Citizens Property Insurance Corporation

Annual Report of Aggregate Net Probable Maximum Losses,
Financing Options, and Potential Assessments

February 2017

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The data contained in this report is unaudited. This report is prepared by Raymond James as financial advisor to Citizens Property Insurance Corporation.

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Purpose and Scope

Section 627.35191 Florida Statutes, enacted in 2013, requires Citizens Property Insurance Corporation (Citizens) to provide a report to the Legislature and the Financial Services Commission regarding the aggregate net probable maximum losses, financing options, and potential assessments of Citizens. Section 627.35191 Florida Statutes follows:

> **§ 627.35191 Annual report of aggregate net probable maximum losses, financing options, and potential assessments.** No later than February 1 of each year, the Florida Hurricane Catastrophe Fund and Citizens Property Insurance Corporation shall each submit a report to the Legislature and the Financial Services Commission identifying their respective aggregate net probable maximum losses, financing options, and potential assessments. The report issued by the fund and the corporation must include their respective 50-year, 100-year, and 250-year probable maximum losses; analysis of all reasonable financing strategies for each such probable maximum loss, including the amount and term of debt instruments; specification of the percentage assessments that would be needed to support each of the financing strategies; and calculations of the aggregate assessment burden on Florida property and casualty policyholders for each of the probable maximum losses.

Introduction

Citizens plays an important role in the provision of property insurance coverage for Florida residents unable to find coverage in the private market. Eleven consecutive seasons without major hurricane losses has given Citizens an opportunity to accumulate resources in preparation for future storms. Citizens has significant financial resources as of the end of 2016, with estimated combined surplus of approximately $7.4 billion. In addition to its surplus, Citizens' financial resources also include pre-event debt totaling $3.2 billion that provides liquidity, and a risk transfer program that transfers approximately $2.5 billion through traditional reinsurance markets and the capital markets, and approximately $2.7 billion through the Florida Hurricane Catastrophe Fund (FHCF).

Notwithstanding the diversity and magnitude of its financial resources, if Florida is impacted by an extreme storm or series of storms, Citizens may need to rely on its assessment capability and / or post-event financing to meet its policyholder obligations.

As a result of significant depopulation and eleven consecutive years without major hurricane losses, Citizens' current financial position is its strongest to date. Citizens has accumulated substantial levels of surplus and is also expecting to execute a risk transfer plan (through traditional reinsurance markets and capital markets) to bolster its claim paying resources in 2017 and to reduce or eliminate any potential assessments. Major catastrophic losses, either from an extreme single event or from multiple events that lead to exhaustion of its claims paying resources resulting in a deficit to any of Citizens' accounts and levying of the emergency assessment, may require Citizens to issue post-event bonds in order to meet its cashflow needs. Repayment of these post-event bonds would be funded through the collection of the associated emergency assessment. For a 1-100 year event, Citizens is projected to have no assessment burden; the potential assessment burden for a 1-250 year event is at a historical low with a potential annual emergency assessment rate of 0.10% if the deficit were financed over a 30-year period at a 5% interest rate[1].

The analyses presented in this report summarize Citizens' claims-paying resources and how Citizens would apply these resources after an event or series of events.

Aggregate Net Probable Maximum Loss

Through three accounts, Citizens provides property insurance coverage in Florida to individuals and businesses that meet statutory criteria. While these accounts are maintained separately for financial purposes (including deficit and assessment calculations), two of the accounts – the Personal Lines Account (PLA) and Commercial Lines Account (CLA) – are combined for purposes of FHCF coverage and bond security. A summary of the three accounts follows:

- Coastal Account: The Coastal Account provides wind-only and multi-peril coverage for policyholders (residential and commercial) in defined geographic areas near the coast.

- Personal Lines Account: The PLA provides residential multi-peril and ex-wind coverage throughout Florida.

[1] The assessment rate would be 0.21% if the deficit were financed over a 10-year period at a 5% interest rate.

- Commercial Lines Account: The CLA provides commercial residential (condominium association, etc.) and commercial nonresidential coverage throughout Florida.

Table 1 presents the projected aggregate net Probable Maximum Loss (PML), including 10% of loss to account for Loss Adjustment Expenses, from storms of the return time specified for: (1) the PLA/CLA; (2) the Coastal Account; and (3) all three accounts combined. The loss calculations are as of December 31, 2016 and were prepared by Citizens using AIR Atlantic Tropical Cyclone Model v15.0.2 as implemented in Touchstone v4.0. Table 1 also presents Citizens' projected payment sources for each return time, including surplus, FHCF mandatory coverage reimbursement and private risk transfer, and identifies any shortfalls which would require the levy of the policyholder surcharge, regular assessment (Coastal Account only) and emergency assessment.

Table 1
($ in millions)

Coastal

Return Time (Years)	PML (Coastal)[1]	Projected FHCF Reimbursement	Projected Payment from Surplus[2]	Private Reinsurance / Catastrophe Bonds[3]	Assessable Shortfall
250	$7,279	$1,376	$3,283	$1,000	$1,619
100	$4,635	$1,376	$2,259	$1,000	N/A
50	$2,910	$1,376	$1,005	$528	N/A

PLA/CLA

Return Time (Years)	PML (PLA/CLA)[1]	Projected FHCF Reimbursement	Projected Payment from Surplus[2]	Private Reinsurance / Catastrophe Bonds[3]	Assessable Shortfall
250	$3,883	$1,055	$2,828	N/A	N/A
100	2,216	1,055	1,162	N/A	N/A
50	1,272	747	525	N/A	N/A

Total Coastal & PLA/CLA[4]

Return Time (Years)	PML (Coastal and PLA/CLA)[1]	Projected FHCF Reimbursement	Projected Payment from Surplus[2]	Private Reinsurance / Catastrophe Bonds[3]	Assessable Shortfall
250	$11,161	$2,431	$6,111	$1,000	$1,619
100	6,851	2,431	3,420	1,000	N/A
50	4,182	2,123	1,530	528	N/A

[1] *All PMLs reflect single event modeled losses as of December 31, 2016 per AIR Atlantic Tropical Cyclone Model v15.0.2 as implemented in Touchstone v4.0 based on Standard Sea Surface Temperature (SSST), including demand surge, excluding storm surge, and including 10% of loss to account for Loss Adjustment Expense. The PML numbers are higher by approximately 5% for aggregate events or losses.*

[2] *Surplus is estimated as of 12/31/16 and includes 2017 net projected income/(loss) with $1 billion of projected traditional reinsurance / catastrophe bonds for the 2017 season. Due to the sufficient funds to cover the adjusted net loss in an event with a 50 and 100 year return time for the Coastal Account and for an event with an event with 50, 100, and 250 year return time for PLA/CLA only the necessary funds are included on the table resulting in zero potential for post-event bonding.*

[3] *Private reinsurance/catastrophe bonds are estimated amounts per Citizens' projected risk transfer program for 2017. These amounts are preliminary, however, and may change subject to market conditions.*

[4] *Total PMLs are a sum of the PLA/CLA and Coastal PMLs in this analysis to be consistent with FHCF allocation. Combined PMLs are marginally different than the sum of the individual PMLs at these return times.*

Numbers may not add due to rounding.

Financing Options

Citizens may undertake two basic types of financings: (1) pre-event financing – to provide liquid funds to meet policyholder obligations in a timely manner (Citizens uses this financing primarily as a "bridge" to ultimate claims-paying resources such as FHCF reimbursements or assessments); and (2) post-event financing – to provide the ultimate source of payment of covered claims in excess of accumulated surplus, FHCF reimbursements, other private reinsurance recoveries, Citizens policyholder surcharges, and regular assessments (Coastal Account only).

Citizens currently has five series of pre-event bonds outstanding (four in the Coastal Account in the amount of over $2.3 billion and one in the PLA/CLA in the amount of $900 million), totaling over $3.2 billion. Of this total, $869 million in the Coastal Account and $130 million in the PLA/CLA will mature prior to the 2017 hurricane season, leaving over $2.2 billion in total external pre-event liquidity (approximately $1.5 billion in the Coastal Account and $770 million in the PLA/CLA) available for the 2017 season. Together with Citizens' accumulated surplus, this external pre-event liquidity provides the source of immediately available funds to pay claims. For 2017, liquidity sources in the Coastal Account are projected to total approximately $5.8 billion (approximately $3.3 billion of estimated surplus in addition to approximately $1.5 billion of pre-event bonds and $1.0 billion of projected private risk transfer). Similarly, liquidity sources in the PLA/CLA available for 2017 are projected to total approximately $4.9 billion (approximately $4.1 billion of estimated surplus in addition to $770 million of pre-event bonds). Citizens' pre-event bonds are serviced primarily from the investment earnings on the bond proceeds (which are retained pending their need to pay future claims) and from the collection of policyholder premiums. There are no assessments associated with pre-event bonds.

For 2017, Citizens is currently projected to purchase from the FHCF over $2.4 billion in reinsurance (approximately $1.4 billion for the Coastal Account and over $1.0 billion for PLA/CLA). Citizens is currently evaluating market conditions, however, and is projected to have $1.0 billion of private risk transfer in 2017, which would reduce the projected assessable shortfall, if needed.

During 2015, Citizens defeased its remaining post-event bonds that were issued in order for Citizens to meet its policyholder obligations from the 2005 storms. The associated assessments were also eliminated for all policies issued or renewed on or after July 1, 2015. As such, Citizens has no post-event bonds outstanding.

Citizens' outstanding debt has long-term underlying ratings of A+/AA-/A1 from Standard & Poor's, Fitch, and Moody's, respectively.

Three assessment tiers must be used by Citizens in a statutorily prescribed manner to fund any deficits caused by storm losses (see the following section for a description of each assessment type). The Citizens policyholder surcharge is collected over a 12 month period and the regular assessment (Coastal Account only) is due within 30 days of billing. As a result of their relatively short collection periods, these "one-time" levies require no financing. However, if Citizens experiences losses sufficient to exhaust both of these one-time levies, Citizens is obligated to levy an emergency assessment. Emergency assessments can be levied over time in the amount of up to 10% of aggregate state-wide assessable premium per year, per account, and may be used to secure post-event bond financing. Citizens does not have a specific maturity limitation on its indebtedness, though the analysis in this report assumes that Citizens would finance any remaining deficit over a 30-year period.

Conditions in the municipal and corporate markets are favorable, having significantly improved in recent years. U.S. corporate bond sales increased to over $1.5 trillion in 2016, marginally surpassing the prior record in 2015, as investors sought higher-yielding alternatives to government securities and companies took advantage of relative all-time low interest rates. The corporate bond market has topped $1 trillion each year since 2010 as interest rates have been consistently historically low. After declining significantly in 2013 and 2014, municipal issuance has also rebounded strongly. In 2016, the long-term municipal bond market was 15% higher than 2015 and 38% higher than 2014, with $434 billion in total issuance, of which $39 billion was taxable.

Table 2
($ in billions)

	Municipal Issuance				Corporate Issuance	
Year	Tax-Exempt ($B)	Taxable ($B)	Total ($B)	% Change from Prior Yr	Par ($B)	% Change from Prior Yr
2011	$247	$31	$278	-35%	$1,045	-4%
2012	$335	$32	$367	32%	$1,387	33%
2013	$277	$35	$312	-15%	$1,420	2%
2014	$292	$23	$315	1%	$1,489	5%
2015	$350	$28	$378	20%	$1,513	2%
2016	$395	$39	$434	15%	$1,528	1%

Source: SIFMA and Thomson Reuters.

Although financial market conditions have significantly improved since the financial crisis and are currently conducive to favorable debt issuance, it is not possible to guarantee future financial market conditions. If long-term bonding in sufficient amounts is not immediately available, Citizens may need to explore alternatives, including the levying of emergency assessments with no financing, issuing bonds in multiple tranches over time and / or other interim financing alternatives.

Assessment Impact

Citizens has a three tier assessment structure as prescribed by Florida Statutes. Two important features of the Citizens assessment structure are (1) each account (i.e. the Coastal, PLA, and CLA) calculates its deficit separately, and each account has separate assessment authority. Therefore, there is the potential for concurrent assessments caused by deficits in more than one of Citizens' accounts; and (2) unlike emergency assessments, Citizens' policyholder surcharges and regular assessments (Coastal Account only) are one-time levies that cannot be financed. With these factors in mind, the basic construct of Citizens' assessments for 2017 is as follows (note that this is a high-level summary and is therefore not exhaustive and may omit certain precise attributes):

(1) Any deficit in an account (defined generally as losses and expenses in excess of surplus, FHCF reimbursement and private reinsurance) is first funded by Citizens' policyholder surcharge, up to a maximum of 15% of Citizens policyholder premium, per account.

(2) For the Coastal Account only, any remaining deficit is then funded by a regular assessment of up to 2% of written premium on insurance companies writing most types of property and casualty policies in Florida. There is no regular assessment for the PLA/CLA.

(3) Any remaining deficit is then funded through the collection of emergency assessments, which can be levied directly on policyholders of most property and casualty lines in Florida at the greater of 10% of the assessment base or 10% of the remaining deficit per account. This effectively gives Citizens the ability to finance any deficit over a 10-year period, although Citizens could choose to finance the assessment over a longer period. These emergency assessments would typically be used to secure post-event bonds, the proceeds of which would be used to pay policyholder claims in a timely manner.

Table 3 below presents the estimated assessment impact, by assessment type, for each of the three return periods.

Table 3
($ in millions)

Coastal

Return Time (Years)	Assessable Shortfall ($ in MM)	Citizens' Policyholders Surcharge[1]		Regular Assessments[1]		Emergency Assessments		
		$ Amount in MM	%	$ Amount in MM	%	Total $ Amount in MM[2]	Annual $ Amount in MM	Annual %[3]
250	$1,619	$150	15.0%	$810	2.0%	$659	$43	0.10%
100	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
50	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

PLA/CLA

Return Time (Years)	Assessable Shortfall ($ in MM)	Citizens' Policyholders Surcharge[1]		Regular Assessments[1]		Emergency Assessments		
		$ Amount in MM	%	$ Amount in MM	%	Total $ Amount in MM[2]	Annual $ Amount in MM	Annual %[3]
250	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
100	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
50	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Total Coastal & PLA/CLA[4]

Return Time (Years)	Assessable Shortfall ($ in MM)	Citizens' Policyholders Surcharge[1]		Regular Assessments[1]		Emergency Assessments[4]		
		$ Amount in MM	%	$ Amount in MM	%	Total $ Amount in MM[2]	Annual $ Amount in MM	Annual %[3]
250	$1,619	$150	15.0%	$810	2.0%	$659	$43	0.10%
100	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
50	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Policyholder surcharge levied on Citizens policyholders only
Regular assessments levied on non-Citizens policyholders only
Emergency assessments levied on both Citizens and non-Citizens policyholders

[1] *These assessments are one-time assessments for the first year only. Citizens policyholders surcharges are based on projected written premiums of $1.001 billion for 2017. Citizens' regular assessments are based on a projected assessment base of approximately $40.5 billion for 2016.*

[2] *Total amount of assessments represents the gross amount financed over 30 years using an assumed interest rate of 5%. There is a high probability, but not any certainty that assessable shortfalls can be financed at assumed interest rates. The amount which can be financed after an event may be smaller and is subject to market conditions.*

[3] *Represents annual assessment amount over a 30 year period using an assumed interest rate of 5% and projected emergency assessment base of approximately $41.5 billion, which is the actual base for 2015. If financed over a 10-year period, the assessment rate would be 0.21% at a 5% interest rate.*

[4] *Total PMLs are a sum of the PLA/CLA and Coastal PMLs in this analysis to be consistent with FHCF allocation. Combined PMLs are marginally different than the sum of the individual PMLs at these return times.*

Numbers may not add due to rounding.

Conclusion

Significant depopulation driven by the continued interest of the private market in Citizens' policies along with eleven consecutive years without major hurricane losses have largely contributed to the substantial levels of Citizens' surplus. In addition, with lower prices in the reinsurance market, Citizens is projected to have approximately $1.0 billion of private risk transfer (through traditional reinsurance markets and capital markets) available for 2017, further strengthening Citizens' claims paying resources and reducing any potential assessments. For catastrophic losses which exceed Citizens' available surplus and risk transfer program, Citizens will rely on its policyholder surcharge, regular assessment (Coastal Account only) and post-event bonding for claims paying capacity.

For major catastrophic losses, either from an extreme single event or from multiple events that result in a deficit to any of Citizens' accounts and activation of the emergency assessment, Citizens may issue post-event bonds in order to meet liquidity demands. Repayment of these post-event bonds would be funded through the collection of the associated emergency assessment. Citizens' financial position is the strongest since Citizens was created; for a 1-100 year event, Citizens is projected to have no assessment burden, and the projected assessment burden for a 1-250 year event is at an all-time low with a potential annual emergency assessment rate of 0.10% if financed over a 30-year period and 0.21% if financed over a 10-year period. In addition, conditions in the financial markets have significantly improved during recent years, resulting in additional financing capacity for large issues due to strong demand and historically low interest rates. There can be no guarantee, however, that adequate financing capacity will be available to Citizens following a major catastrophic event that may require a large post-event financing.

The ability of Citizens to pay claims in full and in a timely manner remains critical to the people whose homes and businesses are insured and to the Florida economy in general. Citizens' financial position and available financing options continue to allow Citizens to meet its statutory obligations while reducing the likelihood and size of potential assessments.