Citizens Property Insurance Corporation

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

February 2021

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

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Purpose and Scope

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

> **627.35191 Required Reports. —**
> (1) By February 1 of each year, the Florida Hurricane Catastrophe Fund and Citizens Property Insurance Corporation shall each submit a report to the Legislature and the Financial Services Commission identifying their respective aggregate net probable maximum losses, financing options, and potential assessments. The report issued by the fund and the corporation must include their respective 50-year, 100-year, and 250-year probable maximum losses; analysis of all reasonable financing strategies for each such probable maximum loss, including the amount and term of debt instruments; specification of the percentage assessments that would be needed to support each of the financing strategies; and calculations of the aggregate assessment burden on Florida property and casualty policyholders for each of the probable maximum losses.

Introduction

Citizens plays an important role in the provision of property insurance coverage for Florida residents unable to find coverage in the private market. Eleven consecutive seasons with minimal claims payment activity until Hurricane Irma in 2017 and Hurricane Michael in 2018, have given Citizens an opportunity to accumulate resources in preparation for future storms. Citizens had stable financial resources available for the 2020 season, with estimated combined surplus in all three accounts (PLA, CLA and Coastal) of $6.5 billion. In addition to its surplus, Citizens' financial resources for 2020 also included pre-event debt totaling $820 million that provides liquidity, and a risk transfer program that transfers over $1.0 billion through traditional reinsurance markets and the capital markets, and approximately $2.0 billion through the Florida Hurricane Catastrophe Fund (FHCF).

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

As a result of significant depopulation and no losses over the past eleven years prior to Hurricane Irma in 2017 and Hurricane Michael in 2018, Citizens' current financial position is stable. Citizens has accumulated surplus and is also expecting to execute a risk transfer plan (through traditional reinsurance markets and capital markets) to bolster its claim paying resources and preserve surplus for sustainability for both the Coastal and Personal Lines Accounts in 2021 and to reduce or eliminate any potential assessments. Major catastrophic losses, either from an extreme single event or from multiple events that lead to exhaustion of its claims paying resources resulting in a deficit to any of Citizens' accounts may require Citizens to issue post-event bonds in order to meet its cashflow needs. Repayment of these post-event bonds would be funded through the collection of the associated emergency assessment. For up to a 1-250 year event, Citizens is projected to have an assessment burden of approximately $2.2 billion for PLA/CLA and $833 million for the Coastal Account.

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

Aggregate Net Probable Maximum Losses

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

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

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

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

Table 1 on the following page presents the projected net Probable Maximum Loss (PML), including 10% of loss to account for Loss Adjustment Expenses, from storms of the return time specified for: (1) the Coastal Account; (2) the PLA and CLA on an additive basis; and (3) all three accounts combined on an additive basis. The loss calculations are as of December 31, 2020 and were prepared by Citizens using AIR Hurricane Model for the United States Version 17.0.1 as implemented in Touchstone v7.3.0. Table 1 also illustrates Citizens' projected payment sources for each return time, including surplus, FHCF mandatory coverage reimbursement and private risk transfer, and identifies any shortfalls which would require the levy of the policyholder surcharge, regular assessment (Coastal Account only) and emergency assessment.

Table 1
($ in millions)

Coastal

Return Time (Years)	PML[1]	Projected FHCF Reimbursement	Projected Payment from Surplus[2]	Projected Private Reinsurance / Catastrophe Bonds[3]	Projected Assessable Shortfall
250	$6,665	$1,199	$2,919	$1,715	$833
100	$4,076	$1,199	$1,163	$1,715	$0
50	$2,480	$1,199	$723	$558	$0

PLA and CLA[4]

Return Time (Years)	PML[1]	Projected FHCF Reimbursement	Projected Payment from Surplus[2]	Projected Private Reinsurance / Catastrophe Bonds[3]	Projected Assessable Shortfall
250	$6,553	$1,541	$1,877	$926	$2,209
100	$3,714	$1,541	$1,246	$926	$0
50	$2,173	$1,281	$661	$231	$0

Total Coastal, PLA and CLA[5]

Return Time (Years)	PML[1]	Projected FHCF Reimbursement	Projected Payment from Surplus[2]	Projected Private Reinsurance / Catastrophe Bonds[3]	Projected Assessable Shortfall
250	$13,218	$2,740	$4,796	$2,641	$3,041
100	$7,790	$2,740	$2,409	$2,641	$0
50	$4,652	$2,479	$1,385	$789	$0

[1] All PMLs reflect single event modeled losses as of December 31, 2020 per AIR Hurricane Model for the United States Version 17.0.1 as implemented in Touchstone v7.3.0 based on Standard Sea Surface Temperature (SSST), including demand surge, excluding storm surge, including 10% of loss to account for Loss Adjustment Expense. PMLs are projected to the beginning of storm season using a factor of 15% for the residential portion of the Coastal Account, -4% for the non-residential portion of the Coastal Account and 27% for the PLA from the December 31, 2020 PMLs. In addition, the PML numbers are higher by approximately 5% for aggregate events or losses.

[2] Surplus is estimated as of 12/31/20 and includes 2021 net projected income/(loss) with $2.641 billion of projected traditional reinsurance / catastrophe bonds for the 2021 season. Due to the sufficient funds to cover the adjusted net loss for an event with 50 and 100 year return time for the Coastal Account as well as the PLA and CLA only the necessary funds are included on the table resulting in zero potential for post-event bonding.

[3] Private reinsurance/catastrophe bonds are estimated amounts per Citizens' projected risk transfer program for 2021. These amounts are preliminary, however, and may change subject to market conditions.

[4] Although PLA and CLA is combined for FHCF recoveries and pre-event bonding, surplus from one account cannot be used to offset deficits in another account. The combination of PLA and CLA PMLs and resources are shown on an additive basis.

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

Numbers may not add due to rounding.

Financing Options

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

Citizens currently has two series of pre-event bonds outstanding (one in the Coastal Account in the amount of $500 million and one in the PLA/CLA in the amount of $320 million), totaling over $820 million. Of this total, $160 million in the PLA/CLA will mature early in the 2021 hurricane season, resulting in $660 million in total external pre-event liquidity ($500 million in the Coastal Account and $160 million in the PLA/CLA) available for the 2021 season. Together with Citizens' accumulated surplus, this external pre-event liquidity provides the source of immediately available funds to pay claims. For 2021, liquidity sources in the Coastal Account are projected to total over $5.1 billion (over $2.9 billion of estimated surplus in addition to $500 million of pre-event bonds and over $1.7 billion of projected private risk transfer). Liquidity sources in the PLA available for 2021 are projected to total approximately $2.8 billion (approximately $1.7 billion of estimated surplus in addition to $160 million of pre-event bonds and over $900 million of projected private risk transfer). Additionally, CLA has over $1.9 billion in liquidity resources which is comprised of surplus. For purposes of this analysis, Citizens' $160 million of PLA/CLA pre-event bonds available in 2021 are reflected in PLA's available liquidity resources. Citizens' pre-event bonds are serviced primarily from the investment earnings on the bond proceeds (which are retained pending their need to pay future claims) and from the collection of policyholder premiums. There are no active assessments associated with pre-event bonds.

For 2021, Citizens is currently projected to purchase from the FHCF approximately $2.7 billion in reinsurance (approximately $1.2 billion for the Coastal Account and $1.5 billion for PLA/CLA). Citizens is currently evaluating market conditions, however, and is projected to have over $1.7 billion of private risk transfer for the Coastal Account in 2021 and over $900 million of private risk transfer for the PLA, which would reduce the projected assessable shortfall (if needed).

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

Conditions in the municipal and corporate markets are favorable, having significantly improved in recent years. The corporate bond market has topped $1 trillion each year since 2010 and reached record levels in 2020 with approximately $2.3 trillion of issuance, or 61% higher than 2019 issuance. The municipal market has also been very strong over the last eleven years. In 2020, municipal long-term issuance was $473 billion, which is 11% higher as compared to $426 billion of issuance in 2019 as issuers took advantage of record low interest rates.

Table 2
($ in billions)

	Corporate Issuance		Municipal Issuance	
Year	Par ($B)	% Change from Prior Yr	Par ($B)	% Change from Prior Yr
2011	$1,044	-4%	$295	-32%
2012	$1,389	33%	$383	30%
2013	$1,413	2%	$335	-12%
2014	$1,472	4%	$339	1%
2015	$1,511	3%	$399	18%
2016	$1,542	2%	$446	12%
2017	$1,669	8%	$439	-2%
2018	$1,372	-18%	$346	-21%
2019	$1,415	3%	$426	23%
2020	$2,279	61%	$473	11%

Source: SIFMA

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

Assessment Impact

Citizens has a three tier assessment structure as prescribed by Florida Statutes. Two important features of the Citizens assessment structure are (1) each account (i.e. the Coastal, PLA, and CLA) calculates its deficit separately, and each account has separate assessment authority. Therefore, there is the potential for concurrent assessments caused by deficits in more than one of Citizens' accounts; and (2) unlike emergency assessments, Citizens' policyholder surcharges and regular assessments (Coastal Account only) are one-time levies that cannot be financed. With these factors in mind, the basic construct of Citizens' assessments for 2021 is as follows (note that this is a high-level summary and is therefore not exhaustive and may omit certain precise attributes):

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

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

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

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

Table 3
($ in millions)

Coastal

Return Time (Years)	Projected Assessable Shortfall ($ in MM)	Citizens' Policyholders Surcharge		Regular Assessments		Emergency Assessments[2]		
		$ Amount in MM	%	$ Amount in MM	%	Total $ Amount in MM	Annual $ Amount in MM	Annual %
250	$833	$207	15.0%	$626	1.2%	$0	$0	0.00%
100	$0	$0	0.0%	$0	0.0%	$0	$0	0.00%
50	$0	$0	0.0%	$0	0.0%	$0	$0	0.00%

PLA and CLA

Return Time (Years)	Projected Assessable Shortfall ($ in MM)	Citizens' Policyholders Surcharge		Regular Assessments		Emergency Assessments[2]		
		$ Amount in MM	%	$ Amount in MM	%	Total $ Amount in MM	Annual $ Amount in MM	Annual %
250	$2,209	$207	15.0%	N/A	N/A	$2,002	$130	0.24%
100	$0	$0	0.0%	N/A	N/A	$0	$0	0.00%
50	$0	$0	0.0%	N/A	N/A	$0	$0	0.00%

Total Coastal, PLA and CLA

Return Time (Years)	Projected Assessable Shortfall ($ in MM)	Citizens' Policyholders Surcharge		Regular Assessments		Emergency Assessments[2]		
		$ Amount in MM	%	$ Amount in MM	%	Total $ Amount in MM	Annual $ Amount in MM	Annual %
250	$3,041	$414	30.0%	$626	1.2%	$2,002	$130	0.24%
100	$0	$0	0.0%	$0	0.0%	$0	$0	0.00%
50	$0	$0	0.0%	$0	0.0%	$0	$0	0.00%

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

[1] These assessments are one-time assessments for the first year only. Citizens' policyholder surcharges are based on projected written premiums of $1.38 billion for 2021.

[2] Represents annual assessment amount over a 30 year period using an assumed interest rate of 5% and the emergency assessment base of $53.2 billion, which was the base for 2019. If the annual assessment amount was over a 10 year period using an assumed interest rate of 4%, the potential assessment rate is 0.46%. If this base is smaller or larger, required assessment percentages would be marginally higher or lower than shown above.

Conclusion

Despite the impact of Hurricanes Irma and Michael, Citizens' financial strength remains stable, primarily due to the projected 2021 risk transfer, with no assessment burden for the Coastal Account or PLA and CLA for an event up to 1-100 years. Citizens' stable financial position is due to depopulation driven in the prior years by the interest of the private market in Citizens' policies, a healthy private commercial market, amount of Citizens' surplus, and an effective and efficient risk transfer program. Citizens is projected to have over $1.7 billion of private risk transfer (through traditional reinsurance markets and capital markets) available for the Coastal Account and over $900 million of private risk transfer (through traditional reinsurance markets and capital markets) for PLA in 2021. For catastrophic losses which exceed Citizens' available surplus and risk transfer program, Citizens will rely on its policyholder surcharge, regular assessment (Coastal Account only) and marginally on post-event bonding for claims paying capacity.

For major catastrophic losses, either from an extreme single event or from multiple events that result in a deficit to any of Citizens' accounts and activation of the emergency assessment, Citizens may issue post-event bonds in order to meet liquidity demands. Repayment of these post-event bonds would be funded through the collection of the associated emergency assessment. Citizens' financial position is stable; Citizens is projected to have no emergency assessment burden in the Coastal Account or the PLA and CLA for up to a 1-100 year event.

The ability of Citizens to pay claims in full and in a timely manner remains critical to the people whose homes and businesses are insured and to the Florida economy in general. Citizens' stable position, including its risk transfer program and pre-event bonds, continues to allow Citizens to meet its statutory obligations while limiting regular assessments in 1-100 year scenario and potential emergency assessments in a 1-250 year scenario.