CITIZENS
PROPERTY INSURANCE CORPORATION

2017 Operating Budget

Executive Summary

As Citizens enters its fifteenth year of operations, the 2017 fiscal year will undeniably present the most demanding challenges – the rate of depopulation has tightened considerably, new business counts for both residential and commercial business are significantly behind last year, and the natural attrition of commercial business, due to an improving private marketplace, is increasing. It is anticipated that the deterioration of private market loss ratios, due in large part to Assignment of Benefits (AOB) activity and substantial increases in litigation of non-weather water losses, will likely reverse the current trend in personal residential policies and that over time this business will again begin to grow. With uncertainty in policies in force (PIF) counts, market trends, and depopulation, the budget preparation must consider additional growth or further reductions in PIF while balancing meaningful expense management with a responsive infrastructure that supports Citizens' statutory mandates. *Stability* and *Continuous Improvement* establish the theme for the preparation and execution of the 2017 budget.

An oversized Citizens, as evidenced by the recent past, reflects an imperfect market environment that tends to improve Citizens' own financial metrics as risks typically welcomed by the private insurance market remain with or are directed into Citizens. An increase in Citizens' policy count has historically contributed to improved loss and loss adjustment expense ratios as well as improved expense ratios. As the private market stabilizes, resulting in a contraction to Citizens' policy count and larger relative population of less desirable risks underwritten by Citizens, financial metrics begin to reverse course leading to eroding profit margins and upward pressure on Citizens' operating ratios as observed over the last two years. While Citizens has traditionally maintained a competitive advantage over the private market in terms of its expense ratio, the recent and precipitous decline in premium volume has understandably caused an increase in Citizens' expense ratio – therefore a more credible objective is to target an expense ratio that is comparable to the private market with consideration given to capabilities provided by Citizens that are not required of private carriers.

Citizens' annual budget process has evolved to include a robust forecasting tool that uses a combination of historical trends and incisive assumptions to produce a forecast of premium values used to begin the initial budgeting process. This forecast effectively has two steps. The first step uses sound statistical methods to extend historical trends when possible, for example in policy counts. The second step uses judgement to consider disruptions to historical trends, which are often beyond Citizens' control. The largest such disruptions are likely to be private market contraction and loss ratio deterioration, both due to increased AOB activity and litigation. Market contraction is anticipated to cause a slight uptick in the number of new policies written by Citizens, starting in the second half of 2017. This leads to a modest increase in direct written premium as compared to 2016, particularly in personal lines. Loss ratio deterioration reflects anticipated additional litigation of claims, with the best estimate assuming the continuation of current upward trends in litigation rates. The Personal Lines Account (PLA) is especially affected, and is expected to have a net loss in 2017. It is important to note that these disruptions are difficult to predict because their effects are not well reflected in historical data.

Citizens' President/CEO and Executive Leadership Team have established clear strategic objectives – *stability* and *continuous improvement* – that have served as guide posts during the preparation of the 2017 budget and that will continue to be articulated throughout the 2017 fiscal year as Citizens prepares to face unprecedented challenges.

Operating Analysis – Four-year Summary ($ in millions)

	2017	2016	2015	2014
Policies inforce	504,202	462,592	503,865	661,161
Policies depopulated	9,173	53,141	272,785	416,623
Policies serviced	513,104	500,304	625,522	941,663
Direct written premium	$ 1,001.0	$ 979.1	$ 1,267.8	$ 2,083.9
Direct earned premium	968.4	1,103.0	1,660.3	2,374.1
Direct earned premium - less depopulation	937.2	969.5	1,269.8	2,026.8
Ceded written premium - depopulation	$ (9.7)	$ (58.1)	$ (180.7)	$ (455.0)
Ceded written premium - FHCF	(162.8)	(179.9)	(226.4)	(345.1)
Ceded written premium - reinsurance	(70.0)	(181.4)	(282.6)	(303.9)
Losses incurred	$ (439.3)	$ (353.1)	$ (402.5)	$ (441.2)
Loss adjustment expenses (LAE) incurred	(85.7)	(92.2)	(86.5)	(198.9)
Underwriting expenses*	(111.6)	(107.7)	(138.8)	(210.9)
Administrative expenses	(146.4)	(137.2)	(140.0)	(163.7)
Underwriting gain (loss)	$ (78.6)	$ (82.0)	$ (7.1)	$ 363.2
Direct loss ratio	46.9%	36.4%	31.7%	21.8%
Direct LAE ratio	9.1%	9.5%	6.8%	9.8%
Expense ratio	25.8%	25.0%	22.0%	18.0%
Combined ratio	81.8%	70.9%	60.5%	49.6%

* consists of producer commissions, taxes and assessments, and other underwriting expenses
Note: *2017 is budgeted; 2016 is projected*

Several trends emerge and become pronounced over the four-year period from 2014 to 2017, including overall decreases in direct written premium and premium ceded through depopulation, and increases in the loss/LAE and expense ratios. In developing the 2017 operating budget, these trends and their related financial impact were analyzed to ensure both appropriate cost containment and requisite infrastructure are in place to support Citizens' operations. Following are highlights from the 2017 operating budget:

Policies inforce, ***direct written premium*** and ***ceded written premium (depopulation):*** Overall inforce policy count and premium is expected to increase modestly from 2016 to 2017 due to decreased depopulation and additional new business. The number of policies assumed by private insurers has declined since 2014, even after accounting for Citizens' reduced size – this trend has rapidly accelerated in the fourth quarter of 2016. The decline in policies assumed by private insurers is largely driven by a contraction of capacity in the private market due to AOB activity and litigation along with the associated increased loss costs. It is anticipated that increased loss costs will also lead to an uptick in the number of new policies written by Citizens in the second half of 2017. Although the overall consolidated impact to Citizens is a modest increase in policy count and premium, each of Citizens' three accounts are impacted differently. The PLA business is most sensitive to these market changes as the PLA consists exclusively of multi-peril personal lines policies (note that overall growth is expected to come from policies in the PLA). The Coastal Account and Commercial Lines Account (CLA) business is expected to continue to experience moderate depopulation and decline in policy count.

Losses and LAE incurred: While Citizens' losses and loss adjustment expenses (LAE) have generally declined in terms of total dollars, losses and LAE relative to premium have increased. This relative increase, measured by the loss and LAE ratio, is primarily due to AOB activity and associated increased litigation. The litigation rate, and consequently the loss costs, have rapidly increased since 2014 with a continued upward trend expected at least through 2017. Natural volatility makes loss and LAE trends difficult to interpret – Hurricanes Hermine and Matthew contribute $37 million in losses and LAE to 2016, or 3.8% to the direct loss and LAE ratio. Additionally, litigation also increases volatility in loss and LAE trends – outstanding claims may be simultaneously affected by a single court decision, or settled together as was the case when Citizens settled many of its pre-Senate Bill 408 sinkhole suits. Litigation also affects the relative sizes of losses and LAE – Citizens' attorneys' fees are reported within LAE while plaintiff's attorneys' fees are reported within losses. Due to this volatility, the 2017 ratio of LAE-to-losses is projected using recent averages. As of October 2016, Citizens had 9,306 litigated claims pending and continues to receive an average of approximately 850 new claims per month (average of approximately 980 per month from August – October).

Administrative expenses: Included in the 2017 operating budget within administrative expenses are two key corporate initiatives – Citizens' Enterprise Resource Planning (ERP) solution ($8.7 million) and Citizens' Consumer Clearinghouse ($3.6 million). In addition to these two corporate initiatives, Citizens' continues to judiciously invest its resources in infrastructure needed to support its key strategic goals through several key strategic initiatives that will either begin or continue into 2017, including, Water Loss Mitigation Program (including Managed Repair Program), Independent Adjusting Services, Citizens' Internal Control Framework, Fraud Analytics, Security and Data Privacy, Value Stream Optimization, and Market and Product Analysis. Following is a comparison of the 2017 administrative expense budget to the 2016 projection of administrative expenses:

	2017 Budget Total Year	2016 Projection Total Year	Variance ($)	Variance (%)
Salaries	$ 96,782,738	$ 93,136,198	$ 3,646,541	3.9%
Employee Benefits	19,810,652	21,059,982	(1,249,330)	-5.9%
Payroll Taxes	7,116,572	6,695,528	421,044	6.3%
Contingent Staffing	31,752,725	21,165,251	10,587,473	50.0%
Training	908,408	630,231	278,176	44.1%
Recruiting	589,900	616,447	(26,547)	-4.3%
Printing	88,683	88,795	(112)	-0.1%
Operating Supplies	433,689	503,662	(69,973)	-13.9%
Subscriptions & Dues	1,509,458	1,281,312	228,146	17.8%
Postage	404,092	402,808	1,284	0.3%
Telecommunications	4,480,913	4,542,788	(61,875)	-1.4%
Legal	1,068,000	2,147,920	(1,079,920)	-50.3%
Insurance	735,890	830,896	(95,006)	-11.4%
Travel & Meals	1,800,136	1,377,706	422,430	30.7%
Professional Services	14,994,388	9,348,723	5,645,666	60.4%
Miscellaneous	2,500	66,089	(63,589)	-96.2%
Rent	7,428,440	9,864,502	(2,436,062)	-24.7%
Depreciation	5,549,064	4,387,197	1,161,867	26.5%
Producer Fees Collected	(779,500)	(473,568)	(305,932)	-64.6%
Operations & Maintenance	2,477,639	1,093,396	1,384,243	126.6%
Bank Charges	220,603	229,911	(9,308)	-4.0%
Software Maint & Licensing	17,154,124	14,207,713	2,946,411	20.7%
Computer Hardware	3,647,882	2,050,563	1,597,319	77.9%
FMAP Funding	(259,200)	(30,441)	(228,759)	-751.5%
ULAE Expense Allocation	(71,516,339)	(58,023,395)	(13,492,944)	-23.3%
Total Administrative Expenses	$ 146,401,456	$ 137,200,213	$ 9,201,242	6.7%
Total Underwriting Expenses	$ 17,060,285	$ 14,014,169	$ 3,046,116	21.7%
IT Expense Allocation	-	-	-	0.0%
Total Admin & Other Expenses	$ 163,461,741	$ 151,214,382	$ 12,247,359	8.1%

- Salaries, benefits, and payroll taxes – increased $2.8 million, or 2.3% relative to the 2016 projections. While most divisions are forecasting little to no growth in salaries and related costs, the Claims Division is anticipating an increase of $2.6 million due to an increase in anticipated claims volume driven by non-weather water loss claims. Note that all costs incurred within the Claims Division, in addition to certain claims-related costs incurred within other divisions, are allocated out of total administrative expenses and into loss adjustment expenses (LAE) through the ULAE expense allocation.

- Contingent staffing – increased $10.6 million, or 50% relative to the 2016 projections. A majority of budgeted contingent staffing costs ($28.4 million, or 89% of the budgeted 2017 total) are within the Claims Division and reflect anticipated external costs associated with Independent Adjusting firms due to an expected increase in overall claims volume. Note that all costs incurred within the Claims Division, in addition to certain claims-related costs incurred within other divisions, are allocated out of total administrative expenses and into loss adjustment expenses (LAE) through the ULAE expense allocation.

  Note: total personnel costs, as measured by the sum of salaries, benefits, payroll taxes, and contingent staffing, are projected to decline from $104.0 million (2016 projected) to $102.7 million (2017 budgeted) when removing the impact of the Claims Division through the ULAE expense allocation.

- Professional services – increased $5.6 million, or 60% relative to the 2016 projections. Included within the 2017 operating budget is $8.4 million in professional services related to two corporate initiatives – the ERP solution and Consumer Clearinghouse. Professional services also include fees for investment analytics, commercial banking, financial advisement, and specialized technical services related to specific software and systems.

- Rent – decreased $2.4 million, or 25% relative to the 2016 projections. Reductions in budgeted rent costs are the result of Citizens' 2016 Real Estate Consolidation initiative that sought to consolidate multiple Citizens' offices in both Jacksonville and Tallahassee into a single office building each in Tallahassee and Jacksonville.

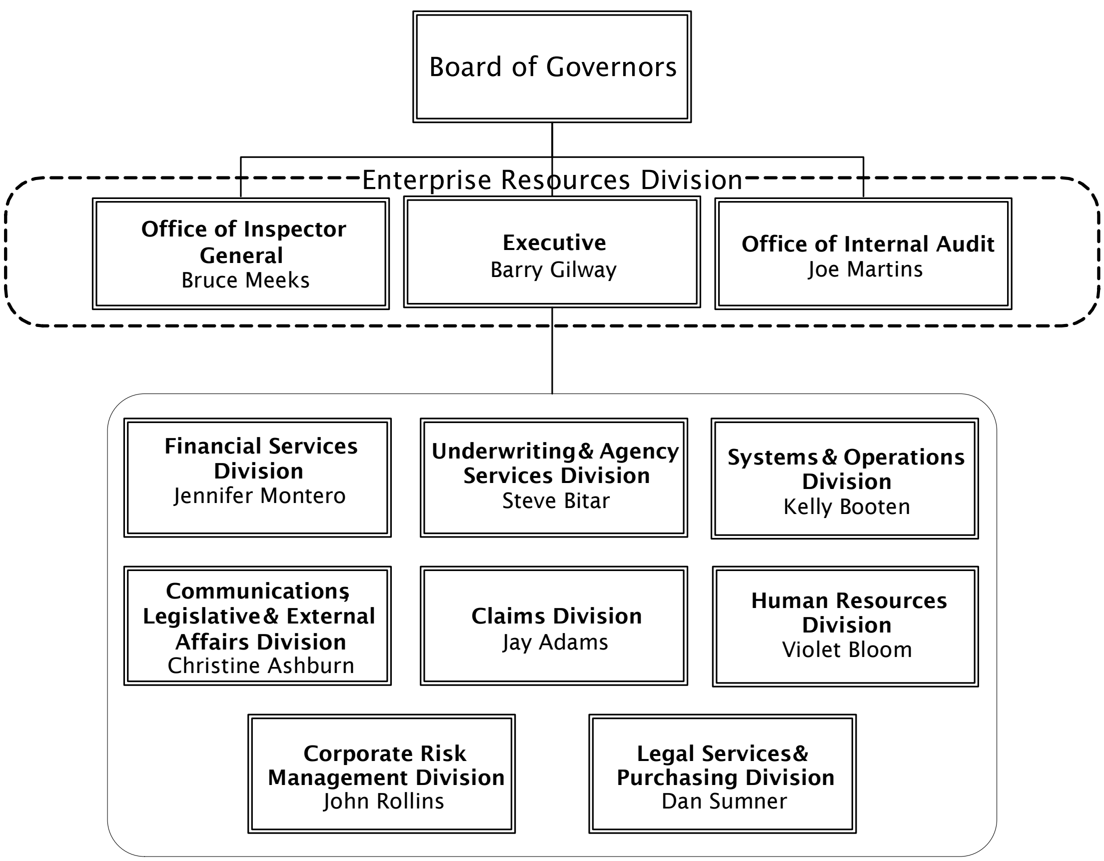
- Software maintenance and licensing – increased $2.9 million, or 21% relative to the 2016 projections. Included within the 2017 operating budget are software and licensing costs related to the ERP solution and internal website replacement as well as software costs to maintain and support enterprise systems including storage, governance and security.

- Computer hardware – increased $1.6 million, or 78% relative to the 2016 projections. Computer hardware includes costs related to the structured refresh and replacement of aged desktop, laptops and peripheral equipment, including catastrophe operations equipment, and hardware maintenance to support the technical infrastructure.

- Total underwriting expenses – increased $3.1 million, or 22% relative to the 2016 projections. The addition of three wind-only products through the Consumer Clearinghouse, the personal lines underwriting renewal initiative, loss history report ordering, and planned outsourcing of commercial lines underwriting processing account for a majority of costs included within budgeted 2017 total underwriting expenses.

- IT expense allocation was implemented to support cost / benefit decision-making by business units consuming certain IT resources. *Technology chargebacks* include allocation for desktop and notebook computers, wireless devices, email, and telecommunications. Allocations are made based on actual equipment counts and communication services are pro-rated based on division staff. *Enterprise project and enhancement chargebacks* are based on actual hours applied to the development and enhancement of business systems. *Business applications and software* are licensing charges of software used exclusively by one or more business partner areas to support day-to-day business operations. Allocations are made monthly and represent "fully loaded" costs to include related fixed costs and overhead.

Citizens' Organizational Structure by Division



During 2016, two corporate realignments were effected – Enterprise Risk Management (ERM) was realigned from Corporate Risk Management to the Office of Internal Audit in order to improve efficiency and synergies by having all expertise related to assurance, governance, risk, and internal control under one function, and

Commercial Lines and Personal Lines Underwriting were realigned from Corporate Risk Management to Consumer and Agency Services in order to consolidate all underwriting activities and to create the Underwriting and Agency Services Division.

2017 Operating Budget Assumptions

Pages 8 – 9 of the 2017 Operating Budget provide key assumptions, ratios, and other relevant information for the proposed budget. These assumptions are the cornerstone for most components of the budget, including premiums written and ceded, losses and LAE incurred, risk transfer costs, PML levels, producer (agent) commissions, servicing carrier fees, other processing fees, investment income and expense, and taxes and assessments,

Key assumptions include:

- Section I, Item A – an increase policies in force of 9% is largely driven the elimination of significant depopulation in the PLA, along with an uptick in the number of new policies written by Citizens starting in mid-2017.

- Section I, Item B – the best estimate is that, from a budgeting perspective, no significant number of policies will be assumed in the PLA in 2017. This is primarily due to AOB activity and litigation, and associated increased loss costs. Policies in the Coastal account and CLA are still expected to experience some assumption activity. In particular, assumption activity should continue for some wind-only policies, which are not directly affected by the increased loss costs due to AOB activity and litigation, and which will continue to see rate increases under the statutory 10% glide path.

- Section II, Item A – the direct written premium increases both due to Citizens' modest increase in policy count, and also due to rate increases under the 10% statutory glide path. Rising loss costs have increased Citizens' rate indications, in turn increasing the 2017 direct written premium. That extra premium, and more, would be spent on the additional loss and loss adjustment expenses.

- Section III, Item A – premium ceded due to depopulation is projected based upon the number of policies expected to be removed (refer to the comment above for Section I, Item B).

- Section III, Item B – the mandatory layer of the Florida Hurricane Catastrophe Fund (FHCF) will be purchased. Total premium ceded to the FHCF is expected to modestly increase as Citizens' policy count and written premium increase, as explained for Section I.

- Section III, Item C – as a placeholder, the estimated premium ceded to private reinsurers is $70M, which includes a new 2017 program to transfer $754 million of hurricane exposure using both traditional risk transfer and alternative risk transfer, both within the Coastal Account only. This is in addition to the 2017 portion from the multi-year 2015 program which transfers $300 million of risk to capital markets. On a combined basis, the 2017 program together with the multi-year 2015 program would represent total private risk transfer for the 2017 hurricane season of $1.054 billion for the Coastal Account. Because the estimated reinsurance coverage continues to leave 60% of the Coastal Account's surplus exposed in a 1 in 100 year event, the final reinsurance coverage purchased may increase as market conditions warrant. The 2017 risk transfer program is expected to eliminate the likelihood of assessments within the Coastal Account at a 1-in-100 year event (note that the PLA/CLA has sufficient sources to fund a 1-in-100 year event). Approval by the Board of Governors is required to purchase private reinsurance and will be presented to the Board of Governors in the Spring of 2017.

- Section IV, Item A – projected loss and loss adjustment expense (LAE) ratios were selected by Citizens' Chief Actuary and reviewed by management. The budgeted non-hurricane loss ratios for each account take into consideration the current loss ratio, impact of the 2016 rate filing (effective 2/1/2017), recent loss trends, and the effect of increased AOB and litigation rates. The budgeted loss ratios for 2017 include a provision for average non-hurricane catastrophes activities but no provision for hurricanes. The ratio of LAE of losses are especially volatile because Citizens' attorneys' fees are considered LAE, while plaintiff's attorneys' fees are considered loss. Because of this volatility, the ratio of 2017 loss adjustment costs to losses is projected using recent averages.

- Section V, Items A, B and C – projected PML estimates for 2017 compared to 2016. Budgeted PML estimates are presented for 10, 25, and 100-year return periods. The PML estimates for 2017 are based upon exposures as of June 30, 2016 adjusted for forecasted changes in exposure through June 2017. The PML estimates for 2016 are based upon exposures as of September 30, 2015, but excluding actual October 2015 and projected November 2015 depopulation change. All PMLs are modeled using AIR Touchstone. The PMLs have changed relative to the 2016 budget due to increased or decreased policy counts in the PLA, or Coastal account and CLA, respectively.

- Section VI, Items A and B – both producer commission and premium tax rates are similar to the 2016 budgeted rates. While commission rates have not changed for 2017, the effective commission rate per policy can differ based on the geographic location of the underlying policies.

- Section VII – this section provides assumptions with respect to the allocation of administrative expenses among the three accounts presented. The allocations are based primarily upon anticipated direct written premium.

Budgeted Statement of Operations – Notes

- **Premiums written – direct** consists of policies underwritten directly by Citizens that may or may not be assumed as part of the depopulation process. The initial assumption of a policy from Citizens does not reduce direct premiums written until that policy is subsequently renewed by the takeout carrier and is no longer underwritten by Citizens. In order for a depopulated policy to reduce direct premiums written in the same year it was depopulated, the policy must have a renewal date within that same year.

- **Premiums ceded (FHCF)** represents premiums ceded to the Florida Hurricane Catastrophe Fund (FHCF). Note that Citizens is required to purchase coverage at the 90% level from the FHCF.

- **Premiums ceded (Private)** represents premiums ceded through Citizens' traditional reinsurance and capital markets risk transfer program. Note that Citizens is required to make its best efforts to procure catastrophe reinsurance at reasonable rates to cover its projected 100-year probable maximum loss as determined by the Board of Governors.

- **Premiums ceded (Depop)** consists of policies that are assumed from Citizens by takeout carriers in the current year. Upon assumption, Citizens cedes the remaining unearned premium reserve on the underlying policies. Effective October 2011, Citizens no longer charges a ceding commission to takeout carriers on policies assumed.

- **Losses incurred** consists of budgeted accident year 2017 losses incurred and do not contemplate a catastrophic event. A contingency statement of operations is provided within the 2017 operating budget and includes varying levels of projected catastrophic losses using hurricane catastrophe models. Budgeted losses are computed using the estimated non-hurricane loss ratio for each account multiplied by budgeted direct premium earned (excluding earned premiums ceded through depopulation).

- **Loss adjustment expenses (LAE)** represents the cost to adjust claims and includes the cost of both internal resources (ULAE) and external vendor costs (ALAE).

- **Producer commissions** are generally a consistent percentage of aggregate direct premium written, however per-policy commission rates may differ.

- **Taxes & assessments** are largely comprised of premium tax due to the Florida Department of Revenue. Taxes and assessments are estimated using an effective rate based on actual historical values.

- **Administrative expenses** consist of costs incurred to support the overall operations of the Company that are not directly related to policy acquisition and policy servicing activities.

- **Other underwriting expenses** consist of amounts paid to third-parties for policy-related activities including printing and postage, policy administration, GIS services, and building characteristic identifiers.

- **Investment income – net** consists of interest income, amortization of premium or discounts, realized gains and losses, and fees paid to external professional money managers.

- **Interest expense – net** consists of interest expenses, net of premium or discount amortization, on Citizens' outstanding bonds issued for the purpose of providing pre-event liquidity.

- **Other income and expenses** is comprised primarily of pay plan installment fees for policyholders selecting a quarterly or semi-annual pay plan.