

MEMORANDUM

TO: Jennifer Montero, Chief Financial Officer
Citizens Property Insurance Corporation

FROM: Kapil Bhatia, Raymond James & Associates, Inc.

RE: Citizens' Legacy Securities

DATE: September 4, 2019

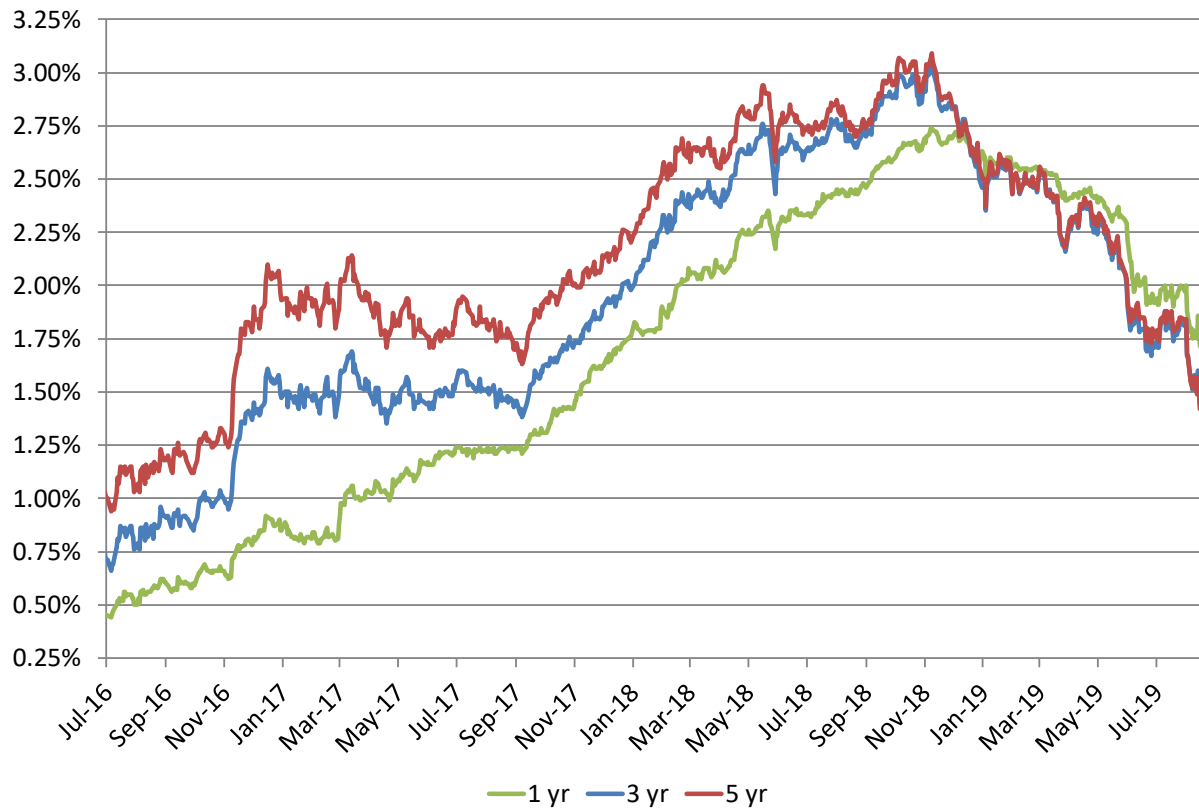
Citizens' legacy securities were acquired by its former investment manager in 2007 before the financial market collapse. Citizens held these assets during the worst of the financial crisis and recovered 71% of its original principal value up until 2016. We evaluated the sale of the Structured Investment Vehicles ("SIV") legacy securities in March 2016 and received Board approval in June 2016 to strategically sell its securities based on bids received. As a result, Citizens sold two SIVs – Pacific West and Atlantic East – and held Issuer Entity (Ottimo), AFF Financing and Lehman bonds as the market conditions for these securities was not as liquid and they were continuing to generate cash flow. For Issuer Entity (Ottimo) and AFF Financing, we recovered approximately \$180 million of principal prior to 2016 and have recovered approximately \$26 million of additional principal since 2016. Due to the amortization and prepayments of underlying assets, both securities' remaining outstanding amounts have significantly decreased and that has increased the administrative costs as well as the potential risks. Additionally, market conditions have also changed since 2016, liquidity is constrained and the cash flow has been reduced. Lehman bonds have remained completely illiquid and have a current market value of approximately \$350,000, or approximately 1.3% of outstanding par of \$26.5 million, and has not produced any significant cash flow. Based on these factors, we recommend that the Board authorize Citizens staff to work with its Financial Advisor to sell its remaining SIV legacy securities and Lehman bonds to end the legacy of illiquid securities.

A summary of Treasury rate movements are shown in the chart on the following page. As shown in the accompanying table, Treasury rates from 1-3 years have increased significantly as compared to three years prior when we last evaluated the sale of Citizens' SIV legacy securities in 2016 due to the Federal Reserve increasing rates three times in 2017 and four times in 2018.

Fed Funds Rate and U.S. Treasury Rates						
	Fed Funds	1-Year	2-Year	3-Year	5-Year	10-Year
Current	2.13	1.72	1.50	1.44	1.42	1.55
1-Yr Prior	1.91	2.43	2.60	2.65	2.70	2.82
2-Yrs Prior	1.16	1.24	1.33	1.48	1.80	2.22
3-Yrs Prior	0.40	0.58	0.74	0.86	1.15	1.55
4-Yrs Prior	0.14	0.36	0.67	0.98	1.48	2.12
5-Yrs Prior	0.09	0.12	0.52	0.98	1.68	2.39
5-Yr Average	0.98	1.19	1.41	1.59	1.90	2.31
10-Yr Average	0.55	0.70	0.93	1.18	1.67	2.46
Current as % Above / Below 5-Yr Average	117%	44%	7%	-9%	-25%	-33%
Current as % Above / Below 10-Yr Average	284%	146%	60%	22%	-15%	-37%

However, rates have recently started to decrease again as the global economy is slowing down and Federal Reserve has cut rates once so far in 2019 and is projected to cut rates 1-2 additional times this year and the yield curve is getting flatter.

U.S. Treasury Rates (2016-2019)



The proceeds from the sale of its remaining SIV will be reinvested in liquid securities pursuant to its investment policy in order to maximize investment returns. Liquidating these securities will also eliminate associated market and liquidity risk as well as volatility and will bring the overall portfolio into compliance with the investment policy. Citizens will incur estimated realized losses after selling the securities in the range of approximately \$10.6-\$14.1 million. However, Citizens has continued to receive interest payments and has recovered \$102 million, or approximately 72% of the original write down of \$142 million over the last 10 years.

A summary of Citizens' legacy securities history is shown on the following page:

CPIC Illiquid Assets Summary (As of June 30, 2019)			
(\$ In Millions)	Issuer Entity (Ottimo)	AFF Financing	Total Remaining Legacy Securities
Original Acquisition Cost ¹	\$46.5	\$225.0	\$271.4
Total Write Downs ²	(\$30.4)	(\$111.6)	(\$141.9)
Principal Recoveries	\$11.9	\$90.6	\$102.5
Net Total Writedowns	(\$18.5)	(\$21.0)	(\$39.5)
Disposal Gain/Loss	\$0.0	\$0.0	\$0.0
Amortization	\$0.0	\$0.2	\$0.2
Principal Paydowns	\$20.2	\$183.4	\$203.6
Current Amortized Cost	\$7.7	\$20.7	\$28.5
Estimated Market Value Range	\$2.2-\$3.0	\$12.1-\$14.8	\$14.3-\$17.8
Estimated Loss Range	(\$4.7)-(\$5.5)	(\$5.9)-(\$8.6)	(\$10.6)-(\$14.1)

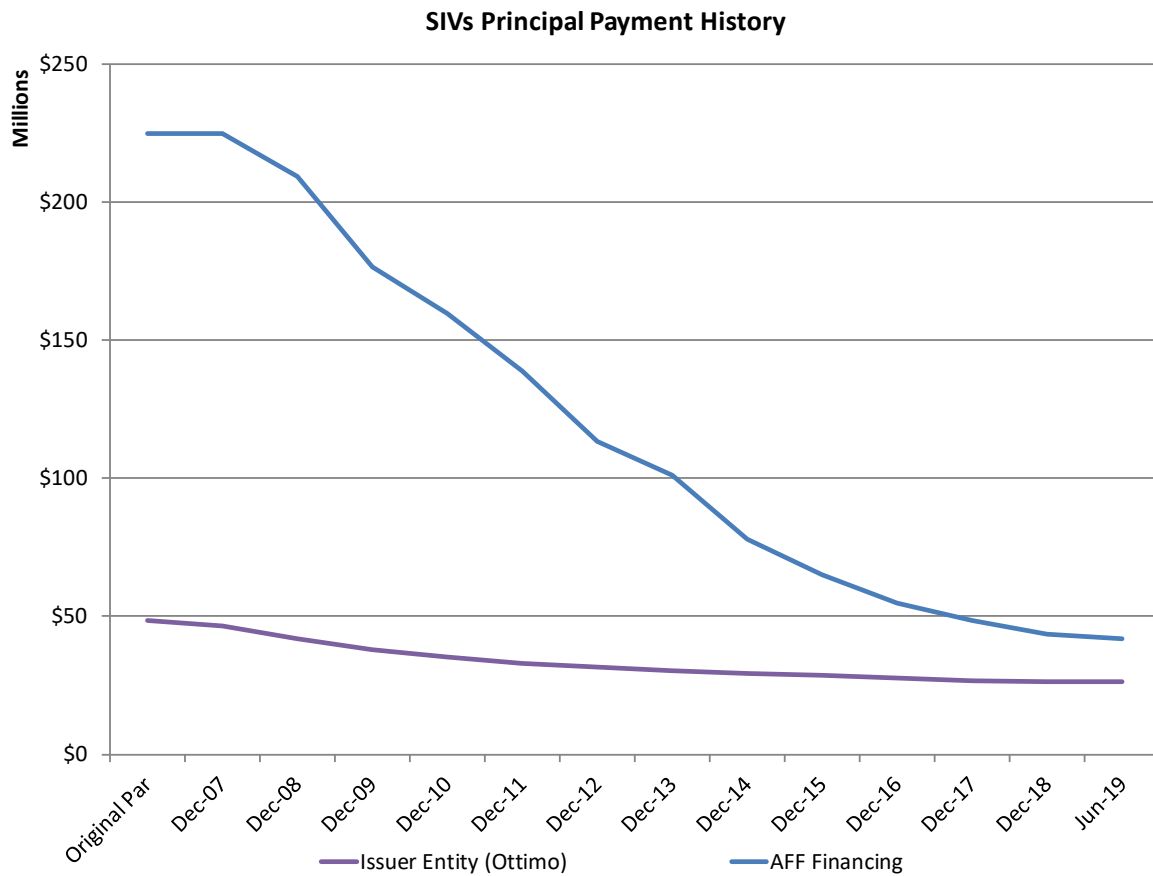
¹ Original securities were issued at a discount

² Writedowns occurred on December 31, 2007, September 30, 2008, and December 31, 2008.

As shown in the table above, the market sale price of the SIV portfolio could be approximately \$14.3-\$17.8 million. The sale of the SIV portfolio will allow Citizens to end the last chapters of the 2007 financial crisis within its portfolio.

As seen in the table and graph below, the original SIV legacy par amount in August 2007 was approximately \$273 million and is currently at \$68.1 million as of June 30, 2019. Since August 2007, Citizens has received approximately \$205 million of principal payments, or 75% of the original par. The current sale price is expected to be approximately \$14.3-\$17.8 million.

SIVs Principal Payment History			
(\$ in Millions)	Issuer Entity (Ottimo)	AFF Financing	Total
Original Par	\$48.4	\$225.0	\$273.4
Current Par	\$26.2	\$41.8	\$68.1
Amount of Principal Received	\$22.2	\$183.2	\$205.3
% of Original Par Paid Off	45.8%	81.4%	75.1%



Conclusion

We evaluated the sale of the SIV legacy securities in 2016 and strategically sold two securities and held the remaining securities, and since then we have recovered \$26 million of principal. As market conditions have significantly changed since 2016, liquidity is constrained and the cash flow from the underlying SIV assets has decreased and therefore the potential risk has increased, therefore we recommend that the Board authorize Citizens staff to work with its Financial Advisor to sell its remaining SIV legacy securities in the range of \$14.3-\$17.8 million, and also sell the Lehman bonds at a marginal residual value of approximately \$350,000 thereby ending the legacy of illiquid securities.