PICO HOLDINGS INC /NEW
Form 10-K
March 03, 2017
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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
Common Stock, Par Value $0.001	NASDAQ Stock Market LLC

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.

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", "estima 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) 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.

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-feet 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. Located in Washoe County, east of Reno.	Water rights and land are available for sale, lease or other partnering arrangements. 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.
Colorado:		
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. Located 25 miles east of Albuquerque.	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.
Lower Rio Grande Basin	Approximately 1,261 acre-feet of agricultural water rights. Located in Dona Ana and Sierra Counties.	Water is available for sale, lease or other partnering opportunities. 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. Located in Santa Fe and Bernalillo Counties.	Water is available for sale, lease, or other partnering opportunities.

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)
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 the 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[(1)]	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[(1)]	Total
West	3,869	415	4,284
Southeast	882	712	1,594
Total	4,751	1,127	5,878

(1) 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.

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 [1]	$669,289	$653,292	$649,578	$607,547	$501,213
Debt [1]	$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 [1]	$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 [2]	$14.22	$15.04	$18.50	$20.79	$20.82

[1] Excludes balances classified as discontinued operations.

[2] 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 loses 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	