

PICO HOLDINGS INC /NEW

Form 10-K

March 03, 2017

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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FORM 10-K

ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2016

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 033-36383

PICO HOLDINGS, INC.

(Exact Name of Registrant as Specified in Its Charter)

California

94-2723335

(State or other jurisdiction of incorporation) (IRS Employer Identification No.)

7979 Ivanhoe Avenue, Suite 300 La Jolla, California 92037

(Address of Principal Executive Offices, including Zip Code)

Registrant's Telephone Number, Including Area Code

(888) 389-3222

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
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Common Stock, Par Value \$0.001	NASDAQ Stock Market LLC
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Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act.

Yes ¨ No ý

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No ý

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer ¨ Accelerated filer ý Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12-b of the Act). Yes ¨ No ý

At June 30, 2016, the aggregate market value of shares of the registrant's common stock held by non-affiliates of the registrant (based upon the closing sale price of such shares on the NASDAQ Global Select Market on June 30, 2016) was \$192.8 million, which excludes shares of common stock held in treasury and shares held by executive officers, directors, and stockholders whose ownership exceeds 10% of the registrant's common stock outstanding at June 30, 2016. This calculation does not reflect a determination that such persons are deemed to be affiliates for any other purposes.

On February 17, 2017, the registrant had 23,072,403 shares of common stock, \$0.001 par value, outstanding.

#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Definitive Proxy Statement to be filed with the United States Securities and Exchange Commission pursuant to Regulation 14A in connection with the registrant's 2017 Annual Meeting of Shareholders, to be filed subsequent to the date hereof, are incorporated by reference into Part III of this Annual Report on Form 10-K.

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## PART I

### Note About “Forward-Looking Statements”

This Annual Report on Form 10-K (including “Management’s Discussion and Analysis of Financial Condition and Results of Operations”) contains “forward-looking statements,” as defined in the Private Securities Litigation Reform Act of 1995, regarding our business, financial condition, results of operations, and prospects, including, without limitation, statements about our expectations, beliefs, intentions, anticipated developments, and other information concerning future matters. Words such as “may”, “will”, “could”, “expects”, “anticipates”, “intends”, “plans”, “believes”, “seeks”, “estimates”, and similar expressions or variations of such words are intended to identify forward-looking statements, but are not the exclusive means of identifying forward-looking statements in this Annual Report on Form 10-K.

Although forward-looking statements in this Annual Report on Form 10-K reflect the good faith judgment of our management, such statements can only be based on current expectations and assumptions and are not guarantees of future performance. Consequently, forward-looking statements are inherently subject to risk and uncertainties, and the actual results and outcomes could differ materially from future results and outcomes expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences in results and outcomes include, without limitation, those discussed under Part I, Item 1A “Risk Factors”, as well as those discussed elsewhere in this Annual Report on Form 10-K and in other filings we may make from time to time with the United States Securities and Exchange Commission (“SEC”) after the date of this report. Readers are urged not to place undue reliance on these forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. We undertake no obligation to (and we expressly disclaim any obligation to) revise or update any forward-looking statements, whether as a result of new information, subsequent events, or otherwise, in order to reflect any event or circumstance that may arise after the date of this Annual Report on Form 10-K, unless otherwise required by law. Readers are urged to carefully review and consider the various disclosures made in this Annual Report on Form 10-K, and the other filings we may make from time to time with the SEC after the date of this report, which attempt to advise interested parties of the risks and uncertainties that may affect our business, financial condition, results of operations, and prospects.

## ITEM 1. BUSINESS

### Introduction

PICO Holdings, Inc. is a diversified holding company that was incorporated in 1981. In this Annual Report on Form 10-K, PICO and its subsidiaries are collectively referred to as “PICO”, “the Company”, or by words such as “we”, “us”, and “our.”

Our objective is to maximize long-term shareholder value. Currently, we believe the highest potential return to shareholders is from a return of capital. As we monetize assets, rather than reinvest the proceeds, we intend to return capital back to shareholders through a stock repurchase program or by other means such as special dividends.

As of December 31, 2016, our business was separated into the following segments:

- Water Resource and Water Storage Operations;
- Real Estate Operations;
- Corporate; and
- Discontinued Agribusiness Operations.

As of December 31, 2016, our major consolidated subsidiaries were (wholly-owned unless otherwise noted):

- Vidler Water Company, Inc. (“Vidler”) which owns water resources and water storage operations in the southwestern United States, with assets and operations in Nevada, Arizona, Colorado and New Mexico; and

UCP, Inc. (“UCP”), a 56.8% owned subsidiary which is a homebuilder and land developer in markets located in California and Puget Sound area of Washington State, North Carolina, South Carolina and Tennessee.

The address of our main office is 7979 Ivanhoe Avenue, Suite 300, La Jolla, California 92037, and our telephone number is (888) 389-3222.

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and, if applicable, amendments to those reports, are made available free of charge on our web site ([www.picoholdings.com](http://www.picoholdings.com)) as soon as reasonably practicable after the reports are electronically filed or furnished with the SEC. Our website also contains other material about PICO. Information on our website is not incorporated by reference into this Annual Report on Form 10-K.

#### Operating Segments and Major Subsidiary Companies

The following is a description of our operating segments and major subsidiaries. Unless otherwise noted, we own 100% of each subsidiary. The following discussion of our segments should be read in conjunction with the Consolidated Financial Statements and Notes thereto included elsewhere in this Annual Report on Form 10-K. See Note 12, "Segment Reporting," in the accompanying consolidated financial statements for financial information for each of our operating segments and geographic areas in which we derive revenue. Additional information regarding the performance of and recent developments in our operating segments is included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

#### Our Water Resource and Water Storage Operations

Vidler is primarily focused on selling our existing water rights and storage credits that we own in the southwestern United States. In this operation, we developed new sources of water for municipal and industrial use, either from existing supplies of water, such as water used for agricultural purposes, acquired unappropriated (previously unused) water, or discovered new water sources based on science and targeted exploration. We are not a water utility, and do not currently intend to enter into regulated utility activities.

A water right is the legal right to divert water and put it to beneficial use. Water rights are real property rights which can be bought and sold and are commonly measured in acre-feet, which is a measure of the volume of water required to cover an area of one acre to a depth of one foot and is equal to 325,850 gallons. The value of a water right depends on a number of factors, which may include location, the seniority of the right, whether or not the right is transferable, or if the water can be moved from one location to another. We believe we have purchased water rights at prices consistent with their then current use, which was typically agricultural in nature, with the expectation that the value would increase as we converted the water rights through the development process to a higher use, such as municipal and industrial use. We acquired and developed water resources with the expectation that such water resources would be the most competitive source of water (the most economical source of water supply) to support new growth in municipalities or new commercial and industrial projects.

Certain areas of the Southwest confronting long-term growth have insufficient known supplies of water to support their future economic and population growth. The inefficient allocation of available water between agricultural users and municipal or industrial users, the lack of available known water supplies in a particular location, or inadequate infrastructure to fully utilize or store existing and new water supplies provide opportunities for us to apply our water resource development expertise.

The development of our water assets required significant capital and expertise. A complete project, from acquisition, through development, permitting, and sale is a long-term endeavor. Typically, in the regions in which we operate, new housing, commercial and industrial developments require an assured water supply (for example, in Arizona, access to water supplies for at least 100 years is required) before a permit for the development will be issued.

We have acquired or developed water rights and water related assets in Arizona, Idaho, Nevada, Colorado, and New Mexico. We also developed and operated our own water storage facility near Phoenix, Arizona, utilize water storage capacity operated by third parties in Arizona, and "bank," or store, water with municipalities in Nevada and New

Mexico.

We have also entered into “teaming” and joint resource development arrangements with third parties who have water assets but lack the capital or expertise to commercially develop these assets. The first of these arrangements was a water delivery teaming agreement in southern Nevada with the Lincoln County Water District (“Lincoln/Vidler”), which is developing water resources in Lincoln County, Nevada. In northern Nevada, we have also entered into a joint development agreement with Carson City and Lyon County, Nevada to develop and provide water resources in Lyon County as well as a water banking agreement with Washoe County in Reno, Nevada.

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We generate revenues by:

- selling our developed water rights to project developers including real estate developers, power generating facilities or other commercial and industrial users who must secure rights to an assured supply of water in order to receive permits for their development projects;
- selling our developed water rights to water utilities, municipalities and other government agencies for their specific needs, including to support population growth;
- selling our stored water to state agencies, commercial developers or municipalities that have either exhausted their existing water supplies or require reserves for future water obligations, or, in instances where our water represents the most economical source of water, for their commercial projects or communities; and
- leasing our water, farmland or ranch land while further developing the water resource.

We owned the following significant water resource and water storage assets at December 31, 2016:

#### Fish Springs Ranch

We own a 51% membership interest in, and are the managing partner of, Fish Springs Ranch, LLC (“FSR”), which owns the Fish Springs Ranch and other properties totaling approximately 7,313 acres in Honey Lake Valley in Washoe County, approximately 40 miles north of Reno, Nevada. FSR also owns 12,984 acre-feet of permitted water rights related to the properties of which 7,984 acre-feet are designated as water credits, transferable to other areas within Washoe County (such as Reno and Sparks) to support community development. Currently, there is no regulatory approval to export the additional 5,000 acre-feet per year of water from FSR to support development in northern Reno, and it is uncertain whether such regulatory approval will be granted in the future. To date, we have funded all of the operational expenses, development, and construction costs incurred in this partnership. We are entitled to recover the amount we have funded and in addition, we are entitled to receive an annual financing cost of the London Inter-Bank Offered Rate (“LIBOR”) plus 450 basis points from funding of the pipeline related expenditures, as we generate revenue from the sale of FSR water credits.

During 2006, we began construction of a pipeline and an electrical substation to provide the power required to pump the water to the north valleys region of Reno. In July 2008, we completed construction of and dedicated our pipeline and associated infrastructure to Washoe County, Nevada under the terms of an Infrastructure Dedication Agreement (“IDA”) between Washoe County and FSR. Under the provisions of the IDA, Washoe County is responsible for the operation and maintenance of the pipeline and we own the exclusive right to the capacity of the pipeline to allow for the sale of water for future economic development in the north valley area of Reno. Our 7,984 acre-feet of water that has regulatory approval to be imported to the north valleys of Reno is available for sale under a Water Banking Agreement entered into between FSR and Washoe County. Under the Water Banking Agreement, Washoe County holds our water rights in trust. We can sell our water credits to developers, who must then dedicate the water to the local water utility for service. In December 2014, Washoe County Water Utilities merged with the Truckee Meadows Water Authority (“TMWA”), consolidating water supply service in Washoe County. Also effective at the end of 2014, FSR, Washoe County, and TMWA consented to the Assignment of the Water Banking Agreement and the IDA to the Truckee Meadows Water Authority.

During 2011, a recession and other poor economic conditions in the area, including a high rate of unemployment in Washoe County, caused the rate of population growth to slow considerably. In addition, the then issued population growth estimates from the Nevada State Demographer were significantly lower than previous population projections. These factors caused a decline in the estimated fair value of our water credits and pipeline rights to approximately \$84.9 million compared to its then carrying value of \$101.1 million. Consequently during 2011, we recorded a \$16.2 million impairment loss to reflect the decrease in the estimated fair value of the asset. For similar reasons, during 2013, we recorded another impairment loss on this asset of \$993,000.

Carson/Lyon

The capital of Nevada, Carson City, and Lyon County are located in the western part of the state, close to Lake Tahoe and the border with California. While Carson City's housing growth has been and is expected to be minimal due to land constraints, there is planned growth for the Dayton corridor, directly east of Carson City. The planned growth in this area is anticipated to be driven by the employment growth at the Tahoe Reno Industrial Center ("TRIC") and the construction of the extension of the USA Parkway, scheduled to be completed by late 2017. The USA Parkway connects Interstate route 80 to TRIC and the extension will connect Interstate route 80 and TRIC to U.S. route 50 near Silver Springs, Lyon County. There are currently few existing water sources to support future growth and development in the Dayton corridor area and Vidler has been working with Carson City and Lyon County for several years on ways to deliver water to support this expected growth.

In 2007, we entered into development and improvement agreements with both Carson City and Lyon County to provide water resources for planned future growth in Lyon County and to connect, or “intertie,” the municipal water systems of Carson City and Lyon County. The agreements allow for Carson River water rights owned or controlled by us to be conveyed for use in Lyon County. The agreements also allow us to bank water with Lyon County and authorize us to build the infrastructure to upgrade and inter-connect the Carson City and Lyon County water systems.

We own water rights consisting of both Carson River agriculture designated water rights and certain municipal and industrial designated water rights. On completion of our re-designation development process of the agriculture designated water rights to municipal and industrial use, we anticipate that we will have up to 4,000 acre-feet available for municipal use in Lyon County for future development, as and when demand occurs, principally by means of delivery through the new infrastructure we constructed.

Due to recession and prevailing economic conditions during 2010, including a high rate of unemployment in Lyon County, the rate of growth of development in the Dayton corridor had slowed considerably which caused a decline in the estimated fair value of our asset. Consequently, we recorded an impairment loss on this asset of \$10.3 million in the fourth quarter of 2010.

#### Vidler Arizona Recharge Facility

We built and received the necessary permits to operate a full-scale water “recharge” facility that allows us to bank water underground in the Harquahala Valley, Arizona. “Recharge” is the process of placing water into storage underground. We have the permitted right, through September 2020, to recharge 100,000 acre-feet of water per year at the Vidler Arizona Recharge Facility, and we are permitted to store as much as one million acre-feet of water in the aquifer underlying much of the valley. When needed, the water will be “recovered,” or removed from storage, by ground water wells. This stored water creates a long term storage credit (“LTSC”).

We hold our Colorado River water at this facility, which is a primary source of water for the Lower Basin States of Arizona, California, and Nevada. The water storage facility is strategically located adjacent to the Central Arizona Project (“CAP”) aqueduct, a conveyance canal running from Lake Havasu to Phoenix and Tucson. The recharged water was from surplus flows of CAP water which Arizona wanted recharged in Arizona, as opposed to that water flowing downstream. Proximity to the CAP provides a competitive advantage as it minimizes the cost of water conveyance.

We are able to provide storage for users located both within Arizona and out of state (with approvals from the state of Arizona). Potential users include industrial companies, power-generating companies, developers, and local governmental political subdivisions in Arizona, and out-of-state users such as municipalities and water agencies in Nevada and California. The Arizona Water Banking Authority (“AWBA”) has the responsibility for intrastate and interstate storage of water for governmental entities. To date, we have not stored water at the facility for any third party.

While Arizona is the only southwestern state with surplus flows of Colorado River water available for storage, in recent years there has been little to no surplus flows available to us as drought conditions have reduced the flow of the Colorado River and other water users have fully utilized their water allocations. In the future, we do not anticipate purchasing and storing surplus flows of Colorado River water and we have discontinued using the recharge element of the storage site. At December 31, 2016, we had LTSCs of approximately 251,000 acre-feet of water in storage at the facility. To date, we have not generated any revenue from selling our stored water at this facility.

#### Phoenix AMA Water Storage

As of December 31, 2016, we owned approximately 157,000 acre-feet of LTSCs stored in the Arizona Active Management Area (“AMA”), 126,000 acre-feet of which is in the Roosevelt Water Conservation District (“RWCD”). For the purposes of storing water, the RWCD is part of the Phoenix AMA, which corresponds to the Phoenix metropolitan area. Accordingly, water stored in the AMA may be recovered and used anywhere in the AMA and could have a variety of uses for commercial developments within the Phoenix metropolitan area. During 2011 and 2012 we acquired additional LTSCs in RWCD and also LTSCs in five other storage sites in the AMA. All of the storage sites we utilize within the AMA are operated by third parties.

In December 2016, we signed two purchase and sale agreements for the sale of a total of 100,000 acre-feet of LTSCs for gross proceeds of \$25 million. The sales closed in the first quarter of 2017 and will result in reported income before income taxes of approximately \$12.5 million.

### Harquahala Valley Ground Water Basin

Any new residential development in Arizona must obtain a permit from the Arizona Department of Water Resources certifying a “designated assured water supply” sufficient to sustain the development for at least 100 years. Harquahala Valley groundwater meets the designation of assured water supply.

Under Arizona law, the property and water rights in the Harquahala Valley are located in one of three areas in the state from which groundwater may be withdrawn and transferred from a rural area to a metropolitan area. In July 1998, we were granted approval for the transportation of three acre-feet of groundwater per acre of previously irrigated ground, totaling 3,837 acre-feet of groundwater, from Harquahala Valley into the Phoenix-Scottsdale metropolitan area. During 2011, we were granted approval for 9,877 acre-feet of groundwater, which included the prior 3,837 acre-feet awarded.

We own 1,926 acres of land and have the ability to utilize 6,040 acre-feet of groundwater for development within the Harquahala Basin. The Analysis of Adequate Water Supply for the 6,040 acre-feet must be renewed before December 2021 in order to maintain these rights.

In addition, the area in and around the Harquahala Valley appears to be a desirable area to site natural gas fired and solar power-generating plants. The site’s proximity to energy transmission lines and the high solarity in the region are strengths of the location. The water assets we own in this region could potentially provide a water source for energy plants that might be constructed in this area.

### Lincoln County, Nevada Water Delivery and Teaming Agreement

Lincoln/Vidler entered into a water delivery teaming agreement to locate and develop water resources in Lincoln County, Nevada for planned projects under the County’s master plan. Under the agreement, proceeds from sales of water will be shared equally after Vidler is reimbursed for the expenses incurred in developing water resources in Lincoln County. Lincoln/Vidler has filed applications for more than 100,000 acre-feet of water rights with the intention of supplying water for residential, commercial, and industrial use, as contemplated by the county’s approved master plan. We believe that this is the only known new source of water for Lincoln County. Although it is uncertain, Vidler currently anticipates that up to 40,000 acre-feet of water rights will ultimately be permitted from these applications, and put to use for planned projects in Lincoln County.

### Tule Desert Groundwater Basin

Lincoln/Vidler jointly filed permit applications in 1998 for approximately 14,000 acre-feet of water rights for industrial use from the Tule Desert Groundwater Basin in Lincoln County, Nevada. In November 2002, the Nevada State Engineer awarded Lincoln/Vidler a permit for 2,100 acre-feet of water rights, which Lincoln/Vidler subsequently sold in 2005, and ruled that an additional 7,240 acre-feet could be granted pending additional studies by Lincoln/Vidler (the “2002 Ruling”). Subsequent to the 2002 Ruling and consistent with the Nevada State Engineer’s conditions, we completed these additional engineering and scientific studies.

On April 15, 2010, Lincoln/Vidler and the Nevada State Engineer announced that we entered into a Settlement Agreement with respect to litigation between the parties regarding the amount of water to be permitted in the Tule Desert Groundwater Basin. The Settlement Agreement resulted in the granting to Lincoln/Vidler of the original application of 7,240 acre-feet of water rights with an initial 2,900 acre-feet of water rights available for sale or lease by Lincoln/Vidler. The balance of the water rights (4,340 acre-feet) is the subject of staged pumping and development over the next several years to further refine the modeling of the basin and potential impacts, if any, from deep aquifer pumping in the remote, unpopulated desert valley in Lincoln County, Nevada.

The Tule Desert Groundwater Basin water resources were developed by Lincoln/Vidler to support the Lincoln County Recreation, Conservation and Development Act of 2004 (the “Land Act”) and Vidler’s proposed Toquop Power generation project, as discussed below. The water permitted under the Settlement Agreement is anticipated to provide sufficient water resources to support the development of the Toquop Power generation project and a portion of Land Act properties.

#### Lincoln County Power Plant Project

We developed the Toquop Power project. We are finalizing the required studies and National Environmental Protection Act (“NEPA”) permits for the project. We continue to engage in discussions with potential energy generation partners capable of building a power generation facility in Lincoln County. We own 100% of this power plant project, as it is not part of the Lincoln/Vidler teaming agreement.

## Kane Springs

In 2005, Lincoln/Vidler agreed to sell water to a developer of Coyote Springs, a new planned residential and commercial development 60 miles north of Las Vegas, as and when supplies were permitted from Lincoln/Vidler's existing applications in Kane Springs, Nevada. Lincoln/Vidler currently has priority applications for approximately 17,375 acre-feet of water in Kane Springs for which the Nevada State Engineer has requested additional data before making a determination on the applications from this groundwater basin. The actual permits received may be for a lesser quantity, which cannot be accurately predicted.

Currently, we have an option agreement with a developer to sell our remaining 500 acre-feet of water rights we own in this area at a price of \$8,858 per acre-foot. In January 2015, we signed an amendment to the option agreement whereby if all 500 acre-feet are purchased by the developer, the purchase price will be reduced by \$2,500 per acre-foot in exchange for the developer incurring additional drilling costs that would have been incurred by us in connection with the sale. The agreement expires in September 2017 and requires an annual option fee of \$60,000 to maintain the rights under the option. To date, the developer has made all required annual option payments.

The following table summarizes our other water rights and real estate assets at December 31, 2016:

Name and location of asset	Brief description	Present commercial use
Nevada: Truckee River Water Rights	Approximately 299 acre-feet of Truckee River water rights permitted for municipal use.	Water rights are available to support development through sale, lease, or partnering arrangements.
Dry Lake	Vidler owns 595 acres of agricultural and ranch land in Dry Lake Valley. Lincoln/Vidler owns the 1,009 acre-feet of permitted agricultural groundwater rights associated with the land.	Water rights and land are available to support development through sale, lease, or partnering arrangements.
Muddy River	Located in Lincoln County. 267 acre-feet of water rights.  Located 35 miles east of Las Vegas.	Currently leased to Southern Nevada Water Authority through September 30, 2018.
Dodge Flat	1,428 acre-feet of permitted municipal and industrial use water rights, and 1,068 acres of land.	Water rights and land are available for sale, lease or other partnering arrangements.
Colorado:	Located in Washoe County, east of Reno.	In November 2014, we entered into an option agreement with a solar developer for the potential development of a solar power project of up to 180 megawatts.
Tunnel	Approximately 161 acre-feet of water rights.  Located in Summit County (the Colorado Rockies), near Breckenridge.	61 acre-feet of water leased under long term leases. 100 acre-feet are available for sale or lease.
New Mexico: Campbell Ranch	Application for a new appropriation of 717 acre-feet of ground water. Vidler is in	In November 2014, our application was denied by the New Mexico State Engineer causing us to record an

partnership with the land owner. The water rights would be used for a new residential and commercial development. impairment loss of \$3.5 million which reduced the capitalized costs and other assets of this project to zero. We appealed this decision on November 19, 2014.

Located 25 miles east of Albuquerque.

Lower Rio Grande Basin

Approximately 1,261 acre-feet of agricultural water rights.

Water is available for sale, lease or other partnering opportunities.

Located in Dona Ana and Sierra Counties.

In 2014, we entered into a long term lease for a portion of these water rights.

Middle Rio Grande Basin

Approximately 85 acre-feet of municipal rights together with an option to purchase an additional 16 acre-feet.

Water is available for sale, lease, or other partnering opportunities.

Located in Santa Fe and Bernalillo Counties.



## Our Real Estate Operations

Our real estate operations are primarily conducted through UCP, a homebuilder and land developer with land acquisition and entitlement expertise in California, Washington State, North Carolina, South Carolina and Tennessee.

We formed UCP, LLC, the predecessor company to UCP, in 2007 with the objective of acquiring attractive and well-located finished and partially-developed residential lots, primarily in select California and Washington markets. In 2010, UCP, LLC formed Benchmark Communities, LLC (“Benchmark”) to design, construct and sell high quality single-family homes on certain of the lots owned by UCP, LLC.

On July 23, 2013, UCP, Inc. completed an initial public offering (“IPO”). Since our acquisition of UCP, LLC and through the completion of UCP’s IPO, UCP, LLC operated as a wholly owned subsidiary of the Company. Subsequent to the IPO, we have held a majority of the voting power of UCP, Inc. and of the economic interests of UCP, LLC, the subsidiary through which we operate our business. As of December 31, 2016, we owned 56.8% of the voting interest in UCP, Inc. and we owned 56.8% of the economic interests of UCP, LLC and UCP, Inc. owned 43.2% of the economic interests of UCP, LLC.

On April 10, 2014, we completed the acquisition of the assets and liabilities of Citizens Homes, Inc. (“Citizens”) used in the purchase of real estate and the construction and marketing of residential homes in North Carolina, South Carolina and Tennessee, (the “Citizens Acquisition”) in order to position us to expand our operations into markets located in North Carolina, South Carolina and Tennessee. The Citizens Acquisition provides increased scale and presence in established markets with immediate revenue opportunities through an established backlog. Additional synergies are expected in the areas of purchasing leverage and integrating the best practices in operational effectiveness.

## Our Business Strategy

We actively source, evaluate and acquire land for residential real estate development and homebuilding. For each of our real estate assets, we periodically analyze ways to maximize value by either (i) building single-family homes and marketing them for sale under our Benchmark Communities brand, or (ii) completing entitlement work and horizontal infrastructure development and selling lots to third-party homebuilders. We perform this analysis using a disciplined analytical process, which we believe is a differentiating component of our business strategy.

As of December 31, 2016, we owned or controlled 6,638 lots, providing us with significant lot supply, which we believe will support our business strategy for a multi-year period. We believe that our sizable inventory of well-located land provides us with a significant opportunity to develop communities and design, construct, and sell homes under our Benchmark Communities brand. While we expect to opportunistically sell select residential lots to third-party homebuilders when we believe that will maximize our returns or lower our risk, we expect that homebuilding and home sales will constitute our primary means of generating revenue growth for the foreseeable future. As of December 31, 2016, we had 121 completed homes (including 61 model homes) and 400 under construction homes (including 5 model homes).

When acquiring real estate assets, we focus on seeking maximum long-term risk-adjusted returns. Our underwriting and operating philosophies emphasize capital preservation, risk identification and mitigation, and risk-adjusted returns. We seek to mitigate our exposure to market downturns and capitalize on market upturns through the following key strategies:

- identifying and regularly reviewing the risks associated with our assets and business, including market, entitlement and environmental risks, and structuring transactions to minimize the impact of those risks;

- maintaining high quality in our construction activities;
- maintaining a strong balance sheet, using a prudent amount of leverage;
- leveraging our purchasing power and controlling costs;
- attracting highly experienced professionals and encouraging them to maintain a deep understanding and ownership of their respective disciplines;
- maintaining a strong corporate culture that is based on our core values, including integrity, honesty, transparency, innovation, quality and excellence; and
- maintaining rigorous supervision over our operations.

## Markets

We operate in five states in two distinct markets, West and Southeast. In our Western market our operations are homebuilding and land development and in our Southeastern market our operations are mainly homebuilding. We believe that these areas have attractive residential real estate investment characteristics, such as favorable long-term population demographics, a demand for single-family housing that often exceeds available supply, large and growing employment bases, and the ability to generate above-average returns. We continue to experience significant homebuilding and land development opportunities in our current markets and are evaluating potential expansion opportunities in other markets that we believe have attractive long-term investment characteristics.

State	Market(s)
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West

California	Central Valley area (Fresno and Madera counties) Monterey Bay area (Monterey County) South San Francisco Bay area (Santa Clara and San Benito counties) Southern California (Los Angeles, Ventura and Kern counties)
Washington	Puget Sound area (King, Snohomish, Thurston and Kitsap counties)

Southeast

North Carolina	Charlotte area
South Carolina	Myrtle Beach area
Tennessee	Nashville area

## Homebuilding Operations

We build homes through our wholly owned homebuilding subsidiary, Benchmark Communities. We are diversified by product offering, which we believe reduces our exposure to any particular market or customer segment. We decide to target specific and identifiable buyer segments by project and geographic market, in part dictated by each particular asset, its location, topography and competitive market positioning, and the amenities of the surrounding area and the community in which it is located.

We believe our customers look for distinctive new homes; accordingly, we design homes in thoughtful and creative ways to create homes that we expect buyers will find highly desirable. We seek to accomplish this by collecting and analyzing information about the characteristics of our target buyer segments and incorporating our analysis into new home designs. We source information about our target buyer segments from our experience selling new homes and through market research that enables us to identify design preferences that we believe will appeal to our customers. We target diverse buyer segments, including first-time buyers, first-time move-up buyers, second-time move-up buyers and active-adult buyers. Most of our communities target multiple buyer segments, enabling us to seek increased sales pace and reduce our dependence on any single buyer segment.

We contract with third party architects, engineers and interior designers to assist our experienced internal product development personnel in designing homes that are intended to reflect our target customers' tastes and preferences. In addition to identifying desirable design and amenities, this process includes a rigorous value engineering strategy that allows us to seek efficiencies in the construction process.

## Customer Experience

We seek to make the home buying experience friendly, effective and efficient. Our integrated quality assurance and customer care functions assign the same personnel at each community the responsibility for monitoring quality control and managing the customer experience. As a standard practice, we seek to communicate with each homeowner

multiple times during their first two years of ownership in an effort to ensure satisfaction with their new home. Additionally, we monitor the effectiveness of our customer experience efforts with third-party surveys that measure our home buyers' perception of the quality of our homes and the responsiveness of our customer service. Our customer experience program seeks to optimize customer care in terms of availability, response time and effectiveness, and we believe that it reduces our exposure to future liability claims. We believe that our continuing commitment to quality and the customer experience provides a compelling value proposition for prospective home buyers and reduces our exposure to long-term construction defect claims.

## Homebuilding, Marketing and Sales Process

Homebuilding is a local business. As a result, we focus on the unique characteristics of each market and submarket. Each of our markets is managed locally by a division president who has a deep understanding of the local market, including our competition. Additionally, our division presidents maintain a broad network of relationships with land sellers, land developers, subcontractors and realtors.

In order to balance construction capacity with consumer demand, we release homes for sale in small phases, usually four to eight homes. We use sales prices as the lever to maintain equilibrium between capacity and demand. In markets where demand is out-pacing construction capacity we have been able to raise prices and improve gross margins. From time to time we may identify specific communities where demand has lagged construction capacity. In these cases, we have used incentives in order to increase demand.

We utilize a construction methodology that allows us to standardize the time of new home starts in order to reduce labor and material costs and the administrative inefficiencies in the construction process. Our even flow method provides visibility to our material suppliers, vendors and subcontractors, helping them balance their labor and material needs consistently over time, which we believe results in higher-quality craftsmanship and lower production costs. Our even flow method provides us with enhanced visibility, oversight and control of our production process, staffing and cash flow requirements. As a result, we believe that we are able to more effectively manage our working capital and borrowing needs.

Generally, we seek to pre-sell homes before we commence construction. This allows customers to choose certain structural and finish options and often offers us higher profitability as compared to homes that are constructed prior to identifying a buyer. Pre-sold homes often result in superior customer satisfaction and higher gross margins. During periods of strong demand, we have been successful in pre-selling a majority of our homes before construction begins. Given our even flow method, when there is an opportunity to start construction of a home that is not yet sold we will do so in order to have homes available for customers who would like to move into a new home quickly. Homes that are under construction or completed that are not yet sold are attractive to customers who are renting, who are relocating, and who have had or are having a major change in their lives such as marriage, birth of a child or divorce. Homes that are unsold and under construction or completed allow us to compete more aggressively with the resale market where time from contract to close is usually 45 to 60 days.

We routinely monitor and actively manage our production process to align our inventory with prevailing and expected future home absorption trends. In the event our inventory begins to build faster than homes are sold, we will typically reduce or halt the start of any additional unsold homes in order to bring our supply in balance with consumer demand. This allows us to more efficiently manage our inventory and asset levels as well as our capital needs with the objective of improving our overall return metrics.

Our sales and marketing process uses extensive advertising and promotional strategies, including Benchmark Communities' website, community marketing brochures, and the use of billboards and other roadside signage. Brokerage operations are conducted through our wholly owned subsidiaries in each state.

We typically staff two sales professionals at each of our communities. Our in-house sales teams have offices in their respective model home complex and are responsible for selling homes, interfacing with customers between the time a sales contract is executed and the home sale closes, and coordinating with our escrow management department. Our sales personnel work with potential buyers to determine their unique needs and then by demonstrating the functionality and livability of our homes with floor plans, price information, development and construction timetables, tours of model homes and the selection of amenities. Our sales personnel are internally trained, generally have prior experience selling new homes in their respective markets, and are licensed by applicable real estate oversight

agencies.

Model homes are one of our primary sales tools. Depending on the amount of time we expect it will take to complete sales at a community and the number of different homes we are offering, we typically build between two and four model homes. Our marketing staff uses interior designers, architects and color consultants to create model homes designed to appeal to our targeted buyer segments. Our models typically include features that are included in the base price of the particular home model, and options and upgrades that a home buyer may elect to purchase. We often use an on-site design center that offers our customers the opportunity to purchase various options and upgrades and provides additional revenue opportunities for us.

### Home Buyer Financing

The majority of our home buyers finance a significant portion of the purchase price of their home with long-term mortgage financing. We assist prospective purchasers in obtaining mortgage financing by providing referrals to one of our preferred lenders. Our preferred lenders have a track record of offering our customers competitive rates and terms, a desire to enhance our customer's experience and the ability to perform on an agreed schedule in order to meet our expectations and those of our customers. Through our lender referral process, we seek to reduce the challenges our customers encounter when trying to obtain mortgage financing for our homes.

### Quality Control and Customer Service

We pay particular attention to the product design process and carefully consider quality and choice of materials in order to attempt to eliminate building deficiencies. The quality and workmanship of the subcontractors we employ are monitored and we make regular inspections and evaluations of our subcontractors to seek to ensure that our standards are met.

We have quality control and customer service staff who seek to provide a positive experience for each home buyer throughout the pre-sale, sale, building, closing and post-closing periods. These employees are responsible for providing after sales customer service. Our quality and service initiatives include taking home buyers on a comprehensive tour of their home prior to closing and using customer survey results to improve our standards of quality and customer satisfaction.

### Warranty Program

We provide a "fit and finish" warranty on our home sales that covers workmanship and materials consistent with local market custom (two years in the West homebuilding segment and one year in the Southeast homebuilding segment). As is customary in the homebuilding industry, our trade partners who build our homes are contractually obligated to provide warranty repairs inside the fit and finish warranty period, including structural and water intrusion repairs up to the period designated by the relevant state statute.

Along with our homeowners receiving warranty information, they also receive important home maintenance guidelines in an effort to help them enjoy and prolong the durability of their home. Customers who actively and correctly maintain their home not only protect the value of their home, but minimize the longer-term risk to us that is normally associated with homes that are not properly maintained.

The limited warranty covering construction defects is transferable to subsequent buyers not under direct contract with us and requires that home buyers agree to the conditions, restrictions and procedures set forth in the warranty. We accrue estimated warranty costs based upon our estimates of the expense we expect to incur for work under warranty.

### Raw Materials

When constructing homes we use various materials and components. It has typically taken us four to six months to construct a home, during which time we are subject to price fluctuations in raw materials.

### Land Development

As a homebuilder and land developer, we are positioned to either build new homes on our lots or to sell our lots to third-party homebuilders. While our business plan emphasizes building new homes, we proactively monitor market conditions and our operations allow us to opportunistically sell a portion of our lots to third-party homebuilders if we

believe that will maximize our returns or lower our risk. We believe that our ability and willingness to opportunistically build on or sell our lots to third-party homebuilders afford us the following important advantages:

- exploit periods of cyclical expansion by building on our lots;

- manage our operating margins and reduce operating income volatility by opportunistically selling lots as operating performance and market conditions dictate; and

- manage operating risk in periods where we anticipate cyclical contraction by reducing our land supply through lot sales.



We benefit from the long-standing relationships our executive management team at UCP has with key land owners, brokers, lenders, as well as development and real estate companies in our market. These relationships have provided opportunities to evaluate and privately negotiate acquisitions outside of a broader marketing process. In addition, we believe that our financial position, positive reputation in our markets among potential land sellers and brokers, as well as our track record of acquiring lots since 2008, provide land sellers and brokers confidence that we will consummate transactions in a highly professional, efficient and transparent manner. Our ability to regularly do so in turn strengthens these relationships for future opportunities. We believe our relationships with land owners and brokers will continue to provide opportunities to source land acquisitions prior to a full marketing process, helping us to maintain a significant pipeline of opportunities on favorable terms and prices.

The land development process in our markets can be very complex and often requires highly-experienced individuals that can respond to numerous unforeseen challenges with a high degree of competency and integrity. We actively seek land acquisition opportunities where others might seek to avoid complexities, as we believe we can add significant value through our expertise in entitlements, re-entitlements, horizontal land planning and development.

#### Acquisition Process

Our ability to identify, evaluate and acquire land in desirable locations and on favorable terms is critical to our success. We evaluate land opportunities based on risk-adjusted returns and employ a rigorous due diligence process to identify risks, which we then seek to mitigate.

We leverage our relationships with land owners, brokers, developers and financial institutions, and our history of purchasing land, to seek the “first look” at land acquisition opportunities or to evaluate opportunities before they are broadly marketed. We use a variety of transaction structures, including purchase and option contracts, to maximize our risk-adjusted return, with particular emphasis on reducing our risk, conserving our capital while accommodating the particular needs of each seller.

We combine our entitlement, land development and homebuilding expertise to increase the flexibility of our business, seek enhanced margins, control our lot deliveries and maximize returns. Additionally, we believe that the integration of the entitlement, development and homebuilding process allows us to deliver communities that achieve a high level of customer satisfaction. Our entitlement expertise allows us to add value through the zoning and land planning process. Our land development entitlement expertise allows us to consider a broader range of land acquisition opportunities from which to seek superior risk-adjusted returns.

We selectively evaluate expansion opportunities in our existing markets as well as new markets that we believe have attractive long-term investment characteristics. These characteristics include, among others, demand for single-family housing that exceeds available supply, well regarded educational systems and institutions, high educational attainment levels, desirable transportation infrastructure, proximity to major trade corridors, positive employment trends, diverse employment bases and high barriers to the development of residential real estate, such as geographic or political factors.

## Owned and Controlled Lots

The following tables present certain information with respect to our owned or controlled lots, which were pursuant to purchase or option contracts:

	As of December 31, 2016		
	Owned	Controlled <sup>(1)</sup>	Total
West	3,205	870	4,075
Southeast	826	1,737	2,563
Total	4,031	2,607	6,638

	As of December 31, 2015		
	Owned	Controlled <sup>(1)</sup>	Total
West	3,869	415	4,284
Southeast	882	712	1,594
Total	4,751	1,127	5,878

<sup>(1)</sup> Controlled lots are those subject to a purchase or option contract.

## Our Financing Strategy

We intend to use debt and equity as part of our ongoing financing strategy at UCP, coupled with redeployment of cash flows from continuing operations. This strategy provides us with the financial flexibility to access capital on attractive terms. In that regard, we expect to employ prudent levels of leverage to finance the acquisition and development of our lots and construction of our homes. We attempt to match the duration of our real estate assets with the duration of the capital that finances each asset.

Our debt in this segment is primarily comprised of senior notes due on October 21, 2017, and project-level secured acquisition, development and construction loans. Substantially all of UCP's project debt is guaranteed by UCP, LLC and UCP, Inc. We consider a number of factors when evaluating the level of our debt, and when making decisions regarding additional borrowing, including the purchase price of assets to be acquired with debt financing, the estimated market value of our assets, the expected asset's duration, and the ability of particular assets to generate cash flow to cover the expected debt service.

We intend to finance future acquisitions and developments with the most advantageous source of capital available to us at the time of the transaction, which may include a combination of common and preferred equity issued by UCP, secured and unsecured corporate level debt issued by UCP, property-level debt and mortgage financing and other public, private or bank debt.

## Government Regulation and Environmental Matters

We are subject to various local, state, and federal statutes, ordinances, rules, and regulations concerning zoning, building design, construction, and similar matters, including local regulations which impose restrictive zoning and density requirements in order to limit the number of homes that can be built within the boundaries of a particular locality. In addition, we are subject to registration and filing requirements in connection with the construction, advertisement, and sale of our communities in certain states and localities in which we operate. We may also be subject to periodic delays or may be precluded entirely from developing communities due to building moratoriums that could be implemented in the future in the states in which we operate. Generally, such moratoriums relate to insufficient water or sewerage facilities or inadequate road capacity.

In addition, some state and local governments in markets where we operate have approved, and others may approve, slow-growth, or no-growth initiatives that could negatively affect the availability of land and building opportunities within those areas. Approval of these initiatives could adversely affect our ability to build and sell homes in the affected markets and/or could require the satisfaction of additional administrative and regulatory requirements, which could result in slowing the progress or increasing the costs of our homebuilding operations in these markets. Any such delays or costs could have a negative effect on our future revenues and earnings.

We are also subject to a variety of local, state, and federal laws and regulations concerning protection of health and the environment. The particular environmental laws which apply to any given community vary greatly according to the community site, the site's environmental conditions, and the present and former uses of the site. These environmental laws may result in delays, may cause us to incur substantial compliance, remediation, and/or other costs; and prohibit or severely restrict development and homebuilding activity.

Despite our past ability to obtain necessary permits and approvals for our communities, we anticipate that increasingly stringent requirements will be imposed on developers and homebuilders in the future. Although we cannot predict the effect of these requirements, they could result in time-consuming and expensive compliance programs and in substantial expenditures, which could cause delays and increase our cost of operations. In addition, our ability to obtain or renew permits or approvals and the continued effectiveness of permits already granted or approvals already obtained is dependent upon many factors, some of which are beyond our control, such as changes in policies, rules, and regulations and their interpretation and application.

#### Seasonality

The homebuilding industry generally exhibits seasonality. We have historically experienced, and in the future expect to continue to experience, variability in our operating results and capital needs on a quarterly basis. Although we enter into home sales contracts throughout the year, a significant portion of our sales activity takes place during the spring and summer, with the corresponding closings taking place during the fall and winter. Additionally, our capital needs are typically greater during the spring and summer when we are building homes for delivery later in the year. Accordingly, our revenue may fluctuate significantly on a quarterly basis, and we must maintain sufficient liquidity to meet short-term operating requirements. As a result of seasonal variation, our quarterly results of operations and financial position at the end of a particular quarter are not necessarily representative of the results we expect at year-end.

#### Competition

The homebuilding and land development industry is highly competitive. We compete with numerous large national and regional homebuilding companies and with smaller local homebuilders and land developers for, among other things, home buyers, financing, desirable land parcels, raw materials and skilled management and labor resources. We also compete with sales of existing homes and, to a lesser extent, with the rental housing market. Our homes compete on the basis of design, quality, price and location. In addition to home sales, we sell lots to third-party homebuilders. We compete for land buyers with other land owners. Our land holdings compete on the basis of quality, market positioning, location and price.

The homebuilding and land development industry has historically been subject to significant volatility. We may be at a competitive disadvantage with regard to certain of our national competitors whose operations are more geographically diversified than ours, as these competitors may be better able to withstand any future regional downturn in the housing market.

We compete directly with a number of large national homebuilders who are larger and may have greater financial and operational resources. This may give our competitors an advantage in marketing their products, securing materials and labor at lower prices, purchasing land and allowing their homes to be delivered to customers more quickly and at more favorable prices. This competition could reduce our market share and limit our ability to expand our business.

#### Our Corporate Segment

Our corporate segment includes our residual investments in small businesses which have typically been venture capital-type situations. In addition, the segment includes the results of deferred compensation investment assets held in trust for the benefit of certain current and former officers and the corresponding and offsetting deferred compensation liabilities, and corporate overhead expenses.

The following are the most significant investments in small businesses that we currently own:

We own common and preferred stock of, and have made a loan to Mindjet Inc. (“Mindjet”), a privately held company located in San Francisco, California that provides software to help business innovation by providing a framework to build sustainable, predictable, and repeatable innovation processes. The investment balances in Mindjet are held at cost and included in investments in our consolidated financial statements while the outstanding loan balance is included in other assets. At December 31, 2016, we controlled 19.3% of the voting stock of the company and the carrying value of our total investment in Mindjet was \$2.3 million, comprised of \$1.3 million in preferred stock and a loan of \$1 million.

We operate Mendell Energy, LLC (“Mendell”), a wholly owned oil and gas venture which owns and operates oil and gas leases, primarily located within the Wattenberg Field in Colorado. In August 2016, we entered into a purchase and sale agreement to sell the majority of the assets of Mendell for gross proceeds of \$9.6 million. After the sale of the majority of the assets, we own an insignificant amount of oil and gas leases, some of which were sold during the first quarter of 2017. See Note 11 “Related- Party Transactions” for additional information. At December 31, 2016, we had a net carrying value of \$9.7 million in Mendell which primarily consisted of unrestricted cash.

We own preferred stock in Synthonics, a preclinical stage biopharmaceutical company focused on the development and discovery of patentable small molecule drugs that incorporate a metal coordination chemistry. The company targets approved drugs, advanced clinical candidates or previously studied compounds with pharmacokinetic properties that are believed to limit the drugs’ clinical safety, tolerability or efficacy and can be improved through metal coordination. Metal coordination entails attaching a pharmaceutically acceptable metal, such as magnesium, calcium, zinc or bismuth, to an active agent to create a new, patentable compound. The company believes its approach enables more efficient and less expensive drug discovery and clinical development than conventional drug research and development approaches. The company intends to license one or more of the drugs to integrated pharmaceutical companies that would assist in the development of such drugs and assume responsibility for their approval, marketing and distribution. However, they have not commercialized any products or generated any significant revenue to date, and expect to incur operating losses into the foreseeable future. Mr. Slepicka, a former non-employee director of our Company, co-founded Synthonics and is currently their Chairman, Chief Executive Officer and acting Chief Financial Officer. Mr. Slepicka resigned as a member of the Company’s Board of Directors effective July 27, 2016. At December 31, 2016, we owned 18.2% of the voting interest of the company. We made our initial investment in Synthonics during 2010 when we purchased 273,229 shares of series D convertible voting preferred stock for \$2.1 million. In 2013, we invested \$110,000 for an additional 15,000 shares of the same series D convertible voting preferred stock. In February 2014, we initiated a \$400,000 line of credit to Synthonics which bore interest at 15% per annum and in May 2014, we increased the line to \$450,000. The outstanding balance of the line of credit and accrued interest was repaid in April 2015. During the fourth quarter of 2016, we recorded an impairment loss on of our investment reducing the carrying value to zero.

It is reasonably possible given the volatile nature of the software industry that circumstances may change in the future which could require us to record impairment losses on our investments included in this segment.

#### Employees

At December 31, 2016, PICO had 234 employees, including 203 at UCP.

#### Executive Officers

The executive officers of PICO are:

Name	Age	Position
Maxim C. W. Webb	55	President, Chief Executive Officer and Chairman of the Board
John T. Perri	47	Chief Financial Officer and Secretary

Mr. Webb has served as our President, Chief Executive Officer, and as a member of our board of directors since October 2016. Effective December 2, 2016, Mr. Webb was appointed Chairman of the Board of Directors. Mr. Webb also serves as a director of UCP, Inc. (since May 2013) and as an officer of Vidler Water Company, Inc. (since 2001). He has served in various capacities since joining our company in 2001, including Chief Financial Officer, Treasurer, Executive Vice President and Secretary from 2001 to October 2016.

Mr. Perri has served as our Chief Financial Officer and Secretary since October 2016. He has served in various capacities since joining our company in 1998, including Vice President, Chief Accounting Officer from 2010 to October 2016, Financial Reporting Manager, Corporate Controller and Vice President, Controller from 2003 to 2010.

## ITEM 1A. RISK FACTORS

The following information sets out factors that could cause our actual results to differ materially from those contained in forward-looking statements we have made in this Annual Report on Form 10-K and those we may make from time to time. You should carefully consider the following risks, together with other matters described in this Form 10-K or incorporated herein by reference in evaluating our business and prospects. If any of the following risks occurs, our business, financial condition or operating results could be harmed. In such case, the trading price of our securities could decline, in some cases significantly.

General economic conditions could have a material adverse effect on our financial results, financial condition and the demand for and the fair value of our assets.

All of our businesses are sensitive to general economic conditions, whether internationally, nationally, or locally. General poor economic conditions and the resulting effect of non-existent or slow rates of growth in the markets in which we operate could have a material adverse effect on the demand for both our real estate and water assets. These poor economic conditions include higher unemployment, inflation, deflation, decreases in consumer demand, changes in buying patterns, a weakened dollar, higher consumer debt levels, and higher tax rates and other changes in tax laws or other economic factors that may affect commercial and residential real estate development.

Specifically, high national or regional unemployment may arrest or delay any significant recovery of the residential real estate markets in which we operate, which could adversely affect the demand for our real estate and water assets. Any prolonged lack of demand for our real estate and water assets could have a significant adverse effect on our revenues, results of operations, cash flows, and the return on our investment from these assets.

Our future revenue is uncertain and depends on a number of factors that may make our revenue, profitability, cash flows, and the fair value of our assets volatile.

Our future revenue and profitability related to our water resource and water storage operations will primarily be dependent on our ability to develop and sell or lease water assets. In light of the fact that our water resource and water storage operations represent a large percentage of our overall business at present, our long-term profitability and the fair value of the assets related to our water resource and water storage operations will be affected by various factors, including the drought in the southwest, regulatory approvals and permits associated with such assets, transportation arrangements, and changing technology. We may also encounter unforeseen technical or other difficulties which could result in cost increases with respect to our water resource and water storage development projects. Moreover, our profitability and the fair value of the assets related to our water resource and water storage operations is significantly affected by changes in the market price of water. Future sales and prices of water may fluctuate widely as demand is affected by climatic, economic, demographic and technological factors as well as the relative strength of the residential, commercial, financial, and industrial real estate markets. Additionally, to the extent that we possess junior or conditional water rights, during extreme climatic conditions, such as periods of low flow or drought, our water rights could be subordinated to superior water rights holders. The factors described above are not within our control.

Our future revenue, growth, and the demand for and the fair value of our assets related to our land development and homebuilding activities depends, in part, upon our ability to successfully identify and acquire attractive land parcels for development of single-family homes at reasonable prices. Our ability to acquire land parcels for new single-family homes may be adversely affected by changes in the general availability of land parcels, the willingness of land sellers to sell land prices at reasonable prices, competition for available land parcels, availability of financing to acquire land parcels, zoning and other market conditions. If the supply of land parcels appropriate for development of single-family homes is limited because of these factors, or for any other reason, our ability to grow and increase the fair value of our



assets related to our land development and homebuilding business could be significantly limited, and our land development and homebuilding revenue and gross margin could remain static or decline and it could adversely affect the return on our investment from these assets.

One or more of the above factors in one or more of our operating segments could impact our revenue and profitability, negatively affect our financial condition and cash flows, cause our results of operations to be volatile, and could negatively impact our rate of return on our real estate and water assets and cause us to divest such assets for less than our intended return on our investment.

A downturn in the recent improvement that the homebuilding and land development industry has experienced would materially adversely affect our business, results of operations, and the demand for and the fair value of our assets.

The homebuilding industry experienced a significant and sustained downturn in recent years having been impacted by factors that include, but are not limited to, weak general economic and employment growth, a lack of consumer confidence, large supplies of resale and foreclosed homes, a significant number of homeowners whose outstanding principal balance on their mortgage loan exceeds the market value of their home, and tight lending standards and practices for mortgage loans that limit consumers' ability to qualify for mortgage financing to purchase a home. These factors resulted in an industry-wide weakness in demand for new homes and caused a material adverse effect on the growth of the local economies and the homebuilding industry in the southwestern United States ("U.S.") markets where a substantial amount of our real estate and water assets are located, including the states of Nevada, Arizona, California, Colorado, and New Mexico. However, in 2012, we noted a significant improvement in the housing market which led to increased levels of real estate development activity. The continuation of the recent improvement in residential and commercial real estate development process and activity is essential for our ability to generate operating income in our water resource and water storage, and land development and homebuilding businesses. We are unable to predict whether and to what extent this recovery will continue or its timing. Any future slow-down in real estate and homebuilding activity could adversely impact various development projects within the markets in which our real estate and water assets are located and this could materially affect the demand for and the fair value of these assets and our ability to monetize these assets. Declines and weak conditions in the U.S. housing market have reduced our revenues and created losses in our water resource and water storage, and land development and homebuilding businesses in prior years and could do so in the future.

We may not be able to realize the anticipated value of our real estate and water assets in our projected time frame, if at all.

We expect that the current rate of growth of the economy will continue to have an impact on real estate market fundamentals. Depending on how markets perform both in the short and long-term, the state of the economy, both nationally and locally in the markets where our assets are concentrated, could result in a decline in the value of our existing real estate and water assets, or result in our having to retain such assets for longer than we initially expected, which would negatively impact our rate of return on our real estate and water assets, cause us to divest such assets for less than our intended return on investment, or cause us to incur impairments on the book values of such assets to estimated fair value. Such events would adversely impact our financial condition, results of operations and cash flows.

The fair values of our real estate and water assets are linked to growth factors concerning the local markets in which our assets are concentrated and may be impacted by broader economic issues.

Both the demand and fair value of our real estate and water assets are significantly affected by the growth in population and the general state of the local economies where our real estate and water assets are located. These local economies may be affected by factors such as the local level of employment and the availability of financing and interest rates, where (1) our real estate and water assets are located, primarily in Arizona and northern Nevada, but also in Colorado and New Mexico and (2) our land development and homebuilding assets are located, primarily in California and also Washington, North Carolina, South Carolina and Tennessee. The unemployment rate in these states, as well as issues related to the credit markets, may prolong a slowdown of the local economies where our real estate and water assets are located. This could materially and adversely affect the demand for and the fair value of our real estate and water assets and, consequently, adversely affect our growth and revenues, results of operations, cash flows and the return on our investment from these assets.

The fair values of our real estate and water assets may decrease which could adversely affect our results of operations by impairments and write-downs.

The fair value of our water resource and water storage assets and our land and homebuilding assets depends on market conditions. We acquire water resources and land for expansion into new markets and for replacement of inventory and expansion within our current markets. The valuation of real estate and water assets is inherently subjective and based on the individual characteristics of each asset. Factors such as changes in regulatory requirements and applicable laws, political conditions, the condition of financial markets, local and national economic conditions, the financial condition of customers, potentially adverse tax consequences, and interest and inflation rate fluctuations subject valuations to uncertainties. In addition, our valuations are made on the basis of assumptions that may not prove to reflect economic or demographic reality. If population growth and, as a result, water and/or housing demand in our markets fails to meet our expectations when we acquired our real estate and water assets, our profitability may be adversely affected and we may not be able to recover our costs when we sell our real estate and water assets. We regularly review the value of our real estate and water assets. These reviews have resulted in significant impairments to our water resource assets and /or land development assets. Such impairments have adversely affected our results of operations and our financial condition in those years.

If future market conditions adversely impact the anticipated timing of and amount of sales of our real estate and water assets we may be required to record further significant impairments to the carrying value of our real estate and water assets which would adversely affect our results of operations and our financial condition.

\* Our water resource and water storage operations are concentrated in a limited number of assets, making our profitability and the fair value of those assets vulnerable to conditions and fluctuations in a limited number of local economies.

We anticipate that a significant amount of our water resource and water storage segment revenue, results of operations and cash flows will come from a limited number of assets, which primarily consist of our water resources in Nevada and Arizona and our water storage operations in Arizona. Water resources in this region are scarce and we may not be successful in continuing to develop additional water assets. If we are unable to develop additional water assets, our revenues will be derived from a limited number of assets, primarily located in Arizona and Nevada. Our two most significant assets are our water storage operations in Arizona and our water resources to serve the northern valleys of Reno, Nevada. As a result of this concentration, our invested capital and results of operations will be vulnerable to the conditions and fluctuations in these local economies and potentially to changes in local government regulations.

Our Arizona Recharge Facility is one of the few private sector water storage sites in Arizona. At December 31, 2016, we had approximately 251,000 acre-feet of water stored at the facility. In addition, we had approximately 157,000 acre-feet of water stored in the Phoenix Active Management Area at December 31, 2016. We have not stored any water on behalf of any customers and as of December 31, 2016, had not generated any material revenue from the recharge facility or from the water stored in the Phoenix Active Management Area. We believe that the best economic return on the assets arises from storing water when surplus water is available and selling this water in periods when water is in more limited supply. However, we cannot be certain that we will ultimately be able to sell the stored water at a price sufficient to provide an adequate economic profit, if at all.

We constructed a pipeline approximately 35 miles long to deliver water from Fish Springs Ranch to the northern valleys of Reno, Nevada. As of December 31, 2016, the total cost of the pipeline project, including our water credits (net of impairment losses incurred to date) carried on our balance sheet was approximately \$83.9 million. To date, we have sold only a small amount of the water credits and we cannot provide any assurance that the sales prices we may obtain in the future will provide an adequate economic return, if at all. Furthermore, we believe the principal buyers of this water are likely real estate developers who are contending with the effects of the current weak demand that exists for new homes and residential development in this area. Any prolonged weak demand for new homes and residential development, and, as a result, for our assets in Nevada and Arizona, would have a material adverse effect on our future revenues, results of operations, cash flows, and the return on our investment from those assets.

We are subject to laws and regulations, which may increase our costs, result in liabilities, limit the areas in which we can build homes and delay completion of our projects.

Our real estate operations are subject to a variety of local, state, federal and other laws, statutes, ordinances, rules and regulations concerning the environment, hazardous materials, the discharge of pollutants and human health and safety. The particular environmental requirements which apply to any given project site vary according to multiple factors, including the site's location, its environmental conditions, the current and former uses of the site, the presence or absence of state- or federal-listed endangered or threatened plants or animals or sensitive habitats, and conditions at nearby properties. We may not identify all of these concerns during any pre-acquisition or pre-development review of project sites. Environmental requirements and conditions may result in delays, may cause us to incur substantial compliance and other costs, and can prohibit or severely restrict development and homebuilding activity in environmentally sensitive regions or in areas contaminated by others before we commence development. We are also

subject to third-party challenges, such as by environmental groups or neighborhood associations, under environmental laws and regulations governing the permits and other approvals for our real estate projects and operations. Sometimes regulators from different governmental agencies do not concur on development, remedial standards or property use restrictions for a project, and the resulting delays or additional costs can be material for a given project.

In addition, in cases where a state-listed or federally-listed endangered or threatened species is involved and related agency rule-making and litigation are ongoing, the outcome of such rule-making and litigation can be unpredictable and can result in unplanned or unforeseeable restrictions on, or the prohibition of, development and building activity in identified environmentally sensitive areas.

Our real estate operations are also subject to numerous other laws and regulations that affect the land development and homebuilding process, including laws and regulations related to zoning, permitted land uses, levels of density, building design, water and waste disposal and use of open spaces. We are typically required to obtain permits, entitlements and approvals from local authorities to start and carry out residential development or home construction. Such permits, entitlements and approvals may, from time-to-time, be opposed or challenged by local governments or other interested parties, adding delays, costs and risks of non-approval to the process. Our obligation to comply with the laws and regulations under which we operate, and our need to ensure that our subcontractors and other agents comply with these laws and regulations may result in delays in construction and land development and may also cause us to incur substantial additional and unbudgeted costs.

We will face significant competition in marketing and selling new homes.

We have entered the homebuilding business by constructing, marketing and selling single-family homes on certain of our finished residential lots that we own in California, Washington, North Carolina, South Carolina and Tennessee. We aim to build homes only in those markets where we have identified that a sufficient demand exists for new homes. However, the homebuilding industry is highly competitive and we will be competing with a number of national and local homebuilders in selling homes to satisfy expected demand. These competitors, especially the national homebuilders, have greater resources and experience in this industry than we have. Such competition could result in lower than anticipated sales volumes and/or profit margins that are below our expectations. In addition, we will have to compete with the resale of existing homes, including foreclosed homes, which could also negatively affect the number and price of homes we are able to sell and the time our homes remain on the market.

We use leverage to finance a portion of the cost to acquire our land development assets and to construct homes.

We currently use, and expect to continue to use, debt to finance a portion of the cost of constructing our homes and acquiring and developing our lots. Such debt is primarily comprised of project-level secured acquisition, development and construction loans, with recourse limited to the securing collateral.

Incurring debt could subject us to many risks that, if realized, would adversely affect us, including the risk that:

- our cash flow from our land development and homebuilding operations may be insufficient to make required payments of principal of and interest on the debt which is likely to result in acceleration of the maturity of such debt;
- our debt may increase our vulnerability to adverse economic and industry conditions with no assurance that investment yields will increase with higher financing cost;
- we may be required to dedicate a portion of our cash flow from our land development and homebuilding operations to payments on our debt, thereby reducing funds available for the operations and capital expenditures; and
- the terms of any refinancing may not be as favorable as the terms of the debt being refinanced.

If we do not have sufficient funds to repay our debt at maturity, it may be necessary to refinance the debt through additional debt or additional equity financings which could dilute our interest in our land development and homebuilding business. If, at the time of any refinancing, prevailing interest rates or other factors result in higher interest rates on refinancing, increases in interest expense could adversely affect our cash flows and results of operations. If we are unable to refinance our debt on acceptable terms, we may be forced to dispose of our land development and housing assets on disadvantageous terms, potentially resulting in losses. To the extent we cannot meet any future debt service obligations, we will risk losing some or all of our assets that may be pledged to secure our obligations to foreclosure. Defaults under our debt agreements used to finance a portion of the cost of constructing homes and acquiring and developing lots could have a material adverse effect on our land development and homebuilding business, prospects, liquidity, financial condition, results of operations, and the return on our investment from those assets.

We may be subject to significant warranty, construction defect and liability claims in the ordinary course of our homebuilding business.

As a homebuilder, we may be subject to home warranty and construction defect claims arising in the ordinary course of business. We may also be subject to liability claims for injuries that occur in the course of construction activities. Due to the inherent uncertainties in such claims, we cannot provide assurance that our insurance coverage or our subcontractors' insurance and financial resources will be sufficient to meet any warranty, construction defect and liability claims we may receive in the future. If we are subject to claims beyond our insurance coverage, our profit from our homebuilding activities may be less than we expect and our financial condition and the return on our investment from those assets may be adversely affected.

We will be relying on the performance of our subcontractors to build horizontal infrastructure and homes according to our budget, timetable and quality.

We rely on subcontractors to perform the actual construction of horizontal infrastructure (in the cases where we are completing the development of entitled lots to finished lots) and of the homes we are building on certain of our finished lots. In certain cases, we will also rely on the subcontractor to select and obtain raw materials. Our subcontractors may fail to meet either our quality control or be unable to build and complete the horizontal infrastructure or homes in the expected timetable due to subcontractor related issues such as being unable to obtain sufficient materials or skilled labor, or due to external factors such as delays arising from severe weather conditions.

Any such failure by our subcontractors could lead to increases in construction costs and construction delays. Such increases could negatively impact the price and number of finished lots and homes we are able to sell.

Our homebuilding operations may be adversely impacted by the availability of and the demand for mortgage financing and any changes to the tax benefits associated with owning a home.

To successfully market and sell the homes we construct depends on the ability of home buyers to obtain mortgage financing for the purchase of these new homes. Current credit requirements for mortgage financing are significantly greater than in the past which makes it more difficult for a potential home buyer to obtain mortgage financing. In addition, any significant increase in interest rates from current rates may also lead to increased mortgage finance costs leading to a decline in demand and availability of mortgage financing. Any decline in the availability of mortgage financing may lead to a reduced demand for the homes we have already constructed, or intend to construct. Furthermore, the demand for homes in general, and the homes we intend to construct, may be affected by changes in federal and state income tax laws. Current federal, and many state, tax laws allow the deduction of, among other homeowner expenses, mortgage interest and property taxes against an individual's taxable income. Any changes to the current tax laws which reduce or eliminate these deductions, or reduce or eliminate the exclusion of taxable gain from the sale of a principal residence, would likely lead to a greatly reduced demand for homes. This would lead to a materially adverse impact on the homebuilding business, and the fair value of those assets in general, and our revenues, cash flows, financial condition, and the return on our investment from those assets specifically.

\* UCP has substantial indebtedness, which may exacerbate the adverse effect of any declines in UCP's business, industry or the general economy and exposes UCP to the risk of default. UCP may be unable to service their debt.

As of December 31, 2016, UCP had approximately \$161.7 million of outstanding debt. UCP's substantial outstanding debt, and the limitations imposed on UCP by the instruments and agreements governing its outstanding indebtedness, could have significant adverse consequences, including the following:

• UCP's cash flow may be insufficient to meet its required principal and interest payments;

• UCP may use a substantial portion of their cash flows to make principal and interest payments and UCP may be unable to obtain additional financing as needed or on favorable terms, which could, among other things, have a material adverse effect on their ability to complete our development pipeline, capitalize upon emerging acquisition opportunities, fund working capital or capital expenditures, or meet their other business needs;

• UCP may be unable to refinance its debt at maturity or the refinancing terms may be less favorable than the terms of their original debt;

• UCP may be forced to dispose of one or more of their properties, possibly on unfavorable terms or in violation of certain covenants to which UCP may be subject;

• UCP may be required to maintain certain debt and coverage and other financial ratios at specified levels, which may limit their ability to obtain additional financing in the future, thereby reducing their financial flexibility to react to changes in their business;



• UCP's vulnerability to general adverse economic and industry conditions may be increased; approximately \$81.3 million of UCP's debt bears interest at variable rates, which exposes it to increased interest expense in a rising interest rate environment;

• UCP may be at a competitive disadvantage relative to its competitors that have less debt;

• UCP's flexibility in planning for, or reacting to, changes in their business and the markets in which UCP operates may be limited; and

• UCP may default on its debt by failure to make required payments or to comply with certain covenants, which could result in an event of default entitling a creditor to declare all amounts owed to it to be due and payable, and possibly entitling other creditors (due to cross-default or cross-acceleration provisions) to accelerate the maturity of amounts owed to such other creditors or, if such debt is secured, to foreclose on UCP's assets that secure such obligation.

In addition, in October 2014, UCP completed a private offering of \$75 million in aggregate principal amount of 8.5% Senior Notes, which mature on October 21, 2017 (the “2017 Notes”). UCP’s ability to satisfy this maturity when it becomes due will depend on its future operating performance and financial results, which will be subject, in part, to factors beyond its control, including interest rates and general economic, financial and competitive conditions. UCP’s sources of capital to satisfy this maturity may include retained capital, the issuance of equity securities, debt financing and refinancing, and asset sales or a combination of any of the foregoing. However, no assurance can be given that any of these sources of capital will be available to UCP on favorable terms, or at all, or that such sources will enable UCP to be able to satisfy this maturity. Any refinancing of the 2017 Notes may be on terms less favorable than those applicable to the 2017 Notes. As a result, we can provide no assurance that UCP will be able to refinance or repay the 2017 Notes. UCP’s failure to refinance or repay the 2017 Notes at their stated maturity would have a material adverse impact on UCP’s financial condition, results of operations, cash flow, liquidity, the market price of its Class A common stock and its ability to achieve its objectives.

The occurrence of any one of these events could have a material adverse effect on our financial condition, liquidity, results of operations and/or business.

We may suffer uninsured losses or suffer material losses in excess of insurance limits.

We could suffer physical damage to any of our assets at one or more of our different businesses and liabilities resulting in losses that may not be fully recoverable by insurance. In addition, certain types of risks, such as personal injury claims, may be, or may become in the future, either uninsurable or not economically insurable, or may not be currently or in the future covered by our insurance policies or otherwise be subject to significant deductibles or limits. Should an uninsured loss or a loss in excess of insured limits occur or be subject to deductibles, we could sustain financial loss or lose capital invested in the affected asset(s) as well as anticipated future income from that asset. In addition, we could be liable to repair damage or meet liabilities caused by risks that are uninsured or subject to deductibles.

We may not receive all of the permitted water rights we expect from the water rights applications we have filed in Nevada and New Mexico.

We have filed certain water rights applications in Nevada and New Mexico. In Nevada this is primarily as part of the water teaming agreement with Lincoln County. We deploy the capital required to enable the filed applications to be converted into permitted water rights over time as and when we deem appropriate or as otherwise required. We only expend capital in those areas where our initial investigations lead us to believe that we can obtain a sufficient volume of water to provide an adequate economic return on the capital employed in the project. These capital expenditures largely consist of drilling and engineering costs for water production, costs of monitoring wells, legal and consulting costs for hearings with the State Engineer, and NEPA compliance costs. Until the State Engineer in the relevant state permits the water rights we are applying for, we cannot provide any assurance that we will be awarded all of the water that we expect based on the results of our drilling and our legal position and it may be a considerable period of time before we are able to ascertain the final volume of water rights, if any, that will be permitted by the State Engineers. Any significant reduction in the volume of water awarded to us from our original base expectation of the amount of water that may be permitted may result in the write down of capitalized costs which could adversely affect the return on our investment from those assets, our revenues, results of operations, and cash flows.

Variances in physical availability of water, along with environmental and legal restrictions and legal impediments, could impact profitability.

We value our water assets, in part, based upon the volume (as measured in acre-feet) of water we anticipate from water rights applications and our permitted water rights. The water and water rights held by us and the transferability

of these rights to other uses, persons, and places of use are governed by the laws concerning water rights in the states of Arizona, Colorado, Nevada, and New Mexico. The volumes of water actually derived from the water rights applications or permitted rights may vary considerably based upon physical availability and may be further limited by applicable legal restrictions.

As a result, the volume of water anticipated from the water rights applications or permitted rights may not in every case represent a reliable, firm annual yield of water, but in some cases describe the face amount of the water right claims or management's best estimate of such entitlement. Additionally, we may face legal restrictions on the sale or transfer of some of our water assets, which may affect their commercial value. If the volume of water yielded from our water rights applications is less than our expectations, or we are unable to transfer or sell our water assets, we may lose some or all of our anticipated returns, which may adversely affect our revenues, profitability and cash flows.

Purchasers of our real estate and water assets may default on their obligations to us and adversely affect our results of operations and cash flow.

In certain circumstances, we finance sales of real estate and water assets, and we secure such financing through deeds of trust on the property, which are only released once the financing has been fully paid off. Purchasers of our real estate and water assets may default on their financing obligations. Such defaults may have an adverse effect on our business, financial condition, and the results of operations and cash flows.

Our sale of water assets may be subject to environmental regulations which would impact our revenues, profitability, and cash flows.

The quality of the water assets we lease or sell may be subject to regulation by the United States Environmental Protection Agency acting pursuant to the United States Safe Drinking Water Act. While environmental regulations do not directly affect us, the regulations regarding the quality of water distributed affects our intended customers and may, therefore, depending on the quality of our water, impact the price and terms upon which we may in the future sell our water assets. If we need to reduce the price of our water assets in order to make a sale to our intended customers, our balance sheet, return on investment, results of operations and financial condition could suffer.

Our water asset sales may meet with political opposition in certain locations, thereby limiting our growth in these areas.

The water assets we hold and the transferability of these assets and rights to other uses, persons, or places of use are governed by the laws concerning water rights in the states of Arizona, Nevada, Colorado and New Mexico. Our sale of water assets is subject to the risks of delay associated with receiving all necessary regulatory approvals and permits. Additionally, the transfer of water resources from one use to another may affect the economic base or impact other issues of a community including development, and will, in some instances, be met with local opposition. Moreover, municipalities who will likely regulate the use of any water we might sell to them in order to manage growth, could create additional requirements that we must satisfy to sell and convey water assets.

If we are unable to effectively transfer, sell and convey water resources, our ability to monetize these assets will suffer and our return on investment, revenues and financial condition would decline.

If our businesses or investments otherwise fail or decline in value, our financial condition and the return on our investment could suffer.

Historically, we have acquired and invested in businesses and assets that we believed were undervalued or that would benefit from additional capital, restructuring of operations, strategic initiatives, or improved competitiveness through operational efficiencies. If any previously acquired business, investment or asset fails or its fair value declines, we could experience a material adverse effect on our business, financial condition, the results of operations and cash flows. If we are not successful managing our previous acquisitions and investments, our business, financial condition, results of operations and cash flows could be materially affected. Such business failures, declines in fair values, and/or failure to manage acquisitions or investments, could result in a negative return on equity. We could also lose part or all of our capital in these businesses and experience reductions in our net income, cash flows, assets and equity.

Future dispositions of our businesses, assets, operations and investments, if unsuccessful, could reduce the value of our common shares. Any future dispositions may result in significant changes in the composition of our assets and liabilities. Consequently, our financial condition, results of operations and the trading price of our common shares may be affected by factors different from those historically affecting our financial condition, results of operations and trading price at the present time.

We may need additional capital in the future to fund our business and financing may not be available on favorable terms, if at all, or without dilution to our shareholders.

We currently anticipate that our available capital resources and operating cash flows will be sufficient to meet our expected working capital and capital expenditure requirements for at least the next 12 months. However, we cannot provide any assurance that such resources will be sufficient to fund our business. We may raise additional funds through public or private debt, equity or hybrid securities financings, including, without limitation, through the issuance of securities. We currently have an effective shelf registration statement which allows us to sell up to \$400 million of a variety of securities in one or more offerings in the public markets.

We may experience difficulty in raising necessary capital in view of the recent volatility in the capital markets and increases in the cost of finance. Increasingly stringent rating standards could make it more difficult for us to obtain financing. If we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our shareholders could be significantly diluted, and these newly issued securities may have rights, preferences or privileges senior to those of existing shareholders. Indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations. The additional financing we may need may not be available to us, or on favorable terms. If adequate funds are not available or are not available on acceptable terms, if and when needed, our ability to fund our operations or otherwise execute our strategic plan would be significantly limited. In any such case, our business, operating results or financial condition could be materially adversely affected.

\* Our ability to utilize net operating loss carryforwards and certain other tax attributes may be limited.

Under Section 382 of the Internal Revenue Code of 1986, as amended, if our Company undergoes an “ownership change” (generally defined as a greater than 50% change (by value) in our equity ownership over a three year period), the ability to use our pre-change net operating loss carryforwards and other pre-change tax attributes to offset our post-change income may be limited. We may experience ownership changes in the future as a result of shifts in our stock ownership. As of December 31, 2016, we had federal and state net operating loss carryforwards of approximately \$137.1 million and \$205.6 million, respectively, which, depending on our value at the time of any ownership changes, could be limited.

We may not be able to retain key management personnel we need to succeed, which could adversely affect our ability to successfully operate our businesses.

To run our day-to-day operations and to successfully manage our businesses we must, among other things, continue to retain key management. We rely on the services of a small team of key executive officers. If they depart, it could have a significant adverse effect upon our business. Also, increased competition for skilled management and staff employees in our businesses could cause us to experience significant increases in operating costs and reduced profitability.

Because our operations are diverse, analysts and investors may not be able to evaluate us adequately, which may negatively influence the price of our stock.

We are a diversified holding company with significant operations in different business segments. We own businesses that are unique, complex in nature, and difficult to understand. In particular, the water resource business is a developing industry in the United States with very little historical and comparable data, very complex valuation issues and a limited following of analysts. Because we are complex, analysts and investors may not be able to adequately evaluate our operations and enterprise as a going concern. This could cause analysts and investors to make inaccurate evaluations of our stock, or to overlook PICO in general. As a result, the trading volume and price of our stock could suffer and may be subject to excessive volatility.

Fluctuations in the market price of our common stock may affect your ability to sell your shares.

The trading price of our common stock has historically been, and we expect will continue to be, subject to fluctuations. The market price of our common stock may be significantly impacted by:

- quarterly variations in financial performance and condition of our various businesses;
- shortfalls in revenue or earnings from estimates forecast by securities analysts or others;
- changes in estimates by such analysts;

the ability to monetize our assets, including assets related to our water resource and real estate businesses, for an adequate economic return;

- our competitors' announcements of extraordinary events such as acquisitions;
- litigation; and
- general economic conditions and other matters described herein.

Our results of operations have been subject to significant fluctuations, particularly on a quarterly basis, and our future results of operations could fluctuate significantly from quarter to quarter and from year to year. Causes of such fluctuations may include the inclusion or exclusion of operating earnings from sold operations, one time transactions, and impairment losses. Statements or changes in opinions, ratings, or earnings estimates made by brokerage firms or industry analysts relating to the markets in which we do business or relating to us specifically could result in an immediate and adverse effect on the market price of our common stock. Such fluctuations in the market price of our common stock could affect the value of your investment and your ability to sell your shares.

Litigation may harm our business or otherwise distract our management.

Substantial, complex or extended litigation could cause us to incur large expenditures and distract our management. For example, lawsuits by employees, shareholders or customers could be very costly and substantially disrupt our business. Additionally, from time to time we or our subsidiaries will have disputes with companies or individuals which may result in litigation that could necessitate our management's attention and require us to expend our resources. We may be unable to accurately assess our level of exposure to specific litigation and we cannot provide any assurance that we will always be able to resolve such disputes out of court or on terms favorable to us. We may be forced to resolve litigation in a manner not favorable to us, and such resolution could have a material adverse impact on our consolidated financial condition or results of operations.

We have been, and continue to be, the subject of stockholder activism efforts that could cause a material disruption to our business.

Certain investors have taken steps to involve themselves in the governance and strategic direction of our Company due to governance and strategic-related disagreements with us. While we have formally settled with certain of such activists, other investors could take steps to involve themselves in the governance and strategic direction of our Company. Such stockholder activism efforts could result in substantial costs and diversion of management's attention and resources, harming our business and adversely affecting the market price of our common stock.

Our governing documents could prevent an acquisition of our company or limit the price that investors might be willing to pay for our common stock.

Certain provisions of our articles of incorporation and the California General Corporation Law could discourage a third party from acquiring, or make it more difficult for a third party to acquire, control of our company without approval of our board of directors. For example, our bylaws require advance notice for stockholder proposals and nominations for election to our board of directors. We are also subject to the provisions of Section 1203 of the California General Corporation Law, which requires a fairness opinion to be provided to our shareholders in connection with their consideration of any proposed "interested party" reorganization transaction. All or any of these factors could limit the price that certain investors might be willing to pay in the future for shares of our common stock.

If equity analysts do not publish research or reports about our business or if they issue unfavorable commentary or downgrade our common stock, the price of our common stock could decline.

The trading market for our common stock will rely in part on the research and reports that equity research analysts may publish about us and our business. We do not control these analysts. The price of our stock could decline if one or more equity analysts downgrade our stock or if those analysts issue other unfavorable commentary or cease publishing reports about us or our business.

Our business could be negatively impacted by cyber security threats.

In the ordinary course of our business, we use our data centers and our networks to store and access our proprietary business information. We face various cyber security threats, including cyber security attacks to our information technology infrastructure and attempts by others to gain access to our proprietary or sensitive information. The procedures and controls we use to monitor these threats and mitigate our exposure may not be sufficient to prevent cyber security incidents. The result of these incidents could include disrupted operations, lost opportunities, misstated financial data, liability for stolen assets or information, increased costs arising from the implementation of additional security protective measures, litigation and reputational damage. Any remedial costs or other liabilities related to



cyber security incidents may not be fully insured or indemnified by other means.

THE FOREGOING FACTORS, INDIVIDUALLY OR IN AGGREGATE, COULD MATERIALLY ADVERSELY AFFECT OUR OPERATING RESULTS AND CASH FLOWS AND FINANCIAL CONDITION AND COULD MAKE COMPARISON OF HISTORIC FINANCIAL STATEMENTS, INCLUDING RESULTS OF OPERATIONS AND CASH FLOWS AND BALANCES, DIFFICULT OR NOT MEANINGFUL.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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## ITEM 2. PROPERTIES

We lease office space in La Jolla, California for our principal executive offices. Our water resource and water storage operations lease office space in Carson City, Nevada. Our real estate operations lease office space in San Jose, California; Fresno, California; Valencia, California, and Bellevue, Washington; Charlotte and Raleigh, North Carolina; Myrtle Beach, South Carolina, and Nashville, Tennessee. We continually evaluate our current and future space capacity in relation to our business needs. We believe that our existing facilities are suitable and adequate to meet our current business requirements and that suitable replacement and additional space will be available in the future on commercially reasonable terms.

We have significant holdings of real estate and water assets in the southwestern United States. For a description of our real estate and water assets, see “Item 1 - Operating Segments and Major Subsidiary Companies.”

## ITEM 3. LEGAL PROCEEDINGS

Neither we nor our subsidiaries are parties to any potentially material pending legal proceedings.

We are subject to various litigation matters that arise in the ordinary course of our business. Based upon information presently available, management is of the opinion that resolution of such litigation will not likely have a material effect on our consolidated financial position, results of operations, or cash flows. Because litigation is inherently unpredictable and unfavorable resolutions could occur, assessing contingencies is highly subjective and requires judgments about future events. When evaluating contingencies, we may be unable to provide a meaningful estimate due to a number of factors, including the procedural status of the matter in question, the presence of complex or novel legal theories, and/or the ongoing discovery and development of information important to the matters. In addition, damage amounts claimed in litigation against us may be unsupported, exaggerated or unrelated to possible outcomes, and as such are not meaningful indicators of our potential liability. We regularly review contingencies to determine the adequacy of our accruals and related disclosures. The amount of ultimate loss may differ from these estimates, and it is possible that cash flows or results of operations could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies. Whether any losses finally determined in any claim, action, investigation or proceeding could reasonably have a material effect on our business, financial condition, results of operations or cash flows will depend on a number of variables, including: the timing and amount of such losses; the structure and type of any remedies; the significance of the impact any such losses, damages or remedies may have on our consolidated financial statements; and the unique facts and circumstances of the particular matter that may give rise to additional factors.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the NASDAQ Global Select Market under the symbol "PICO." The following table sets out the quarterly high and low sales prices for the past two years as reported on the NASDAQ Global Select Market. These reported prices reflect inter-dealer prices, without adjustments for retail markups, markdowns, or commissions.

	2016		2015	
	High	Low	High	Low
First Quarter	\$10.61	\$7.82	\$19.04	\$14.97
Second Quarter	\$10.41	\$8.47	\$19.20	\$14.61
Third Quarter	\$11.77	\$9.35	\$14.88	\$9.68
Fourth Quarter	\$15.35	\$10.51	\$11.27	\$8.95

On February 24, 2017, the closing sale price of our common stock was \$13.65 and there were approximately 404 holders of record.

We have not declared or paid any dividends during the last two years. Any future decision to pay dividends on our common stock will be at the discretion of our board of directors and will depend upon, among other factors, our ability to monetize assets, our results of operations, financial condition, capital requirements, and other factors our board of directors may deem relevant.

The indentures under which UCP's 8.5% notes payable due 2017 were issued contain certain restrictive covenants, including limitations on payment of dividends by UCP. UCP has not declared or paid any dividends since its IPO, and do not expect to pay any dividends in the foreseeable future.

## Company Stock Performance Graph

This graph compares the total return on an indexed basis of a \$100 investment in PICO common stock, the Standard & Poor's 500 Index, and the Russell 2000 Index. The measurement points utilized in the graph consist of the last trading day in each calendar year, which closely approximates the last day of our fiscal year in that calendar year.

The stock price performance shown on the graph is not necessarily indicative of future price performance.

## ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total number of shares purchased	Average Price Paid per Share	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
10/1/2016 - 10/31/16	—	—	—	—
11/1/2016 - 11/30/16	—	—	—	—
12/1/2016 - 12/31/16	—	—	—	—

## ITEM 6. SELECTED FINANCIAL DATA

The following table presents our selected consolidated financial data. The information set forth below is not necessarily indicative of the results of future operations and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and the related notes thereto included elsewhere in this document.

	Year Ended December 31,				
	2016	2015	2014	2013	2012
Operating Results	(In thousands, except per share data)				
Revenues and other income:					
Sale of real estate and water assets	\$355,001	\$282,681	\$192,368	\$116,776	\$59,020
Sale of software				13,649	
Impairment loss on investment in unconsolidated affiliate	(2,170 )	(20,696 )	(1,078 )		
Other income	9,747	4,678	1,198	29,756	5,756
Total revenues and other income	\$362,578	\$266,663	\$192,488	\$160,181	\$64,776
Loss from continuing operations	\$(11,652 )	\$(31,611 )	\$(45,531 )	\$(5,929 )	\$(15,855 )
Net loss from discontinued operations, net of tax	(1,377 )	(49,268 )	(14,074 )	(23,265 )	(15,797 )
Net (income) loss attributable to noncontrolling interests	(8,836 )	(979 )	7,180	6,896	2,579
Net loss attributable to PICO Holdings, Inc.	\$(21,865 )	\$(81,858 )	\$(52,425 )	\$(22,298 )	\$(29,073 )
Net loss per common share – basic and diluted:					
Loss from continuing operations	\$(0.89 )	\$(1.49 )	\$(1.76 )	\$(0.09 )	\$(0.66 )
Loss from discontinued operations	\$(0.06 )	\$(2.07 )	\$(0.54 )	\$(0.89 )	\$(0.62 )
Net loss per common share – basic and diluted	\$(0.95 )	\$(3.56 )	\$(2.30 )	\$(0.98 )	\$(1.28 )
Weighted average shares outstanding – basic and diluted	23,054	23,014	22,802	22,742	22,755

	As of December 31,				
	2016	2015	2014	2013	2012
Financial Condition	(In thousands, except per share data)				
Total assets <sup>(1)</sup>	\$669,289	\$653,292	\$649,578	\$607,547	\$501,213
Debt <sup>(1)</sup>	\$160,994	\$155,966	\$133,139	\$48,325	\$46,508
Net assets of discontinued operations	\$6,229	\$8,185	\$57,966	\$61,045	\$66,117
Total liabilities <sup>(1)</sup>	\$247,949	\$227,473	\$195,999	\$103,747	\$88,834
Total PICO Holdings, Inc. shareholders' equity	\$327,994	\$346,412	\$425,481	\$472,889	\$473,225
Book value per share <sup>(2)</sup>	\$14.22	\$15.04	\$18.50	\$20.79	\$20.82

<sup>(1)</sup> Excludes balances classified as discontinued operations.

<sup>(2)</sup> Book value per share is computed by dividing total PICO Holdings, Inc. shareholders' equity by the net of total shares issued less shares held as treasury shares.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### INTRODUCTION

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to help the reader understand our Company. The MD&A should be read in conjunction with our consolidated financial statements and the accompanying notes, presented later in this Annual Report on Form 10-K. The MD&A includes the following sections:

- Company Summary, Recent Developments, and Future Outlook — a brief description of our operations, the critical factors affecting them, and their future prospects;
- Critical Accounting Policies, Estimates and Judgments — a discussion of accounting policies which require critical judgments and estimates. Our significant accounting policies, including the critical accounting policies discussed in this section, are summarized in the notes to the consolidated financial statements;
- Results of Operations — an analysis of our consolidated results of operations for the past three years, presented in our consolidated financial statements; and
- Liquidity and Capital Resources — an analysis of cash flows, sources and uses of cash, contractual obligations and a discussion of factors affecting our future cash flow.

### COMPANY SUMMARY, RECENT DEVELOPMENTS, AND FUTURE OUTLOOK

#### WATER RESOURCE AND WATER STORAGE OPERATIONS

The long-term future demand for our water assets is driven by population and economic growth relative to currently available water supplies in the southwestern United States. Specifically, our more recent development activities have been in Arizona, Colorado, Nevada and New Mexico.

Over the past five years, the population growth of these states also exceeded the national growth rate collectively and individually, with the exception of New Mexico. According to the Census Bureau's estimate of state population changes for the period April 1, 2010 to July 1, 2016, Nevada's growth rate was 8.9%, Arizona 8.4%, Colorado 10.2%, and New Mexico 1.1%. These population growth statistics compare to the national total growth rate of 4.7% over the same period.

Historically, a significant portion of the Southwest's water supplies have come from the Colorado River. The balance is provided by other surface rights, such as rivers and lakes, groundwater (water pumped from underground aquifers), and water previously stored in reservoirs or aquifers. Prolonged droughts (decreased snow pack runoff and the related decreased surface water) and rapid population growth in the past twenty years have exacerbated the region's general water scarcity.

In December 2012, the U.S. Department of the Interior released a report titled: The Colorado River Basin Water Supply and Demand Study, examining the future water demands on the Colorado River Basin. The report projects water supply and demand imbalances throughout the Colorado River Basin and adjacent areas over the next 50 years. The average imbalance in future supply and demand is projected to be greater than 3.2 million acre-feet per year by 2060. The study projects that the largest increase in demand will come from municipal and industrial users, owing to population growth. The Colorado River Basin currently provides water to some 40 million people, and the study estimates that this number could nearly double to approximately 76.5 million people by 2060, under a rapid growth scenario.

The following is a summary of the recent developments of our water resource and water storage assets by geographical region.

Arizona

At December 31, 2016, we owned 157,000 LTSCs, within the Phoenix AMA and 251,000 LTSCs in the Vidler Recharge site in Harquahala Valley.

Several market catalysts with respect to our LTSCs continue to emerge including the recent drought in the western United States, continued structural deficits on the Colorado River system, Indian Firming and Settlement obligations by the state of Arizona and increased water demand from overall growth in Arizona. These supply and demand dynamics have led to sales of our LTSC that we recently announced, and continued and increasing interest from other parties contemplating buying our LTSCs at prices that we believe reflect the true value of our LTSCs.

In December 2016, we entered into agreements with the Arizona Water Bank Authority and the Central Arizona Groundwater Replenishment District for the sale of 100,000 LTSC stored in the Phoenix AMA. The transactions closed in the first quarter of 2017 generating gross cash proceeds of \$25 million.

Arizona has an obligation to “firm” Indian water supplies as negotiated through various Indian Water Settlement Agreements. Section 105 of the Settlements Act (S. 437) titled “Firming of Central Arizona Project Indian Water,” authorizes the Secretary of Interior and the State of Arizona to develop a firming program to ensure that 60,648 acre-feet of non-Indian Agricultural priority water be made available for reallocation to Indian Tribes for a 100 year period, which is to be delivered during shortage years on the Colorado River. It is estimated that the total Indian Firming obligation is approximately 550,000 acre-feet over the 100 year period. To date approximately 105,000 acre-feet has been secured by Arizona for firming obligations. We believe our LTSCs can be used to help Arizona meet this obligation.

A shortage on the Colorado system will be declared by the Secretary of the Interior when on January 1, of any year, Lake Mead’s surface water elevation is at or below 1075 ft. When Lake Mead is at an elevation of 1075 ft. and at or above 1050 ft., Nevada’s share of the shortage is 13,000 acre-feet and Arizona’s cut-back to its allocation is 320,000 acre-feet. In contrast, California suffers no loss to their allocation from the Colorado River. When Lake Mead is at an elevation of 1050 ft. and at or above 1025 ft., Nevada will suffer a loss of 17,000 acre-feet from their allocation, Arizona will suffer a cut-back to their allocation of 400,000 acre-feet, and California will not suffer any cut-back to their allocation. If Lake Mead’s surface water elevation level is below 1025 ft., then Nevada will suffer a loss to its allocation of 20,000 acre-feet and Arizona will suffer a loss to its allocation of 480,000 acre-feet. To put this in context, Arizona’s annual allocation of Colorado River water is 2.8 million acre-feet. As such, the cut back in allocation of just 320,000 acre-feet represents over 11% of Arizona’s annual allocation.

It is not only drought which impacts the level of Lake Mead. The Colorado River system has been determined to suffer from a structural deficit of 1.2 million acre-feet annually. This means that on an average annual water year, Lake Mead will lose 1.2 million acre-feet to the system, due to evaporation, treaty obligations with Mexico and allocations of water to Arizona, Nevada and California that exceeds what the system yields. We believe that Vidler’s LTSCs are well positioned to buffer Arizona through times of shortage and our LTSCs could be purchased by state entities to be used directly or to help sustain levels in Lake Mead.

#### Nevada

In September 2014, Tesla Motors, Inc. (“Tesla”) announced that its \$5 billion lithium-ion battery “Gigafactory” plant would be constructed on property known as the Tahoe Reno Industrial Center (“TRIC”), in northern Nevada. TRIC is a 107,000 acre industrial park proximate to Interstate 80 and 15 miles east of Reno, NV. In connection with the announcement, the Nevada Legislature approved a \$1.25 billion incentive package for Tesla. Tesla expects the plant to be fully operational in 2017 and it is anticipated to hire approximately 6,500 employees.

According to Tesla, at the end of 2016 the plant had over 1,000 employees and the total number of workers is expected to increase significantly in the coming months as Tesla ramps up production ahead of the Model 3 launch. The total invested capital in the Gigafactory plant through September 30, 2016 was approximately \$608.4 million according to recent reports by Tesla.

The Economic Development Authority of Western Nevada (Reno, Sparks, Tahoe areas) estimated that the region will generate 51,000 primary and secondary jobs from 2015 to 2019. We believe that this increased employment will directly and indirectly create the need for new residential, commercial and industrial development specifically in the greater Reno area and in Lyon County. In addition, growth in this region is anticipated to be driven by the construction of the extension of the USA Parkway, scheduled to be completed by late 2017. The USA Parkway



connects Interstate route 80 to TRIC and the extension will connect Interstate route 80 and TRIC to U.S. route 50 near Silver Springs, Lyon County.

Nevada's unemployment rate averaged 5.8% during 2016, which is down nearly a full percentage point from 2015. At December 31, 2016, the unemployment rate stood at 5.1%, the lowest unemployment rate since November 2007, and down 1.2 percentage points from December 2015. For the year as a whole, initial estimates by the Nevada Department of Employment, Training and Rehabilitation suggest that employment levels averaged 1.29 million per month, which equates to an additional 32,500 jobs in 2016, an increase of approximately 2.6%. Of this increase, the private sector added 30,000 jobs (up 2.7%) and the public sector added 2,600 jobs (up 1.7%). December 2016 saw nearly 1.31 million jobs in Nevada, which is an all-time high in employment for the state.

Current economic conditions have manifested into new business openings, fewer apartment vacancies and the greater absorption of existing housing inventory. This activity has resulted in multiple new housing projects entering the approval process with local governments in Reno, Sparks, Carson City, Lyon County and Fernley. Within the Reno-Sparks area of Nevada, there has been an approximately 29% year-over-year increase in building permits for single-family and multi-family homes combined, and an approximately 28% increase in Nevada overall. We believe this activity creates demand for our water resources as developers pursue their projects.

In February 2015, we finalized an option agreement with a private developer for the sale of approximately 700 acre-feet of municipal and industrial water rights located in Carson / Lyon. The developer owns land in proximity to the intersection of the proposed USA Parkway and Highway 50. The initial purchase price was \$30,000 per acre-foot of water and increases by 10% per year from January 1, 2017 until the expiration of the initial option period on December 31, 2019. We did not record any sales in 2016 under this option agreement.

## REAL ESTATE OPERATIONS

Our real estate segment revenues are primarily derived from UCP's sale of residential developments in California, Washington, North Carolina, South Carolina and Tennessee.

During the year ended December 31, 2016, the overall U.S. housing market continued to show signs of improvement, driven by factors such as continued supply and demand imbalance, low mortgage rates, improving employment growth, and higher average customer sentiment. Individual markets continue to experience varying results, as local home inventories, affordability, and employment factors strongly influence local markets.

We believe homebuilding and land development is a local business. As a result, we expect local market conditions will affect our community count, revenue operating performance. Local market trends are the principal factors that impact our revenue growth and revenue related costs and expenses. For example, when these trends are favorable, we expect our revenues from homebuilding and land development, as well as the costs and expenses that vary with revenue, to generally increase; conversely, when these trends are negative, we expect our revenue and the costs and expenses that vary with revenue to generally decline, although in each case the impact may not be immediate or directly proportional. When trends are favorable, we would expect to increase our community count by opening additional communities and expanding existing communities; conversely, when these trends are negative, we would expect to reduce or maintain our community count or decrease the pace at which we open additional communities and expand existing communities.

Operations within this segment reflect UCP's continued focus on a number of initiatives, including growing their homebuilding operations and revenues by increasing home sales at existing communities, improving gross margin percentages, improving operating efficiency by seeking to reduce non-revenue-related expenses as a percentage of revenue, and managing their balance sheet by maintaining appropriate cash balances, real estate, and leverage.

## CORPORATE

### Mindjet

During the third quarter of 2015, Mindjet raised additional capital from existing shareholders. We elected not to participate in the offering and as a result, our existing investment in preferred stock was converted to common stock at five shares of preferred stock for one share of common stock, and our investment in convertible debt was converted into nonvoting preferred stock resulting in a decline in our voting ownership to 19.3%. In addition, we lost our right to a board seat. Given the current voting interest and loss of board representation, we determined we no longer had

significant influence over the operating and financial policies of Mindjet and therefore discontinued the equity method of accounting and the remaining investment in common and preferred stock was held at cost at December 31, 2016. Prior to the conversion, our share of the losses reported by Mindjet were allocated to the carrying value of the common stock investment until it reached zero and then to the preferred stock and convertible debt.

## Mendell

During the year ended December 31, 2016, we entered into a purchase and sale agreement to sell the majority of the assets used in the Mendell oil and gas operations for gross proceeds of \$9.6 million. After consideration of liabilities assumed by the buyer, cash proceeds to the Company were \$9 million. The purchase and sale agreement provided for a Company guarantee of \$1 million for any indemnification claims made by the buyer within one year of the sale. As the carrying value of the assets sold was reduced significantly in prior periods due to impairment losses and depletion charges, the Company recorded a gain on sale before income taxes of \$8.7 million for the year ended December 31, 2016. The majority of the remaining oil and gas leases were sold during the three months ending March 31, 2017 in a related-party transaction with our oil and gas management agent. See Note 11 “Related- Party Transactions” for additional information.

## Synthonics

During the year ended December 31, 2016, we recorded an impairment loss on our investment in Synthonics as the estimated fair value was less than the carrying value. See Note 4 “Investments” and Note 11 “Related- Party Transactions” for additional information.

## DISCONTINUED AGRIBUSINESS OPERATIONS

In July 2015, we sold substantially all of the assets used in our agribusiness segment to CHS Inc. (“CHS”). As a result of the transaction, the assets and liabilities of our agribusiness segment qualified as held-for-sale and have been classified as discontinued agribusiness operations in the accompanying consolidated financial statements as of the earliest period presented. We recorded a loss on sale of discontinued agribusiness operations during 2015 and 2016. See Note 13 “Discontinued Agribusiness Operations” in the accompanying consolidated financial statements for additional information.

## CRITICAL ACCOUNTING POLICIES, ESTIMATES, AND JUDGEMENTS

This section describes the most important accounting policies affecting our assets and liabilities, and the results of our operations. Since the estimates, assumptions, and judgments involved in the accounting policies described below have the greatest potential impact on our financial statements, we consider these to be our critical accounting policies:

- how we determine the fair value and carrying value of our real estate, tangible and intangible water assets;
- accounting for investments in unconsolidated affiliates;
- how and when we recognize revenue when we sell real estate and water assets; and
- how we determine our income tax provision, deferred tax assets and liabilities, and reserves for unrecognized tax benefits, as well as the need for valuation allowances on our deferred tax assets.

We believe that an understanding of these accounting policies will help the reader to analyze and interpret our financial statements.

Our consolidated financial statements, and the accompanying notes, are prepared in accordance with GAAP, which requires us to make estimates, using available data and our judgment, for things such as valuing assets, accruing liabilities, recognizing revenues, and estimating expenses. Due to the uncertainty inherent in these matters, actual results could differ from the estimates we use in applying the critical accounting policies. We base our estimates on historical experience, and various other assumptions, which we believe to be reasonable under the circumstances.

The following are the significant subjective estimates used in preparing our financial statements:

1. Fair value and carrying value of our real estate, tangible and intangible water assets

Our principal long-lived assets are real estate, tangible and intangible water assets. At December 31, 2016, the total carrying value of real estate, tangible, and intangible water assets was \$557.8 million, or approximately 83% of our total assets. These assets are carried at cost, less any recorded impairments.

#### Real estate and tangible water assets

We review our long-lived real estate and tangible water assets as facts and circumstances change, or if there are indications of impairment present, to ensure that the estimated undiscounted future cash flows, excluding interest charges, from the use and eventual disposition of these assets will at least recover their carrying value. Cash flow forecasts are prepared for each discrete asset. We engage in a rigorous process to prepare and review the cash flow models which utilize the most recent information available to us. However, the process inevitably involves the use of significant estimates and assumptions, especially the estimated current and future demand for these assets, the estimated future market values of our assets, the timing of the disposition of these assets, the ongoing cost of maintenance and improvement of the assets, and the current and projected income earned and other uncertain future events. As a result, our estimates are likely to change from period to period. In addition, our estimates may change as unanticipated events transpire which would cause us to reconsider the current and future use of the assets.

If we use different assumptions, if our plans change, or if the conditions in future periods differ from our forecasts, our financial condition and results of operations could be materially impacted.

During each of the three years ended December 31, 2016, 2015, and 2014, our estimates of costs and revenues on certain real estate projects in specific markets changed due to declining prices of similar assets, unfavorable market conditions, project specific complications, and other factors. As a result, certain undiscounted cash flow streams were less than the carrying values of the assets and consequently, we recorded impairment losses of \$2.6 million, \$1.2 million, and \$6.4 million in 2016, 2015 and 2014, respectively, which reduced the carrying value of the assets to their fair value.

#### Intangible water assets

Our intangible water assets are accounted for as indefinite-lived intangible assets. Accordingly, until the asset is sold, they are not amortized, that is, their value is not charged as an expense in our consolidated statement of operations and comprehensive income or loss over time, but the assets are carried at cost and reviewed for impairment, at least annually during the fourth quarter, and more frequently if a specific event occurs or there are changes in circumstances which suggest that the asset may be impaired. Such events or changes may include lawsuits, court decisions, regulatory mandates, and economic conditions, including interest rates, demand for residential and commercial real estate, changes in population, and increases or decreases in prices of similar assets. Once the assets are sold, the value is charged to cost of real estate and water assets sold in our consolidated statement of operations and comprehensive income or loss.

When we calculate the fair value of intangible water assets, we use a discounted cash flow model, under which the future net cash flows from the asset are forecasted and then discounted back to their present value using a weighted average cost of capital approach to determining the appropriate discount rate. Preparing these cash flow models requires us to make significant assumptions about revenues and expenses as well as the specific risks inherent in the assets. If the carrying value exceeds the fair value, an impairment loss is recognized equal to the difference. We conduct extensive reviews utilizing the most recent information available to us; however, the review process inevitably involves the use of significant estimates and assumptions, especially the estimated current asset pricing, potential price escalation, discount rates, absorption rates and timing, and demand for these assets. These models are sensitive to minor changes in any of the input variables.

In summary, the cash flow models for our most significant indefinite-lived intangible assets forecast initial sales to begin within approximately one year, and then increase until the assets are completely sold over the next 39 years. We have assumed sale proceeds for the assets that are based on our estimates of the likely future sales price per acre-foot. These per-unit sale prices are estimated based on the demand and supply fundamentals in the markets which these

assets serve. If we use different assumptions, if our plans change, or if the conditions in future periods differ from our forecasts, our financial condition and results of operations could be materially impacted.

There were no material impairment losses recorded on our intangible water assets in 2016 or 2015.

In 2014, we determined that the fair values of the intangible water assets of approximately \$1.1 million and \$2.2 million, respectively, were below the carrying values of \$2.9 million and \$2.6 million, respectively, resulting in impairment losses of \$1.8 million and \$438,000, respectively, recorded in our consolidated statement of operations and comprehensive income or loss. The losses were reported as a component of our water resource and water storage operations segment results. This was the first such impairment loss recorded on each of these assets. There were no other impairment losses on any other intangible water assets recorded in 2014.

## 2. Accounting for investments in unconsolidated affiliates

Depending on the circumstances, and our judgment about the level of our involvement with an investee company, we apply either fair value accounting or the equity method of accounting for investments in equity securities. When we own an investment where we have the ability to exercise significant influence over the company's operating and financial decisions, we apply the equity method of accounting.

Apart from our equity investments in private companies which are carried at historical cost, we apply the provisions of the fair value method to all of our other equity securities, and to all of our debt securities, unless it is impractical to estimate such fair value. We classify such investments as held-for-sale. Fair value accounting requires us to record held-for-sale marketable investments at their fair value, with any unrealized holding gains or losses, net of income tax effects reported in accumulated other comprehensive income in our consolidated balance sheet. Investments in private companies are generally held at the lower of cost or their fair value.

During the period that we hold an investment, the equity method of accounting may have a different impact on our financial statements than fair value accounting would. The most significant difference between the two policies is that, under the equity method, we include our share of the unconsolidated affiliate's earnings or losses in our statement of operations and comprehensive income or loss, which also increases or decreases the carrying value of the investment. In addition, any dividends received from the affiliate reduce the carrying value of the investment. For securities classified as held-for-sale, the income recorded in the statement of operations and comprehensive income or loss is from dividends and realized gains or losses, and other-than-temporary impairment losses, if applicable, are reported as a realized loss and reduce revenues correspondingly and we record unrealized gains and losses, net of related deferred income taxes, in accumulated other comprehensive income or loss in the shareholders' equity section of our balance sheet.

The assessment of what constitutes the ability to exercise "significant influence" requires us to make significant judgments about financial and operational control over the affiliate. We look at various factors in making this determination. These include our percentage ownership of voting stock, whether or not we have representation on the affiliate's board of directors, transactions between us and the affiliate, the ability to obtain timely quarterly financial information, and whether our management can influence the operating and financial policies of the affiliate company. When we have this kind of influence, we adopt the equity method and change all of our previously reported results to show the investment as if we had applied the equity method of accounting from the date of our first purchase.

The use of fair value accounting or the equity method can result in significantly different carrying values at specific balance sheet dates, and contributions to our statement of operations in any individual year during the course of the investment. However, over the entire life of the investment, the total impact of the investment on shareholders' equity will be the same whichever method is adopted.

We evaluate our investments to determine if any other-than-temporary impairment loss exists. In general, these reviews require consideration of several factors, including the extent and duration of the decline in market value of the investee, specific adverse conditions affecting the investee's business and industry, the financial condition of the investee, and the long-term prospects of the investee. Accordingly, we have to make important assumptions regarding our intent and ability to hold the security, and our assessment of the overall worth of the security. Risks and uncertainties in our methodology for reviewing unrealized losses for other-than-temporary declines include our judgments regarding the overall worth of the issuer and its long-term prospects, and our ability to obtain our assessment of the overall worth of the business.

If an unrealized loss is in fact other-than-temporary, an impairment loss will be recorded. If we impair an equity method investment or an investment held at cost, an impairment loss will affect shareholders' equity. There will also



be an impact on reported income before and after tax, and on earnings per share, due to recognition of the unrealized loss and related tax effects. When a loss for other-than-temporary impairment is recorded, our basis in the security is decreased. Consequently, if the market value of the security later recovers and we sell the security, a correspondingly greater gain will be recorded in the statement of operations and comprehensive income or loss.

During 2014 and into the third quarter of 2015, we believed that the collective attributes of our common and preferred stock investment in Mindjet, including our right to a seat on its board of directors, enabled us to exert significant influence over the operating and financial decisions of Mindjet. Consequently, we accounted for the investment in common stock using the equity method of accounting. During the third quarter of 2015, our voting ownership of Mindjet decreased from 28.4% to 19.3%, and we lost our contractual right to a seat on its board of directors. As a result, during the third quarter of 2015, we concluded that we no longer exercised significant influence over Mindjet and consequently, we ceased accounting for our investment in common stock using the equity method, and held the investment at cost. Recurring operational losses reported by Mindjet and impairment losses recorded reduced the carrying value of our investment in common stock to zero at December 31, 2015. Once the common stock was reduced to zero, we applied a portion of the losses reported by Mindjet against the carrying value of our investment in preferred stock. Combined with the impairment losses recorded, the carrying value of our investment in preferred stock was also reduced to zero prior to the conversion of our investment in debt security to preferred stock.

We tested for impairment loss on our investment in Mindjet predominately due to significantly increased, and continuing operating losses and resulting liquidity issues the company was experiencing, actual financial results that were significantly less than their projections, and market conditions that adversely affected the value of Mindjet. The fair value of our investment in Mindjet was based on an analysis of the financial and operational aspects of the company, including consideration of business enterprise value-to-revenue ratios for comparable public companies to current revenue metrics for the company. The determination of the business enterprise value based on the foregoing was then considered in an analysis of the distribution of equity value to the various classes of debt and equity issued by Mindjet in order to reflect differences in value due to differing liquidation preferences, dividend and voting rights. As a result of the analysis, we recorded a \$20.7 million and \$1.1 million impairment loss on our investment for the years ended December 31, 2015 and 2014, respectively, as the estimated fair value of our investment was less than the carrying value. We did not record an impairment loss during the year ended December 31, 2016. It is reasonably possible, given the volatile nature of software businesses, that circumstances may change in the future which could require us to record additional impairment losses on the remaining investment in Mindjet.

### 3. Revenue recognition

#### Sale of real estate and water assets

We recognize revenue when there is a legally binding sale contract, the profit is determinable (the collectability of the sales price is reasonably assured, or any amount that will not be collectible can be estimated), the earnings process is virtually complete (we are not obliged to perform significant activities after the sale to earn the profit, meaning we have transferred all risks and rewards to the buyer), and the buyer's initial and continuing investment are adequate to demonstrate a commitment to pay for the property.

Unless all of these conditions are met, we use the deposit method of accounting. Under the deposit method of accounting, until the conditions to fully recognize a sale are met, payments received from the buyer are recorded as a liability on our balance sheet, and no gain is recognized.

#### Sale of finished homes

Revenues from sales of finished homes are recognized when the sales are closed and title passes to the new homeowner, the new homeowners initial and continuing investment is adequate to demonstrate a commitment to pay for the home, the new homeowners receivable is not subject to future subordination and we do not have a substantial continuing involvement with the new home.

### 4. Income taxes

Our income tax expense, deferred tax assets and liabilities, and reserves for unrecognized tax benefits reflect our best assessment of estimated future taxes to be paid. We are subject to federal and various state income taxes. We have multiple state filing groups with different income tax generating abilities. Significant judgments and estimates are required in determining the consolidated income tax expense.

Deferred income taxes arise from temporary differences between the tax and financial statement recognition of revenue and expense. In evaluating our ability to recover our deferred tax assets within the jurisdiction from which they arise we consider all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, tax planning strategies and recent financial operating results. We consider many factors when assessing the likelihood of future realization of our deferred tax assets, including recent cumulative earnings experience by taxing jurisdiction, expectations of future transactions, the carryforward periods available to us for tax reporting purposes, our historical use of tax attributes, and availability of tax planning strategies. These assumptions require significant judgment about future events however, they are consistent with the plans and estimates we use to manage our underlying businesses. In evaluating the objective evidence that historical results provide, we consider three years of cumulative operating income or loss.

Our deferred tax assets are primarily comprised of two separate tax paying entities, PICO and UCP, Inc. As a result of the analysis of all available evidence as of December 31, 2011, we recorded a full valuation allowance on PICO's net deferred tax assets. Our evaluation at December 31, 2016 resulted in the same conclusion and we therefore continue to hold a full valuation allowance on certain of our reported consolidated net deferred tax assets. If our assumptions change and we determine we will be able to realize these attributes, the tax benefits relating to any reversal of the valuation allowance on deferred tax assets at December 31, 2016 will be recognized as a reduction of income tax expense. If our assumptions do not change, each year we could record an additional valuation allowance on any increases in the deferred tax assets. Previously, UCP, Inc. also recorded a full valuation allowance on its deferred tax assets. However, UCP Inc. completed an evaluation at December 31, 2016 and concluded that a valuation allowance was no longer necessary and consequently, the valuation allowance was reversed. The benefit of the reversal and subsequent tax impacts are a component of the aggregate noncontrolling interest recorded in PICO's consolidated financial statements.

Changes in tax laws and rates could also affect recorded deferred tax assets and liabilities in the future. We are not aware of any such changes that would have a material effect on our results of operations, cash flows or financial position. The calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax laws and regulations in a multitude of jurisdictions.

The accounting guidance for income taxes provides that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. The guidance also provides information on measurement, de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

We recognize tax liabilities in accordance with accounting guidance on income taxes and we adjust these liabilities when our judgment changes as a result of the evaluation of new information not previously available. Due to the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from our current estimate of the tax liabilities. These differences will be reflected as increases or decreases to income tax expense in the period in which they are determined. Currently, we have no material unrecognized tax benefits on any open tax years.

## RESULTS OF OPERATIONS -- YEARS ENDED DECEMBER 31, 2016, 2015, AND 2014

### Overview of Economic Conditions and Impact on Results of Operations

Numerous factors can affect the performance of an individual market. However, we believe that trends in employment, housing inventory, affordability, interest rates, and home prices have a particularly significant impact. We expect that these market trends will have an impact on our operating performance. Trends in housing inventory,

home affordability, employment, interest rates and home prices are the principal factors that affect our revenue and many of our costs and expenses. For example, when these trends are favorable, we expect our revenue, as well as our related costs and expenses, to generally increase; conversely, when these trends are negative, we expect our revenue and cost of sales to generally decline, although in each case the impact may not be immediate. There has been a recovery and improvement in the housing markets from levels seen during the slow-down between 2007 and 2011 (with seasonal fluctuations) which has led to increased levels of real estate development activity in the past two to three years, and we believe that a continuation of the housing recovery will lead to increased demand for our real estate, and intangible and tangible water assets (which are held in our real estate segment and water resource and water storage segment, respectively). Individual markets continue to experience varying results, as local home inventories, affordability, and employment factors strongly influence each local market and any deterioration in the markets in which we operate has the potential to cause additional impairment losses on our real estate and water assets.

Our revenues and results of operations fluctuate widely from period to period. For example, we recognize revenue from the sale of real estate and water assets when specific transactions close, and as a result, sales of real estate and water assets for any individual quarter are not necessarily indicative of revenues for future quarters or the full financial year.

## PICO Holdings, Inc. Shareholders' Equity

	December 31,			Change	
	2016	2015	2014	2015 to 2016	2014 to 2015
Shareholders' equity	\$327,994	\$346,412	\$425,481	\$(18,418)	\$(79,069)
Shareholders' equity per share	\$14.22	\$15.04	\$18.50	\$(0.82)	\$(3.46)

The decrease in shareholders' equity during 2016 was due to the comprehensive loss of \$20.2 million. The most significant transactions that contributed to the loss for the period were severance and other expenses related to the termination of our former CEO in October 2016, and \$7 million of impairment losses, primarily related to goodwill and real estate assets, recorded during the year.

The decrease in shareholders' equity during 2015 was due to the comprehensive loss of \$81.6 million. The two most significant transactions that contributed to the loss for the period were the losses recorded on the sale of our discontinued agribusiness operations and the impairment loss on our investment in Mindjet.

## Treasury Stock

During 2014, we retired 3 million shares of our common stock that were previously classified as treasury stock, held at a cost of \$55 million, in conjunction with the liquidation of several of our wholly-owned holding companies that owned the shares of PICO common stock. The retirement of treasury stock reduced both the number of our shares issued and the number of treasury shares and, as a result, did not affect our net shares outstanding and had no impact on our book value per share or earnings per share.

## Total Assets and Liabilities

	December 31, 2016	December 31, 2015	Change
Total assets	\$ 675,794	\$ 662,085	\$ 13,709
Total liabilities	\$ 248,225	\$ 228,081	\$ 20,144

Total assets increased during the year ended December 31, 2016, primarily due to the following:

- An increase in real estate and water assets of \$6.7 million from the acquisition and development of real estate in UCP;
- An increase in other assets of \$4.6 million primarily the result of a \$5.5 million increase in deferred tax assets related to UCP, a \$4.4 million increase in notes and other receivables related to reimbursable land development costs under a fixed price general contracting service contract, partially offset by a decrease in goodwill of \$4.2 million due to impairment loss recorded due to revised financial forecasts for the Southeast operations, related to the Citizens Homes, Inc. ("Citizens") acquisition;
- An increase in cash and cash equivalents of \$4.1 million primarily due to a higher volume of home sales; and
- An increase in investments by \$2.5 million primarily due to security appreciation; offset by
- A decrease in investments of \$2.2 million related to an impairment loss on our investment in Synthonics; and
- A decrease in the assets held in our discontinued agribusiness operations by \$2.3 million primarily due to the release of the operational escrow related to an environmental permit in conjunction with the previous sale of our discontinued agribusiness operations.

Total liabilities increased during the year ended December 31, 2016 primarily due to the following:

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An increase in other liabilities of \$13 million, primarily related to \$10.4 million in accrued severance remaining to be paid to our former CEO; and

• An increase in our debt balance of \$5 million that was used for the acquisition and development of real estate.

## Results of Operations

Our results of operations were as follows (in thousands):

	Year Ended December 31,			Change	
	2016	2015	2014	2015 to 2016	2014 to 2015
Total revenue and other income	\$362,578	\$266,663	\$192,488	\$95,915	\$74,175
Total costs and expenses	\$380,581	\$297,813	\$239,457	\$82,768	\$58,356

## Revenue

The majority of our recurring revenue was generated in our real estate operations, which recorded revenue from the sale of residential homes and lots. Our revenue from real estate operations increased during 2016 and 2015 as the result of a significant increase in the number of homes sold year-over-year. Our corporate revenues increased significantly year-over-year due to revenue from the sale of the majority of the assets used in our oil and gas operations during 2016, compared to the impairment loss of \$20.7 million recorded in the segment on our investment in Mindjet, which reduced revenues significantly during the year ended December 31, 2015. Offsetting the increases year-over-year was a decrease in revenue from water resource and water storage operations due to sales of real estate and water rights in Arizona during 2015 with no significant sales in 2016, and an impairment loss of \$2.2 million on our investment in Synthonics in 2016.

## Costs and Expenses

The majority of our costs and expenses were related to cost of real estate and water assets sold. The increase in costs and expenses during 2016 and 2015 was primarily related to cost of real estate sold in our real estate segment due to the increased number of homes sold year-over-year, \$10.4 million severance expense accrual related to the termination of our former CEO in October 2016, and a \$4.2 million loss on impairment of goodwill during 2016.

## Income Taxes

We continued to record a full valuation allowance on the deferred tax assets attributable to our continuing operations. However, during 2016 the valuation allowance recorded against the net deferred tax assets allocable to UCP's noncontrolling interest was reversed, resulting in a net tax benefit of \$5.5 million. Our effective tax rate for the years ended December 31, 2016, 2015, and 2014, was a tax benefit of 35.3%, 9.5%, and 7.5%, respectively. The effective tax rate differed from our federal corporate income tax rate of 35% due primarily to the valuation allowance changes recorded on our net deferred tax assets in each of the years. Additionally, during 2015, we recorded a \$2.8 million tax benefit due to the reversal of the taxable temporary difference related to our investment in Mindjet that reversed during the year due to the impairment loss recorded on the investment. Such temporary difference was originally recorded during 2013 which contributed to the significant effective tax rate in that year and was not expected to reverse within a period that would have allowed us to offset with existing deductible temporary differences.

## Equity in Loss of Unconsolidated Affiliates

We previously accounted for our investment in common stock of Mindjet using the equity method of accounting, which resulted in recording our proportional share of Mindjet's losses in the consolidated statement of operations and comprehensive income or loss for years ended December 31, 2015 and 2014. During the third quarter of 2015, we lost significant influence over Mindjet and discontinued the equity method of accounting as our voting ownership declined in conjunction with Mindjet issuing additional voting stock in an offering that we did not participate in and the resulting loss of our seat on its board. Consequently, we do not anticipate recording any additional equity method



losses related to our investment in Mindjet.

#### Noncontrolling Interests

The results attributable to noncontrolling interest represent the share of net income or loss from our less than wholly-owned consolidated subsidiaries that is allocated, based on relative ownership percentage, to the noncontrolling shareholders of those entities. The 43.2% of UCP owned by noncontrolling interest is our most significant noncontrolling interest at December 31, 2016.

## Comprehensive Income or Loss

We report comprehensive income or loss as well as net income or loss from the consolidated statement of operations and comprehensive income or loss. Comprehensive income measures changes in shareholders' equity, and includes unrealized items which are not recorded in the consolidated statement of operations.

## WATER RESOURCE AND WATER STORAGE OPERATIONS

Thousands of dollars	Year Ended December 31,			Change	
	2016	2015	2014	2015 to 2016	2014 to 2015
Revenue and other income:					
Sale of real estate and water assets	\$633	\$3,856	\$1,220	\$(3,223)	\$2,636
Other	319	476	360	(157 )	116
Segment total revenue and other income	952	4,332	1,580	(3,380 )	2,752
Cost of sales and expenses:					
Cost of real estate and water assets sold	326	1,239	726	(913 )	513
Impairment loss on intangible and long-lived assets		269	5,791	(269 )	(5,522 )
Depreciation and amortization	355	1,037	1,098	(682 )	(61 )
Overhead expense	4,407	4,675	5,277	(268 )	(602 )
Project expense	1,340	970	1,272	370	(302 )
Segment total expenses	6,428	8,190	14,164	(1,762 )	(5,974 )
Loss before income taxes	\$(5,476)	\$(3,858)	\$(12,584)	\$(1,618)	\$8,726

Historically, our water resource and water storage segment revenue and results have been volatile and infrequent. Since the date of closing generally determines the accounting period in which the sales revenue and cost of sales are recorded, our reported revenues and income in this segment fluctuate from period to period, depending on the dates when specific transactions close. Consequently, revenue in any one year is not necessarily indicative of likely revenue in future years.

## Segment Revenue

During 2016, we did not consummate any significant sales of real estate and water assets. Revenue in the period consisted primarily of lease income and option fees. During 2015, we sold 258 acres of real estate and approximately 774 acre-feet of water rights in the Harquahala Valley area of Arizona for cash proceeds of \$3.4 million, which generated a gross margin of \$2.4 million. During 2014, revenue was primarily the result of the sale of 200 acres of real estate and approximately 28 acre-feet of stock water rights in Lincoln County, Nevada for total proceeds of \$940,000 and a gross margin of \$488,000.

Other revenue for all periods presented consists largely of water and farm lease income and option payments received.

## Segment Expenses

In 2016, our total expenses decreased primarily as a result of a decrease in cost of real estate and water assets sold. The lower cost of real estate and water assets sold in 2016 was the result of no significant real estate or water asset sales during the year. There were no significant fluctuations in other costs and expenses year-over-year.

In 2015, our total expenses decreased significantly as we did not recognize any material impairment losses on intangible and long-lived assets during the year. All other costs and expenses remained consistent year-over-year.

In 2014, our total expenses included impairment losses recorded as a result of our review of indefinite-lived intangible assets that concluded the estimated fair values of certain intangible assets of approximately \$3.3 million were below the carrying values of \$5.6 million, resulting in an impairment loss of \$2.3 million. Also during 2014, certain water rights applications were denied by the New Mexico State Engineer and as a result, we recorded an impairment loss of \$3.5 million which reduced the carrying value of the capitalized costs to zero.

Overhead expenses consist of costs which are not directly related to the development of specific water assets, such as salaries and benefits, professional fees, office rent, insurance and audit fees.

Project expenses consisted of costs related to the ongoing maintenance of our assets, such as site maintenance and professional fees and other on-going costs such as property taxes on our real estate. Project costs are expensed as appropriate, and fluctuate from period to period depending on activity in our various projects. Historically, project expenses principally related to:

- certain costs related to intangible water rights in the Tule Desert groundwater basin and the Dry Lake Valley (both part of the Lincoln County, Nevada agreement); and
- certain costs for water resource development in Nevada and New Mexico.

During 2016 our Arizona Recharge Facility was fully depreciated, reducing our annual operation and maintenance expense related to the site by approximately \$1 million annually, of which \$879,000 was depreciation. In general, we expect project costs to decrease year-over-year as our assets are essentially fully developed. However, one-time unexpected costs could be incurred occasionally. During the year ended December 31, 2016, project expenses increased primarily due to one-time maintenance and legal charges related to our Arizona Recharge Facility and associated water credits, which we do not expect to recur in the future. In addition, we currently expect to continue to incur legal and consulting project costs related to the appeal of the denial of our water applications issued by the New Mexico State Engineer's ruling noted above.

Although we generated significant revenue from the sale of water credits during the first quarter of 2017, if we fail to continue to generate revenue, incur additional expenses beyond expectations, continue to report operating losses, or if expected prices for our water assets fall, we could be required to record additional impairment losses on our real estate, tangible and intangible water assets owned in this segment.

## REAL ESTATE OPERATIONS

Thousands of dollars	Year Ended December 31,			Change	
	2016	2015	2014	2015 to 2016	2014 to 2015
Revenue and other income:					
Sale of real estate	\$354,368	\$278,826	\$191,148	\$75,542	\$87,678
Other	377	370	292	7	78
Segment total revenue and other income	354,745	279,196	191,440	75,549	87,756
Cost of sales and expenses:					
Cost of real estate sold	290,412	226,476	157,474	63,936	69,002
Impairment loss on intangible and long-lived assets	6,811	1,197	2,865	5,614	(1,668 )
General, administrative, and other	29,848	26,434	27,990	3,414	(1,556 )
Sales and marketing	19,610	18,695	13,642	915	5,053
Segment total expenses	346,681	272,802	201,971	73,879	70,831
Income (loss) before income taxes	\$8,064	\$6,394	\$(10,531 )	\$1,670	\$16,925

As of December 31, 2016, our businesses in the real estate operations segment were primarily conducted through our 56.8% owned subsidiaries UCP, Inc. and UCP, LLC and its homebuilding and land development operations in California, Washington, North Carolina, South Carolina, and Tennessee.

UCP actively sourced, underwrote, and acquired real estate in its target markets to increase its land inventory and ability to either build and sell homes through its wholly owned subsidiary, Benchmark Communities, or develop land and sell lots to third-party homebuilders. During 2014, UCP acquired Citizens Homes, Inc. Citizens builds and sells homes in North Carolina, South Carolina and Tennessee. In addition to expanding its business in existing markets in these states, UCP continues to evaluate opportunities to expand into other markets with favorable housing demand fundamentals, including, in particular, long-term population and employment growth.

Our real estate sales are contingent upon numerous factors and, as such, the timing and volume of real estate sales in any one quarter is unpredictable. Historically, the level of real estate sales has fluctuated from period to period. Accordingly, it should not be assumed that the level of sales as reported will be maintained in future years.

During the year ended December 31, 2016, the overall U.S. housing market continued to show signs of improvement, driven by factors such as continued supply and demand imbalance, low mortgage rates, employment growth and rising consumer confidence. Individual markets continue to experience varying results, as local home inventories, affordability and employment factors strongly influence local markets.

#### Summary Results of UCP Revenue and Gross Margin for Homes and Lots

	Year Ended December 31,		
	2016	2015	2014
Lots sold	66	295	348
Homes sold	820	701	432
Average active selling communities during the period	28	28	16
Revenue (in thousands)			
Lot revenue - total	\$5,450	\$21,134	\$32,513
Lot revenue - per lot <sup>(1)</sup>	\$61	\$72	\$93
Home revenue - total	\$343,919	\$252,632	\$155,382
Home revenue - per home	\$419	\$360	\$360
General contracting revenue		5,060	3,253
Gross Margin (in thousands, except for percentages)			
Gross margin - lots	\$812	\$5,844	\$7,168
Gross margin percentage - lots	15	% 28	% 22
Gross margin - homes	\$62,901	\$45,810	\$26,080
Gross margin percentage - homes	18	% 18	% 17
Gross margin total - lots and homes	\$63,713	\$51,654	\$33,248
Gross margin percentage total - lots and homes	18	% 19	% 18

<sup>(1)</sup> The revenue per lot in 2016 does not include \$1.4 million of revenue for the sale of real estate owned by UCP but not previously included in UCP's lot count.

#### Segment Revenue and Gross Margin

In the following discussion, gross margin is defined as sale of real estate less cost of real estate sold, and gross margin percentage is defined as gross margin divided by sale of real estate.

In 2016, the increase in total segment revenue was primarily attributable to an increase in the number of homes sold and an increase in the average sales price of homes sold during the period, offset by a decrease in the number of lots sold.

The gross margin percentage of homes sold remained consistent from 2015 to 2016 as the revenue and cost per home sold each increased.

The gross margin percentage of lots sold decreased in 2016 as a result of a land sale in Bakersfield, California of 65 lots that were impaired and written down to fair value thereby reducing the gross margin.

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The gross margin percentage of homes sold increased modestly in 2015, due to an increase in the number of homes delivered and a decrease in the costs associated with cost of real estate sold. Additionally, the increase was a result of our focus on improving gross margins in 2015 by driving efficiency in purchasing and field operations coupled with the impact of new communities generating superior gross margins. We were able to do this by focusing on cost side management and gaining additional incremental revenue by focusing on pre-sales and reducing the number of spec sales, increasing lot premiums where appropriate, and a more deliberate ala carte options offering.

The gross margin percentage of lots sold increased in 2015, primarily due to a lower cost basis as compared to the sale price of the lots we sold during the 2014.

In 2015, the increase in total segment revenue was primarily attributable to the following combination of factors:

- an increase in the number of homes sold and the number of selling communities;
- a decrease in the average selling price (“ASP”) of homes sold;
- an increase in the number of lots sold;
- and
- an increase in revenue per lot.

#### Backlog

UCP’s homebuilding backlog (homes under sales contracts that have not yet closed at the end of the relevant period) at December 31, 2016 was \$149.6 million as compared to backlog of \$108.8 million at December 31, 2015. The growth in backlog value is related to strong new order growth for the year ended December 31, 2016 compared to December 31, 2015, which was slightly offset by a decrease in average sales price of homes in backlog as a result of product and geographic mix.

Sales contracts relating to homes in backlog may be canceled by the purchaser for a number of reasons. Accordingly, backlog may not be indicative of future segment revenue.

#### Segment Expenses

In 2016, segment expenses increased as the result of the following factors:

- an increase in cost of real estate sold, consistent with the increase in sales; and
- an increase in impairment loss on intangible and long-lived assets, primarily attributable to a \$4.2 million impairment loss on goodwill recorded due to revised financial forecasts for the Southeast operations, related to the Citizens acquisition.

In 2015, segment expenses increased as the result of the following factors:

- an increase in cost of real estate sold, consistent with the increase in sales; and
- an increase in sales and marketing expense, primarily attributable to an increase in the headcount of on-site sales personnel, the number of model homes and associated expenses as well as our marketing efforts to introduce our new communities.

In 2014, segment expenses increased as the result of the following factors:



an increase in cost of real estate sold, consistent with the increase sales noted in the segment revenue and gross margin section; and  
an increase in operating expenses, comprised of: an increase in salaries and benefits of \$4.5 million due to additional headcount as UCP continued to grow its development and homebuilding business and as a result of the acquisition of Citizens; an increase in stock-based compensation expense of \$1.5 million; an increase in marketing and sales costs of \$3.5 million due to an increased volume of homes sold in 2014; and an increase in consulting expense of \$1.6 million, incurred primarily in connection with the Citizen's acquisition.

The Company recorded an impairment loss of \$2.4 million on real estate located in Bakersfield, California during 2016. The Company entered into a contract to sell the remaining lots in the real estate for less than its carrying value at a future date and as a result, the real estate was written down to its fair value, less selling costs. Based on a variety of economic factors, including unemployment and building activity in the local areas, during the year ended December 31, 2015, we recorded an impairment loss of \$923,000 on real estate located in Kern County, California and owned by UCP. There were no impairment losses recorded in the year ended December 31, 2014 for UCP's real estate.

If we report operating losses in the future, or if market conditions deteriorate, we could be required to record additional impairment losses on our real estate.

## CORPORATE

Thousands of dollars	Year Ended December 31,			Change	
	2016	2015	2014	2015 to 2016	2014 to 2015
Revenue:					
Deferred compensation revenue	\$483	\$1,087	\$734	\$(604)	\$353
Impairment loss on investment in unconsolidated affiliate	(2,170)	(20,696)	(1,078)	18,526	(19,618)
Loss on dissolution or abandonment of consolidated subsidiary	(1,968)		(9,336)	(1,968)	9,336
Other	10,536	2,744	9,148	7,792	(6,404)
Segment total revenue and other income (losses)	6,881	(16,865)	(532)	23,746	(16,333)
Costs and expenses:					
Stock-based compensation expense	2,850	1,907	3,415	943	(1,508)
Impairment loss on intangible and long-lived assets	201	1,816	4,428	(1,615)	(2,612)
Deferred compensation expense	3,491	1,368	1,190	2,123	178
Foreign exchange (gain) loss	(1)	184	2,347	(185)	(2,163)
General, administrative, and other	20,931	11,546	11,942	9,385	(396)
Segment total expenses	27,472	16,821	23,322	10,651	(6,501)
Loss before income taxes	\$(20,591)	\$(33,686)	\$(23,854)	\$13,095	\$(9,832)

The corporate segment consisted primarily of cash and, our investments in Mindjet and Synthomics, the assets, liabilities and the results of operations of our oil and gas venture, Mendell Energy, and other parent company assets and liabilities which are not contained in other segments, including the assets and liabilities of the deferred compensation trusts held for the benefit of certain officers. Revenue included sales from our oil and gas operations, and realized gains or losses on the sale or impairment of securities and vary considerably from year to year. The segment results above do not include our share of the income or loss from any investments we account for using the equity method during the respective years presented.

The expenses recorded in this segment primarily consisted of parent company costs which are not allocated to our other segments, for example, salaries and benefits, directors' fees, shareholder costs, rent for our head office, stock-based compensation expense, deferred compensation expense, and expenses related to the operations of our oil and gas venture, which consisted primarily of our administrative service agreement for the management and administration of the oil and gas wells.

Corporate segment results fluctuate due to one or more individually significant revenue or expense items which occur irregularly, for example, realized gains or losses on the sale of investments, or which can change significantly from period to period, such as foreign currency gains or losses. Consequently, the corporate segment results are not typically comparable from year to year.

### Deferred Compensation Revenues and Expense

The participants in the deferred compensation plan bear the risk of the investment return on the deferred compensation assets, similar to a defined contribution plan such as a 401(k) plan. The investment income and realized gains or losses from the deferred compensation assets are recorded as revenue in the period that they are earned, and a corresponding and offsetting cost or benefit is recorded as deferred compensation expense or recovery. The change in net unrealized

appreciation or depreciation in the deferred compensation assets is charged to compensation expense. Once the deferred compensation has been distributed, over the lifetime of the assets, the revenue and deferred compensation expense equal and there is no net effect on segment results.

## Segment Revenues

In 2016, segment revenues primarily included a gain of \$8.7 million which resulted from the sale of the majority of the assets used in our oil and gas operations. The assets sold had previously been significantly reduced by impairment losses recorded in 2015 and 2014. There was no corresponding gain recorded during 2015. We recorded an impairment loss of \$2.2 million on our investment in Synthonics in 2016 due to continuing losses and deteriorating market conditions. This is compared to a \$20.7 million impairment loss on our investment in Mindjet during 2015 which was recorded due to deteriorating financial conditions that had adversely affected the value of our investment. During the year ended December 31, 2016, we ceased further operations within our 51% owned subsidiary, Klalab, Inc. (“Klalab”) and recorded a \$2 million loss on abandonment during the fourth quarter of 2016.

In 2015, the decrease in segment revenue was primarily due to the \$20.7 million impairment loss on our investment in Mindjet, as described above, while we recorded a \$1.1 million impairment charge in 2014 due to similar adverse economic conditions at Mindjet. Additionally, we recorded a loss of \$9.3 million in 2014 arising from the dissolution of our subsidiary whose currency was denominated in Swiss Francs, with no corresponding loss in 2015.

Included in other income was revenue from our oil and gas operations of \$1.1 million, \$1.3 million, and \$3.1 million for the years ended December 31, 2016, 2015, and 2014, respectively. The decline in oil and gas revenue year-over-year from 2015 to 2016 was primarily due to the sale the majority of the assets used in our oil and gas operations in October 2016. The decline in these revenues from 2014 to 2015 was primarily due to significantly lower market prices for our oil and gas in 2015, which decreased by approximately 54%.

## Segment Expenses

In 2016, segment expenses increased as compared to 2015, primarily due to a \$10.4 million severance expense accrual related to the termination of our former CEO and increased legal expenses related to shareholder activism efforts. These were offset by a decrease in salary expense from a reduction in executive compensation and employee headcount.

In 2015, segment expenses decreased as compared to 2014, primarily due to reduced stock based compensation expense, foreign exchange losses, and comparatively less impairment loss recorded on our oil and gas assets. Due to the significant declines in crude oil and natural gas prices during 2015, and the operational expenses for each well, we completed an impairment analysis on our oil and gas assets during the year. Based on our assumptions we determined certain capitalized costs would not be recovered, which resulted in an impairment loss for the year ended December 31, 2015 of \$1.8 million. This was the second such impairment loss recorded on these assets.

Included within general, administrative, and other is \$2 million, \$2.6 million, and \$3.4 million of expenses related to our oil and gas operations for the years ended December 31, 2016, 2015, and 2014, respectively. The most significant expense in our oil and gas operations is for our administrative service agreement, which totaled \$1.1 million, \$1.3 million, and \$1.1 million for the years ended December 31, 2016, 2015, and 2014, respectfully. In addition, we recorded depletion, amortization, and depreciation expense of \$393,000, \$464,000, and \$1.1 million for the years ended December 31, 2016, 2015, and 2014, respectfully.

It is reasonably possible, given the volatile nature of the software industry, that circumstances may change in the future which could require us to record additional impairment losses on our investment included in this segment.

## Foreign Exchange Gain or Loss

The foreign exchange gain or loss recorded in this segment in 2014 primarily resulted from the effect of fluctuations in the exchange rate between the Swiss Franc and the U.S. dollar on the amount of an intercompany loan, which was denominated in Swiss Francs. In conjunction with the dissolution of certain wholly-owned subsidiaries during 2014, the intercompany loan was canceled. The foreign exchange losses in 2016 and 2015 primarily related to our investments in certain foreign equity securities.

#### Stock-Based Compensation Expense

Stock-based compensation expense is calculated based on the fair value of the award on the grant date and is recognized over the vesting period of the awards. As of December 31, 2016, there was \$936,000 of unrecognized stock-based compensation expense, which we expect to record ratably until the last award vests. Of the \$936,000, \$508,000 related to Restricted Stock Units (“RSU”) and \$428,000 related to performance-based price-contingent stock options (“PBO”).

The stock-based compensation expense consisted primarily of the following awards (in thousands):

	Year Ended December 31,		
	2016	2015	2014
PBO - Officers <sup>(1)</sup>	\$1,412	\$1,029	\$82
RSU - Officers <sup>(2)</sup>	1,205	533	2,995
RSU - Directors	179	269	321
RSU - Management	54	76	17
Total stock-based compensation expense	\$2,850	\$1,907	\$3,415

<sup>(1)</sup> Includes \$428,000 in stock-based compensation in 2016 related to accelerated vesting of 87,302 awards upon the termination of our former CEO.

<sup>(2)</sup> Includes \$651,000 in stock-based compensation in 2016 related to accelerated vesting of 35,714 awards upon the termination of our former CEO.

#### DISCONTINUED AGRIBUSINESS OPERATIONS

Thousands of dollars	Year Ended December 31,			Change	
	2016	2015	2014	2015 to 2016	2014 to 2015
Revenue and other income:					
Sales of canola oil and meal		\$82,267	\$163,855	\$(82,267)	\$(81,588)
Loss on trading derivatives		(159)	(1,966)	159	1,807
Other	\$590	126	519	464	(393)
Segment total revenue and other	590	82,234	162,408	(81,644)	(80,174)
Cost of goods sold:					
Cost of canola oil and meal sold		79,763	137,565	(79,763)	(57,802)
Depreciation		4,360	8,079	(4,360)	(3,719)
Other direct costs of production		5,938	11,024	(5,938)	(5,086)
Total cost of goods sold	—	90,061	156,668	(90,061)	(66,607)
Expenses:					
Impairment loss on intangible and long-lived assets		1,875		(1,875)	1,875
Interest		3,259	5,536	(3,259)	(2,277)
Plant costs, overhead, and other	111	17,578	14,278	(17,467)	3,300
Segment total expenses	111	112,773	176,482	(112,662)	(63,709)
Income (loss) before income taxes	\$479	\$(30,539)	\$(14,074)	\$31,018	\$(16,465)

We completed the sale of substantially all of the assets used in our agribusiness operations on July 31, 2015 and as a result, we no longer operated an agribusiness segment as of that date. We classified our agribusiness operations as a discontinued agribusiness operation in the accompanying consolidated financial statements. Results from the operations during the seven months ended July 31, 2015 have been included, along with certain transaction costs, in the 2015 financial results. In the first quarter of 2016, we recorded a \$1.9 million loss primarily related to a waste water permit issue. We do not expect to record any other significant expenses related to the operations or sale of our discontinued agribusiness operations, however, any future adjustments to the sale price, including resolution of possible indemnification obligations above our initial expectations, and any other costs and expenses incurred in connection with the disposition of the business will be reported within our discontinued agribusiness operations.

In February 2017, we received the final \$6 million that had been held in escrow to cover any potential general indemnification claims related to the sale.

## LIQUIDITY AND CAPITAL RESOURCES -- YEARS ENDED DECEMBER 31, 2016, 2015, AND 2014

Our assets primarily consist of real estate and tangible and intangible water assets, cash and cash equivalents, and investments in publicly-traded securities. Our liquid funds are generally held in money market funds.

Our cash and cash equivalents and available-for-sale investments held in each segment at December 31, 2016 were as follows:

Water resource and water storage operations segment held cash of \$138,000.

Real estate operations segment held cash of \$40.9 million.

Corporate segment held cash of \$19.5 million, and marketable equity and debt securities with a market value of \$20.7 million and \$4.4 million, respectively. Included in those totals is \$1.9 million in cash, \$20.1 million in equities and \$4.4 million in debt securities that are held in deferred compensation rabbi trusts accounts, which will be used to pay the related and offsetting deferred compensation liabilities.

Discontinued agribusiness segment held cash of \$438,000.

Our primary sources of funds include existing cash, the sale of tangible and intangible water resource assets, loans and debt or equity offerings, and sales of our businesses. We are not subject to any debt covenants which limit our ability to obtain additional financing through debt or equity offerings. Debt covenants and restrictions in UCP limit us from transferring cash from those operations for use elsewhere in our Company. However, we expect to receive required cash distributions from UCP for minimum tax payments due as the underlying partnership generates taxable income. Regardless, cash flows from the majority of our real estate operations are restricted for use in those operations.

During the first quarter of 2017, we sold 100,000 LTSC, receiving \$25 million in cash proceeds, and collected the \$6 million escrow account balance related to the sale of our agribusiness operations. It is our intention to return capital to shareholders as soon as practical via a share buyback, special dividend, or other transactions with consideration of our working capital needs.

Our cash flows fluctuate depending on the capital requirements of our operating subsidiaries. The sale of and costs incurred to acquire and develop real estate and water assets are generally classified as operating activities in the consolidated statement of cash flows. The cash flow profiles of our principal operating segments are as follows:

### Water Resource and Water Storage Operations

A substantial portion of our revenue in this segment has come from one-time sales of real estate and water assets. The assets are typically long-term water resource development projects to support growth for particular communities in the southwestern U.S. The timing and amount of sales and cash flows depend on a number of factors which are difficult to project, and cannot be directly compared from one period to another. Our project expenses are generally discretionary in nature.

### Real Estate Operations

We are a homebuilder and developer in California, Washington State, North Carolina, South Carolina, and Tennessee. We finance additional acquisitions, development and construction costs from our existing cash, proceeds of the sale of existing lots and homes, and/or through external financing.

Certain of our debt agreements in our real estate operations contain various significant financial covenants, with each of which we were in compliance at December 31, 2016, as follows:



1) Certain of our real estate debt include provisions that require minimum loan-to-value ratios. During the term of the loan, the lender may require us to obtain a third-party written appraisal of the underlying real estate collateral. If the appraised fair value of the collateral securing the loan is below the specified minimum, we may be required to make principal payments in order to maintain the required loan-to-value ratios. As of December 31, 2016, the lenders have not requested, and we have not obtained, any such appraisals.

2) UCP's senior notes limit its ability to, among other things, incur or guarantee additional unsecured and secured debt (provided that UCP may incur debt so long as UCP's ratio of debt to its consolidated tangible assets (on a pro forma basis) would be equal to or less than 45% and provided that the aggregate amount of secured debt may not exceed the greater of \$75 million or 30% of UCP's consolidated tangible assets); pay dividends and make certain investments and other restricted payments; acquire unimproved real property in excess of \$75 million per fiscal year or in excess of \$150 million over the term of the notes, except to the extent funded with subordinated obligations or the proceeds of equity issuances; create or incur certain liens; transfer or sell certain assets; and merge or consolidate with other companies or transfer or sell all or substantially all of UCP's consolidated assets. Additionally, the notes require UCP to maintain at least \$50 million of consolidated tangible assets not subject to liens securing debt; maintain a minimum net worth of \$175 million; maintain a minimum of \$15 million of unrestricted cash and/or cash equivalents; and not permit decreases in the amount of consolidated tangible assets by more than \$25 million in any fiscal year or more than \$50 million at any time.

For the senior notes due 2017, UCP has various alternatives to meet this obligation when it comes due in October 2017. We believe that UCP currently has sufficient capital resources to fund its operations for at least the next twelve months, including the repayment of this debt obligation when it matures. The sources include UCPs available cash, available borrowing capacity and cash being generated from UCPs backlog of home sales. As part of this consideration, UCP generally has the ability to defer future investment activity, such as acquiring and developing land, or building additional homes for sale where borrowing capacity is currently not available.

We also believe that UCP has access to new sources of capital, as needed, to fund further investment in its business for land acquisitions and new development activities. UCP recently demonstrated its ability to obtain financing on its portfolio of projects when it put a new \$25 million borrowing base credit facility in place with a large regional commercial bank during the fourth quarter of 2016. As a result of this facility, UCP is able to reduce its borrowing costs, fees associated with the facility, and its administrative costs as compared to its existing project level loans. As of December 31, 2016, UCP had drawn \$10.5 million on this new facility, leaving \$14.5 million in available borrowing capacity. With unlevered real estate development inventory of \$194.9 million as of December 31, 2016, UCP expects to continue to put in place similar new borrowing based credit facilities so that UCP can provide funds to support future project developments.

#### Corporate

In conjunction with terminating our former CEO, we accrued \$10.4 million in severance benefits, stock-based compensation, and other related expenses during the year ended December 31, 2016. In accordance with applicable regulations, we are required to pay the severance benefits, settle the vested RSU, and distribute certain deferred compensation balances to our former CEO, valued at approximately \$23.3 million as of December 31, 2016, no earlier than six months and a day after the effective date of the termination. See Note 11, "Related-Party Transactions" for additional information.

Our corporate segment generates a modest amount of cash flow from the sale of oil and gas production from our wells in Colorado. During 2016, we sold a majority of these assets for gross proceeds of \$9.6 million. After certain holdbacks and consideration of liabilities assumed by the buyer, we received \$9 million in cash proceeds. We also sold certain of our other remaining oil and gas leases early in 2017. See Note 11, "Related-Party Transactions" for additional information. We do not expect to reinvest the proceeds or fund any additional capital into our oil and gas operations and we expect to completely wind -down our oil and gas operations during 2017 by selling our remaining producing oil and gas wells and leases and plugging and abandoning inactive wells.

#### Discontinued Agribusiness Operations

During the third quarter of 2015, we sold our agribusiness operations.

We were required to deposit \$10.2 million of the net proceeds in two separate escrow accounts. The first escrow account required \$6 million to secure general indemnification obligations and to refund of any difference in the final working capital balance. The second escrow account required \$4.2 million for specified operational matters (“operational escrow”). During October 2015, the Company received \$2.4 million of the operational escrow upon resolution of one issue, however, during January 2016, the Company forfeited the remaining operational escrow balance of \$1.8 million as a result of an unfavorable resolution on the second matter. In February 2017 we received the remaining \$6 million general indemnification escrow balance as no significant claims had been made.

We have also guaranteed up to \$8 million for any indemnification claims in excess of the \$6 million general indemnification escrow pursuant to the terms of a guaranty agreement with the buyer that will remain in force for five years from the date of sale.

## Consolidated Cash and Securities

We have limited working capital reserves. At December 31, 2016 and 2015, we had unrestricted and available cash and securities of \$18.7 million and \$13.1 million, respectively, which could be used for general corporate purposes.

Including all cash on hand at December 31, 2016, the \$25 million in cash we received from the sale of our storage credits, and \$6 million in cash we received related to the sale of our agribusiness operations during the first quarter of 2017, and an estimated \$8.1 million we expect to receive from UCP during 2017 for tax distributions, we anticipate total cash resources of approximately \$58.2 million during 2017.

At December 31, 2016, we forecast that our 2017 annual net operating cash burn (excluding UCP's operations and the tax distributions we expect to receive from UCP noted above) was approximately \$9.9 million which was comprised of expected expenditure of approximately \$10.8 million offset by recurring revenue and other certain receipts of approximately \$931,000.

After the \$10.4 million payment of the one-time severance benefit to our former CEO, we expect to have \$38 million in cash available as follows (in thousands):

Cash at December 31, 2016	\$18,740
Non-recurring revenue and other receipts, net	39,500
	58,240
Annual net operating burn	(9,852 )
Severance	(10,389 )
Cash available	\$37,999

Given our current cash balances we believe that we have sufficient resources to cover our cash needs for at least the next 12 months. In the long-term, we estimate that existing cash resources and cash from operations will provide us with adequate funding for future operations. However, if additional funding is needed, we could defer significant expenditures, sell assets, obtain a line of credit, or complete a debt or equity offering. Any additional equity offerings may be dilutive to our stockholders and any additional debt offerings may include operating covenants that could restrict our business.

## Cash Flow

Our cash flows from operating, investing, and financing activities were as follows (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Cash provided by (used in):			
Operating activities - continuing operations	\$(5,843)	\$(31,490)	\$(146,687)
Operating activities - discontinued agribusiness operations	(509 )	(17,433 )	(1,405 )
Total operating activities	(6,352 )	(48,923 )	(148,092 )
Investing activities - continuing operations	7,609	4,070	504
Investing activities - discontinued agribusiness operations	8	102,523	(5,396 )
Total investing activities	7,617	106,593	(4,892 )
Financing activities	2,315	(63,248 )	76,027
Effect of exchange rates on cash			1,896
Increase (decrease) in cash and cash equivalents	\$3,580	\$(5,578 )	\$(75,061 )



### Cash Flows From Operating Activities

During 2016, the primary uses of operating cash for continuing operations were \$301.4 million to acquire and develop our residential homes and lots. We had cash outflows of \$56.1 million for overhead expenses, primarily for salaries, benefits, marketing expenses, professional fees, and various project and other expenses. Offsetting the uses of cash from operations was \$350 million cash received from the sale of residential homes and lots.

During 2015, the primary uses of operating cash for continuing operations were \$264.2 million to acquire and develop our residential homes and lots. We used \$52.3 million for overhead expenses, primarily for salaries, benefits, marketing expenses, professional fees, and various project and other expenses. Offsetting the uses of cash from operating operations were \$279.2 million in cash received from the sale of residential homes and lots, \$3.9 million from the sale of water assets, and \$1.4 million from sales of oil and gas. Our discontinued agribusiness operations used \$74.3 million to purchase canola seed, \$36.5 million for overhead and operating expenses, and \$3.3 million in cash paid for interest. Partially offsetting the uses of cash was \$82.1 million generated from the sales of canola oil and meal.

During 2014, the primary uses of operating cash for continuing operations were \$282.8 million to acquire and develop our residential homes and lots. We used \$60.9 million for overhead expenses, primarily for salaries, benefits, marketing expenses, professional fees, and various project and other expenses. Offsetting the uses of cash from operating activities were \$190.7 million in cash received from the sale of residential homes and lots, \$3.9 million from realized gains on investments and sales of oil and gas, and \$1.2 million in cash received from sales of real estate and water assets. Our discontinued agribusiness operations used \$150.6 million to purchase canola seed, \$12 million for overhead and operating expenses, and \$4.7 million in cash paid for interest. Offsetting the uses of cash was \$168.6 million generated from the sales of canola oil and meal.

### Cash Flows From Investing Activities

During 2016, the primary cash inflows from investing activities of continuing operations included \$9 million from the sale of the majority of our oil and gas assets, and \$1.1 million from the sale and maturity of debt and equity securities, offset by \$1.5 million used to purchase debt and equity securities and a \$1.3 million increase in restricted cash.

During 2015, the primary cash inflows from investing activities of continuing operations included \$9.3 million from the sale and maturity of debt and equity securities, offset by \$2.3 million used to purchase debt and equity securities and \$3.1 million used to purchase property, plant, and equipment. During 2015, investing activities from our discontinued agribusiness operations provided \$97.5 million in net proceeds from the sale of our discontinued agribusiness operations, which was comprised of gross proceeds from the sale of \$105.3 million less \$7.8 million currently held back in escrow, and \$5 million in cash released from the restricted debt service reserve account.

During 2014, the primary uses of cash for continuing operations were \$14 million used in the acquisition of the assets of Citizens, \$5.3 million used to purchase property, plant, and equipment, primarily in our oil and gas operations, and \$11 million to purchase additional debt and equity securities. These uses of cash from continuing operations were offset by \$31 million received from the sale of debt and equity securities. Our discontinued agribusiness operations used \$6.4 million to purchase property, plant, and equipment and generated \$991,000 from the release of restricted deposits.

### Cash Flows From Financing Activities

During 2016, financing activities, including discontinued agribusiness operations, provided cash of \$2.3 million, primarily from draws on debt arrangements of \$154 million used primarily to fund the acquisition and development of

our real estate projects, offset by \$150 million of mortgage debt repaid when certain real estate properties were sold.

During 2015, financing activities, including discontinued agribusiness operations, used cash of \$63.2 million, primarily due to repayments of debt of \$209.1 million, including \$96.6 million paid on debt arrangements in our discontinued agribusiness operations and \$112.4 million of mortgage debt repaid when certain real estate properties were sold. These uses of cash were offset by cash proceeds of \$147.2 million provided from our debt arrangements, including \$12.7 million from our working capital line of credit within our discontinued agribusiness operations and \$134.5 million used primarily to fund the acquisition and development of our real estate projects.

During 2014, financing activities, including discontinued operations, provided cash of \$76 million, primarily due to the cash proceeds of \$184.7 million from our debt arrangements, which includes the \$75 million in notes issued by UCP during the year, used primarily to fund the acquisition and development of our real estate projects, offset by repayments of debt of \$101.5 million comprised of \$48.4 million primarily of construction debt repaid when certain real estate properties were sold, \$34.5 million repaid on our agribusiness debt, and \$18.6 million in repayments of Swiss debt.

Although we cannot accurately predict the effect of inflation on our operations, we do not believe that inflation has had a material impact on our net revenues or results of operations, or is likely to in the foreseeable future.

#### Off-Balance Sheet Arrangements

As of December 31, 2016, we had no off-balance sheet arrangements, other than those discussed throughout this document, that have, or are reasonably likely to have, a material current or future effect on our consolidated financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

#### Aggregate Contractual Obligations:

The following table provides a summary of our contractual cash obligations and other commitments and contingencies as of December 31, 2016 (in thousands):

Contractual Obligations	Payments Due by Period				Total
	Less than 1 year	1-3 years	3-5 years	More than 5 years	
Debt	\$120,785	\$40,943			\$161,728
Interest on debt	8,214	943			9,157
Operating leases	1,194	1,916	\$ 89		3,199
Other <sup>(1)</sup>	33,586				33,586
Total	\$163,779	\$43,802	\$ 89	\$	—\$207,670

<sup>(1)</sup> Amount represents accrued severance and deferred compensation expected to be paid to our former CEO as a result of his termination.

We had no liabilities or potential interest for unrecognized tax benefits associated with uncertain tax positions at December 31, 2016.



ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our balance sheet includes a certain amount of assets and liabilities whose fair value is subject to market risk. Market risk is the risk of loss arising from adverse changes in market interest rates or prices. We currently have interest rate risk as it relates to the modest amount of debt securities we hold, and equity price risk as it relates to our marketable equity securities. The estimated fair value of our reported debt is based on cash flow models discounted at the then-current interest rates and an estimate of the then-current spread above those rates at which we could borrow, which are Level 3 inputs in the fair value hierarchy.

At December 31, 2016, we had \$4.4 million of debt securities and \$20.7 million of marketable equity securities, and at December 31, 2015, we had \$4.5 million of debt securities and \$18.1 million of marketable equity securities, which were subject to market risk.

Our debt securities principally consist of bonds with short and medium terms to maturity. The deferred compensation accounts have held both investment-grade and below investment-grade bonds. In the deferred compensation accounts, we manage interest rate risk by matching the maturities of the bonds to the participant's pre-selected payout schedule.

We use two models to report the sensitivity of our assets and liabilities subject to the above risks. For debt securities, we use duration modeling to calculate changes in fair value. The model calculates the price of a fixed maturity assuming a theoretical 100 basis point, or a 1% increase in interest rates and compares that to the current price of the security. At December 31, 2016 and 2015, the model did not calculate a material loss in fair value. For our marketable equity securities, we use a hypothetical 20% decrease in fair value to analyze the sensitivity. The hypothetical 20% decrease in fair value of our marketable equity securities would produce a loss in fair value at December 31, 2016 and 2015, of \$4.1 million and \$3.6 million, respectively, that would reduce our unrealized appreciation in shareholders' equity.

Actual results may differ from the hypothetical results assumed in this disclosure due to possible actions we may take to mitigate adverse changes in fair value, and because the fair value of securities may be affected by both factors related to the individual securities (e.g. credit concerns about a bond issuer) and general market conditions.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our financial statements as of December 31, 2016 and 2015 and for each of the three years in the period ended December 31, 2016, and the Report of the Registered Independent Public Accounting Firm are included in this report as listed in the index.

## SELECTED QUARTERLY FINANCIAL DATA

Summarized unaudited quarterly financial data (in thousands, except per share amounts) for 2016 and 2015 are shown below. In management's opinion, the interim financial statements from which the following data has been derived contain all adjustments necessary for a fair presentation of results for such interim periods and are of a normal recurring nature.

	Three Months Ended			
	March 31, 2016	June 30, 2016	September 30, 2016	December 31, 2016
Sale of real estate and water assets	\$68,323	\$82,870	\$95,816	\$107,992
Impairment loss on investment in unconsolidated affiliate				(2,170 )
Other	714	839	892	7,302
Total revenue and other income	\$69,037	\$83,709	\$96,708	\$113,124
Gross profit - real estate and water assets	\$11,757	\$16,256	\$16,839	\$19,411
Loss from continuing operations	\$(4,953 )	\$(2,669 )	\$(1,841 )	\$(2,189 )
Net income (loss) from discontinued agribusiness operations, net of tax	\$(1,889 )	\$(54 )	\$(16 )	\$582
Net loss	\$(6,842 )	\$(2,723 )	\$(1,857 )	\$(1,607 )
Net loss attributable to PICO Holdings, Inc.	\$(6,801 )	\$(3,398 )	\$(2,900 )	\$(8,766 )
Net income (loss) per common share – basic and diluted:				
Loss from continuing operations	\$(0.21 )	\$(0.15 )	\$(0.13 )	\$(0.40 )
Income (loss) from discontinued agribusiness operations	\$(0.08 )			\$0.02

	Three Months Ended			
	March 31, 2015 <sup>(2)</sup>	June 30, 2015	September 30, 2015	December 31, 2015
Sale of real estate and water assets	\$43,610	\$55,063	\$77,044	\$106,964
Impairment loss on investment in unconsolidated affiliate <sup>(1)</sup>		(20,696 )		
Other <sup>(1)</sup>	1,714	741	1,047	1,176
Total revenue and other income	\$45,324	\$35,108	\$78,091	\$108,140
Gross profit - real estate and water assets	\$7,277	\$9,455	\$16,418	\$21,816
Loss from continuing operations	\$(9,327 )	\$(25,098 )	\$(865 )	\$3,679
Net loss from discontinued agribusiness operations, net of tax	\$(10,482)	\$(25,716)	\$(11,573)	\$(1,497 )
Net income (loss)	\$(19,809)	\$(50,814)	\$(12,438)	\$2,182
Net loss attributable to PICO Holdings, Inc.	\$(16,825)	\$(49,770)	\$(14,092)	\$(1,171 )
Net income (loss) per common share – basic and diluted:				
Income (loss) from continuing operations	\$(0.32 )	\$(1.08 )	\$(0.11 )	\$0.02
Loss from discontinued agribusiness operations	\$(0.41 )	\$(1.09 )	\$(0.50 )	\$(0.07 )

<sup>(1)</sup> Impairment loss on investment in unconsolidated affiliate was previously included in other income.

<sup>(2)</sup> On July 13, 2015, we entered into an agreement with CHS Hallock, LLC, a wholly owned subsidiary of CHS Inc. (“CHS”), to sell substantially all of the assets used in our agribusiness segment. The sale closed on July 31, 2015. We recorded a loss on the sale of \$18.7 million during the year ended December 31, 2015, to write down the assets sold to their fair values as determined in the sale agreement. As a result of the transaction, the assets and liabilities of our agribusiness segment qualified as held-for-sale and have been classified as discontinued agribusiness operations in the accompanying consolidated financial statements as of the earliest period presented. Consequently, these prior periods have been recast from amounts previously reported to reflect the agribusiness segment as discontinued agribusiness operations. See Note 13 “Discontinued Agribusiness Operations,” in the accompanying consolidated financial statements for additional information.

PICO HOLDINGS, INC. AND SUBSIDIARIES  
CONSOLIDATED FINANCIAL STATEMENTS  
AS OF DECEMBER 31, 2016 AND 2015  
AND FOR EACH OF THE  
THREE YEARS IN THE PERIOD  
ENDED DECEMBER 31, 2016

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
PICO Holdings, Inc.  
La Jolla, California

We have audited the accompanying consolidated balance sheets of PICO Holdings, Inc. and subsidiaries (the "Company") as of December 31, 2016 and 2015, and the related consolidated statements of operations and comprehensive income or loss, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2016. Our audits also included the financial statement schedule listed in the Index at Item 15. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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 audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of PICO Holdings, Inc. and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2016, based on the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 2, 2017, expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP  
San Diego, California  
March 2, 2017

PICO HOLDINGS, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

December 31, 2016 and 2015

(In thousands)

	2016	2015
Assets		
Cash and cash equivalents	\$60,542	\$56,462
Investments (\$25,071 and \$22,590 measured at fair value at December 31, 2016 and 2015, respectively)	26,383	26,072
Real estate and tangible water assets, net	430,898	424,235
Intangible assets, net	126,897	126,533
Other assets	24,569	19,990
Assets held-for-sale	6,505	8,793
Total assets	\$675,794	\$662,085
Liabilities and shareholders' equity		
Debt, net	\$160,994	\$155,966
Accounts payable and accrued expenses	35,040	34,458
Deferred compensation	27,322	25,493
Other liabilities	24,593	11,556
Liabilities held-for-sale	276	608
Total liabilities	248,225	228,081
Commitments and contingencies		
Common stock, \$.001 par value; authorized 100,000 shares, 23,125 issued and 23,070 outstanding at December 31, 2016, and 23,116 issued and 23,038 outstanding at December 31, 2015	23	23
Additional paid-in capital	495,468	494,207
Accumulated deficit	(173,231 )	(151,366 )
Accumulated other comprehensive income	6,661	4,961
Treasury stock, at cost (common shares: 55 and 78 at December 31, 2016 and December 31, 2015, respectively)	(927 )	(1,413 )
Total PICO Holdings, Inc. shareholders' equity	327,994	346,412
Noncontrolling interest in subsidiaries	99,575	87,592
Total equity	427,569	434,004
Total liabilities and equity	\$675,794	\$662,085

The accompanying notes are an integral part of the consolidated financial statements.

PICO HOLDINGS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME OR LOSS  
For the years ended December 31, 2016, 2015, and 2014  
(In thousands, except per share data)

	2016	2015	2014
Revenues and other income:			
Sale of real estate and water assets	\$355,001	\$282,681	\$192,368
Impairment loss on investment in unconsolidated affiliate	(2,170 )	(20,696 )	(1,078 )
Other income, net	9,747	4,678	1,198
Total revenues and other income	362,578	266,663	192,488
Cost of sales and expenses:			
Cost of real estate and water assets sold	290,738	227,715	158,200
General, administrative, and other	61,537	45,780	51,457
Sales and marketing	19,798	18,824	13,662
Impairment loss on intangible and long-lived assets	7,012	3,282	13,084
Depreciation and amortization	1,496	2,212	3,054
Total costs and expenses	380,581	297,813	239,457
Loss from continuing operations before income taxes and equity in loss of unconsolidated affiliates	(18,003 )	(31,150 )	(46,969 )
Benefit for federal and state income taxes	6,351	2,961	3,514
Equity in loss of unconsolidated affiliate		(3,422 )	(2,076 )
Loss from continuing operations	(11,652 )	(31,611 )	(45,531 )
Income (loss) from discontinued agribusiness operations, net of tax	479	(30,539 )	(14,074 )
Loss on sale of discontinued agribusiness operations, net of tax	(1,856 )	(18,729 )	
Net loss from discontinued agribusiness operations, net of tax	(1,377 )	(49,268 )	(14,074 )
Net loss	(13,029 )	(80,879 )	(59,605 )
Net (income) loss attributable to noncontrolling interests	(8,836 )	(979 )	7,180
Net loss attributable to PICO Holdings, Inc.	\$(21,865 )	\$(81,858 )	\$(52,425 )

The accompanying notes are an integral part of the consolidated financial statements.

PICO HOLDINGS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME OR LOSS,  
CONTINUED

(In thousands, except per share data)

	2016	2015	2014
Other comprehensive loss:			
Net loss	\$(13,029)	\$(80,879)	\$(59,605)
Other comprehensive loss, net of tax:			
Unrealized gain (loss) on securities, net of deferred income tax and reclassification adjustments	1,671	292	(2,093 )
Foreign currency translation	29	(48 )	6,578
Total other comprehensive income, net of tax	1,700	244	4,485
Comprehensive loss	(11,329 )	(80,635 )	(55,120 )
Comprehensive (income) loss attributable to noncontrolling interests	(8,836 )	(979 )	7,180
Comprehensive loss attributable to PICO Holdings, Inc.	\$(20,165)	\$(81,614)	\$(47,940)
Net loss per common share – basic and diluted:			
Loss from continuing operations	\$(0.89 )	\$(1.49 )	\$(1.76 )
Loss from discontinued agribusiness operations	\$(0.06 )	\$(2.07 )	\$(0.54 )
Net loss per common share – basic and diluted	\$(0.95 )	\$(3.56 )	\$(2.30 )
Weighted average shares outstanding	23,054	23,014	22,802

The accompanying notes are an integral part of the consolidated financial statements.



PICO HOLDINGS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY  
For the year ended December 31, 2014  
(In thousands)

	Shares of Common Stock Issued	Common Stock	Additional Paid-in Capital	Retained Earnings/ Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Shares of Treasury Stock	Treasury Stock, at Cost	Non-controlling Interest	Total
Beginning balance, December 31, 2013	25,821	\$ 26	\$546,307	\$(17,083 )	\$ 232	3,073	\$(56,593)	\$ 91,956	\$564,845
Stock-based compensation expense			5,228					1,865	7,093
Exercise of restricted stock units	247		(4,919 )					(817 )	(5,736 )
Retirement of treasury stock	(2,985 )	(3 )	(54,954 )			(2,985 )	54,957		—
Sale of treasury stock						(10 )	223		223
Contributions from noncontrolling interest								240	240
Net loss				(52,425 )				(7,180 )	(59,605 )
Unrealized loss on investments, net of deferred income tax of \$1,076 and reclassification adjustments of \$4,646					(2,093 )				(2,093 )
Foreign currency translation					6,578				6,578
Ending balance, December 31, 2014	23,083	\$ 23	\$491,662	\$(69,508 )	\$ 4,717	78	\$(1,413 )	\$ 86,064	\$511,545

The accompanying notes are an integral part of the consolidated financial statements

PICO HOLDINGS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY  
For the year ended December 31, 2015  
(In thousands)

	Shares of Common Stock Issued	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Shares of Treasury Stock at Cost	Treasury Stock, at Cost	Non-controlling Interest	Total
Beginning balance, December 31, 2014	23,083	\$ 23	\$491,662	\$(69,508 )	\$ 4,717	78	\$(1,413)	\$ 86,064	\$511,545
Stock-based compensation expense			2,882					734	3,616
Exercise of restricted stock units	33								—
Withholding taxes paid on vested restricted stock units at UCP, Inc.			(337 )					(159 )	(496 )
Distribution to noncontrolling interest								(26 )	(26 )
Net loss				(81,858 )				979	(80,879 )
Unrealized gain on investments, net of deferred income tax of \$173 and reclassification adjustments of \$741					292				292
Foreign currency translation					(48 )				(48 )
Ending balance, December 31, 2015	23,116	\$ 23	\$494,207	\$(151,366 )	\$ 4,961	78	\$(1,413)	\$ 87,592	\$434,004

The accompanying notes are an integral part of the consolidated financial statements

PICO HOLDINGS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY  
For the year ended December 31, 2016  
(In thousands)

	Shares of Common Stock Issued	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Shares of Treasury Stock	Treasury Stock, at Cost	Non-controlling Interest	Total
Beginning balance, December 31, 2015	23,116	\$ 23	\$494,207	\$(151,366 )	\$ 4,961	78	\$(1,413)	\$ 87,592	\$434,004
Stock-based compensation expense			3,507					498	4,005
Exercise of restricted stock units	9								—
Withholding taxes paid on vested restricted stock units at UCP, Inc.			(26 )					(20 )	(46 )
Changes in ownership of noncontrolling interest			(1,951 )					1,951	—
UCP, Inc.'s acquisition of its class A common stock								(1,250 )	(1,250 )
Distribution of treasury stock to deferred compensation plan participants			(269 )			(23 )	486		217
Abandonment of consolidated subsidiary								1,968	1,968
Net income (loss)				(21,865 )				8,836	(13,029 )
Unrealized gain on investments, net of deferred income tax of \$900 and reclassification adjustments of \$297					1,671				1,671
Foreign currency translation					29				29
Ending balance, December 31, 2016	23,125	\$ 23	\$495,468	\$(173,231 )	\$ 6,661	55	\$(927 )	\$ 99,575	\$427,569

The accompanying notes are an integral part of the consolidated financial statements

PICO HOLDINGS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
For the years ended December 31, 2016, 2015, and 2014  
(In thousands)

	2016	2015	2014
Operating activities:			
Net loss	\$(13,029)	\$(80,879)	\$(59,605)
Adjustments to reconcile net loss to net cash used in operating activities:			
Benefit for deferred income taxes	(6,398 )	(2,913 )	(3,315 )
Depreciation and amortization expense	1,496	2,212	3,054
Stock-based compensation expense	4,005	3,616	7,067
Impairment loss on investment in unconsolidated affiliate	2,170	20,696	1,078
Impairment loss on goodwill	4,223		
Impairment loss on intangible and long-lived assets	2,790	3,282	13,084
Gain on sale of available-for-sale investments	(133 )	(1,101 )	(4,733 )
Loss on abandonment or liquidation of consolidated subsidiary	1,968		9,336
Loss from discontinued operations, net	1,377	49,268	14,074
Fair value adjustment of contingent consideration	(2,347 )	(1,195 )	
Gain on sale of property, plant and equipment	(8,605 )		
Equity in loss of unconsolidated affiliate		3,422	2,076
Changes in assets and liabilities, net of effects of acquisitions and dispositions:			
Notes and other receivables	(3,832 )	227	(785 )
Real estate, water, and intangible assets	(9,890 )	(40,235 )	(132,005 )
Income taxes	(78 )		3,624
Other assets	1,182	(204 )	(2,613 )
Deferred compensation	2,685	909	423
Accounts payable and accrued expenses	16,530	11,311	2,628
Other operating activities, net	43	94	(75 )
Cash used in operating activities - continuing operations	(5,843 )	(31,490 )	(146,687 )
Cash used in operating activities - discontinued agribusiness operations	(509 )	(17,433 )	(1,405 )
Net cash used in operating activities	(6,352 )	(48,923 )	(148,092 )
Investing activities:			
Proceeds from the sale of investments	1,068	7,938	31,036
Proceeds from maturity of investments	18	1,343	
Purchases of investments	(1,511 )	(2,316 )	(11,046 )
Increase in restricted deposits	(1,297 )		(250 )
Proceeds from the sale of property, plant and equipment	8,988		
Purchases of property, plant and equipment	(318 )	(3,108 )	(5,270 )
Cash used in the acquisition of a consolidated subsidiary			(14,006 )
Other investing activities, net	661	213	40
Cash provided by investing activities - continuing operations	7,609	4,070	504
Cash provided by (used in) investing activities - discontinued agribusiness operations	8	102,523	(5,396 )
Net cash provided by (used in) investing activities	7,617	106,593	(4,892 )
Financing activities:			
Proceeds from debt	154,034	147,170	184,684
Repayment of debt	(149,796)	(209,068)	(101,462)
Debt issuance costs	(627 )	(827 )	(1,920 )

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Payment of withholding taxes on exercise of restricted stock units	(46 )	(496 )	(5,737 )
Proceeds from sale of treasury stock (purchases by UCP, Inc. of its class A common stock)	(1,250 )		220
Other financing activities, net		(27 )	242
Net cash provided by (used in) financing activities	2,315	(63,248 )	76,027
Effect of exchange rate changes on cash			1,896
Net increase (decrease) in cash and cash equivalents	3,580	(5,578 )	(75,061 )
Cash and cash equivalents, beginning of year	57,400	62,978	138,039
Cash and cash equivalents, end of year	60,980	57,400	62,978
Less cash and cash equivalents of discontinued agribusiness operations, end of year	438	938	301
Cash and cash equivalents of continuing operations, end of year	\$60,542	\$56,462	\$62,677

PICO HOLDINGS, INC. AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED  
 For the years ended December 31, 2016, 2015 and 2014  
 (In thousands)

	2016	2015	2014
Supplemental disclosure of cash flow information:			
Cash paid (received) during the year for:			
Payment (refund) of federal and state income taxes	\$124	\$(67 )	\$(3,817 )
Interest paid, net of amounts capitalized		\$3,295	\$5,183
Non-cash investing and financing activities:			
Issuance of common stock for vested restricted stock units	\$348	\$1,609	\$11,463
Fair value of assets acquired in Citizens acquisition			\$19,418
Cash paid for the acquisition of consolidated subsidiaries			\$(14,006)
Contingent consideration and liabilities assumed in Citizens acquisition			\$5,412
Accrued debt issuance costs			\$473
Unpaid liability incurred for construction costs		\$388	\$917
Distribution of debt and equity securities in satisfaction of deferred compensation liability (including 22,644 shares of treasury stock)	\$856		

The accompanying notes are an integral part of the consolidated financial statements

PICO HOLDINGS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Operations

## 1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

### Organization and Operations:

PICO Holdings, Inc., together with its subsidiaries (collectively, “PICO” or the “Company”), is a diversified holding company. As of December 31, 2016, the Company has presented its consolidated financial statements and the accompanying notes to the consolidated financial statements using the guidelines prescribed for real estate companies, as the majority of the Company’s assets and operations are primarily engaged in real estate and related activities.

Currently PICO’s major activities include developing water resources and water storage operations in the southwestern United States, homebuilding, and land development.

The following are the Company’s significant operating subsidiaries as of December 31, 2016. All subsidiaries are wholly-owned except where indicated:

Vidler Water Company, Inc. (“Vidler”) is a Nevada corporation. Vidler owns water resources and water storage operations in the southwestern United States, with assets and operations in Nevada, Arizona, Colorado and New Mexico. Currently, Vidler is primarily focused on selling its existing water rights and storage credits.

UCP, Inc. (“UCP”) is a public company homebuilder and land developer which owns and develops real estate in California, Washington State, North Carolina, South Carolina, and Tennessee. UCP operates its homebuilder business through its subsidiary, Benchmark Communities, LLC (“Benchmark”). PICO owns 56.8% of UCP.

### Principles of Consolidation:

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned, majority-owned and controlled subsidiaries, and have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). Intercompany balances and transactions have been eliminated in consolidation.





#### Use of Estimates in Preparation of Financial Statements:

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses for each reporting period. The significant estimates made in the preparation of the Company's consolidated financial statements relate to the application of the equity method of accounting, intangibles, real estate and water assets, deferred income taxes, stock-based compensation, and contingent liabilities. While management believes that the carrying value of such assets and liabilities were appropriate as of December 31, 2016 and December 31, 2015, it is reasonably possible that actual results could differ from the estimates upon which the carrying values were based.

#### Real Estate and Tangible Water Assets:

Real estate and tangible water assets include the cost of certain tangible water assets, water storage credits and related storage facilities, real estate, including raw land and real estate being developed and any real estate improvements. The Company capitalizes pre-acquisition costs, the purchase price of real estate, development costs and other allocated costs, including interest, during development and construction. Pre-acquisition costs, including non-refundable land deposits, are expensed to cost of sales when the Company determines continuation of the related project is not probable.

Additional costs to develop or otherwise get real estate and tangible water assets ready for their intended use are capitalized. These costs typically include direct construction costs, legal fees, engineering, consulting, direct cost of well drilling or related construction, and any interest costs capitalized on qualifying assets during the development period. The Company expenses all maintenance and repair costs on real estate and tangible water assets. The types of costs capitalized are consistent across periods presented. Tangible water assets consist of various water interests currently in development or awaiting permitting. Amortization of real estate improvements is computed on the straight-line method over the estimated useful lives of the improvements ranging from five to fifteen years.

#### Intangible Water Assets:

Intangible water assets include the costs of indefinite-lived intangible assets and is comprised of water rights and the exclusive right to use two water transportation pipelines. The Company capitalizes development and entitlement costs and other allocated costs, including interest, during the development period of the assets to tangible water assets and transfers the costs to intangible water assets when water rights are permitted. Water rights consist of various water interests acquired or developed independently or in conjunction with the acquisition of real estate. When the Company purchases intangible water assets that are attached to real estate, an allocation of the total purchase price, including any direct costs of the acquisition, is made at the date of acquisition based on the estimated relative fair values of the water rights and the real estate.

Intangible assets with indefinite useful lives are not amortized but are tested for impairment at least annually in the fourth quarter, or more frequently if events or changes in circumstances indicate that the asset may be impaired, by comparing the fair value of the assets to their carrying amounts. The fair value of the intangible assets is calculated using discounted cash flow models that incorporate a wide range of assumptions including current asset pricing, price escalation, discount rates, absorption rates, timing of sales, and costs. These models are sensitive to minor changes in any of the input variables.

#### Investments:

The Company's investment portfolio at December 31, 2016 and 2015 was comprised of corporate bonds and equity securities. Corporate bonds are purchased based on the maturity and yield-to-maturity of the bond and an analysis of the fundamental characteristics of the issuer. The Company's investments in equity securities consisted of common stock of publicly traded and private small-capitalization companies in the United States ("U.S.") and selected foreign markets.

The Company classifies its marketable securities as available-for-sale investments. Such investments are reported at fair value, with unrealized gains and losses, net of tax effects, recorded in accumulated other comprehensive income. Investments in private companies are generally held at the lower of cost or fair value, unless the Company has the ability to exercise significant influence. The Company reports the amortization of premium and accretion of discount on the level yield method relating to bonds acquired at other than par value and realized investment gains and losses in other income. The cost of any equity security sold is determined using an average cost basis and specific identification for bond cost. Sales and purchases of investments are recorded on the trade date.

Investment in Unconsolidated Affiliate:

Investments where the Company owns at least 20% but not more than 50% of the voting interest, or has the ability to exercise significant influence, but not control, over the investee are accounted for under the equity method of accounting. Accordingly, the Company's share of the income or loss of the affiliate is included in the Company's consolidated results. Any impairment losses recorded against investments accounted for under the equity method of accounting are included in impairment loss on investment in unconsolidated affiliates.

Other-than-Temporary Impairment:

All of the Company's debt and equity investments are subject to a periodic impairment review. The Company recognizes an impairment loss when a decline in the fair value of its investments below the cost basis is judged to be other-than-temporary.

Factors considered in determining whether a loss is temporary on an equity security includes the length of time and extent to which the investments fair value has been less than the cost basis, the financial condition and near-term prospects of the investee, extent of the loss related to credit of the issuer, the expected cash flows from the security, the Company's intent to sell the security and whether or not the Company will be required to sell the security before the recovery of its cost. If a security is impaired and continues to decline in value, additional impairment losses are recorded in the period of the decline if deemed other-than-temporary. Subsequent recoveries of the value are reported as unrealized gains and are part of other comprehensive income or loss.

The Company will recognize an impairment loss on debt securities if the Company (a) intends to sell or expects to be required to sell the security before its amortized cost is recovered, or (b) does not expect to ultimately recover the amortized cost basis even if the Company does not intend to sell the security. Impairment losses on debt securities that are expected to be sold before the amortized cost is recovered are recognized in earnings. For debt securities that the Company does not expect to recover the amortized costs basis, credit losses are recognized in earnings and the difference between fair value and the amortized cost basis net of the credit loss is recognized in other comprehensive income.

Impairment of Long-Lived Assets:

The Company records an impairment loss when the condition exists where the carrying amount of a long-lived asset or asset group is not recoverable. Impairment of long-lived assets is triggered when the estimated future undiscounted cash flows, excluding interest charges, for the lowest level for which there is identifiable cash flows that are independent of the cash flows of other groups of assets do not exceed the carrying amount. The Company prepares and analyzes cash flows at appropriate levels of grouped assets. If the events or circumstances indicate that the remaining balance may be impaired, such impairment will be measured based upon the difference between the carrying amount and the fair value of such assets determined using the estimated future discounted cash flows, excluding interest charges, generated from the use and ultimate disposition of the respective long-lived asset.

Noncontrolling Interests:

The Company reports the share of the results of operations that are attributable to other owners of its consolidated subsidiaries that are less than wholly-owned as noncontrolling interest in the accompanying consolidated financial statements. In the consolidated statement of operations and comprehensive income or loss, the income or loss attributable to the noncontrolling interest is reported separately and the accumulated income or loss attributable to the noncontrolling interest, along with any changes in ownership of the subsidiary, is reported within shareholders' equity.

The Company allocates UCP Class A common stock issued in connection with the vesting of UCP restricted stock units (“RSU”) and stock-based compensation expense between additional paid-in-capital and noncontrolling interest within the consolidated statements of equity. The equity allocations for the UCP, LLC operating partnership are based on the economic and voting interest percentages of the Company and its noncontrolling interest in UCP. Issuances of UCP Class A common stock for UCP RSUs affect the economic and voting interest percentages, which accordingly are adjusted at the end of each issuance period. The economic and voting interest percentages prevailing during the period are used to determine the current period equity allocations for the operating partnership.

Cash and Cash Equivalents:

Cash and cash equivalents include short-term, highly liquid instruments, purchased with original maturities of three months or less.

Other Assets:

Other assets include the following significant account balances:

Property, Plant and Equipment, Net:

Property, plant and equipment are carried at cost, net of accumulated depreciation. Depreciation is computed on the straight-line method over the estimated lives of the assets. Buildings and leasehold improvements are depreciated over the shorter of the useful life or lease term and range from 15 to 30 years, office furniture and fixtures are generally depreciated over seven years, and computer equipment is depreciated over three years. Maintenance and repairs are charged to expense as incurred, while significant improvements are capitalized. Gains or losses on the sale of property, plant and equipment are included in other income.

Capitalized property, plant and equipment costs include all development costs incurred to get the asset ready for its intended use and includes capitalized interest on qualifying assets during the development period.

In August 2016, the Company entered into a purchase and sale agreement to sell the majority of the assets used in its oil and gas operations effective October 1, 2016 for gross proceeds of \$9.6 million. After consideration of liabilities assumed by the buyer, cash proceeds to the Company were \$9 million. The purchase and sale agreement provides for a Company guarantee of \$1 million for any indemnification claims made by the buyer within one year of the sale. As the carrying value of the assets sold was reduced significantly in prior periods due to impairment losses and depletion charges, the Company recorded a gain on sale before income taxes of \$8.7 million during the fourth quarter of 2016 that is reported within other income in the consolidated statement of operations and comprehensive income or loss and within the Company's corporate segment results.

Notes and Other Receivables:

The Company's notes and other receivables included warranty insurance, manufacturer rebates, utility reimbursement costs, reimbursable land development costs under a fixed price general contracting service contract, and installment notes from the sale of real estate and water assets. The Company records a provision for doubtful accounts to allow for any specific accounts which may be unrecoverable and is based upon an analysis of the Company's prior collection experience, customer creditworthiness, current economic trends and underlying value of the real estate, if applicable. Certain notes are secured by the underlying assets, which allows the Company to recover the property if and when a buyer defaults. No significant provision for bad debts was required on any receivables or installment notes from the sale of real estate and water assets during the years ended December 31, 2016 and 2015.

Goodwill:

The Company records goodwill that arises from costs in excess of the fair value of net assets acquired in a business combination. The balance is not amortized but is tested for impairment at least annually in the fourth quarter, or more frequently if events or changes in circumstances indicate that the asset may be impaired. Goodwill is tested for impairment at the reporting unit level, which is generally the subsidiary company level. A discounted cash flow model is used to estimate the fair value of the reporting unit, which considers forecasted cash flows discounted at an estimated weighted-average cost of capital. The Company selected the discounted cash flow methodology as it believes it is comparable to what would be used by market participants. The weighted-average cost of capital is an estimate of the overall after-tax rate of return required by equity and debt market participants of a business enterprise. This analysis requires significant judgment, including discount rates, growth rates and terminal values and the timing of expected future cash flows. Discount rate assumptions are based on an assessment of the risk inherent in the future cash flows of the respective reporting unit. Factors which could necessitate an interim impairment assessment include

a sustained decline in our stock price, prolonged negative industry or economic trends and significant underperformance relative to expected historical or projected future operating results.

Accounts payable and accrued expenses:

Accounts payable and accrued expenses includes trade payables and accrued construction payables.

Deferred Compensation:

The Company reports the investment returns generated in the deferred compensation accounts in other income with a corresponding increase in the trust assets (except in the case of PICO stock, which is reported as treasury stock, at cost). There is an increase in the deferred compensation liability when there is appreciation in the market value of the assets held, with a corresponding expense recognized in operating and other costs. In the event the trust assets decline in value, the Company reverses previously expensed compensation. The assets of the plan are held in rabbi trust accounts. Such accounts hold various investments that are consistent with the Company's investment policy, and are accounted for and reported as available-for-sale securities in the accompanying consolidated balance sheets. Assets of the trust will be distributed according to predetermined payout elections established by each participant.

Other Liabilities:

Other liabilities includes employee benefits, unearned revenues, option payments and deposits received, warranty liabilities, deferred tax liabilities, and accrued interest, and other accrued liabilities.

Revenue Recognition:

Sale of Real Estate and Water Assets:

Revenue recognition on the sale of real estate and water assets conforms with accounting literature related to the sale of real estate, and is recognized in full when there is a legally binding sale contract, the profit is determinable (the collectability of the sales price is reasonably assured, or any amount that will not be collectible can be estimated), the earnings process is virtually complete (the Company is not obligated to perform significant activities after the sale to earn the profit, meaning the Company has transferred all risks and rewards to the buyer), and the buyer's initial and continuing investment is adequate to demonstrate a commitment to pay for the property. If these conditions are not met, the Company records the cash received as deferred revenue until the conditions to recognize full profit are met.

Sale of Finished Homes:

Revenue from sales of finished homes is included in the sale of real estate and water assets in the accompanying consolidated statement of operations and comprehensive income or loss and is recognized when the sale closes and title passes to the new homeowner, the new homeowners initial and continuing investment is adequate to demonstrate a commitment to pay for the home, the new homeowners receivable is not subject to future subordination and the Company does not have a substantial continuing involvement with the new home.

Other Income, Net:

Included in other income are various transactional results including realized gains and losses from the sale of investments and property, plant and equipment, interest income, sales of oil and gas, and other sources not considered to be the core focus of the existing operating entities within the group.

Cost of Sales:

Cost of Real Estate and Water Assets:

Cost of real estate and water assets sold includes direct costs of the acquisition of the asset less any impairment losses previously recorded against the asset, development costs incurred to get the asset ready for use, and any capitalized interest costs incurred during the development period.



Cost of Homes Sold:

Cost of homes sold includes direct home construction costs, closing costs, real estate acquisition and development costs, development period interest, and common costs. Direct construction and development costs are accumulated during the period of construction and charged to cost of homes sold under specific identification methods, as are closing costs. Estimates of costs incurred or to be incurred but not paid are accrued at the time of closing. Real estate development for common costs are allocated to each lot based on a relative fair value of the lots under development.

General, Administrative, and Other:

General, administrative, and other costs include general overhead expenses such as salaries and benefits, stock-based compensation, consulting, audit, tax, legal, insurance, property taxes, and other general operating expenses.

The Company has elected to reclassify “Interest” from a separate line item on the consolidated statement of operations and comprehensive income or loss to “General, administrative, and other.” Prior periods presented have been recast from amounts previously reported.

Sales and Marketing:

Sales and marketing costs include sales and marketing related salaries and benefits and sales commissions.

Stock-Based Compensation:

Stock-based compensation expense is measured at the grant date based on the fair values of the awards and is recognized as expense over the period in which the share-based compensation vests using the straight-line method.

Accounting for Income Taxes:

The Company’s provision for income tax expense includes federal and state income taxes currently payable and those deferred because of temporary differences between the income tax and financial reporting bases of the assets and liabilities. The asset and liability method of accounting for income taxes also requires the Company to reflect the effect of a tax rate change on accumulated deferred income taxes in income in the period in which the change is enacted.

In assessing the realization of deferred income taxes, management considers whether it is more likely than not that any deferred income tax assets will be realized. The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income during the period in which temporary differences become deductible. If it is more likely than not that some or all of the deferred income tax assets will not be realized a valuation allowance is recorded. At December 31, 2016, the Company concluded that it is likely that not all of its deferred tax assets will be realized, and accordingly, a valuation allowance was recorded against the deferred tax assets that are not expected to be realized.

The Company recognizes any uncertain income tax positions on income tax returns at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized unless it has a greater than a 50% likelihood of being sustained. The Company recognizes any interest and penalties related to uncertain tax positions in income tax expense.

Loss per Share:

Basic earnings or loss per share was computed by dividing net earnings by the weighted average number of shares outstanding during the period. Diluted earnings or loss per share was computed similarly to basic earnings or loss per share except the weighted average shares outstanding are increased to include additional shares from the assumed exercise of any common stock equivalents using the treasury method, if dilutive. The Company’s free-standing stock appreciation rights (“SAR”), performance-based price-contingent stock options (“PBO”), and RSU are considered common stock equivalents for this purpose. The number of additional shares related to these common stock equivalents is calculated using the treasury stock method.

For the three years ended December 31, 2016, the Company's common stock equivalents were excluded from the diluted per share calculation because their effect on earnings per share was anti-dilutive.

Translation of Foreign Currency:

Financial statements of foreign operations were translated into U.S. dollars using average rates of exchange in effect during the applicable year for revenues, expenses, realized gains and losses, and the exchange rate in effect at the balance sheet date for assets and liabilities. Unrealized exchange gains and losses arising on translation were reflected within accumulated other comprehensive income or loss. Realized foreign currency gains or losses were reported within total costs and expenses in the consolidated statement of operations and comprehensive income or loss. Any accumulated foreign currency included in other comprehensive income or loss that existed at a sale date or date of dissolution of a subsidiary was part of the gain or loss realized on the transaction as reported in the consolidated statements of operations and comprehensive income or loss.

Consolidation of Variable Interest Entities:

The Company consolidates variable interest entities (“VIE”) where it has a controlling financial interest. A controlling financial interest will have both of the following characteristics: (1) the power to direct the activities of a VIE that most significantly impact the VIE economic performance and (2) the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. The Company did not consolidate any VIE at December 31, 2016 or 2015.

Recently Issued Accounting Pronouncements:

In April 2015, the Financial Accounting Standards Board (“FASB”) issued guidance on simplifying the presentation of debt issuance costs, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. For public business entities, the guidance was effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Entities are to apply the new guidance on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. The Company adopted the guidance effective January 1, 2016. Prior to adoption, the Company included debt issuance costs in other assets on its consolidated balance sheets. Beginning in the three months ended March 31, 2016, the Company changed its presentation of debt issuance costs for all periods presented and the Company reclassified \$1.5 million of debt issuance costs at December 31, 2015 as a direct deduction from the carrying amounts of its debt liabilities both on the consolidated balance sheets and in the notes to the consolidated financial statements.

In February 2016, the FASB issued guidance on leases to increase transparency and comparability among organizations. The guidance will require the lessee to recognize lease assets and lease liabilities on the balance sheet and disclose key information about lease arrangements for all leases with a term greater than 12 months. The guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years for public business entities. Early adoption of the guidance is permitted. The Company is currently evaluating the effect this guidance will have on the consolidated financial statements.

In March 2016, the FASB issued guidance on accounting for share-based payments to employees. The guidance clarifies income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. It is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods for public business entities. Early adoption is permitted in any interim or annual period. If early adoption is selected in an interim period, any adjustments should be reflected as of the beginning of the fiscal year of that interim period and all amendments of the guidance must be adopted in the interim period. The Company is currently evaluating the effect this guidance will have on the consolidated financial statements.

In March 2016, the FASB issued guidance on revenue from contracts with customers. The amendments in this update do not change the core principle of the existing guidance issued in May 2014 but clarify the implementation guidance of determining whether the company is a principal or agent in a contractual agreement. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. The guidance provides a five-step analysis of transactions to determine when and how revenue is recognized. Other major provisions include capitalization of certain contract costs, consideration of time value of money in the transaction price, and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. The guidance also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity’s contracts with customers. The guidance is effective for the interim and annual periods beginning on or after December 15, 2017. The guidance permits the use of either a retrospective or cumulative effect transition method. The Company is currently evaluating the effect this guidance will have on the consolidated financial statements.

In April 2016, the FASB issued guidance on revenue from contracts with customers. The amendments in this update do not change the core principle of the existing guidance issued in May 2014 but clarify contract performance obligations and licensing implementation guidance. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. The guidance provides a five-step analysis of transactions to determine when and how revenue is recognized. Other major provisions include capitalization of certain contract costs, consideration of time value of money in the transaction price, and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. The guidance also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The guidance is effective for the interim and annual periods beginning on or after December 15, 2017. The guidance permits the use of either a retrospective or cumulative effect transition method. The Company is currently evaluating the effect this guidance will have on the consolidated financial statements.

In May 2016, the FASB issued guidance on revenue from contracts with customers. The amendments in this update do not change the core principle of the existing guidance issued in May 2014, but clarify contract performance obligations and licensing implementation guidance. The amendments address narrow-scope improvements to the guidance on collectability, noncash consideration, and completed contracts at transition. Additionally, the amendments in this update provide a practical expedient for contract modifications at transition and an accounting policy election related to the presentation of sales taxes and other similar taxes collected from customers. The guidance is effective for the interim and annual periods beginning on or after December 15, 2017. The guidance permits the use of either a retrospective or cumulative effect transition method. The Company is currently evaluating the effect this guidance will have on the consolidated financial statements.

In August 2016, the FASB issued guidance on classification of certain cash receipts and cash payments on the statement of cash flows. The amendments in this update clarify guidance on the following eight specific cash flow issues: debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments or other instruments with coupon rates that are insignificant in relation to the effective interest rate, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of company-owned life insurance policies, distributions received from equity method investees, beneficial interests in securitization transactions and separately identifiable cash flows and application of the predominance principle. For public business entities, the guidance is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The guidance should be applied using a retrospective transition method to each period presented. The Company is currently evaluating the effect this guidance will have on the consolidated financial statements.

In November 2016, the FASB issued guidance on classification and presentation of changes in restricted cash and equivalents on the statement of cash flows. The amendments in this update provide specific guidance that had previously not existed, including how to address classification and presentation changes in restricted cash and equivalents that occur when there are transfers between cash or cash equivalents and restricted cash or restricted cash equivalents or direct cash payments made from restricted cash or restricted cash equivalents. For public business entities, the guidance is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The guidance should be applied using a retrospective transition method to each period presented. For transactions for which the acquisition date occurs before the issuance date of the amendments or in which a subsidiary is deconsolidated or a group of assets is derecognized that occur before the issuance date of the amendments, early adoption is permitted only when the transaction has not been reported in the financial statements that have been issued or made available for issuance. The Company is currently evaluating the effect this guidance will have on the consolidated financial statements.

In December 2016, the FASB issued guidance on revenue from contracts with customers. The amendments in this update do not change the core principle of the existing guidance issued in May 2014, but affect narrow aspects of the guidance. The amendments address narrow-scope technical corrections or improvements to the guidance on loan guarantee fees, impairment testing of contract costs, provisions for losses on construction-type and production-type contracts, the scope of the topic, disclosure of remaining and prior-period performance obligations, contract modifications, contract asset versus receivable, refund liability, advertising costs, fixed-odds wagering contracts in the casino industry, and cost capitalization for advisors to private and public funds. The guidance is effective for the interim and annual periods beginning on or after December 15, 2017. The guidance permits the use of either a retrospective or cumulative effect transition method. The Company is currently evaluating the effect this guidance will have on the consolidated financial statements.



## 2. REAL ESTATE AND TANGIBLE WATER ASSETS, NET

The cost assigned to the various components of real estate and tangible water assets were as follows (in thousands):

	December 31,	
	2016	2015
Real estate and improvements held and used, net of accumulated amortization of \$12,003 at December 31, 2016 and \$11,778 at December 31, 2015	\$9,469	\$9,694
Residential real estate and home construction inventories	373,724	362,056
Other real estate inventories completed or under development	5,207	9,971
Tangible water assets	42,498	42,514
Total real estate and tangible water assets, net	\$430,898	\$424,235

Amortization of real estate improvements was approximately \$225,000 for the year ended December 31, 2016 and \$879,000 for each of the years ended December 31, 2015 and 2014.

### Impairment Losses during 2016:

During the year ended December 31, 2016, the Company recorded an impairment loss of \$2.4 million on real estate located in Bakersfield, California reducing the carrying value to \$5.6 million. The Company entered into a contract to sell the remaining lots in the real estate for less than its carrying value at a future date and as a result, the real estate was written down to its fair value, less selling costs. The loss was reported in the consolidated statement of operations and comprehensive income or loss within impairment loss on intangible and long-lived assets and was included in the results of operations of the real estate operations segment.

### Impairment Losses during 2015:

During the year ended December 31, 2015, the Company recorded an impairment loss of \$923,000 on real estate located in Kern County, California and owned by UCP reducing the carrying value to \$6 million. The loss was reported in the consolidated statement of operations and comprehensive income or loss within impairment loss on intangible and long-lived assets and was included in the results of operations of the real estate operations segment.

During the year ended December 31, 2015, the Company accepted an offer for \$3.4 million for real estate owned near Fresno, California. As a result, an impairment loss of \$274,000 was recorded that reduced the carrying value of the real estate to the offer price. The real estate is not part of UCP's results of operations, nor is it included in UCP's inventory of lots. The loss was reported in the consolidated statement of operations and comprehensive income or loss within impairment loss on intangible and long-lived assets and was included in the results of operations of the real estate operations segment.

### Sale of Intangible Water Assets in 2017:

During the three months ended March 31, 2017, we sold 100,000 Long Term Storage Credits for cash proceeds of \$25 million resulting in income before taxes of \$12.5 million. The transaction will be recorded in the Company's condensed consolidated financial statements for the three months ended March 31, 2017.

## 3. INTANGIBLE ASSETS, NET AND GOODWILL

### Intangible Assets:

The Company's carrying amounts of its intangible assets were as follows (in thousands):



	December 31,	
	2016	2015
Pipeline rights and water credits at Fish Springs Ranch	\$83,897	\$83,897
Pipeline rights and water rights at Carson-Lyon	25,569	24,831
Other, net of accumulated amortization	17,431	17,805
Total intangible assets, net	\$126,897	\$126,533

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#### Fish Springs Ranch Pipeline Rights and Water Credits:

There are 13,000 acre-feet per-year of permitted water rights at Fish Springs Ranch. The existing permit allows up to 8,000 acre-feet of water per year to be exported to support the development in the Reno, Nevada area. Under a settlement agreement signed in 2007, the Pyramid Lake Paiute Tribe (the "Tribe") agreed to not oppose any permitting activities for the pumping and export of groundwater in excess of 8,000 acre-feet of water per year, and in exchange, Fish Springs Ranch will pay the Tribe 12% of the gross sales price for each acre-foot of additional water that Fish Springs Ranch sells in excess of 8,000 acre-feet per year, up to 13,000 acre-feet per year. The obligation to expense and pay the 12% fee is due only if and when the Company sells water in excess of 8,000 acre-feet, and accordingly, Fish Springs Ranch will record the liability for such amounts as they become due upon the sale of any such excess water. Currently Fish Springs Ranch does not have regulatory approval to export any water in excess of 8,000 acre-feet per year from Fish Springs Ranch to support further development in northern Reno, and it is uncertain whether such regulatory approval will be granted in the future.

#### Impairment Losses during 2016:

There were no impairment losses recognized on intangible assets during the year ended December 31, 2016.

#### Impairment Losses during 2015:

As a result of the Company's annual review of indefinite-lived intangible assets, using a discounted cash flow model, the Company recorded an impairment loss of \$269,000, reducing the carrying value to \$3 million. The loss was recorded in the consolidated statement of operations and comprehensive income or loss within impairment loss on intangible and long-lived assets. The loss was also recorded in the water resource and water storage operations segment results. This was the first such impairment recorded on this asset. There were no other impairment losses on any other intangible assets during the year ended December 31, 2015.

#### Goodwill:

The Company had a goodwill balance of \$4.2 million at December 31, 2015. During 2016 the Company recorded an impairment loss of \$4.2 million on goodwill related to the Citizens Homes, Inc. ("Citizens") acquisition due to revised financial forecasts for the Southeast homebuilding operations as a result of several factors including weather that delayed new community openings, abandonment of certain opportunities to open new communities as the opportunities did not meet UCP's underwriting criteria, and lower margins on older communities still in existence from the land purchased as part of the Citizens acquisition. The loss was reported in the Company's Real Estate operations reducing the balance of the goodwill to zero at December 31, 2016. The revised forecasts also reduced the contingent consideration liability related to the Citizens acquisition by \$2.3 million leaving a balance of \$360,000 at December 31, 2016.

The Company estimated the fair value of goodwill based on applying the income approach by determining the present value of the estimated future cash flows at a discount rate. When estimating future cash flows, the Company makes various assumptions, including, but not limited to: (i) forecast adjusted pre-tax net income over a ten year period; (ii) weighted average cost of capital; (iii) terminal growth; and (iv) revenue growth and operating profit margin. The risk adjusted discount rate of 14.5% and terminal growth rate of 2.0% were applied to forecast adjusted pre-tax net income.

There were no other acquisitions, disposals, or impairments of goodwill during the years ended December 31, 2016 or December 31, 2015.

## 4. INVESTMENTS

The cost and carrying value of available-for-sale investments were as follows (in thousands):

December 31, 2016	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Value
Debt securities: corporate bonds	\$4,306	\$ 82	\$ (6 )	\$4,382
Marketable equity securities	10,400	10,327	(38 )	20,689
Total	\$ 14,706	\$ 10,409	\$ (44 )	\$ 25,071

December 31, 2015	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Value
Debt securities: corporate bonds	\$4,458	\$ 46	\$ (51 )	\$4,453
Marketable equity securities	10,339	7,879	(81 )	18,137
Total	\$14,797	\$ 7,925	\$ (132 )	\$22,590

The amortized cost and carrying value of investments in debt securities, by contractual maturity, are shown below. Actual maturity dates may differ from contractual maturity dates because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands):

	December 31, 2016		December 31, 2015	
	Amortized Cost	Carrying Value	Amortized Cost	Carrying Value
Due in one year or less	\$182	\$ 183	\$38	\$ 37
Due after one year through five years	4,124	4,199	2,603	2,566
Due after five years			1,817	1,850
	\$4,306	\$ 4,382	\$4,458	\$ 4,453

Included in other income, net in the accompanying consolidated financial statements is the net realized gain or loss on investments (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Gross realized gains:			
Debt securities		\$419	\$7
Equity securities and other investments	\$610	1,010	5,545
Total gain	610	1,429	5,552
Gross realized losses:			
Debt securities	(90 )	(4 )	(116 )
Equity securities and other investments <sup>(1)</sup>	(4,525 )	(21,020 )	(1,781 )
Total loss	(4,615 )	(21,024 )	(1,897 )
Net realized gain (loss)	\$(4,005)	\$(19,595)	\$3,655

<sup>(1)</sup> Included within this caption for the years ended December 31, 2016, 2015, and 2014, is \$2.2 million, \$20.7 million and \$1.1 million, respectively, that is reported in a separate line, impairment loss on unconsolidated affiliate, within the Company's consolidated statements of operations and comprehensive income or loss for the years then ended.

#### Significant Realized Gains and Losses:

During the year ended December 31, 2016, the Company's 51% owned subsidiary, Klalab, Inc. ("Klalab"), ceased further operations. The Company originally purchased a 51% interest in Klalab in 2011, with its founder retaining the remaining 49% noncontrolling interest. Historically, 49% of the losses from the operations have been allocated to noncontrolling interest that resulted in a deficit in the balance attributable to the noncontrolling interest. As the noncontrolling interest was not obligated to fund such deficit, the balance was recorded as a realized loss upon abandonment of the business. As such, the Company recorded a \$2 million loss during the fourth quarter of 2016, which is included within other income, net within the Company's consolidated statements of operations and comprehensive income or loss for the year then ended and also reported in the gross realized loss on equity securities in the table above.

The realized losses reported in 2015 were primarily due to the \$20.7 million impairment loss on the investment in Mindjet, Inc. (“Mindjet”) common and preferred shares discussed below.

## Debt Securities

At December 31, 2016, there were unrealized losses on certain bonds held by the Company. The Company does not consider those bonds to be other-than-temporarily impaired because the Company expects to hold, and will not be required to sell, these particular bonds, and expects to recover the entire amortized cost basis at maturity. There were no impairment losses recorded on debt securities during the three years ended December 31, 2016.

## Marketable Equity Securities

At December 31, 2016, the Company reviewed all of its equity securities in an unrealized loss position and concluded certain securities were not other-than-temporarily impaired as the declines were not of sufficient duration and severity, and publicly-available financial information, collectively, did not indicate impairment. The primary cause of the losses on those securities was normal market volatility. No material impairment losses were recorded on marketable equity securities during the three years ended December 31, 2016.

## Other Investments:

The Company owned the following investments that are not classified as available-for-sale (in thousands):

	December 31, 2016		December 31, 2015	
	Carrying Value	Voting Interest	Carrying Value	Voting Interest
Investment in Synthonics	\$—	18.2 %	\$2,170	18.3 %
Investment in Mindjet:				
Investment in common stock	\$—	19.3 %	\$—	19.3 %
Investment in preferred stock	1,312		1,312	
	\$1,312	19.3 %	\$1,312	19.3 %
Total	\$1,312		\$3,482	

## Investment in Synthonics:

Synthonics, Inc. (“Synthonics”) is a private company co-founded by a previous member of the Company’s board of directors. The Company’s investment consists of preferred shares as discussed in Note 11 “Related-Party Transactions.” During 2016, the Company recorded an impairment loss of \$2.2 million on its investment in Synthonics as the estimated fair value was less than the carrying value due to continuing losses, the resulting liquidity issues, and decreased market conditions that have adversely affected the value. The loss is recorded within impairment loss on investment in unconsolidated affiliate in the Company’s consolidated statements of operations and comprehensive income or loss for the year then ended December 31, 2016 and also reported in the gross realized loss on equity securities in the table above. The fair value approach relied primarily on Level 3 unobservable inputs, whereby the enterprise value was determined using book value multiples that included assumptions regarding an entity’s risks and uncertainties. The estimates were based upon assumptions believed to be reasonable, but which by their nature are uncertain and unpredictable.

## Investment in Mindjet:

During 2015, Mindjet raised additional capital from existing shareholders. The Company elected not to participate in the offering and as a result, the Company’s existing investment in preferred stock was converted to common stock at five shares of preferred stock for one share of common stock, and the Company’s investment in convertible debt was

converted into nonvoting preferred stock resulting in a decline in the Company's voting ownership to 19.3%. In addition, the Company lost its right to a board seat. Given the resulting voting interest and loss of board representation, the Company determined it no longer had significant influence over the operating and financial policies of Mindjet and therefore discontinued the equity method of accounting for the investment in common stock during the third quarter of 2015. The remaining carrying value of the investment, including a convertible note receivable and associated interest was approximately \$2.3 million at December 31, 2016 and 2015.

The Company had previously accounted for the investment in common stock using the equity method of accounting. This resulted in recording a loss within equity in loss of unconsolidated affiliate in the consolidated statement of operations and comprehensive income or loss of \$3.4 million and \$2.1 million for the years ended December 31, 2015 and 2014, respectively. The Company's share of the losses reported by Mindjet during 2015 was allocated to the carrying value of the common stock investment until it reached zero and then to the preferred stock and convertible debt.

During 2015, the Company recorded a \$20.7 million impairment loss on the investment in Mindjet common and preferred shares as the estimated fair value was less than the carrying value due to significantly increased, and continuing operating losses and resulting liquidity issues, actual financial results significantly less than projections, and unfavorable market conditions that have adversely affected the value of Mindjet. Such loss was recorded in impairment loss on investment in unconsolidated affiliate in the consolidated statement of operations and comprehensive income or loss. The fair value of the investment in Mindjet was based on an analysis of the financial and operational aspects of the company, including consideration of business enterprise value-to-revenue ratios for comparable public companies to current revenue metrics for the company. Determination of the business enterprise value based on the foregoing was then considered in an analysis of the distribution of equity value to the various classes of debt and equity issued by Mindjet in order to reflect differences in value due to differing liquidation preferences, dividend and voting rights. The fair value approach relied primarily on Level 3 unobservable inputs, whereby expected future cash flows were determined using revenue multiples that included assumptions regarding an entity's assumptions about risk and uncertainties. The estimates were based upon assumptions believed to be reasonable, but which by their nature are uncertain and unpredictable.

It is reasonably possible that the Company's ownership percentage in Mindjet will continue to decline as other shareholders fund the ongoing operations with additional equity capital and upon conversion of notes. The Company does not anticipate investing any additional capital into Mindjet.

The carrying value of the Company's investment in Mindjet is subject to impairment testing at each reporting period, or more frequently if facts and circumstances indicate the investment may be impaired. It is reasonably possible that circumstances may continue to deteriorate which could require the Company to record additional impairment losses on the remaining investment balances.

## 5. DISCLOSURES ABOUT FAIR VALUE

### Recurring Fair Value Measurements

Assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability. The following tables set forth the Company's assets and liabilities that were measured at fair value, on a recurring basis, by level within the fair value hierarchy. There were no significant transfers between Level 1 and Level 2 during the years ended December 31, 2016 and 2015. The Company's policy is to recognize transfers between levels at the end of the reporting period.

At December 31, 2016 (in thousands):

Quoted Prices In Active Markets for	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2016
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	Identical Assets (Level 1)		
Assets			
Available-for-sale equity securities <sup>(1)</sup>	\$ 12,545	\$ 8,144	\$ 20,689
Available-for-sale debt securities <sup>(1)</sup>	\$ 4,382		\$ 4,382
Total	\$ 16,927	\$ 8,144	\$ 25,071
Liabilities			
Contingent consideration <sup>(2)</sup>		\$ 360	\$ 360

At December 31, 2015 (in thousands):

	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2015
<b>Assets</b>				
Available-for-sale equity securities <sup>(1)</sup>	\$ 10,685	\$ 7,452		\$ 18,137
Available-for-sale debt securities <sup>(1)</sup>	\$ 4,453			\$ 4,453
Total	\$ 15,138	\$ 7,452		\$ 22,590
<b>Liabilities</b>				
Contingent consideration <sup>(2)</sup>			\$ 2,707	\$ 2,707

<sup>(1)</sup> Where there are quoted market prices that are readily available in an active market, securities are classified as Level 1 of the valuation hierarchy. Level 1 available-for-sale investments are valued using quoted market prices multiplied by the number of shares owned and debt securities are valued using a market quote in an active market. All Level 2 available-for-sale securities are one class because they all contain similar risks and are valued using market prices and include securities where the markets are not active, that is where there are few transactions, or the prices are not current or the prices vary considerably over time. Inputs include directly or indirectly observable inputs such as quoted prices. Level 3 available-for-sale securities would include securities where valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

<sup>(2)</sup> Included in this caption is the contingent consideration arrangement that the Company entered into as part of the acquisition of Citizens. The contingent consideration arrangement requires the Company to pay up to a maximum of \$6 million of additional consideration based upon achievement of various pre-tax net income performance milestones of the new business (“performance milestones”) over a five year period commencing on April 1, 2014. Payout calculations are made based on calendar year performance, except for the sixth payout calculation, which will be calculated based on the achievement of performance milestones from January 1, 2019 through March 25, 2019. Payouts are to be made on an annual basis. The potential undiscounted amount of all future payments that the Company could be required to make under the contingent consideration arrangement is between zero and \$6 million. The estimated fair value of the contingent consideration was estimated based on applying the weighted probability of achievement of the performance milestones. The measurement is based on significant inputs that are not observable in the market, which are defined as Level 3 inputs. Key assumptions include: (1) forecasted adjusted pre-tax net income over the contingent consideration period, (2) revenue appreciation, (3) cost inflation, (4) sales and marketing and general and administrative costs. The estimated revenue appreciation of 4.5%, cost inflation of 1.5%, and sales and marketing and general and administrative costs were applied to forecast adjusted net income over the contingent consideration period. The change in estimated fair value of the contingent consideration was \$2.3 million for the year ended December 31, 2016.

#### Non-Recurring Fair Value Measurements

Assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company’s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset.

The following table sets forth the Company's non-financial assets that were measured at fair value, on a non-recurring basis, by level within the fair value hierarchy.

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Year Ended December 31, 2016 (in thousands):

Asset Description	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Loss
Goodwill <sup>(1)</sup>			\$ —	\$4,223
Real estate and development costs <sup>(2)</sup>			\$ 5,645	\$2,397
Real estate and development costs <sup>(3)</sup>			\$ 1,066	\$191
Oil and gas wells <sup>(4)</sup>			\$ —	\$201
Investment in unconsolidated affiliate <sup>(5)</sup>			\$ —	\$2,170

<sup>(1)</sup> The Company had non-recurring fair value measurements of goodwill discussed in Note 3, “Intangible Assets and Goodwill.”

<sup>(2)</sup> The Company had non-recurring fair value measurements of real estate assets discussed in Note 2, “Real Estate and Tangible Water Assets.”

<sup>(3)</sup> The Company had non-recurring fair value measurements of real estate assets in its Southeast homebuilding operations. The loss was reported in the consolidated statements of operations and comprehensive income or loss within impairment loss on intangible and long-lived assets and was included in the results of operations of the real estate segment.

<sup>(4)</sup> The Company recorded an impairment loss to write down the value of certain oil and gas wells. The loss was reported in the consolidated statements of operations and comprehensive income or loss within impairment loss on intangible and long-lived assets and was included in the results of operations of the corporate segment.

<sup>(5)</sup> The Company had a non-recurring fair value measurement on its investment in Synthonics that resulted in an impairment loss discussed in Note 4 “Investments.”

Year Ended December 31, 2015 (in thousands):

Asset Description	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Loss
Intangible water assets <sup>(1)</sup>			\$ 3,023	\$269
Oil and gas wells <sup>(2)</sup>			\$ 2,542	\$1,816
Real estate and development costs <sup>(3)</sup>			\$ 3,400	\$274
Real estate and development costs <sup>(3)</sup>			\$ 5,960	\$923
Investment in unconsolidated affiliate <sup>(4)</sup>			\$ 2,163	\$20,696

<sup>(1)</sup> The Company had a non-recurring fair value measurement for intangible assets that resulted in an impairment loss discussed in Note 3 “Goodwill and Intangible Assets.”

<sup>(2)</sup> The Company recorded an impairment loss to write down the value of capitalized development costs related to its oil and gas wells. The estimated fair value of the wells was determined using a discounted cash flow model. The loss was reported in the consolidated statement of operations and comprehensive income or loss within impairment loss on intangible and long-lived assets and was included in the results of operations of the corporate segment.

(3) The Company had a non-recurring fair value measurement of a real estate asset discussed in Note 2 “Real Estate and Tangible Water Assets, Net.”

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(4) The Company had a non-recurring fair value measurement on its investment in Mindjet that resulted in an impairment loss discussed in Note 4 “Investments.”

#### Estimated Fair Value of Financial Instruments Not Carried at Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The level within the fair value hierarchy in which the fair value measurements are classified include measurements using quoted prices in active markets for identical assets or liabilities (Level 1), quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active (Level 2), and significant valuation assumptions that are not readily observable in the market (Level 3).

As of December 31, 2016 and 2015, the fair values of cash and cash equivalents, accounts payable, and accounts receivable approximated their carrying values because of the short-term nature of these assets or liabilities. The estimated fair value of the Company’s investments in unconsolidated affiliates approximated their carrying values. The estimated fair value of the Company’s debt is based on cash flow models discounted at the then-current interest rates and an estimate of the then-current spread above those rates at which the Company could borrow, which are Level 3 inputs in the fair value hierarchy. The estimated fair value of certain of the Company’s other investments, which included investments in preferred stock of private companies, cannot be reasonably estimated on a recurring basis.

The following table presents the carrying value and fair value of the Company’s financial instruments which are not carried at fair value (in thousands):

	December 31, 2016		December 31, 2015	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Investments in unconsolidated affiliates equity securities	\$1,312	\$1,312	\$3,482	\$3,482
Financial liabilities:				
Debt	\$161,728	\$161,681	\$157,490	\$166,769

## 6. DEBT, NET

The Company enters into acquisition, development and construction debt agreements to purchase and develop real estate and for the construction of homes, which are generally secured primarily by the underlying real estate. Certain of the loans are funded in full at the initial loan closing and others are revolving facilities under which the Company may borrow, repay and redraw up to a specified amount during the term of the loan. Acquisition debt is due at various dates but is generally repaid when lots are released from the loans based upon a specific release price, as defined in each respective loan agreement, or the loans are refinanced at current prevailing rates. Construction and development debt is required to be repaid with proceeds from the sale of homes based upon a specific release price, as defined in each respective loan agreement.

The following table details the Company's outstanding debt (in thousands):

	December 31,	
	2016	2015
LIBOR + 3.75% through 2016 <sup>(1)</sup>		\$34,528
Prime + 1.75% through 2016 <sup>(2)</sup>		717
LIBOR + 3.00% through 2016 <sup>(1)</sup>		4,832
LIBOR + 3.50 % through 2017 <sup>(1)</sup>	\$4,693	9,785
LIBOR + 3.75 % through 2017 <sup>(1)</sup>	31,533	18,456
LIBOR + 2.75% through 2018 <sup>(1)</sup>	10,500	
LIBOR + 3.75% through 2018 <sup>(1)</sup>	26,444	
5.50% through 2016		2,342
5.50% through 2017	2,476	
5.00% through 2017	5,607	4,581
10.00% through 2017	1,604	1,604
0.00% through 2017		1,935
8.00% through 2018	4,000	4,000
Senior notes, net	74,871	74,710
Total debt	\$161,728	\$157,490
Debt issuance costs	(734 )	(1,524 )
Total debt, net	\$160,994	\$155,966

<sup>(1)</sup> At December 31, 2016, the 30-day LIBOR rate was 0.77%.

<sup>(2)</sup> At December 31, 2016, the U.S. Prime rate was 3.75%.

At December 31, 2016 and 2015, the Company's real estate debt had a weighted average interest rate of 6.5% and 6.4%, respectively.

As of December 31, 2016 and 2015, the Company had approximately \$238.9 million and \$232.6 million, respectively, available in loan commitments to draw upon, of which approximately \$77.2 million and \$75.1 million, respectively, was available.

## Debt Provisions, Restrictions, and Covenants on Real Estate Debt

Certain of UCP's debt agreements contain various significant financial covenants, each of which UCP was in compliance with at December 31, 2016, and 2015.

The \$75 million of senior notes issued in 2014 by UCP limit UCP's ability to, among other things, incur or guarantee additional unsecured and secured debt (provided that UCP may incur debt so long as UCP's ratio of debt to its

consolidated tangible assets (on a pro forma basis) would be equal to or less than 45% and provided that the aggregate amount of secured debt may not exceed the greater of \$75 million or 30% of UCP's consolidated tangible assets); pay dividends and make certain investments and other restricted payments; acquire unimproved real property in excess of \$75 million per fiscal year or in excess of \$150 million over the term of the notes, except to the extent funded with subordinated obligations or the proceeds of equity issuances; create or incur certain liens; transfer or sell certain assets; and merge or consolidate with other companies or transfer or sell all or substantially all of UCP's consolidated assets.



## Other

The Company's future minimum principal debt repayments were as follows (in thousands):

Year ended December 31,	
2017	\$ 120,785
2018	40,943
2019	—
Total	\$ 161,728

The Company incurred \$12.5 million, \$11.6 million, and \$4 million of interest expense during the years ended December 31, 2016, 2015, and 2014, respectively. The Company capitalized \$12.5 million, \$11.6 million, and \$3.8 million of the interest incurred in 2016, 2015, and 2014, respectively, related to construction and real estate development costs. Due to debt covenants and other restrictions, the total restricted net assets of the Company's consolidated subsidiaries was \$134.3 million at December 31, 2016.

## 7. COMMITMENTS AND CONTINGENCIES

The Company leases some of its offices under non-cancelable operating leases that expire at various dates through 2021. Rent expense for the years ended December 31, 2016, 2015, and 2014, for office space was \$2.1 million, \$1.8 million, and \$1.6 million, respectively.

Future minimum payments under all operating leases were as follows (in thousands):

Year ended December 31,	
2017	\$ 1,194
2018	994
2019	574
2020	348
2021	89
Thereafter	—
Total	\$ 3,199

Neither PICO nor its subsidiaries are parties to any potentially material pending legal proceedings.

The Company is subject to various litigation matters that arise in the ordinary course of its business. Because litigation is inherently unpredictable and unfavorable resolutions could occur, assessing contingencies is highly subjective and requires judgments about future events. When evaluating contingencies, the Company may be unable to provide a meaningful estimate due to a number of factors, including the procedural status of the matter in question, the presence of complex or novel legal theories, and/or the ongoing discovery and development of information important to the matters. In addition, damage amounts claimed in litigation against the Company may be unsupported, exaggerated or unrelated to possible outcomes, and as such are not meaningful indicators of the Company's potential liability. The Company regularly reviews contingencies to determine the adequacy of accruals and related disclosures. The amount of ultimate loss may differ from these estimates, and it is possible that the Company's consolidated financial statements could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies.

Whether any losses finally determined in any claim, action, investigation or proceeding could reasonably have a material effect on the Company's business, financial condition, results of operations or cash flows will depend on a number of variables, including: the timing and amount of such losses; the structure and type of any remedies; the

significance of the impact any such losses, damages or remedies may have on the consolidated financial statements; and the unique facts and circumstances of the particular matter that may give rise to additional factors.

**Purchase Commitments:**

In the ordinary course of business, UCP may enter into purchase or option contracts to procure lots for development and construction of homes. These contracts to purchase properties typically require a cash deposit and are generally contingent upon satisfaction of certain requirements by the sellers, including obtaining applicable property and development entitlements.

UCP may also utilize purchase or option contracts with land sellers as a method of acquiring land in staged takedowns. Purchase or option contracts generally require a non-refundable deposit for the right to acquire lots over a specified period of time at pre-determined prices. UCP generally has the right to terminate obligations under both purchase or option contracts by forfeiting the cash deposit with no further financial responsibility to the land seller.

On September 9, 2016, UCP entered into an Option and Development Agreement whereby UCP assigned the purchase of a land parcel ("Option and Development Agreement"). Under the agreement, UCP will develop the land into finished lots with an option to purchase 241 finished lots on a monthly takedown basis that expires on April 25, 2020, subject to an extension. As of December 31, 2016, there are 226 lots remaining for takedown under the Option and Development Agreement. Land development costs incurred are reimbursable under a fixed price contract. As part of the agreement, UCP made a non-refundable deposit of \$6.1 million in consideration of the purchase option. Because UCP does not own the land, costs that are incurred up to the fixed price amount, for developing the finished lots, will be treated as a receivable for the amounts due. Approximately \$4 million of reimbursable land development costs under the Option and Development Agreement was recorded as a receivable for the year ended December 31, 2016.

As of December 31, 2016, UCP had outstanding \$9.2 million of cash deposits pertaining to purchase contracts for 2,607 optioned lots with an aggregate remaining purchase price of approximately \$106 million. As of December 31, 2015, UCP had outstanding \$3.8 million cash deposits pertaining to purchase contracts for 1,127 optioned lots with an aggregate remaining purchase price of approximately \$80.1 million.

**Surety Bonds:**

UCP obtains surety bonds from third parties in the normal course of business to ensure completion of certain infrastructure improvements at its projects. The performance bonds secure the completion of projects and/or support of obligations to build community improvements, such as roads, sewers, water systems and other utilities. As of December 31, 2016 and 2015, UCP had outstanding surety bonds totaling \$55.2 million and \$37.1 million, respectively. In the event that any such surety bond issued by a third party is called because the required improvements are not completed, UCP could be obligated to reimburse the issuer of the bond. Performance bonds do not have stated expiration dates. Rather, UCP is released from a performance bond as the underlying performance is completed. The Company does not expect that a material amount of any currently outstanding performance bonds will be called.

**8. STOCK-BASED COMPENSATION**

At December 31, 2016, the Company had one stock-based payment arrangement outstanding, the PICO Holdings, Inc. 2014 Equity Incentive Plan (the "2014 Plan"). UCP also issues stock-based compensation under its own long term incentive plan that provides for equity-based awards, which upon vesting results in newly issued shares of UCP Class A common stock.

The 2014 Plan provides for the issuance of up to 3.3 million shares of common stock in the form of PBO, RSU, SAR, non-statutory stock options, restricted stock awards ("RSA"), performance shares, performance units, deferred

compensation awards, and other stock-based awards to employees, directors, and consultants of the Company (or any present or future parent or subsidiary corporation or other affiliated entity of the Company). The 2014 Plan allows for broker assisted cashless exercises and net-settlement of income taxes and employee withholding taxes. Upon exercise of a PBO, RSU, and SAR, the employee will receive newly issued shares of PICO common stock with a fair value equal to the in-the-money value of the award, less applicable federal, state and local withholding and income taxes (however, the holder can elect to pay withholding taxes in cash).

The Company recorded total stock based compensation expense of \$4 million, \$3.6 million and \$7.1 million during the years ended December 31, 2016, 2015 and 2014, respectively. Of the \$4 million in stock based compensation expense recorded during 2016, \$1.2 million related to RSU and stock options for UCP common stock granted to the officers of UCP, of which \$498,000 was allocated to noncontrolling interest. Of the \$3.6 million in stock based compensation expense recorded in 2015, \$1.7 million related to RSU for UCP common stock granted to the officers of UCP, of which \$734,000 was allocated to noncontrolling interest. Of the \$7.1 million in stock based compensation expense recorded in 2014, \$3.7 million related to RSU for UCP common stock granted to the officers of UCP, of which \$1.9 million was allocated to noncontrolling interest.

## Performance-Based Options (PBO):

At various times, the Company has awarded PBO to various members of management. All of the PBO issued contain a market condition based on the achievement of a stock price target during the contractual term and vest monthly over a three year period. The vested portion of the options may be exercised only if the 30-trading-day average closing sales price of the Company's common stock equals or exceeds 125% of the grant date stock price. The stock price contingency may be met any time before the options expire and it only needs to be met once for the PBO to remain exercisable for the remainder of the term. Compensation expense is amortized on a straight-line basis over the requisite service period for the entire award, which is the vesting period of the award. However, any unrecognized compensation expense for unvested awards can be accelerated if the vesting period is modified.

The estimated fair value of the Company's PBO was determined using a Monte Carlo model, which incorporated the following assumptions:

	2015	2014	2014		
	10-Year	10-Year	4.58-Year		
	Option	Option	Option		
Grant date	8/12/2015	11/14/2014	11/14/2014		
Expiration date	8/12/2025	11/14/2024	6/14/2019		
Grant date stock price	\$13.06	\$19.51	\$19.51		
Historical volatility	35.16	% 35.00	% 28.85	%	%
Risk-free rate (annualized)	2.19	% 2.38	% 1.5	%	%
Dividend yield (annualized)	—	% —	% —	%	%
PBO granted	75,000	167,619	285,714		
Weighted average grant date fair value	\$5.87	\$6.51	\$6.51		
Fair value of award on grant date	\$440,000	\$1,475,705	\$1,474,672		

The determination of the fair value of PBO using an option valuation model is affected by the Company's stock price, as well as assumptions regarding a number of complex and subjective variables. The volatility is calculated through an analysis based on historical daily returns of PICO's stock over a look-back period equal to the PBO contractual term. The risk-free interest rate assumption is based upon a risk-neutral framework using the 10-year and 4.58-year zero-coupon risk-free interest rates derived from the treasury constant maturities yield curve on the grant date, for the 10-year PBO award and the 4.58-year PBO award, respectively. The dividend yield assumption is based on the expectation of no future dividend payouts by the Company.

A summary of PBO activity was as follows:

	Performance-Based Options	Weighted-Average Exercise Price Per Share
Outstanding at December 31, 2014	453,333	\$ 19.51
Granted	75,000	\$ 13.06
Forfeited	(75,000 )	\$ 13.06
Outstanding at December 31, 2015 and 2016	453,333	\$ 19.51

Of the PBO outstanding at December 31, 2016, 285,714 expired and were canceled on January 8, 2017 in conjunction with the termination of the Company's former CEO. The remaining 167,619 PBO outstanding are exercisable for up to 10 years from the grant date.



	Performance-Based Options	Weighted-Average Exercise Price Per Share	Weighted-Average Contractual Term Remaining (Years)	Aggregate Intrinsic Value
Vested at December 31, 2014	12,593			
Vested	155,278			
Forfeited	(4,167 )			
Vested at December 31, 2015	163,704	\$ 19.51	5.5	—
Vested	238,413			
Vested at December 31, 2016	402,117	\$ 19.51	4.5	—

During the year ended December 31, 2016, the Company accelerated the vesting of 87,302 PBO and recorded \$428,000 of additional stock-based compensation expense in conjunction with the termination of the Company's former CEO. During the year ended December 31, 2015, all previously recognized compensation expense related to forfeited PBO was reversed and the remaining unamortized expense was canceled. There were no PBO forfeitures during the years ended December 31, 2016 and 2014.

As of December 31, 2016 and December 31, 2015, there were no PBO exercisable as the market condition had not been met. The unrecognized compensation cost related to unvested PBO at December 31, 2016 and 2015 was \$428,000 and \$1.8 million, respectively.

#### Restricted Stock Units (RSU):

RSU awards the recipient, who must be continuously employed by the Company until the vesting date, unless the employment contracts stipulate otherwise, the right to receive one share of the Company's common stock. RSU do not vote and are not entitled to receive dividends. RSU are valued at the Company's closing stock price on the date of grant and compensation expense is recognized ratably over the vesting period for each grant.

A summary of RSU activity was as follows:

	RSU Shares	Weighted-Average Grant Date Fair Value Per Share
Outstanding and unvested at December 31, 2013	469,435	\$ 30.43
Granted	142,131	\$ 19.81
Vested	(469,435)	\$ 30.43
Outstanding and unvested at December 31, 2014	142,131	\$ 19.81
Granted	23,300	\$ 15.68
Vested	(45,753 )	\$ 20.43
Forfeited	(11,020 )	\$ 15.72
Outstanding and unvested at December 31, 2015	108,658	\$ 19.07
Granted	24,326	\$ 10.28
Vested	(76,152 )	\$ 19.14
Forfeited	(8,600 )	\$ 17.30
Outstanding and unvested at December 31, 2016	48,232	\$ 14.85

The unrecognized compensation cost related to unvested RSU for the years ended December 31, 2016 and 2015 was \$508,000 and \$1.8 million, respectively.

In August of 2016, the Company issued 4,854 RSU to one non-employee director that vest over a one year period and in March of 2016, the Company issued 4,868 RSU each to four other non-employee directors of the Company for a total of 19,472 awards that vest one year from the date of grant.

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When an employee award vests, the recipient receives a new share of PICO common stock for each RSU, less that number of shares of common stock equal in value to applicable withholding taxes. During 2016, 9,150 RSU held by non-employee directors vested, which resulted in the delivery of an equal number of newly issued shares of PICO common stock. On December 31, 2016, 67,002 RSU held by various officers and members of management vested, however the delivery of newly issued shares of stock, net of applicable withholding taxes, did not take place until January 2017.

During the year ended December 31, 2016, the Company accelerated the vesting of 35,714 RSU and recorded \$651,000 of additional stock-based compensation expense in conjunction with the termination of the Company's former CEO.

During the years ended December 31, 2016 and 2015, 8,600 and 11,020 RSU were forfeited, respectively. All previously recognized expense was reversed during the respective year and the remaining unamortized expense was canceled. There were no RSU forfeited during the year ended 2014.

#### Stock-Settled Stock Appreciation Right (SAR):

Upon exercise, a SAR entitles the recipient to receive a newly issued share of the Company's common stock equal to the in-the-money value of the award, less applicable federal, state and local withholding and income taxes. SAR do not vote and are not entitled to receive dividends. Compensation expense for SAR was recognized ratably over the vesting period for each grant.

There were no unvested SAR, and therefore no compensation expense recognized, during the three years ended December 31, 2016. In addition, there were no SAR granted or exercised during the three years ended December 31, 2016.

A summary of SAR activity is as follows:

	SAR Shares	Weighted Average Exercise Price Per Share	Weighted Average Contractual Term Remaining (Years)
Outstanding and exercisable at December 31, 2013	1,616,625	\$ 36.45	2.5
Expired	(20,000 )	\$ 33.76	
Outstanding and exercisable at December 31, 2014	1,596,625	\$ 36.49	1.5
Expired	(1,110,155)	\$ 33.76	
Outstanding and exercisable at December 31, 2015	486,470	\$ 42.71	1.5
Expired	(20,000 )	\$ 42.71	
Outstanding and exercisable at December 31, 2016	466,470	\$ 42.71	0.6

At December 31, 2016, none of the outstanding SAR were in-the-money.

#### 9. FEDERAL AND STATE CURRENT AND DEFERRED INCOME TAX

The Company and its subsidiaries file a consolidated federal income tax return. Companies that are less than 80% owned corporations, or entities that are treated as partnerships for federal income tax purposes, file separate federal income tax returns. All of the Company's pre-tax loss from continuing operations in each of the three years ended December 31, 2016, 2015 and 2014 was generated in the U.S. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

The Company's income tax benefit for federal and state income taxes consisted of the following (in thousands):

	Year Ended December		
	31,		
	2016	2015	2014
Current tax benefit (provision)	\$(47 )	\$48	\$199
Deferred tax benefit	6,398	2,913	3,315
Total income tax benefit	\$6,351	\$2,961	\$3,514

The difference between income taxes provided at the Company's federal statutory rate and effective tax rate was as follows (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Federal income tax provision at statutory rate	\$6,301	\$10,902	\$16,439
Change in valuation allowance	(906 )	(13,601 )	(11,784 )
State taxes, net of federal benefit	814	36	184
Nondeductible compensation		(530 )	(1,567 )
Equity in loss of unconsolidated affiliate		2,766	816
Research and development credit		2,248	
Other	142	1,140	(574 )
Total income tax benefit	\$6,351	\$2,961	\$3,514

The 2016 effective tax rate was primarily impacted by changes in valuation allowances against deferred tax assets. As a result of the analysis of all available evidence, during 2016 UCP, Inc. reversed the valuation allowance against its deferred tax assets resulting in the recognition of a net deferred tax asset of \$5.5 million reported in the Company's consolidated financial statements at December 31, 2016. The net deferred tax asset was reflected in the Company's consolidated financial statement as UCP, Inc.'s operating results are included in the Company's consolidated financial statements but are not included in the Company's federal income tax return and consequently, UCP, Inc. utilizes independent and distinct income projections and other assumptions separately from the Company and its other consolidated subsidiaries in determining the realization of its deferred taxes. However, as the Company has no direct economic interest in the results of UCP, Inc., the net tax benefit of UCP, Inc.'s operations is allocated to noncontrolling interest.

The significant components of deferred income tax assets and liabilities were as follows (in thousands):

	December 31,	
	2016	2015
Deferred tax assets:		
Deferred compensation	\$10,908	\$10,199
Impairment loss on securities	1,221	1,292
Impairment loss on water assets	17,277	17,252
Impairment loss on real estate	1,847	1,423
Capitalized expenses	9,788	8,629
Net operating losses, capital losses, and tax credit carryforwards	68,090	65,680
Employee benefits, including stock-based compensation	9,945	5,818
Excess tax basis in affiliate	12,889	14,675
Fixed assets	469	2,312
Other, net	3,545	2,975
Total deferred tax assets	135,979	130,255
Deferred tax liabilities:		
Unrealized appreciation on securities	4,138	3,118
Revaluation of real estate and water assets	5,247	5,254
Excess book basis in affiliate	5,770	6,646
Other, net	2,113	2,118
Total deferred tax liabilities	17,268	17,136
Valuation allowance	(113,229)	(113,119)
Net deferred income tax asset	\$5,482	\$—



Deferred tax assets and liabilities and federal income tax expense in future years can be significantly affected by changes in circumstances that would influence management's conclusions as to the ultimate realization of deferred tax assets. Valuation allowances are established and maintained for deferred tax assets on a "more likely than not" threshold. At December 31, 2011, the Company considered it more likely than not that the deferred tax assets would not be realized and a full valuation allowance was provided. At December 31, 2016, after evaluating the positive and negative evidence, management concluded to maintain a full valuation allowance against its deferred tax assets, except those attributable to UCP. The Company has considered the following possible sources of taxable income when assessing the realization of the deferred tax assets: (1) future reversals of existing taxable temporary differences; (2) taxable income in prior carryback years; (3) tax planning strategies; and (4) future taxable income exclusive of reversing temporary differences and carryforwards. Reliance on future U.S. taxable income as an indicator that a valuation allowance is not required is difficult when there is negative evidence such as the Company's cumulative losses in recent years. In considering the evidence as to whether a valuation allowance is needed, the existence, magnitude and duration of such cumulative losses are factors that are accorded significant weight in the Company's assessment. As a result, a determination was made that there was not sufficient positive evidence to enable the Company to conclude that it was "more likely than not" that certain of these deferred tax assets would be realized. Therefore, the Company has provided a full valuation allowance against the Company's net deferred tax assets except those attributable to the UCP, Inc. balances as discussed above. This assessment will continue to be undertaken in the future. The Company's results of operations may be impacted in the future by the Company's inability to realize a tax benefit for future tax losses or for items that will generate additional deferred tax assets.

The Company's results of operations might be favorably impacted in the future by reversals of valuation allowances if the Company is able to demonstrate sufficient positive evidence that the Company's deferred tax assets will be realized.

The Company had operating loss carryforwards, federal tax credit carryforwards, and state capital loss carryforwards as of December 31, 2016, that will expire if not utilized. The following table summarizes such carryforwards and their expiration as follows (in thousands):

	Federal Net Operating Losses	Federal Tax Credits	State Net Operating Losses	State Capital Losses
Expire 2017 through 2020		\$ 2,751	\$ 14,337	\$ 8,500
Expire 2021 through 2025		782	7,372	
Expire 2026 through 2030		5	17,144	
Expire 2031 through 2036	\$ 137,068	4,093	166,719	
Total	\$ 137,068	\$ 7,631	\$ 205,572	\$ 8,500

Utilization of the Company's U.S. federal and certain state net operating loss and tax credit carryovers may be subject to substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss carryforwards before utilization. As of December 31, 2016, the Company believes that utilization of its federal net operating losses and federal tax credits are not limited under any ownership change limitations provided under the Internal Revenue Code.

The Company is subject to taxation in the U.S. and various state jurisdictions. As of December 31, 2016, the Company's statute is open from 2012 and 2010 forward for federal and for state tax purposes, respectively. The examination by the California Franchise Tax Board of the Company's 2006 through 2008 California income tax returns was closed without an adjustment during 2016.

## 10. ACCUMULATED OTHER COMPREHENSIVE INCOME

The components of accumulated other comprehensive income was as follows (in thousands):

	December 31,	
	2016	2015
Net unrealized gain on available-for-sale investments	\$6,736	\$5,065
Foreign currency translation	(75 )	(104 )
Accumulated other comprehensive income	\$6,661	\$4,961

The unrealized gain on available-for-sale investments is net of a deferred income tax liability of \$3.6 million at December 31, 2016 and \$2.8 million at December 31, 2015.

The following table reports amounts that were reclassified from accumulated other comprehensive income and included in earnings (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Accumulated other comprehensive income - January 1	\$4,961	\$4,717	\$232
Unrealized gain reclassified and recognized in net loss, net of tax <sup>(1)</sup>	(193 )	(481 )	(3,020 )
Foreign exchange reclassified and recognized in net loss, net of tax <sup>(1)</sup>	20	361	6,567
Total reclassified and recognized in net loss, net of tax	(173 )	(120 )	3,547
Unrealized gain on marketable securities, net of tax	1,864	773	927
Accumulated currency, net of tax	9	(409 )	11
Net change in other comprehensive income, net of tax	1,700	244	4,485
Accumulated other comprehensive income - December 31	\$6,661	\$4,961	\$4,717

<sup>(1)</sup> Amounts reclassified from this category are included in other income in the consolidated statement of operations and comprehensive income or loss.

During 2014, the Company substantially liquidated several wholly-owned subsidiaries, one of which conducted business and maintained its financial statements in a foreign denominated local currency. The translation of such financial statements into the Company's U.S. reporting currency created a cumulative translation loss of \$9.3 million, which was reported net of a \$3.1 million tax benefit in accumulated other comprehensive income or loss. In conjunction with the liquidation, the balance of the accumulated foreign currency adjustment was reclassified from accumulated other comprehensive loss and was reported as a loss on liquidation within other income, net in the consolidated statement of operations and comprehensive income or loss for the year ended December 31, 2014.

## 11. RELATED-PARTY TRANSACTIONS

Termination of the Company's CEO and Other Related Changes in Executive Management:

On October 10, 2016, the Company terminated its CEO, effective as of October 12, 2016. In connection with the termination, the Company's board of directors appointed Mr. Maxim C.W. Webb as President and Chief Executive Officer and as a class III director of the Company, effective as of October 12, 2016, with a term that expires at the Company's 2017 Annual Meeting of Stockholders, and appointed Mr. John T. Perri as Chief Financial Officer. Mr. Webb and Mr. Perri irrevocably and unconditionally waived their right to receive any bonus payment that would have otherwise been payable pursuant to the terms of the Company's then existing executive bonus plan

The Company's former CEO is entitled to the severance benefits set forth in Section 4(b) of his Amended and Restated Employment Agreement with the Company, dated March 11, 2016 and filed with the SEC on March 14, 2016 (the "Employment Agreement"). Such benefits include certain severance and vacation differential payments totaling approximately \$10.4 million, certain medical benefits, and immediate vesting of the outstanding RSU and PBO previously granted. The Company's former CEO was also entitled to the balance of his accrued vacation and personal days valued at \$338,000 which was paid to him during October 2016.

The Company accrued the \$10.4 million in severance benefits, vacation differential, stock-based compensation, and related expenses in the fourth quarter of 2016, which is presented within other liabilities in the accompanying consolidated balance sheets. In accordance with applicable regulations, payment of the severance benefits and vacation differential, stock settlement of the vested RSU, and distribution of deferred compensation balances, discussed below, will be made to the Company's former CEO no earlier than six months and a day from the effective date of the termination.





#### Employment Agreements:

In 2016, the Company entered into employment agreements with Mr. Webb and Mr. Perri, effective as of January 1, 2017, that provided for an initial base salary of \$496,000 and \$440,000, respectively for 2017, and standard benefits package, subject to an annual cost of living adjustment that is subject to Compensation Committee approval, certain termination benefits, and participation in a revised bonus plan, as described below.

#### Executive Bonus Plan:

The revised bonus plan is effective from January 1, 2016 through December 31, 2020 and replaced and superseded the previous bonus plan maintained by the Company. Such arrangement awards an annual bonus only if 1) there is a net gain derived from a sale or other disposal of assets, as defined, and 2) cash proceeds from such transactions are distributed directly to the Company's shareholders during the same year.

The agreement establishes a bonus pool that is calculated as 8.75% of the adjusted total net gain from assets sold or otherwise disposed. The plan defines the total net gain as the difference between the cash received in sale or other disposal transactions less (a) the invested capital of each such asset as of the sale date, as determined in accordance with U.S. GAAP, subject to adjustment by the compensation committee to the extent necessary to reflect the capitalization of costs with respect to such assets as required by GAAP; (b) any bonus paid or payable to the Company's management for the sale or other disposition of each such asset, other than any bonus under the bonus plan; and (c) administrative expenses specified in the bonus plan. Such total net gain is then also multiplied by an adjustment factor resulting in an adjusted total net gain. The adjustment factor is a fraction, the numerator of which is the total amount of cash distributed or committed to be distributed to the Company's shareholders with respect to all such assets sold or otherwise disposed of during the year, and the denominator, which is the total amount of cash received after payment of all selling costs, including any fees and commissions for which all such assets were sold or otherwise disposed of during the year. For assets distributed directly to the Company's shareholders, the adjustment factor is 100%. The resulting bonus pool is allocated 55% to Mr. Webb, 32.5% to Mr. Perri, and 12.5% to other employees of the Company who are designated by the compensation committee as eligible to participate in the bonus plan with respect to the applicable bonus plan year, in amounts designated by the compensation committee, in each case based on the recommendation of the Mr. Webb. If there is no such employee designated as eligible to participate in the bonus plan, the remaining 12.5% will not be allocated to any individual in the respective bonus plan year. Each individual will be entitled to his allocated portion of the bonus pool for the year if employed by the Company on the last day of the year. However, in the event that Mr. Webb's or Mr. Perri's employment with the Company is terminated in certain circumstances as provided in their employment agreements such terminated individual will be entitled to payment of an amount under the bonus plan for a portion of the year in which such termination occurs.

For assets sold or otherwise disposed of entirely or partially for non-cash consideration by the Company, the calculation of total net gain with respect to the non-cash consideration will instead be made in the year in which the non-cash consideration is ultimately sold or otherwise disposed of for cash by the Company. For assets distributed directly to the Company's shareholders, other than an asset resulting from a previous sale or other disposal of an asset for non-cash consideration as described in the preceding sentence, the total net gain will be determined by deducting items (a) through (c) above from the value of such assets upon such distribution, as determined in accordance with U.S. GAAP.

#### Deferred Compensation

The Company has agreements with its executive management, and the Company's former CEO, to defer compensation into Rabbi Trust accounts held in the name of the Company. The total value of the deferred compensation obligation for all participants at December 31, 2016 and 2015, was \$27.3 million and \$25.5 million, respectively, and is included

in the accompanying consolidated balance sheets. These totals include a fair value of \$839,000 and \$805,000 of the Company's common stock, for each of the respective years, with the balance in various publicly traded debt and equity securities, and cash. In conjunction with the termination of the Company's former CEO, assets with a value of \$23.3 million as of December 31, 2016 will be distributed from the trust accounts in April 2017.

Within these accounts, the following individuals are the beneficiaries of the following number of PICO common shares:

	December 31, 2016	December 31, 2015
Former CEO	53,996	53,996
Mr. Webb, CEO	1,375	1,375
	55,371	55,371

The trustee for the accounts is U.S. Bank. The accounts are subject to the claims of outside creditors, and the cost of the shares of PICO common stock held in the accounts are reported as treasury stock in the consolidated financial statements.

On January 20, 2015, the Company sold equity securities with a cost basis of \$2.3 million to certain deferred compensation Rabbi Trust accounts held by the Company, for the benefit of the Company's former CEO, for total proceeds of \$5 million, which represented the market value of these securities on the date of sale.

#### Incentive Compensation

Certain officers of Vidler are eligible to receive an annual incentive award based on the combined net income, after certain adjustments, of Vidler. No compensation was earned under this plan during the years ended December 31, 2016, 2015, or 2014.

Certain officers of UCP are eligible to receive an annual incentive compensation award which is paid in cash. Compensation of \$578,000 and \$350,000 was earned under the plan for the years ended December 31, 2016 and 2015, respectively. No compensation was earned under this plan for the year ended December 31, 2014.

#### Investment in Synthonics

The Company has an investment in preferred stock of Synthonics, a company co-founded by Mr. Slepicka, formerly a non-employee director of the Company, who is currently the Chairman, Chief Executive Officer and acting Chief Financial Officer of Synthonics. As of December 31, 2016, the Company had invested \$2.2 million for 18.2% of the voting interest in Synthonics. Mr. Slepicka resigned as a member of the Company's Board of Directors effective July 27, 2016. In addition, the Company extended a \$450,000 line of credit to Synthonics during 2014, which bore interest at 15% per annum. The outstanding balance and accrued interest was repaid in April 2015. During the year ended December 31, 2016, the Company recorded an impairment loss on its investment and wrote the carrying value down to zero. See Note 4 "Investments" for additional information.

#### Sale of Oil and Gas Assets in 2017

In conjunction with exiting our residual oil and gas operations, during the three months ending March 31, 2017, the Company sold the majority of the remaining oil and gas lease assets to the service agent the Company had contracted with to operate and manage such oil and gas operations. The Company received book value for the majority of the assets sold resulting in no significant gain or loss on the transaction. The service agent continues to provide management services to the Company in conjunction with the wind-down of the remaining operations.

## 12. SEGMENT REPORTING

PICO Holdings, Inc. is a diversified holding company. The Company accounts for its segments consistent with the significant accounting policies described in Note 1.

The Company organizes its reportable segments by line of business. Currently, the major businesses that constitute operating and reportable segments are: developing water resources and water storage operations, developing land and homebuilding, corporate, which included investments in debt and equity securities, deferred compensation plans, and oil and gas operations, and the discontinued operations of a canola seed processing plant.

Segment performance is measured by revenues and segment profit before income tax and equity in loss of unconsolidated affiliate. In addition, assets identifiable with segments are disclosed as well as capital expenditures, and depreciation and amortization. The Company's reported revenue for the three years ended December 31, 2016 was earned in the United States and therefore no geographic region disclosure is presented.

### Water Resources and Water Storage Operations

The Company owns water resources and water storage operations in the southwestern United States, with assets and operations in Nevada, Arizona, Colorado and New Mexico. Currently, the Company is primarily focused on selling existing water rights and storage credits.

### Real Estate Operations

The Company is engaged in land development and homebuilding operations primarily in California, Washington, North Carolina, South Carolina, and Tennessee. The ongoing revenues in this segment are primarily from sales in UCP, although the Company does have other real estate holdings that could be sold from time to time.

### Corporate

This segment consists of cash and fixed-income securities, the 19.3% voting interest in Mindjet, the Company's oil and gas venture, which sold the majority of its assets during 2016, deferred compensation assets and liabilities held in trust for the benefit of the Company's current officers and former CEO, and other parent company assets and liabilities.

### Discontinued Agribusiness Operations

During 2015, the Company sold substantially all of the assets used in its agribusiness segment for a net selling price of \$105.3 million. Consequently the segment qualified as held-for-sale and has been classified as discontinued agribusiness operations in the accompanying consolidated financial statements as of the earliest period presented.

Segment information by major operating segment follows (in thousands):

	Water Resources and Water Storage Operations	Real Estate Operations	Corporate	Discontinued Agribusiness Operations	Consolidated
<b>2016</b>					
Total revenues	\$ 952	\$ 354,745	\$ 6,881		\$ 362,578
Impairment loss on intangible and long-lived assets		\$ 6,811	\$ 201		\$ 7,012
Depreciation and amortization	\$ 355	\$ 631	\$ 510		\$ 1,496
Income (loss) from continuing operations before income taxes and equity in loss of unconsolidated affiliate	\$(5,476 )	\$ 8,064	\$(20,591)		\$(18,003 )
Total assets	\$ 185,303	\$ 434,936	\$ 49,050	\$ 6,505	\$ 675,794
Capital expenditure	\$ 29	\$ 166	\$ 123		\$ 318
<b>2015</b>					
Total revenues (losses)	\$ 4,332	\$ 279,196	\$(16,865)		\$ 266,663
Impairment loss on intangible and long-lived assets	\$ 269	\$ 1,197	\$ 1,816		\$ 3,282
Depreciation and amortization	\$ 1,037	\$ 552	\$ 623		\$ 2,212
Income (loss) from continuing operations before income taxes and equity in loss of unconsolidated affiliate	\$(3,858 )	\$ 6,394	\$(33,686)		\$(31,150 )
Equity in loss of unconsolidated affiliate			\$(3,422 )		\$(3,422 )
Total assets	\$ 185,037	\$ 421,411	\$ 46,844	\$ 8,793	\$ 662,085
Capital expenditure	\$ 76	\$ 330	\$ 2,702		\$ 3,108
<b>2014</b>					
Total revenues (losses)	\$ 1,580	\$ 191,440	\$(532 )		\$ 192,488
Interest expense	\$ 18		\$ 210		\$ 228
Impairment loss on intangible and long-lived assets	\$ 5,791	\$ 2,865	\$ 4,428		\$ 13,084
Depreciation and amortization	\$ 1,098	\$ 669	\$ 1,287		\$ 3,054
Loss from continuing operations before income taxes and equity in loss of unconsolidated affiliate	\$(12,584 )	\$(10,531 )	\$(23,854)		\$(46,969 )
Equity in loss of unconsolidated affiliate			\$(2,076 )		\$(2,076 )
Total assets	\$ 186,294	\$ 382,543	\$ 80,741	\$ 152,554	\$ 802,132
Capital expenditure	\$ 230	\$ 1,004	\$ 4,036		\$ 5,270

### 13. DISCONTINUED AGRIBUSINESS OPERATIONS

On July 13, 2015, the Company entered into an agreement to sell substantially all of the assets used in its agribusiness segment to CHS for a net selling price of \$105.3 million. The transaction closed on July 31, 2015. The selling price was determined primarily as an amount equal to \$127 million, less a \$20.9 million working capital balance adjustment. After repayment of \$80.9 million of outstanding debt and \$5.9 million in selling and other related costs of the sale, the Company received net proceeds of \$18.4 million on the date of close. After resolution of the matters discussed below and all selling and related costs of the sale, the Company received final proceeds of \$16.4 million.

The Company was required to deposit \$10.2 million of such net proceeds in two separate escrow accounts, the balance of which is presented within accounts receivable in the table below. The first escrow account required \$6 million to secure general indemnification obligations and for refund of any difference in the final working capital balance with any balance remaining after claims released 18 months from the closing date of the sale. The second escrow account required \$4.2 million for specified operational matters (“operational escrow”).

During October 2015, the Company received \$2.4 million of the operational escrow upon resolution of one matter, however, during January 2016, the Company forfeited the remaining operational escrow balance as a result of an unfavorable resolution on the second matter. As a result of forfeiting the balance, the Company recorded \$1.8 million as additional loss on sale of discontinued operations in the Company’s results during the year ended December 31, 2016. In February 2017, the Company received the final \$6 million that had been held in escrow for general indemnification claims.

The Company also guaranteed up to \$8 million for any indemnification claims in excess of the \$6 million escrow pursuant to the terms of a guaranty agreement with CHS. This guaranty will remain in force for five years from the date of sale. The guaranty has been recorded at estimated fair value that reflects the Company’s expectation that no significant amounts will be paid out under the guaranty. However, any amounts paid by the Company to CHS in excess of the estimate will result in additional loss on the sale.

During the year ended December 31, 2015, the Company recorded a loss of \$18.7 million on the sale of discontinued agribusiness operations. Such loss was included in loss on sale of discontinued agribusiness operations in the accompanying consolidated statement of operations and comprehensive income or loss. The assets of the Company’s discontinued agribusiness presented in the table below at December 31, 2016, were comprised primarily of the operational escrowed funds discussed above and cash. Any assets in excess of the resolution of the outstanding matters, and after payment of remaining liabilities, are available to the Company for any corporate purposes.

The Company’s agribusiness segment qualified as held-for-sale at December 31, 2016 and has been classified as discontinued agribusiness operations in the accompanying consolidated financial statements as of the earliest period presented.

The following table presents the details of the Company's results from discontinued agribusiness operations included in the consolidated statement of operations and comprehensive income or loss (in thousands):

	2016	2015	2014
Revenue and other income:			
Sales of canola oil and meal		\$82,267	\$163,855
Other revenue (loss):			
Loss on trading derivatives		(159)	(1,966)
Other	\$590	126	519
Total revenue and other income	590	82,234	162,408
Cost of goods sold:			
Cost of canola oil and meal sold		79,763	137,565
Depreciation		4,360	8,079
Other direct costs of production		5,938	11,024
Total cost of goods sold	—	90,061	156,668
Impairment loss on intangible and long-lived assets		1,875	
Interest		3,259	5,536
Plant costs and overhead	111	17,578	14,278
Segment total expenses	111	112,773	176,482
Gain (loss) from discontinued agribusiness operations, net of tax	479	(30,539)	(14,074)
Loss on sale of discontinued agribusiness operations, net of tax <sup>(1)</sup>	(1,856)	(18,729)	
Net loss from discontinued agribusiness operations, net of tax	(1,377)	(49,268)	(14,074)
Net loss from discontinued agribusiness operations attributable to noncontrolling interests		1,720	1,718
Net loss from discontinued agribusiness operations attributable to PICO Holdings, Inc.	\$(1,377)	\$(47,548)	\$(12,356)

<sup>(1)</sup> Included within the loss on sale of discontinued agribusiness operations, net of tax for the year ended December 31, 2015 is a \$16.9 million impairment loss on classification of assets as held-for-sale, which was recorded during the second quarter of 2015.

The following table presents the details of the Company's discontinued agribusiness assets and liabilities classified as held-for-sale in the consolidated balance sheets (in thousands):

	December 31, 2016	December 31, 2015
Assets		
Cash and cash equivalents	\$ 438	\$ 938
Accounts receivable	5,993	7,800
Other assets	74	55
Total assets held-for-sale	\$ 6,505	\$ 8,793
Liabilities		
Total liabilities held-for-sale	\$ 276	\$ 608

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

### ITEM 9A. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures.

The Company maintains disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act) designed to provide reasonable assurance that the information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms.

These include controls and procedures designed to ensure that this information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Management, with the participation of the Chief Executive and Chief Financial Officers, evaluated the effectiveness of the Company's disclosure controls and procedures as of December 31, 2016. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective as of December 31, 2016.

#### Management's Annual Report on Internal Control over Financial Reporting.

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes of accounting principles generally accepted in the United States and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the Company's assets;

- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance of achieving their control objectives.

Management, with the participation of the Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2016. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control - Integrated Framework (2013). Based on this assessment, management, with the participation of the Chief Executive Officer and Chief Financial Officer, concluded that, as of December 31, 2016, the Company's internal control over financial reporting was effective based on the COSO criteria (2013).



Deloitte & Touche LLP, the independent registered public accounting firm who audited the Company's consolidated financial statements included in this Form 10-K, has issued an attestation report on the Company's internal control over financial reporting, which is included herein.

Changes in Internal Control over Financial Reporting.

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the quarter ended December 31, 2016, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
PICO Holdings, Inc.  
La Jolla, California

We have audited the internal control over financial reporting of PICO Holdings, Inc. and subsidiaries (the "Company") as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2016 of the Company and our report dated March 2, 2017, expressed an unqualified opinion on those financial statements and financial statement schedule.

/s/ DELOITTE & TOUCHE LLP

San Diego, California

March 2, 2017

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ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item regarding directors will be set forth in the section headed “Election of Directors” in our definitive proxy statement with respect to our 2017 annual meeting of shareholders (the “2017 proxy statement”), to be filed on or before April 30, 2017 and is incorporated herein by reference. The information required by this item regarding the Company’s code of ethics will be set forth in the section headed “Code Of Ethics” in the 2017 proxy statement and is incorporated herein by reference. Information regarding executive officers is set forth in Item 1 of Part 1 of this Report under the caption “Executive Officers.” Other information required by this item will be set forth in the sections headed “Corporate Governance” and “Section 16(a) Beneficial Ownership Reporting Compliance” in the 2017 proxy statement and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item will be set forth in the section headed “Executive Compensation and Related Information” in the 2017 proxy statement and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT, AND RELATED STOCKHOLDER MATTERS

The information required by this item will be set forth in the sections headed “Security Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information” in the 2017 proxy statement and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item will be set forth in the section headed “Certain Relationships and Related Persons Transactions” and “Compensation Committee, Interlocks and Insider Participation” in the 2017 proxy statement and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this item will be set forth in the sections headed “Independent Registered Public Accounting Firm Fees” and “Audit Committee Pre-Approval Policy” in the 2017 proxy statement and is incorporated herein by reference.

## PART IV

## ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

## (a) FINANCIAL SCHEDULES AND EXHIBITS

## 1. Financial Statement Schedules

## SCHEDULE I

## CONDENSED FINANCIAL INFORMATION OF REGISTRANT (PARENT COMPANY ONLY)

## CONDENSED BALANCE SHEETS

December 31, 2016 and 2015

(In thousands)

	2016	2015
Assets		
Cash and cash equivalents	\$11,257	\$11,429
Investments in subsidiaries	414,852	419,285
Debt and equity securities	612	540
Other assets (intercompany receivable of \$16,518 in 2016 and \$19,974 in 2015)	17,729	20,648
Total assets	\$444,450	\$451,902
Liabilities and shareholders' equity		
Accounts payable, accrued expenses and other liabilities (intercompany payable of \$104,361 in 2016 and \$102,697 in 2015)	\$115,529	\$104,077
Common stock, \$.001 par value; authorized 100,000 shares, 23,125 issued and 23,070 outstanding at December 31, 2016, and 23,116 issued and 23,038 outstanding at December 31, 2015	23	23
Additional paid-in capital	495,468	494,207
Accumulated deficit	(173,231)	(151,366)
Accumulated other comprehensive income	6,661	4,961
Total shareholders' equity	328,921	347,825
Total liabilities and shareholders' equity	\$444,450	\$451,902

This statement should be read in conjunction with the notes to the consolidated financial statements included in the Company's Form 10-K.

## SCHEDULE I

## CONDENSED FINANCIAL INFORMATION OF REGISTRANT (PARENT COMPANY ONLY)

## CONDENSED STATEMENTS OF OPERATIONS

For the years ended December 31, 2016, 2015 and 2014

(In thousands, except per share data)

	2016	2015	2014
Revenues:			
Investment income (intercompany interest and dividends of zero in 2016, \$142 in 2015, and \$75,589 in 2014)	\$691	\$948	\$77,124
Expenses:			
Expenses (intercompany interest of \$2,569 in 2016, \$2,468 in 2015, and \$7,389 in 2014)	23,466	12,735	20,551
Income (loss) from continuing operations before income taxes	(22,775 )	(11,787 )	56,573
Equity in income (loss) of subsidiaries	910	(70,071 )	(108,998 )
Net loss	\$(21,865)	\$(81,858)	\$(52,425)

This statement should be read in conjunction with the notes to the consolidated financial statements included in the Company's Form 10-K.

## SCHEDULE I

## CONDENSED FINANCIAL INFORMATION OF REGISTRANT (PARENT COMPANY ONLY)

## CONDENSED STATEMENTS OF CASH FLOWS

For the years ended December 31, 2016, 2015 and 2014

(In thousands)

	2016	2015	2014
Operating activities:			
Cash used in operating activities	\$(13,372)	\$(5,997)	\$(3,439)
Investing activities:			
Proceeds from the sale of debt and equity securities	135	10,153	6,027
Purchases of debt and equity securities			(264)
Purchases of and advances to subsidiaries		(18,563)	(8,376)
Cash received from the repayment of loans and advances to subsidiaries		12,496	8,909
Dividends and other distributions received from subsidiaries	9,565		12,088
Purchases of property, plant and equipment		(8)	(39)
Net cash provided by investing activities	9,700	4,078	18,345
Financing activities:			
Loans from subsidiaries	3,500		
Payment of withholding taxes on exercise of RSU		(126)	(4,118)
Cash provided by (used in) financing activities	3,500	(126)	(4,118)
Net increase (decrease) in cash and cash equivalents	(172)	(2,045)	10,788
Cash and cash equivalents, beginning of year	11,429	13,474	2,686
Cash and cash equivalents, end of year	\$11,257	\$11,429	\$13,474
Supplemental disclosure of cash flow information:			
Cash during the year for:			
Refund of federal and state income taxes	\$226	\$3	\$4,127
Non-cash investing and financing activities:			
Issuance of common stock for vested restricted stock units	\$85	\$559	\$7,464
Dividend received from subsidiaries			\$62,600

This statement should be read in conjunction with the notes to the consolidated financial statements included in the Company's Form 10-K.

1. Exhibits

Exhibit Number	Description
2.1	Asset Purchase Agreement dated July 13, 2015, by and between PICO Northstar Hallock, LLC and CHS Hallock, LLC. <sup>(1)</sup>
3.1	Amended and Restated Articles of Incorporation of PICO Holdings, Inc. <sup>(2)</sup>
3.2	Certificate of Amendment of Amended and Restated Articles of Incorporation of PICO Holdings, Inc. <sup>(3)</sup>
3.3	Amended and Restated Bylaws of PICO Holdings, Inc. <sup>(4)</sup>
3.4	Amendment to Amended and Restated Bylaws of PICO Holdings, Inc. <sup>(3)</sup>
4.1	Indenture, dated October 21, 2014, among UCP, Inc., the guarantors named therein, and Wilmington Trust, National Association, as trustee. <sup>(5)</sup>
10.1	Guaranty, dated July 31, 2015, between PICO Holdings, Inc. and CHS Hallock, LLC. <sup>(6)</sup>
10.2	Restrictive Covenant Agreement, dated July 31, 2015, between CHS Hallock, LLC and PICO Holdings, Inc. <sup>(6)</sup>
10.3†	PICO Holdings, Inc. 2014 Equity Incentive Plan, Stock Option Grant Notice, Stock Option Award Agreement, Stock Option Notice of Exercise, Restricted Stock Unit Grant Notice, Restricted Stock Unit Award Agreement, and Restricted Stock Deferral Election Form. <sup>(7)</sup>
10.4†	Trust for PICO Deferred Holdings, LLC Executive Deferred Compensation dated November 25, 2008 between PICO Deferred Holdings, LLC and U.S. Bank (as successor to Union Bank of California, N.A.) relating to a Deferred Compensation Plan originally established in December 31, 1997. <sup>(8)</sup>
10.5†	Trust for PICO Deferred Holdings, LLC Executive Deferred Compensation dated November 25, 2008 between PICO Deferred Holdings, LLC and U.S. Bank (as successor to Union Bank of California, N.A.) relating to a Deferred Compensation Plan originally established in December 7, 2004. <sup>(8)</sup>
10.6†	Trust for PICO Deferred Holdings, LLC Non-Employee Director Deferred Compensation dated November 25, 2008 between PICO Deferred Holdings, LLC and U.S. Bank (as successor to Union Bank of California, N.A.) relating to a Deferred Compensation Plan originally established in September 25, 2001. <sup>(8)</sup>
10.7†	PICO Deferred Holdings, LLC Deferred Compensation Plan. <sup>(8)</sup>
10.8†	Infrastructure Dedication Agreement between Fish Springs Ranch, LLC, and Washoe County, Nevada dated October 16, 2007. <sup>(2)</sup>
10.9†	Employment Agreement, dated December 14, 2016, by and between PICO Holdings, Inc. and Maxim C.W. Webb. <sup>(9)</sup>
10.10†	Employment Agreement, dated December 14, 2016, by and between PICO Holdings, Inc. and John T. Perri. <sup>(9)</sup>
10.11†	PICO Holdings, Inc. Executive Bonus Plan. <sup>(9)</sup>
10.12†	PICO Holdings, Inc. Nonemployee Director Compensation Policy
10.13	Form of Indemnity Agreement with directors and executive officers of PICO Holdings, Inc. and each of its subsidiaries. <sup>(10)</sup>
10.14†	Directorship Letter Agreement with Eric Speron dated December 18, 2015. <sup>(11)</sup>
10.15	Agreement dated March 22, 2016, among PICO Holdings, Inc. and Leder Holdings, LLC, LH Brokerage, LLC, Leder Holdings Opportunity Fund LLC and Sean M. Leder <sup>(12)</sup>
10.16	Agreement dated January 27, 2017, by and among PICO Holdings, Inc., Bandera Partners LLC, Bandera Master Fund L.P., Gregory Bylinsky and Jefferson Gramm. <sup>(13)</sup>
21.1	Subsidiaries of PICO Holdings, Inc.
23.1	Consent of Independent Registered Public Accounting Firm - Deloitte & Touche LLP.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.



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- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 (Section 906 of the Sarbanes-Oxley Act of 2002).
- 32.2 Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350 (Section 906 of the Sarbanes-Oxley Act of 2002).
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document

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Exhibit Number	Description
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

- † Indicates compensatory plan, contract or arrangement in which directors or executive officers may participate.
- (1) Incorporated by reference to Form 8-K filed with the SEC on July 17, 2015.
  - (2) Incorporated by reference to the Quarterly Report on Form 10-Q filed with the SEC on November 7, 2007.
  - (3) Incorporated by reference to Form 8-K filed with the SEC on July 13, 2016.
  - (4) Incorporated by reference to Form 8-K filed with the SEC on May 19, 2009.
  - (5) Incorporated by reference to Form 8-K filed with the SEC on October 24, 2014.
  - (6) Incorporated by reference to Form 8-K filed with the SEC on August 6, 2015.
  - (7) Incorporated by reference to the Quarterly Report on Form 10-Q filed with the SEC on November 10, 2014.
  - (8) Incorporated by reference to the Annual Report on Form 10-K filed with the SEC on March 1, 2010.
  - (9) Incorporated by reference to Form 8-K filed with the SEC on December 15, 2016.
  - (10) Incorporated by reference to Form 8-K filed with the SEC on March 5, 2013.
  - (11) Incorporated by reference to Form 8-K filed with the SEC on December 22, 2015.
  - (12) Incorporated by reference to Form 8-K filed with the SEC on March 22, 2016.
  - (13) Incorporated by reference to Form 8-K filed with the SEC on January 30, 2017.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

PICO Holdings, Inc.

Date: March 2, 2017 By: /s/ Maxim C. W. Webb  
Maxim C. W. Webb  
Chief Executive Officer  
President and Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below on March 2, 2017 by the following persons on behalf of the Registrant and in the capacities indicated.

/s/ Maxim C. W. Webb Chief Executive Officer, President and Chairman of the Board  
Maxim C. W. Webb (Principal Executive Officer)

/s/ John T. Perri Chief Financial Officer and Secretary  
John T. Perri (Principal Financial Officer)

/s/ Daniel B. Silvers Lead Independent Director  
Daniel B. Silvers

/s/ Michael J. Machado Director  
Michael J. Machado

/s/ Andrew F. Cates Director  
Andrew F. Cates

/s/ Eric H. Speron Director  
Eric H. Speron

/s/ Howard B. Brownstein Director  
Howard B. Brownstein

/s/ Raymond V. Marino II Director  
Raymond V. Marino II