*	
Fire	$ 38,182	6%	$ 52,765	7%
Allied*	266,392	43%	297,557	39%
Homeowners multi peril	320,966	51%	410,428	54%
Total	$ 625,540	100%	$ 760,750	100%

*Includes wind-only policies classified as *Allied*

CATASTROPHE RISK MANAGEMENT

Beginning in 2011, Citizens reentered the risk transfer market as part of a strategic effort aimed at reducing the financial impact of catastrophic risk (wind storms). In each year thereafter, Citizens has increased its reliance on traditional risk transfer markets to reduce overall storm risk levels and in 2012 entered the insurance-linked securities market by sponsoring an indemnity trigger catastrophe bond. Since 2012, Citizens has relied on this dual market approach to leverage both traditional and insurance-linked securities markets to reduce its net exposure to storm risk at efficient pricing levels. In 2016, Citizens' total risk transfer program amounted to $2.46 billion, representing a $1.45 billion (37%) decrease relative to 2015. Total premiums ceded under the 2016 risk transfer program were $181 million, representing a decrease from 2015 of $102 million (36%). In an effort to align budgetary constraints with surplus exposed to storm risk, the 2016 risk transfer program was constructed in part through the redistribution of reinsurance markets that participated in a multi-year excess of loss layer to a single-year layer providing coverage alongside and above coverage provided through the Florida Hurricane Catastrophe Fund.

This redistribution of participating markets resulted in the optimal placement of reinsurance coverage that exposed no more than 60% of surplus within the Coastal Account while at the same time eliminating disruption to Citizens' operating budget. All risk transfer is purchased by and inures solely to the benefit of the Coastal Account.

Pursuant to its enabling statute, Citizens must participate in the Florida Hurricane Catastrophe Fund (FHCF), a statutorily-created reinsurance facility. While private carriers may elect among several coverage options (90%, 75%, 45%), Citizens is required to purchase coverage at the 90% coverage limit. Coverage through the FHCF is purchased for each of Citizens' three accounts, however, catastrophic losses incurred by Citizens on commercial non-residential policies (written only in the CLA and Coastal Account) are not covered by the FHCF. In 2016, the FHCF provided coverage totaling $2.7 billion, representing a decrease of $517 million from 2015 (16%). Total premiums ceded to the FHCF during 2016 were $182 million, or $49 million (21%) less than the amount of premiums ceded during 2015. Because the FHCF has a limit of insurance defined by Florida Statute and because private carriers are able to select one of three coverage options, Citizens' share of the statewide limit is influenced both by its market share and by elections made by private carriers. Citizens' retention levels through the FHCF are affected by Citizens' market share only.

Citizens' risk transfer program, including its participation in the FHCF, does not relieve Citizens from its obligations 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.

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 based on Citizens' GAAP-basis total net position, 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. The Regular Assessment is applied as a uniform percentage of the premium of the policy up to 2% of such premium and is available to reduce or eliminate deficits in the Coastal Account only. Regular Assessments are levied on assessable insurers and insureds, as defined in Section 627.351(6), Florida Statutes, based upon each assessable insurer's or insured'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 or insureds, 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 (Coastal Account only), 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.

DEPOPULATION

Pursuant to the Act, Citizens is authorized to adopt one or more programs, subject to approval by the Office, to facilitate the reduction of both new and renewal writings. Policies may be removed from Citizens at policy renewal or as part of a bulk assumption (Assumption Agreement). For policies that are assumed as part of a bulk assumption, Citizens cedes 100% of the remaining unearned premium reserve at the date of assumption for policies that are assumed. In an assumption, the assuming insurer 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 assuming insurer will write the policy directly. In January 2007, Florida law was amended to state that assumed policies are the direct insurance of the assuming insurer, for the purpose of clarifying that FIGA is liable for assumption period losses occurring during the assumption period if an assuming insurer were liquidated and unable to meet its obligation to policyholders. Citizens provides policy administration services with respect to the assumed policies. All agreements provide for the assuming insurer 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 assuming insurer. During 2016, approximately $1 billion in storm risk was removed through depopulation, marking an appreciable decline relative to 2015 during which approximately $2.5 billion in storm was removed.

FINANCIAL POSITION

Citizens' financial position at December 31 is as follows (unaudited):

	December 31	
	2016	**2015**
	(in thousands)	
Admitted assets		
Bonds	$ 10,815,093	$ 11,484,293
Cash and short-term investments	1,290,512	1,665,225
Total cash and invested assets	12,105,605	13,149,518
Investment income due and accrued	75,183	74,733
Premiums receivable	75,615	89,889
Reinsurance recoverable on paid losses and LAE	1,143	2,606
Other receivables under reinsurance contracts	6,614	32,435
Assessment receivable	907	3,330
Other admitted assets	3,750	10,486
Total admitted assets	$ 12,268,817	$ 13,362,997
Liabilities and accumulated surplus		
Liabilities:		
Loss reserves	$ 499,051	$ 522,740
Loss adjustment expense reserves	221,765	209,872
Retroactive reinsurance ceded	(1,411)	(1,433)
Unearned premiums	440,413	513,336
Taxes and fees payable	(180)	1
Provision for reinsurance	11	11
Bonds payable	3,361,156	4,318,932
Interest payable	12,745	16,592
Advance premiums and suspended cash	24,244	32,248
Other liabilities	309,221	361,006
Total liabilities	4,867,015	5,973,305
Accumulated surplus:		
Restricted	8,237	20,950
Unrestricted	7,393,565	7,368,742
Total accumulated surplus	7,401,802	7,389,692
Total liabilities and accumulated surplus	$ 12,268,817	$ 13,362,997

Cash and invested assets

Citizens employs an investment policy that focuses on principal preservation, competitive returns, and adequate liquidity in order to meet future claim obligations. Citizens' invested assets are governed by five investment policies, three for taxable operating funds and two for tax-exempt bond proceeds: 1) 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; 2) 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; 3) 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; 4) 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; and 5) Claims-Paying Long Duration 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 and Claims-Paying Fund. During 2016, Citizens instituted several changes to its Taxable investment policies, including the development of the Claims-Paying Long Duration Fund (Taxable) which allows for an increase in final maturity (15 years) and dollar weighted average maturity (10 years) as well as the addition of certain highly-rated publicly issued fixed rate asset-back securities. Other changes instituted during 2016 include an extension in dollar weighted average maturity from 397 days to 548 days and 5 years to 6 years within the Liquidity Fund (Taxable) and Claims-Paying Fund (Taxable), respectively, along with an allowable increase in exposure to Corporate fixed-income securities. Citizens' investment policy requires all securities in the portfolio be rated Baa2/BBB/BBB or better (Taxable) and Baa1/BBB+/BBB+ or better (Tax-exempt) by Moody's, S&P and/or Fitch at the time of purchase. Citizens engages independent investment managers to invest bond proceeds and certain operating cash pursuant to its taxable and tax-exempt investment policies. Citizens' investment portfolio consists of high-quality debt instruments such as US Treasury and Agency securities and money market funds, corporate bonds, commercial paper and certificates of deposit, tax-exempt money market funds, taxable municipal bonds, tax-exempt municipal bonds, tax-exempt variable rate demand notes, and prime money market funds.

Declines in market value of invested assets are continually evaluated to determine whether these declines are temporary or other-than-temporary in nature. In making this determination, Citizens monitors external impairment indicators such as issuer credit ratings as well as the extent and length of the related declines and internal impairment indicators such as Citizens' intent and ability with respect to retention of the impaired securities. These indicators are obtained from both third-party valuation services and internal analyses performed by Citizens.

Cash and the amortized cost of Citizens' invested assets totaled approximately $12.1 billion at December 31, 2016, marking a decrease of $1.1 billion from December 31, 2015. Of this decrease, approximately $111 million resulted from net cash used in operating activities driven by year-over-year declines in direct written premium coupled with year-over-year increases in loss and LAE payments. The remaining decrease in cash and invested assets is largely due to net cash outflows associated with Citizens' outstanding bonds payable and the related debt service requirements on those bonds, net of investment income collected.

Other receivables under reinsurance contracts

Other receivables under reinsurance contracts consist of amounts due from assuming insurers for policies assumed through depopulation. Receivables arise as a result of cancellations and premium-bearing endorsements to policies assumed by assuming insurers but for which Citizens is continuing to provide policy administration services. During 2016, and as further discussed on page 7, a substantial decrease in policy assumption activity was observed, most notably during December 2016, leading to an expected decrease in amounts due from assuming insurers

Reserve for losses and loss adjustment expenses

Reserves for unpaid losses and loss adjustment expenses (LAE) are stated at Citizens' estimate of the ultimate cost of settling all incurred but unpaid claims. Incurred losses and LAE represent a combination of payments for loss and LAE as well as changes in reserves that occur during the calendar year. Activity with respect to reserves for unpaid losses and loss adjustment expenses for the years ended December 31, 2016 and 2015 were as follows (*in thousands*) (unaudited):

	2016	2015
Balance at beginning of year	$ 732,612	$ 1,032,988
Incurred related to:		
Current accident year	426,236	356,735
Prior accident years	86,678	132,318
	512,914	489,053
Paid related to:		
Current accident year	157,912	189,275
Prior accident years	366,798	600,153
	524,710	789,429
Balance at end of year	$ 720,816	$ 732,612

Reserves for unpaid losses, net of amounts ceded under reinsurance contracts, decreased approximately $24 million (5%) while reserves for unpaid LAE reserves, net of amounts ceded under reinsurance contracts, increased approximately $12 million (6%). Net unpaid losses and LAE reserves related to the 2004 and 2005 hurricanes, 2008 Tropical Storm Fay, and 2016 Hurricanes Hermine and Matthew increased $13 million as a result of 2016 hurricane losses partially offset by the settlement of outstanding hurricane claims incurred in prior years. It is expected that these loss reserves will continue to run-off through 2017 and likely beyond. Net unpaid losses and LAE reserves not related to hurricanes decreased $37 million due to an overall reduction in the number of policies in force and settlement of reserve balances from prior years. Additional analysis and discussion of current year loss and LAE activity is included, beginning on page 8, within the Results of Operations section.

Bonds payable

Citizens has issued multiple Senior Secured Bonds for the purpose of funding losses in the event of a future catastrophe to ensure that liquidity demands associated with policyholder obligations can be met. These 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. During 2016, cash outflows associated with Citizens' Senior Secured Bonds totaled $923 million in principal repayments and $173 million in debt service payments.

Other liabilities

Effective July 1, 2015, Citizens terminated the 2005 HRA Emergency Assessment that was activated as a result of unprecedented storm activity during 2004 and 2005 during which eight hurricanes made landfall in various southern US states, including Florida. The collection of these assessment funds were used for debt service obligations incurred in connection with the now defeased 2007A post-event bonds that were issued to provide claims paying resources to Citizens. Amounts collected by Citizens in excess of the 2005 HRA Emergency Assessment levy are held in a reserve account and may be used by Citizens to offset future plan year deficits as approved by the Board and Office. At December 31, 2016, funds held in this reserve totaled $144 million. Other liabilities also include amounts payable to reinsurers for premiums ceded under the 2016 risk transfer program. At December 31, 2016, ceded premiums payable totaled $93 million.

RESULTS OF OPERATIONS

Operating results and policies in force for 2016 and 2015 were as follows (unaudited):

	Years Ended December 31	
	2016	2015
	(in thousands)	
Premiums earned	$ 625,540	$ 760,750
Losses incurred	345,768	402,515
Loss adjustment expenses incurred	167,146	86,538
Other underwriting expenses incurred	241,460	278,786
Underwriting loss	(128,834)	(7,090)
Net interest income	171,082	141,084
Net realized gain on sales	66,195	19,047
Interest expense	(137,928)	(160,508)
Net investment income (expense)	99,349	(377)
Assessment income	-	19,326
Other income (expense)	2,407	(6,155)
Net income (loss)	$ (27,078)	$ 5,704
Policies in force	455,843	503,865
Policies serviced	500,071	625,522

Underwriting loss

During 2016, Citizens incurred an underwriting loss of $129 million representing an increase of $122 relative to the underwriting loss incurred during 2015 of $7 million. The current year underwriting loss was substantially the result of continued deterioration in loss and LAE ratios with a notable increase specifically in LAE within the Personal Lines Account. Reductions in year-over-year costs associated with Citizens' risk transfer program along with declines in underwriting expenses partially offset the 2016 underwriting loss.

Direct Written Premium

During 2016, consolidated direct written premium decreased $294 million (23%). By account, decreases in direct written premium were $83 million (15%), $26 million (41%), and $185 million (28%) within the PLA, CLA, and Coastal Account, respectively.

During 2016, Citizens introduced several changes to its existing policy language on certain policy forms in an effort to reduce loss costs associated with non-weather water loss activity and assignment of benefits (AOB). In summary, these changes established a limit of $3,000 (or 1% of Coverage A) for emergency water extraction, with additional coverage available following approval from Citizens, as well as excluding coverage for repairs until one of the following occurs: on-site loss inspection by Citizens, approval by Citizens, or 72 hours after the loss is reported to Citizens. Additional policy changes clarified that coverage is provided for access only to repair the part or portion of the plumbing system that caused the loss, that collapse of plumbing and other similar systems due to age, deterioration or maintenance is expressly not covered, and that coverage is limited to only the part or portion of the plumbing system that caused the loss, regardless of whether the condition of the system prevents repair.

Beginning in the 4th quarter of 2014, Citizens' launched its Commercial Renewal Underwriting Initiative (RUI) in order to review all commercial policies to verify key data and rating elements, including construction type, occupancy, wind mitigation, rating territory, and replacement cost valuations in an effort to eliminate premium leakage and advance the accuracy of data for its commercial book of business. Through December 31, 2016, over 25,000 individual commercial buildings were reviewed (substantially all CR-W, CNR-M and CNR-W policies) with approximately 8,500 commercial buildings (CR-M policies) remaining for a targeted completion in the 1st quarter of 2018.

An analysis of observed trends in direct written premium, by account, follows:

Personal Lines Account

Premium trends continue to be generally driven by policy activity occurring within the DP-3 and HO-3 books of business, which comprised approximately 67% of the policy count and 85% of direct written premium while other policy form counts (DP-1, HO-4, HO-6, MDP-1, and MHO-3) comprised the remainder. Relative to 2015, 2016 new business activity decreased roughly 22% and renewal activity decreased roughly 11%. In addition to reductions in new and renewal business activity during 2016, significant reductions in the number of DP-3 and HO-3 policies assumed during 2016 were also observed. During 2016, roughly $19 million of premium was assumed through depopulation in contrast to the $92 million that was assumed during 2015. Further, during 2016 the renewal rate within the PLA (expressed as the number of policies renewed relative to the number of policies eligible for renewal) increased from 81% (2015) to 83% (2016) staging the potential stabilization or reversal in the recent decline in overall premium activity within the PLA. Also contributing to the year-over-year decline in direct written premium was the 2015 rate filing (effective February 2016) which, for the PLA, generally produced overall rate decreases.

Commercial Lines Account

Historical trends in commercial policies continued in 2016, contributing to a decline in direct written premium of $26 million, from $63 million in 2015 to $37 million in 2016. This decline was driven by three continuing trends: a reduction in new policies, a decreasing renewal rate (defined as the number of policies renewed relative to the number of policies eligible for renewal), and continued depopulation. Fewer than 100 new policies were written in 2016 and an increase of 20% in the number of policies that did not renew in 2016 relative to 2015 was observed. Additionally, $4 million in premium was assumed in the fourth quarter of 2015 and the first half of 2016 rendering these policies ineligible to renew with Citizens during 2016, and further reducing written premium. Certain statutory provisions allow for the removal of commercial residential and non-residential policies whereby Citizens must not renew policies for which a private carrier has made a valid offer of renewal. The impact of these statutory provisions together with the Commercial RUI may contribute to the continued private market interest in certain of Citizens' commercial policies and sustain the persistency of declines in premium volume within the CLA. The 2015 rate filing (effective February 2016) also contributed to the year-over-year declines in direct written premium.

Coastal Account

Direct written premium within the Coastal Account declined by $184 million, from $651 million in 2015 to $466 million in 2016, continuing existing trends. Both new and renewal policy counts declined by approximately 30% due to a combination of $62 million in premium that was assumed during the last quarter of 2015 and the first half of 2016, and a declining commercial renewal rate. Roughly 83% of eligible commercial policies renewed in 2015, declining by 6 percentage points to 77% in 2016. Commercial business continues to represent a smaller percentage of the total Coastal Account – roughly 27% in 2016, reduced from 29% in 2015 and 30% in 2014. Wind-only business, which includes both commercial and personal lines policies, comprised approximately 68% of direct written premium, marking a slight decline from 2015 (69%) and a marginal increase from 2014 (65%), while HW-2 and DW-2 policies continue to account for 39% of direct written premium. The decrease in direct written premium is partially offset by an overall rate increase as a result of the 2015 rate filing (effective February 2016.)

Across all accounts and lines of business, the 2016 rate filings (effective February 2017) are expected to produce approximate rate changes ranging from 0% to 12% depending on the segment of business.

Losses and LAE incurred

During 2016, Citizens' net loss ratio increased marginally by two percentage points from 53% to 55% while the net LAE ratio increased considerably by 16 percentage points from 11% to 27%. Losses incurred during 2016 were $346 million, representing a decrease of $57 million relative to 2015. Conversely, LAE incurred during 2016 were $167 million representing a sizeable increase of $80 million relative to 2015.

An analysis of direct loss and LAE activity, by account, follows:

Personal Lines Account

For the year that ended December 31, 2016, the PLA experienced a direct loss and LAE ratio of 80%, up six percentage points from 2015. While hurricanes Matthew and Hermine (mostly Matthew) contributed roughly three percentage points to the 2016 loss/LAE ratio, the primary driver of loss/LAE activity within the PLA continues to be litigated water claims. Litigated water claims from accident year 2015 account for $65 million of adverse development in calendar year 2016 and is the result of a revision to the projected number of claims that would ultimately enter into litigation. This revised projection impacted both loss and LAE and comprised over 15 percentage points of the overall loss/LAE ratio. For the most recent accident year (2016) the expectation is that that close to 50% of non-sinkhole/non-catastrophe claims will be litigated, contributing to over 60 percentage points of the overall loss/LAE ratio. The expected percentage of claims entering into litigation (close to 50%) is largely due to the volume of claims reported with an Assignment of Benefit and claims that are reported with representation at First Notice of Loss. Calendar year 2016 marked the first year wherein the amount of premium earned for sinkhole coverage exceeded the amount of sinkhole losses and LAE incurred. Pending claims in Accident Years 2011 and prior (i.e. Accident Years that predated Senate Bill 408) have developed and are settling within expected amounts while relatively few sinkhole claims have been reported in 2016. Modest favorable development on AY 2011 (and prior) claims coupled with a low volume of incurred sinkhole loss in accident 2016 resulted in a negligible impact to the 2016 loss/LAE ratio as respects sinkhole losses.

Commercial Lines Account

Despite substantial declines in premium volume within the CLA, commercial-residential policies continue to represent a majority of the CLA book of business. In 2007, the CLA enjoyed roughly $60 million in direct earned premium for commercial-residential business alone. Since 2007, direct earned premium for commercial-residential business has steadily declined ending at $38 million for 2016. The overall 2016 direct loss and LAE ratio of 15% includes approximately five percentage points in losses and LAE related to hurricanes Matthew and Hermine (mostly Matthew). The remaining 10 percentage points were due to non-catastrophe events. The 2015 calendar year loss and LAE ratio was -23% due to approximately $20 million of favorable development stemming from the reduction of commercial-residential sinkhole loss reserves from prior accident years. During 2016, no such favorable development occurred which resulted in a seemingly large swing in the year-over-year loss and LAE ratio.

Coastal Account

For the year that ended December 31, 2016, the direct loss and LAE ratio within the Coastal Account was approximately 29%, marking an increase of roughly 11 percentage points. Approximately five percentage points are due to hurricanes Matthew and Hermine (mostly Matthew). The primary driver of loss and LAE activity unrelated to hurricanes is due to litigated water claims and generally parallels loss and LAE activity within the PLA, with similar impacts both to losses and LAE impacted by litigated water claims. Non-sinkhole/non-catastrophe losses on multi-peril homeowners and fire & allied policies within the Coastal Account contributed over eight percentage points to the loss and LAE ratio, however the overall loss and LAE ratio, in comparison to the PLA, is appreciably lower due to the presence of wind-only policies that typically exhibit minimal loss activity. As in the PLA account, the litigated water claims impacts both losses and LAE.

Net investment (expense) income

Net investment income consists of interest earned on Citizens' invested assets, net realized gains on sales of invested assets, and interest expense incurred on Senior Secured Bonds outstanding. During 2016, Citizens realized a substantial year-over-year increase in net realized gains from the sale of invested assets largely due to the disposition of several legacy assets that resulted in gains of $10 million. During 2015, net realized gains on sales were principally offset by the defeasance of Citizens' 2007A post-event bonds in which future interest expenses were accelerated and recognized as a loss within net realized gains on sales. The 2016 disposition of legacy assets and 2015 bond defeasance costs impact the comparability of year-over-year activity within reported net realized gains on sales. Increases in net investment income of $30 million (21%) were primarily the result of investment policy changes approved in 2015 (effective in the first quarter of 2016) that extended the maximum final maturity and maximum dollar weighted average maturity across several portfolios that necessarily improved overall portfolio returns.

CASH FLOW AND LIQUIDITY

Cash flows for the years ended December 31 are as follows (unaudited):

	Years Ended December 31	
	2016	**2015**
	(in thousands)	
Operating activities		
Premiums collected, net of reinsurance	$ 545,301	$ 580,637
Loss and loss adjustment expenses paid	(523,247)	(791,112)
Underwriting expenses paid	(236,728)	(277,831)
Net investment income received	106,690	68,835
Other income (expenses) received (paid)	(2,525)	9,928
Net cash used in operating activities	(110,509)	(409,542)
Investing activities		
Proceeds from investments sold, matured or repaid	8,830,342	7,883,668
Investments acquired	(8,168,408)	(7,275,745)
Net cash provided by investing activities	661,934	607,923
Financing and miscellaneous activities		
Borrowed funds repaid	(923,085)	(65,655)
Other cash received (disbursed)	(3,053)	75,902
Net cash provided by (used in) financing and miscellaneous activities	(926,138)	10,247
Net increase (decrease) in cash and short-term investments	(374,713)	208,628
Cash and short-term investments:		
Beginning of year	1,665,225	1,456,597
End of year	$ 1,290,512	$ 1,665,225

The year-over-year decrease in net cash used in operating activities was caused by declines in premiums collected resulting from declines in direct written premium. Net cash provided by investing activities has remained relatively unchanged due to ongoing liquidity needs associated with declines in premium levels and depopulation activity. Cash provided by (used in) financing activities generally results from net cash flow activity related to Citizens' Senior Secured Bonds. As a statutorily-created insurer, the availability and adequacy of claims-paying resources are of paramount importance to Citizens' liquidity strategy. In determining its claims-paying resources, Citizens measures total resources, consisting of surplus, pre-event bond proceeds, coverage acquired through risk transfer, and coverage provided by the FHCF, against its modeled 1-in-100 year probable maximum loss (PML) plus 10% for LAE. For the 2016 hurricane season and as of June 30, 2016, Citizens' combined ratio of claims-paying resources to PML was 2.09, denoting that Citizens held available claims-paying resources of $2.09 per $1.00 of losses incurred at the 1-in-100 year PML plus 10% for LAE.