

FINANCIAL STATEMENTS

Citizens Property Insurance Corporation
Year ended December 31, 2003
with Report of Independent Auditors

Citizens Property Insurance Corporation

Audited Financial Statements

Year ended December 31, 2003

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Citizens Property Insurance Corporation

Management's Discussion and Analysis

December 31, 2003

This discussion provides an assessment by management of the current financial position and results of operations for the 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 assets of Citizens exceed its liabilities at the close of the most recent year by \$1.6 billion (*net assets*).
- The Company's total net assets increased by \$430 million. This increase is attributable to funds generated from operations.
- Operating revenues increased 58% primarily due to an increase in new business, in addition to, an increase in premium rates.
- Operating expenses increased 76% primarily due to an increase in premium volume and an increase in the loss ratio for the current accident year.
- Nonoperating income (expenses) decreased 110% due to a decrease in both investment income and income tax benefits.

Citizens Property Insurance Corporation

Management's Discussion and Analysis

December 31, 2003

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 statement of net assets, statement of revenues, expenses and changes in net assets and the statement of cash flows. This report also contains other supplementary information in addition to the basic financial statements.

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

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

The *statement 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.

Citizens Property Insurance Corporation

Management's Discussion and Analysis

December 31, 2003

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 is presented below:

	2003	2002	% Change
	<i>(In thousands)</i>		
Assets			
Cash and investments	\$ 4,170,381	\$ 3,502,632	19%
Receivable for securities	45,340	266	16945%
Interest due and accrued	24,131	24,450	-1%
Premium receivable, net	2,703	842	221%
Other assets	87,775	62,008	42%
Total assets	\$ 4,330,330	\$ 3,590,198	21%
Liabilities and net assets			
Loss and loss adjustments expense reserves	\$ 138,705	\$ 83,144	67%
Unearned premiums	571,000	398,240	43%
Borrowed money	1,652,163	1,774,952	-7%
Payable for securities	116,840	—	100%
Federal income taxes payable	54,899	2,349	2237%
Taxes, licenses and fees payable	22,774	5,561	310%
Other, liabilities	136,256	117,765	16%
Total liabilities	2,692,637	2,382,011	13%
Net assets	1,637,693	1,208,187	36%
Total liabilities and net assets	\$ 4,330,330	\$ 3,590,198	21%

Assets

As shown above, total assets increased \$740 million, or 21%, during 2003 primarily due to an increase in invested assets caused by cash flows generated from operating activities and reinvestment of interest earnings and realized gains.

Citizens Property Insurance Corporation

Management's Discussion and Analysis

December 31, 2003

Financial Analysis (continued)

Cash, cash equivalents and investments totaled \$4.2 billion at December 31, 2003. 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: US Treasury and US government securities, corporate bonds, collateralized mortgage obligations and asset-backed securities. These securities grew \$301 million, or 13%, in 2003 due largely to reinvestment of interest earnings and realized gains. During 2003, the Company received \$106 million and \$694 million from investment earnings and operating activities, respectively.

Cash and cash equivalents grew \$366 million, or 34%, during 2003, primarily due to cash generated from operations. Approximately \$1.1 billion 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 \$2 million, or 221%. This increase is attributed to an increase in written premiums and the timing of collections near year-end 2003 as compared to the prior year. Citizens does not anticipate any unusual collection problems with respect to the premium balances.

Receivable for securities consists of sale proceeds due from brokers for securities yet to be settled. For 2003, receivable for securities increased \$45 million due to an increase in the holdings of a type of mortgage-backed security with a longer settlement period.

The increase in other assets is attributed to a \$17 million increase in deferred policy acquisition costs, which consists mainly of deferred premium taxes and producer commissions. Both increase proportionally with written premiums.

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

Liabilities

Total liabilities increased \$311 million, or 13%, during 2003. The increase is due to increases in losses and LAE reserves, unearned premiums, federal income taxes payable, taxes licenses and fees payable and amounts payable for securities, offset by a decrease in notes payable.

Citizens Property Insurance Corporation

Management's Discussion and Analysis

December 31, 2003

Financial Analysis (continued)

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 for book purposes.

Activity with respect to unpaid losses and LAE for 2003 and 2002 is displayed below:

Loss and LAE Reserve Summary	2003	2002
	<i>(In thousands)</i>	
Unpaid at beginning of year	\$ 83,144	\$ 52,092
Losses and LAE incurred in current year:		
Current year losses and LAE	243,767	97,373
Prior year losses and LAE	(19,439)	4,207
	<u>224,328</u>	<u>101,580</u>
Losses and LAE paid in current year:		
Current year losses and LAE	124,414	44,862
Prior year losses and LAE	44,353	25,666
	<u>168,767</u>	<u>70,528</u>
Unpaid losses and LAE at end of year	<u>\$ 138,705</u>	<u>\$ 83,144</u>

Loss and LAE reserves grew \$56 million or 67% during 2003. This increase represents the net effect of the following:

- The current accident year loss ratio increased to 30% in 2003 compared to 19% for 2002. A higher loss ratio applied to higher premium volume results in higher losses. The higher loss ratio results from:
 - An increase in average amounts paid per claim,
 - Increasing policy counts mean that the claims are newer with less development, and
 - An increase in claims closed with payment (versus without payment).
- An increase of earned premiums. Even if the loss ratio remained constant, the absolute amount of reserves would increase as the earned premiums increase.

Citizens Property Insurance Corporation

Management's Discussion and Analysis

December 31, 2003

Financial Analysis (continued)

- This increase was offset by \$19 million in favorable development of prior year losses and loss adjustment expenses.

Unearned premiums increased due to an increase in written premiums. Unearned premiums increased \$173 million, or 43%, which correlates to a 46% increase in direct written premiums caused by growth in new business.

Notes payable decreased \$123 million during 2003 due mainly to debt service payments made for the Series 1997A Bonds issued by the FRPCJUA.

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, 2003 and 2002, the Company owed brokers \$117 million and \$0, respectively. This increase is due to an increase in the holdings of a type of mortgage-backed security with a longer settlement period.

Other liabilities include advanced premiums, suspended cash and other miscellaneous payables, which combined increased \$18 million, or 16%, as of December 31, 2003 compared to the prior year. The increase in advanced premiums and suspended cash is attributed to growth in new business, which increases the delay in issuing new policies.

Federal income tax payable increased \$53 million, which reflects a federal income tax refund received in 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.

Citizens Property Insurance Corporation

Management's Discussion and Analysis

December 31, 2003

Financial Analysis (continued)

Taxes, licenses and fees payable increased \$17 million or 309% mainly due to a \$16 million income tax refund received from the State of Florida. As explained above, management anticipates the refund will be contested by the State of Florida and has recorded the proceeds as a liability until uncertainties surrounding the matter have been resolved.

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

	2003	2002	% Change
	<i>(in thousands)</i>		
Operating revenue:			
Net earned premiums	\$ 823,902	\$ 522,624	58%
Operating expenses:			
Losses and LAE incurred	224,328	101,580	121%
Other underwriting exp	150,578	112,622	34%
	<u>374,906</u>	<u>214,202</u>	<u>75%</u>
Operating income	448,996	308,422	46%
Non operating income (expense)	<u>(19,490)</u>	196,662	-110%
Change in net assets	<u>\$ 429,506</u>	<u>\$ 505,084</u>	-15%
Policies in force	<u>820,255</u>	<u>606,288</u>	35%
Underwriting ratios			
Loss and LAE ratio (calendar year)	27%	19%	
Expense ratio	18%	22%	
Combined ratio	45%	41%	

Citizens Property Insurance Corporation

Management's Discussion and Analysis

December 31, 2003

Financial Analysis (continued)

Earned premiums increased \$301 million, or 58%, during 2003 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.

Policies in force increased 213,967, or 35%, during 2003 compared to 2002. The increase in policies is due to the following factors;

- Continued growth in Florida's population,
- Increased cost of reinsurance which results in insurers writing fewer policies in Florida.
- Decrease in investment income,
- Insurers concern about frequency of mold and sinkhole claims, and
- The decrease in policies taken out due to the enactment of "consumer choice" in 2002.

During 2003, Citizens increased rates by approximately 34% and 18% for residential policies included in the Personnel Line Account and High Risk Account, respectively.

Premiums ceded to the FHCF totaled \$156 million and \$137 million during 2003 and 2002, respectively, and are included in net earned premiums. Effective, July 1, 2001 the Company entered into a private reinsurance contract through June 30, 2002. Citizens obtained \$90 million of coverage, which complemented the FHCF coverage. Premiums ceded related to these agreements totaled approximately \$14 million in 2002 and are included in net earned premiums. No private reinsurance was procured during 2003.

Also included in net earned premiums are premiums ceded to certain takeout companies. During 2003 and 2002, premiums ceded to these insurers totaled \$24 million and \$12 million, respectively.

Losses and LAE incurred increased \$123 million, or 121%, due mainly to an increase in new policies written and an increase in the loss ratio of the current accident year as previously discussed.

Citizens Property Insurance Corporation

Management's Discussion and Analysis

December 31, 2003

Financial Analysis (continued)

Other underwriting expenses increased \$38 million, or 34%, in 2003 primary 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 2003, commission and premium tax expenses consisted of 59% and 11% of total underwriting expenses, respectively. During 2002, commission and premium taxes expenses consisted of 56% and 15% of total underwriting expenses, respectively.

Non-operating income (expense) consists mainly of net investment income, interest expense and federal income tax expense (benefit). During 2003, investment income, net of investment related expenses, decreased \$157 million or 98%. Approximately \$58 million of this variance relates to interest income received on a federal tax refund collected during 2002 for the FRPCJUA. The remaining variance is due to unfavorable financial market conditions. The average rate of return on interest bearing cash accounts, money market funds, funds held with the State Treasury, and fixed income securities held during 2003 was 2.6% compared to 5.9% in 2002.

Interest expense decreased \$20 million, or 15%, in 2003. The decrease is a result of debt maturities paid just prior to the fourth quarter of 2002 and during 2003. Debt outstanding as of December 31, 2003 and 2002 was \$1.7 billion and \$1.84 billion, respectively.

During 2003, net federal income tax benefits decreased \$88 million, as a result of FRPCJUA (the predecessor entity of Citizens) obtaining tax exempt status. During 2002, the 11th Circuit Court determined that the FRPCJUA was an entity exempt from taxation beginning in 1996. Total refunds received in 2002 and 2003 related to this ruling were \$149 million and \$1,564, respectively.

Additionally, pursuant to a determination letter received from the Internal Revenue Service, Citizens is exempt from federal income taxes. As a result, no income taxes were paid in 2003.

Citizens Property Insurance Corporation

Management's Discussion and Analysis

December 31, 2003

Economic Factors

Management continues to administer programs designed to reduce the number of policies 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 Personal Lines Account. As of May 2004, 64,899 policies from the Personal Lines Account have been assumed by private insurers. The Board's approval of a new takeout incentive plan in September 2003 was designed to depopulate the High-Risk Account. However, no policies have been assumed for this account as of May 2004.

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 the highest for each county within Florida. During 2004, Citizens increased homeowner multiperil rates and residential fire/dwelling rates 2.8% and 16.5% respectively, and increased residential wind-only rates for the High-Risk Account 11.9%. Rate increases were implemented to help fund rising losses and claim related expenses.

Citizens' High-Risk Account provides coverage only in coastal areas of the State, which are more prone to severe damage in the event of a hurricane or other windstorm. During 2004, the Board approved the issuance of \$750 million in senior secured bonds for the High-Risk Account in order for Citizens to provide the resources necessary to pay future catastrophe losses.

Hurricane Charley hit the southwest coast of Florida on August 13, 2004 while Hurricane Frances struck the southeast coast of Florida on September 3, 2004. As a result, Citizens expects to incur net losses of approximately \$1.6 billion. Management anticipates funding all losses from both operating funds and reimbursements from the Florida Hurricane Catastrophe Fund. Currently, no assessments are expected. Significant changes in these estimates are possible as more information becomes available during the claims handling process.

Report of Independent Auditors

Board of Governors
Citizens Property Insurance Corporation

We have audited the accompanying financial statements of Citizens Property Insurance Corporation (the Company), as of and for the year ended December 31, 2003. 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 audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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, 2003, and the results of its operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 27, 2004 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 grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis on pages i through x and the schedule of supplemental revenues, expenses and claim development information on page 28 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 audit was conducted for the purpose of forming an opinion on Citizen's basic financial statements taken as a whole. The supplemental statement of net assets and statement of revenues, expenses and changes in net assets 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

February 27, 2004,
except for Note 16,
as to which the date is
September 3, 2004

Citizens Property Insurance Corporation

Statement of Net Assets (continued)
(in thousands)

	<u>December 31, 2003</u>
Liabilities and net assets	
Current liabilities:	
Loss reserves	\$ 112,645
Loss adjustment expense reserves	26,060
Unearned premiums, net of unearned ceded premium of \$5,381	571,000
Current maturities of long-term debt	275,000
Payable for securities	116,840
Advance premiums and suspended cash	63,834
Federal income taxes payable	54,899
Interest payable	44,116
Taxes and fees payable	22,774
Other current liabilities	28,306
Total current liabilities	<u>1,315,474</u>
Noncurrent liabilities:	
Long-term debt	<u>1,377,163</u>
Total noncurrent liabilities	<u>1,377,163</u>
Total liabilities	<u>2,692,637</u>
Net assets:	
Invested in capital assets	5,633
Unrestricted	<u>1,632,060</u>
Total net assets	<u>1,637,693</u>
Total liabilities and net assets	<u><u>\$ 4,330,330</u></u>

See accompanying notes.

Citizens Property Insurance Corporation

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

	Year ended December 31, 2003
Operating revenue:	
Premiums earned	\$ 823,902
Operating expenses:	
Losses incurred	203,560
Loss adjustment expenses incurred	20,768
Service company fees	11,687
Producer commissions, net	89,158
Taxes and fees	17,113
Processing and other fees	1,636
Other underwriting expenses	28,397
Takeout bonus expense	2,587
Total operating expenses	374,906
Operating income	448,996
Nonoperating revenues (expenses):	
Net investment income	105,789
Interest expense	(119,530)
Income tax benefit	2
Line of credit fees and note issuance costs	(5,751)
Total nonoperating expenses	(19,490)
Change in net assets	429,506
Net assets, beginning of year	1,208,187
Net assets, end of year	\$ 1,637,693

See accompany notes

Citizens Property Insurance Corporation

Statement of Cash Flows
(in thousands)

	Year ended December 31, 2003
Operating activities	
Premiums collected, net of reinsurance	\$ 1,017,916
Losses and loss adjustment expenses paid	(156,268)
Payments to employees for services	(9,883)
Payments for underwriting expenses	(157,774)
Net cash provided by operating activities	693,991
Noncapital activities	
Debt repayment	(125,000)
Interest expense paid	(123,680)
Tax refunds received	52,552
Financing costs paid	(4,093)
Net cash used in noncapital activities	(200,221)
Capital activities	
Fixed assets acquired	(3,895)
Net cash used in capital activities	(3,895)
Investing activities	
Proceeds from investments sold, matured or repaid	3,817,074
Investments acquired	(4,094,280)
Net investment income received	153,630
Net cash used in investing activities	(123,576)
Net increase in cash and cash equivalents	366,299
Cash and cash equivalents:	
Beginning of year	1,076,591
End of year	\$ 1,442,890

Citizens Property Insurance Corporation

Statement of Cash Flows (continued)
(in thousands)

	Year ended December 31, 2003
Operating activities	
Operating income	\$ 448,996
Depreciation expense	2,488
Loss on disposal of fixed assets	15
Adjustments to reconcile net cash provided by operating activities:	
(Increase) decrease in operating assets:	
Deferred acquisition costs	(16,738)
Prepaid reinsurance premiums	(4,692)
Premium receivable, net	(1,860)
Deferred takeout bonuses	(4,434)
Other assets	1,489
Increase (decrease) in operating liabilities:	
Loss and loss expenses reserve	55,561
Unearned premiums	172,760
Advance premium and suspended cash	27,806
Taxes and fees payable	17,213
Other current liabilities	(4,613)
Net cash provided by operating activities	\$ 693,991
 Noncash supplementary information	
Net unrealized loss on investments	\$ 47,542

See accompany notes

Citizens Property Insurance Corporation

Notes to Financial Statements

(In Thousands)

December 31, 2003

1. General

Citizens Property Insurance Corporation (“Citizens”) was established on August 1, 2002, pursuant to Section 627.351(6), Florida Statutes, as amended in 2002 by Senate Bill 1418 and House Bill 385 (the “Act”), 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 a seven member Board of Governors appointed by the Chief Financial Officer of the State of Florida (the “Chief Financial Officer”). The executive director and senior managers of Citizens are engaged by and serve at the pleasure of the Chief Financial Officer. 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

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

1. General (continued)

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.

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 persons 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.

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 ("GAAP") adjusted for certain items. Deficits are calculated separately and assessments are levied separately for each of Citizens' three accounts.

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

1. General (continued)

All insurers authorized to write one or more subject lines of business in Florida are subject to regular assessments by Citizens and are collectively referred to as “assessable insurers”. Surplus lines insureds, who procure one or more of the subject lines of business in the state of Florida from an insurer writing such coverage pursuant to the Surplus Lines Law, are also subject to regular and emergency assessments by Citizens and are collectively referred to as “assessable insureds”. Subject lines of business means insurance written on real or personal property as defined in Section 624.604, Florida Statutes, including insurance for fire, industrial fire, allied lines, farmowners multiperil, homeowners multiperil, commercial multiperil, and mobile homes, and including liability coverage on all such insurance but excluding inland marine and certain vehicle insurance other than insurance on mobile homes used as permanent dwellings.

When a deficit is incurred in any account in a given plan year, regular assessments are levied on assessable insurers based upon each assessable insurer’s share of direct written premium for the subject lines of business in the State of Florida for the calendar year preceding the year in which the deficit occurred, 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.

When the deficit incurred in any account in a particular year is less than or equal to 10% of the aggregate statewide direct premium written for the subject lines of business for the prior calendar year, Citizens must levy a regular assessment in the amount required to recover that deficit. When the deficit incurred in any account in a particular calendar year is greater than 10% of the aggregate statewide direct written premium for subject lines of business for the prior calendar year, Citizens must levy a regular assessment limited to the greater of (i) 10% of the deficit or (ii) 10% of the aggregate statewide direct written premium for subject lines of business for the prior calendar year. Citizens’ determination of the amount of regular assessments to be levied is subject to verification and approval by the Department.

If the deficit in any year in any account is greater than the amount that may be recovered through a regular assessment, Citizens must levy an emergency assessment in the year following the year in which the deficit occurred and annually thereafter until the deficit has been recovered.

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

1. General (continued)

An emergency assessment is imposed directly on policyholders of Citizens, policyholders of each assessable insurer and assessable insureds, collectively. Citizens, assessable insurers and the Florida Surplus Lines Office are responsible for collecting the emergency assessments upon the issuance of a new policy or at the time of policy renewal. The amount of emergency assessments that may be imposed in any one year with respect to a deficit is subject to certain statutory limitations. Citizens' determination of the amount of an emergency assessment is subject to verification by the Department. To date, Citizens has not incurred a deficit in the Personal Lines Account, the Commercial Lines Account or the High-risk Account in excess of the maximum amount of regular assessments that may be assessed.

Citizens is exempt, by statute, from State of Florida corporate income taxes and intangible taxes.

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 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.

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.

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

Adoption of New Accounting Standards

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 the current year, 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.
- 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.

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

Adoption of New Accounting Standards (continued)

- 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.

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.

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

Cash, Cash Equivalents, and Investments (continued)

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.

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 Notes 7 and 8) are deferred and recognized over the term of the related policy. Amortization of deferred policy acquisition costs recognized for the year ended December 31, 2003 was \$145,499.

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 \$2,488 for the year ended December 31, 2003.

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

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 contract period that the related policies are expected to be in force. 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.

Assessments

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

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 would be recorded as a reduction of losses incurred and loss adjustment expenses incurred. Reinsurance recoverables on paid losses would be 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.

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

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.

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 28%, 15%, 4% and 15% of Citizens' insurance coverage exposure lies in Miami-Dade, Broward, Monroe and Palm Beach counties, respectively, as of December 31, 2003. 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, 2003, management believes the Company had no significant concentrations of credit risk.

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

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.

3. Investments

Citizens investments at December 31, 2003 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.

Type	Risk Category			Carrying Amount/ Fair Value
	1	2	3	
U.S. Government and Federally guaranteed obligations	\$ 617,548	\$ -	\$ -	\$ 617,548
Federal agency obligations	567,130	-	-	567,130
Commercial paper	167,005	-	-	167,005
Bonds and notes	1,375,808	-	-	1,375,808
	<u>\$2,727,491</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$2,727,491</u>

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

4. Fixed Assets

A summary of changes in fixed assets and depreciation for the year ended December 31, 2003 follows:

	Beginning Balance	Additions	Reductions/ Adjustments	Ending Balance
Leasehold improvements	\$ 249	\$ 237	\$ 19	\$ 505
Furniture and equipment	6,821	967	(2,275)	5,513
Other capital assets	3,308	2,691	1,522	7,521
Totals at historical cost	<u>10,378</u>	<u>3,895</u>	<u>(734)</u>	<u>13,539</u>
Less accumulated depreciation for:				
Leasehold improvements	(173)	(73)	-	(246)
Furniture and equipment	(4,819)	(837)	1,816	(3,840)
Other capital assets	(1,145)	(1,578)	(1,097)	(3,820)
	<u>\$ 4,241</u>	<u>\$ 1,407</u>	<u>\$ (15)</u>	<u>\$ 5,633</u>

5. Liability for Loss Reserves and Loss Adjustment Expense Reserves

Activity in the liability for loss reserves and loss adjustment expense reserves for the year ended December 31, 2003 are as follows:

Loss reserves and loss adjustment expense reserves, beginning of year	<u>\$ 83,144</u>
Incurred related to:	
Current year	243,767
Prior years	(19,439)
Total incurred	<u>224,328</u>
Paid related to:	
Current year	124,414
Prior years	44,353
Total paid	<u>168,767</u>
Loss reserves and loss adjustment expense reserves, end of year	<u>\$ 138,705</u>

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

5. Liability for Loss Reserves and Loss Adjustment Expense Reserves (continued)

As a result in changes in estimates of insured events in prior years, the provision for loss and loss adjustment expenses decreased by \$19,439 in 2003.

Citizens has entered into agreements with several companies that provide claim adjustment services. The 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 Property Claim Service designated catastrophes 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. No principal payments were made on these notes during the year ended December 31, 2003. Outstanding maturities and unamortized discounts on these notes were \$1,450,000 and \$5,770, respectively at December 31, 2003.

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 (see Note 1). 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

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)
(In Thousands)

6. Notes Payable (continued)

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 year ended December 31, 2003 was \$125,000. Outstanding maturities and unamortized discounts on these notes were \$225,000 and \$28, respectively at December 31, 2003.

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

<u>Year Ending December 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 275,000	\$ 110,781	\$ 385,781
2005	—	99,425	99,425
2006	—	99,425	99,425
2007	400,000	88,763	488,763
2008	—	71,250	71,250
2009-2013	—	356,250	356,250
2014-2018	—	356,250	356,250
2019	1,000,000	17,813	1,017,813
Total	<u>\$ 1,675,000</u>	<u>\$1,199,957</u>	<u>\$ 2,874,957</u>

The total interest expense on the notes for the year ended December 31, 2003 was \$123,857, including discount amortization of \$459 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 \$17,039 at December 31, 2003 and is included in “Long term debt” in the Statement of Net Assets. There were no debt obligations issued during 2003.

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

6. Notes Payable (continued)

Interest Rate Swap Agreements – Citizens had no interest rate exchange agreements outstanding at December 31, 2003 and 2002. 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 under 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, 2003 was \$4,327.

7. Producer Commissions and Servicing Company Fees

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

Additionally, Citizens has entered into agreements with servicing companies to provide underwriting and policy management services. These agreements provide for monthly compensation to the companies based on either a percentage of direct written premiums or a flat fee per policy based on the number of policies processed in a given month. Service carrier fees expensed during 2003 were \$11,687.

8. Income Taxes

Pursuant to a determination letter received from the Internal Revenue Service during 2002, 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.

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

8. Income Taxes (continued)

During 2002, FWUA transferred its assets and liabilities to Citizens in accordance with Florida Statute 627.351(6)(1)(2). Citizens intends to file federal income tax refund claims in excess of \$182 million related to the transfer. During 2003, Citizens received federal and state refunds for approximately \$69 million related to the 2002 taxable year. The amount has been recorded as a liability in the accompanying statement of financial position. Citizens has not recorded any other anticipated refund since it expects that the claim for refund will be contested by the IRS due to the size of the refund and the refund's relationship to Citizens as the former FRPCJUA.

9. Line of Credit Agreements

Line of Credit, High-Risk Account - Effective August 6, 1997 (as amended and restated June 1, 1999 and further amended and restated June 16, 2000 and August 1, 2001 and July 26, 2002), the pre-merger FWUA entered into a Credit Agreement with various lending institutions under which it may currently borrow up to \$480 million. The Credit Agreement is secured by and repaid through the collection of High-Risk Account assessments. The expiration date of the amended credit agreement is July 15, 2004. Citizens is required to pay an annual commitment fee of .30% of the daily amount by which the aggregate amount of the commitment exceeds the outstanding principal amount of the loan. The commitment fee percentage is based on Moody's Investors Service, Inc. ("Moody's") and Standard & Poor's Ratings Services ("S&P") ratings of A- and A3, respectively, on the High-Risk Account Series 1997A Notes. Annual commitment fees associated with this credit agreement were \$900 for the year ended December 31, 2003. No amounts were borrowed under this Amended Credit Agreement through December 31, 2003.

Line of Credit, Personal & Commercial Lines Accounts - 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 is secured by a security interest in emergency assessments (see Note 1). Under certain circumstances, the Line of Credit will 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 is March 24, 2004. Citizens is 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 is based on Moody's and S&P ratings of A and A2, respectively; on the Personal & Commercial Lines Account long-term debt. Annual commitment fees associated with this credit agreement were \$2,884 for the year ended December 31, 2003. No amounts were borrowed under this Amended Credit Agreement through December 31, 2003. This agreement was not renewed after March 24, 2004.

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(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. Premiums ceded to the FHCF, net of refunds received, totaled \$156,214 during 2003 and are included in "Premiums earned" in the accompanying statements of revenues, expenses and changes in net assets. 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:

	2003	
	Coverage Amounts	Retention Amounts
Personal and Commercial Lines Accounts	\$ 967 million	\$ 386 million
High-Risk Account	\$2,540 million	\$1,012 million

Effective July 1, 2002, Citizens entered into a private reinsurance contract through June 1, 2003. Through this contract, Citizens obtained \$90 million of coverage for the Personal Lines Account and the Commercial Lines Account, which complements the FHCF coverage. The contract had an attachment of \$136 million and covers losses not covered by the FHCF. The effect of reinsurance on premiums written and earned is as follows:

	2003	
	Premiums	
	Written	Earned
Direct	\$1,171,996	\$ 999,235
Ceded	(180,026)	(175,333)
Net premiums	\$ 991,970	\$ 823,902

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.

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

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 \$396 for the year ended December 31, 2003, and are included in "Other underwriting expenses" in the accompanying statements of revenues, expenses and changes in net assets.

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 policies are removed at policy renewal, the Takeout Company offers the policyholder a new policy. In a bulk assumption, the Takeout Company agrees to assume, for the policies under the agreement, all insured losses and loss adjustment expenses that occur on or after the date on which the policies are assumed until the expiration of the policy term, at which time a policy is offered to the policyholder by the Takeout Company. 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.

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

12. Depopulation (continued)

During 2003, Citizens ceded \$24,265 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. At December 31, 2003, assumed premiums in the amount of \$709 were due from certain Takeout Companies.

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. Section 627.3511, Florida Statutes, provides that producer commissions need not be refunded by the producers on certain policies.

Certain agreements provide for a policy takeout bonus of up to \$300 per policy to be paid to the Takeout Company. 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. During 2003, Citizens paid out of escrow \$34,962 in accordance with the policy takeout agreements for policies removed in 1999 and 2000. In addition, Citizens paid out \$3,099 in accumulated interest. As of December 31, 2003, \$8,466 is in escrow.

At the end of the three-year period, Citizens requires the Takeout Company 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 2003, Citizens paid into escrow \$0 for underfunded accounts and received \$2,635 for overfunded accounts. These amounts are included in "takeout bonus expense" in the accompanying statements revenues, expenses and changes in net assets.

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

13. Operating Leases

Citizens leases office space and certain office equipment under various operating leases. Rental expense on operating leases amounted to \$1,639 for the years ended December 31, 2003. At December 31, 2003, future minimum payments under operating leases are as follows:

2004	\$1,410
2005	817
2006	680
2007	617
2008	626
After 2008	470
Total	<u>\$4,620</u>

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, et al. v. Florida Windstorm Underwriting Association ("FWUA"), et al., is a class action suit challenging the constitutionality of the statute under which the former FWUA (now merged into Citizens) sought approval of homeowners' rates and requesting premium refunds. On April 20, 2004, the 1st District Court of Appeal declined to decide the constitutionality issue and ruled that refunds, if any, can only be ordered by the Office of Insurance Regulation. Management of Citizens does not believe that the outcome of any of this lawsuit will have a material adverse effect on the financial condition of Citizens.

Due to the nature of Citizens, as a property insurance residual market mechanism with a high concentration of policies in coastal counties (see Note 2), severe storm activity in such areas could result in significant catastrophic losses. In addition to the resources on hand, Citizens has various funding mechanisms in place to address possible catastrophic losses, which includes regular assessments (see Note 1), a line of credit (see Note 9), and reinsurance (see Note 10). Citizens has the ability to levy emergency assessments (see Note 1) in order to repay debt incurred to fund losses. Although Citizens has imposed and collected regular assessments, it has never imposed an emergency assessment and therefore has no experience as to the timing, actual percentage collection or other matters relating to the collection of emergency assessments.

Citizens Property Insurance Corporation

Notes to Financial Statements (continued)

(In Thousands)

15. Subsequent Event – Bond Issuance

During 2004, the Board of Directors for Citizens approved the issuance of \$750 million in senior secured bonds for the High-risk Account. The bonds will be issued in multiple series beginning in May of 2004, and will bear interest at variable, auctioned rates, subsequent to their issuance. Proceeds from the bonds will be used for the purpose of funding losses of the High-Risk Account in the event of a future catastrophe.

16. Subsequent Event- Hurricane Charley and Hurricane Frances

On August 13, 2004, Hurricane Charley struck the southwest coast of Florida, near Punta Gorda, Florida while Hurricane Frances struck the southeast coast of Florida, near West Palm Beach on September 3, 2004. Citizens will likely incur significant losses caused by these hurricanes. Citizens anticipates funding losses associated with Hurricanes Charley and Frances from operating fund reimbursements from FHCF. No assessments are expected to be made. Citizens' expected net losses are estimated to be approximately \$1.6 billion. Significant changes in these estimates are possible as more information becomes available to Citizens during the claims handling process.

Supplemental Information

**Citizens Property Insurance Corporation
Supplemental Revenues, Expenses, and Claim Development Information**

	Policy year ended									
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Net earned premiums and investment revenue	213,658	444,341	521,530	648,109	680,546	480,933	462,207	575,853	754,581	929,691
Unallocated expenses	105,844	138,239	196,603	197,729	229,694	267,415	258,843	254,407	283,265	150,578
Estimated incurred claims and expense, end of policy year	167,831	496,668	240,074	174,388	326,199	112,544	35,855	64,812	97,373	243,767
Paid (cumulative) as of:										
End of policy year	110,605	290,553	133,797	102,805	206,255	69,471	19,544	41,602	44,863	124,414
One year later	146,381	389,292	208,297	141,554	302,455	104,241	27,795	59,874	77,812	
Two years later	129,312	443,252	217,780	149,491	314,598	111,348	28,941	63,674		
Three years later	153,308	449,595	222,366	151,905	318,920	113,198	29,960			
Four years later	153,946	453,712	224,779	153,608	321,162	115,138				
Five years later	154,716	455,632	226,806	154,427	323,390					
Six years later	154,772	456,458	227,814	155,289						
Seven years later	154,898	456,781	229,091							
Eight years later	154,904	457,065								
Nine years later	154,898									
Reestimated incurred claims and expense:										
End of policy year	167,831	496,668	240,074	174,388	326,199	112,544	35,855	64,812	97,373	243,767
One year later	165,829	422,352	238,049	157,638	318,084	116,215	31,832	67,838	87,937	
Two years later	138,895	463,805	230,753	156,317	326,602	118,408	31,698	66,654		
Three years later	159,409	458,786	227,558	159,193	327,268	119,342	30,932			
Four years later	156,144	456,539	230,742	158,343	328,721	117,406				
Five years later	155,519	457,793	229,829	157,470	324,993					
Six years later	155,287	457,871	229,682	155,805						
Seven years later	155,145	457,938	229,527							
Eight years later	155,027	457,490								
Nine years later	154,906									
Increase (decrease) in estimated incurred claims and expense from end of policy year	(12,925)	(39,176)	(10,547)	(18,583)	(1,206)	4,862	(4,923)	1,842	(9,436)	-

Required Supplemental Information

Citizens Property Insurance Corporation

Statement of Net Assets (in thousands)

December 31, 2003

	Consolidated	Personal Lines Account	Commercial Lines Account	High Risk Account
Assets				
Current assets:				
Cash and cash equivalents	\$ 1,442,890	\$ 931,865	\$ 154,760	\$ 356,265
Short-term investments	435,140	177,227	31,519	226,394
Deferred policy acquisition costs	66,397	27,889	4,157	34,351
Receivable for securities	45,340	13,126	2,294	29,920
Investment income due & accrued	24,131	3,483	584	20,064
Prepaid reinsurance premiums	5,381	5,381	-	-
Premiums receivable, net	2,703	1,871	134	698
Total current assets	2,021,982	1,160,842	193,448	667,692
Noncurrent assets:				
Long-term investments	2,292,351	16,156	2,824	2,273,371
Deferred takeout bonus	10,146	10,146	-	-
Fixed assets, net	5,633	4,452	-	1,181
Other assets	218	166	-	52
Inter-account receivable (payable)	-	22,327	(12,300)	(10,027)
Total noncurrent assets	2,308,348	53,247	(9,476)	2,264,577
Total assets	\$ 4,330,330	\$ 1,214,089	\$ 183,972	\$ 2,932,269
Liabilities and net assets				
Current liabilities:				
Loss reserves	\$ 112,645	\$ 94,821	\$ 13,975	\$ 3,849
Loss adjustment expense reserves	26,060	21,208	2,023	2,829
Unearned premiums, net of unearned ceded premium of \$5,381	571,000	252,349	27,479	291,172
Current maturities of long-term debt	275,000	106,400	18,600	150,000
Payable for securities	116,840	13,063	2,284	101,493
Advance premiums and suspended cash	63,834	31,440	3,364	29,030
Federal income taxes payable	54,899	-	-	54,899
Interest payable	44,116	7,208	1,260	35,648
Taxes and fees payable	22,774	3,588	358	18,828
Other current liabilities	28,306	20,566	1,605	6,135
Total current liabilities	1,315,474	550,643	70,948	693,883
Noncurrent liabilities:				
Long-term debt	1,377,163	84,733	14,812	1,277,618
Total noncurrent liabilities	1,377,163	84,733	14,812	1,277,618
Total liabilities	2,692,637	635,376	85,760	1,971,501
Net assets:				
Invested in capital assets	5,633	4,452	-	1,181
Unrestricted	1,632,060	574,261	98,212	959,587
Total net assets	1,637,693	578,713	98,212	960,768
Total liabilities and net assets	\$ 4,330,330	\$ 1,214,089	\$ 183,972	\$ 2,932,269

Citizens Property Insurance Corporation

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

Year ended December 31, 2003

	Consolidated	Personal Lines Account	Commercial Lines Account	High Risk Account
Operating revenue:				
Premiums earned	\$ 823,902	\$ 332,441	\$ 59,912	\$ 431,549
Operating expenses:				
Losses incurred	203,560	182,084	13,568	7,908
Loss adjustment expenses incurred	20,768	17,336	1,181	2,251
Service company fees	11,687	11,498	189	-
Producer commissions, net	89,158	26,524	7,970	54,664
Taxes and fees	17,113	7,649	1,213	8,251
Processing and other fees	1,636	1,621	15	-
Other underwriting expenses	28,397	13,377	2,494	12,526
Takeout bonus expense	2,587	2,587	-	-
Total operating expenses	<u>374,906</u>	<u>262,676</u>	<u>26,630</u>	<u>85,600</u>
Operating income	448,996	69,765	33,282	345,949
Nonoperating revenues (expenses):				
Net investment income	105,789	37,891	7,180	60,718
Interest expense	(119,530)	(14,710)	(2,572)	(102,248)
Income tax benefit	2	2	-	-
Line of credit fees and note issuance costs	(5,751)	(2,834)	(411)	(2,506)
Total nonoperating expenses	<u>(19,490)</u>	<u>20,349</u>	<u>4,197</u>	<u>(44,036)</u>
Change in net assets	<u>429,506</u>	<u>90,114</u>	<u>37,479</u>	<u>301,913</u>
Net assets, beginning of year	<u>1,208,187</u>	<u>488,599</u>	<u>60,733</u>	<u>658,855</u>
Net assets, end of year	<u>\$ 1,637,693</u>	<u>\$ 578,713</u>	<u>\$ 98,212</u>	<u>\$ 960,768</u>

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

Board of Governors
Citizens Property Insurance Corporation

We have audited the financial statements of Citizens Property Insurance Corporation as of and for the year ended December 31, 2003, and have issued our report thereon dated February 27, 2004, except for Note 16, as to which the date is September 3, 2004. 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.

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*.

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 assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. 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 errors 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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

February 27, 2004