

PICO HOLDINGS INC /NEW

Form 10-K

March 14, 2016

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, 2015

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, 2015, 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, 2015) was \$266.7 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, 2015. This calculation does not reflect a determination that such persons are deemed to be affiliates for any other purposes.

On March 11, 2016, the registrant had 23,037,587 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 2016 Annual Meeting of Shareholders, to be filed subsequent to the date hereof, are incorporated by reference into Part III of this Annual Report on Form 10-K.

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## PART I

### Note About “Forward-Looking Statements”

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

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

## ITEM 1. BUSINESS

### Introduction

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

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

As of December 31, 2015, 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, 2015, our major consolidated subsidiaries were (wholly-owned unless otherwise noted):

- Vidler Water Company, Inc. (“Vidler”) which acquires and develops 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 56.9% owned subsidiary which is a homebuilder and land developer in markets located in California and Puget Sound area of Washington State, North Carolina, South Carolina and Tennessee.

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

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

#### Operating Segments and Major Subsidiary Companies

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

#### Our Water Resource and Water Storage Operations

Vidler is engaged in the water resource development business and is primarily focused on developing and selling our existing water rights that we own in the southwestern United States. In this operation, we develop new sources of water for municipal and industrial use, either from existing supplies of water, such as water used for agricultural purposes, acquiring unappropriated (previously unused) water, or discovering 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, California, Idaho, Nevada, and New Mexico. We also developed and operated our own water storage facility near Phoenix, Arizona, utilize water storage capacity operated by third parties in Arizona, and "bank," or store, water with municipalities in Nevada and New

Mexico.

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

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We generate revenues by:

- selling our developed water rights to project developers including real estate developers, power generating facilities or other commercial and industrial users who must secure rights to an assured supply of water in order to receive permits for their development projects;
- selling our developed water rights to water utilities, municipalities and other government agencies for their specific needs, including to support population growth;
- selling our stored water to commercial developers or municipalities that have either exhausted their existing water supplies, 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, 2015:

#### 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 7,360 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. 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. At the end of 2015, 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, 2015, 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.

#### 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 had concluded 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.

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## Kane Springs

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

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

The following table summarizes our other water rights and real estate assets at December 31, 2015:

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.	Currently leased to Southern Nevada Water Authority through September 30, 2016.
Dodge Flat	Located 35 miles east of Las Vegas.  1,428 acre-feet of permitted municipal and industrial use water rights, and 1,068 acres of land.	Water rights and land are available for sale, lease or other partnering arrangements.
Colorado:	Located in Washoe County, east of Reno.	In November 2014, we entered into an option agreement with a solar developer for the potential development of a solar power project of up to 180 megawatts.
Tunnel	Approximately 164 acre-feet of water rights.	63 acre-feet of water leased under long term leases. 101 acre-feet are available for sale or lease.
New Mexico:	Located in Summit County (the Colorado Rockies), near Breckenridge.	
Campbell Ranch	Application for a new appropriation of 717 acre-feet of ground water. Vidler is in partnership with the land owner. The water rights would be used for a new residential and commercial development.	In November 2014, our application was denied by the New Mexico State Engineer causing us to record an 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	Located 25 miles east of Albuquerque.  Approximately 1,261 acre-feet of agricultural water rights.	Water is available for sale, lease or other partnering opportunities.
Middle Rio Grande Basin	Located in Dona Ana and Sierra Counties.  Approximately 101 acre-feet of municipal rights. 16 acre-feet currently under contract, expected to close prior to April 1, 2016.	In 2014, we entered into a long term lease for a portion of these water rights that continued into 2015. Water is available for sale, lease, or other partnering opportunities.

Located in Santa Fe and Bernalillo  
Counties.

#### Our Real Estate Operations

Our real estate operations are primarily conducted through UCP, our 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, 2015, we owned 56.9% of the voting interest in UCP, Inc. and we owned 56.9% of the economic interests of UCP, LLC and UCP, Inc. owned 43.1% 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, 2015, we owned or controlled 5,878 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, 2015, we had 134 completed and 292 under construction homes including 51 model homes, which we believe to be appropriate for our current growth plans.

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. Benchmark Communities operates under the principle that “Everything Matters!” This principle underlies all phases of our new home process including planning, design, construction, sales and the customer experience. 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

We realize that homebuilding is a local business. As a result we focus on the unique characteristics of each market. In our West homebuilding market, consistent with local market custom, we typically release for sale and construct homes in phases of four to twelve homes based upon projected sales rates. In our Southeast market, consistent with local market custom, we typically release lots for sale in phases of eight to twenty lots allowing customers to select a specific home on their chosen lot.

In both markets, we adhere to an “even flow” construction methodology that allows us to standardize the timing of new home starts in order to reduce labor and material costs and 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 to us. Our even-flow method provides us enhanced visibility, oversight, and control of the production process, and allows us to more effectively manage our working capital accounts.

We routinely monitor and actively manage our even flow production process to align with prevailing and expected future unit absorption trends. In the event our inventory builds faster than homes are sold, we will typically halt construction when homes are structurally complete, but prior to the selection of certain amenities, such as flooring and counter tops, until we have entered into a sales contract and received a non-refundable customer deposit. This process allows us to reduce the amount of capital invested in our inventory of homes until homes are under contract and allows buyers to select and customize certain non-structural elements of the home.

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, as follows: (1) BMC Realty Advisors, Inc. (“BMC Realty”) in California and Washington; (2) Builders BMC, Inc. in North Carolina; (3) BMCH Tennessee, LLC in Tennessee; and (4) Benchmark Communities, LLC in South Carolina.

We typically staff two professional sales personnel at each of our communities. Our in-house sales teams have offices in their respective model 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. As of December 31, 2015, we owned 51 completed and seven under construction 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. The on-site design center experience enhances our customer’s experience.

## 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 market and one year in the Southeast homebuilding market). As is customary in the homebuilding industry, our trade partners who build our homes sign contracts with the provision to provide warranty repairs inside the fit and finish warranty period, including structural and water intrusion repairs up to the period designated by the respective State’s Statute of Repose.

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.

There can be no assurance, however, that the terms and limitations of the limited warranty will be effective against claims made by home buyers; that we will be able to renew our insurance coverage or renew it at reasonable rates; that we will not be liable for damages, the cost of repairs, and/or the expense of litigation surrounding possible construction defects, soil subsidence or building related claims; or that claims will not arise out of uninsurable events or circumstances not covered by insurance and not subject to the effective indemnification agreements with our subcontractors.

#### 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 contemplates building new homes on the majority of our lots, 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 us with 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 since 2008, 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, 2015		
	Owned	Controlled <sup>(1)</sup>	Total
West	3,869	415	4,284
Southeast	882	712	1,594
Total	4,751	1,127	5,878

	As of December 31, 2014		
	Owned	Controlled <sup>(1)</sup>	Total
West	4,410	469	4,879
Southeast	1,033	456	1,489
Total	5,443	925	6,368

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

Our property portfolio consisted of 93 communities in 39 cities in our West and Southeast markets as of December 31, 2015 and 83 communities in 38 cities in our West and Southeast markets as of December 31, 2014.

## 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 real estate asset.

Our indebtedness in this segment is primarily comprised of senior notes due in 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 our level of indebtedness and when making decisions regarding the incurrence of new indebtedness, 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 such as D. R. Horton Inc., Pulte Group, Inc., and Lennar Corporation who are larger than we are and may have greater financial and operational resources than we do. 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 investments in small businesses, typically venture capital-type situations, which are reported in this segment until they meet the requirements for separate segment reporting. In addition, the segment includes the results from a portfolio of equity securities in publicly traded companies, the results of deferred compensation investment assets held in trust for the benefit of several PICO officers and non-employee directors 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 company markets its products worldwide and has offices in the United States, Germany, France, Japan, Australia, and the United Kingdom. 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, 2015, we controlled 19.3% of the voting stock of the company and the carrying value of our total investment in Mindjet was \$2.2 million, comprised of \$1.3 million in preferred stock and a loan of \$886,000 that we expect to be converted into additional preferred stock during the first quarter of 2016.

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. Currently, we own approximately 780 acres of oil and gas leases in the Wattenburg Field and have drilled and completed four wells on our leased properties. To date, we have developed the Wattenburg acreage by constructing additional drill sites and a production facility and we obtained permits for several additional wells. In addition, we also own 640 acres of oil and gas leases in Wyoming. In November 2013, we entered into an administrative service agreement with a private company that we pay to assist in the management, operation, direction, and supervision of these oil and gas operations. At December 31, 2015, we had a net carrying value of approximately \$2.5 million in this business venture.



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 director of our Company, co-founded Synthonics and is currently their Chairman, Chief Executive Officer and acting Chief Financial Officer. Mr. Slepicka, along with the other officers of Synthonics, own the majority of the outstanding stock of Synthonics. At December 31, 2015, we owned 18.3% 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. The investment is held at cost and is included in investments in our consolidated financial statements and the outstanding balance of the line of credit was included in other assets.

It is reasonably possible given the volatile nature of the oil and gas, software, and biopharmaceutical industries that circumstances may change in the future which could require us to record impairment losses on our investments in small businesses included in this segment.

#### Employees

At December 31, 2015, PICO had 220 employees.

#### Executive Officers

The executive officers of PICO are:

Name	Age	Position
John R. Hart	56	President, Chief Executive Officer and Director
Maxim C. W. Webb	54	Executive Vice President, Chief Financial Officer, Treasurer and Secretary
John T. Perri	46	Vice President, and Chief Accounting Officer

Mr. Hart has served as our President and Chief Executive Officer and as a member of our board of directors since 1996. Mr. Hart also serves as an officer and/or director of our most significant subsidiaries: Vidler Water Company, Inc. (director since 1995, chairman since 1997 and chief executive officer since 1998); and UCP, Inc. (since May 2013). From 1997 to 2006, Mr. Hart was a director of HyperFeed Technologies, Inc., an 80% owned subsidiary which was dissolved in 2009 following bankruptcy proceedings, where he served as chairman of the nominating committee and as a member of the compensation committee.

Mr. Webb has served as our Chief Financial Officer and Treasurer since May 2001 and as Executive Vice President since 2008. Mr. Webb was appointed as our Secretary in May 2014. Mr. Webb serves as a director of UCP, Inc. (since May 2013) and as an officer of Vidler Water Company, Inc. (since 2001).

Mr. Perri has served as our Vice President and Chief Accounting Officer since 2010. He has served in various capacities since joining our company in 1998, including 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. We have approximately 251,000 acre-feet of water stored at the facility. In addition, we have approximately 157,000 acre-feet of water stored in the Phoenix Active Management Area. We have not stored any water on behalf of any customers and have 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, 2015, the total cost of the pipeline project, including our water credits, (net of impairment losses incurred to date) carried on our balance sheet is 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 indebtedness 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 indebtedness.

As of December 31, 2015, UCP had approximately \$157.5 million of outstanding debt. UCP's substantial outstanding indebtedness, 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 indebtedness at maturity or the refinancing terms may be less favorable than the terms of their original indebtedness;
- 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 \$75.2 million of UCP's indebtedness 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 indebtedness;

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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 indebtedness 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 indebtedness is secured, to foreclose on UCP's assets that secure such obligation.

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.