S&P Capital IQ

CONTENTS

Heritage Insurance Holdings, Inc. NYSE:HRTG

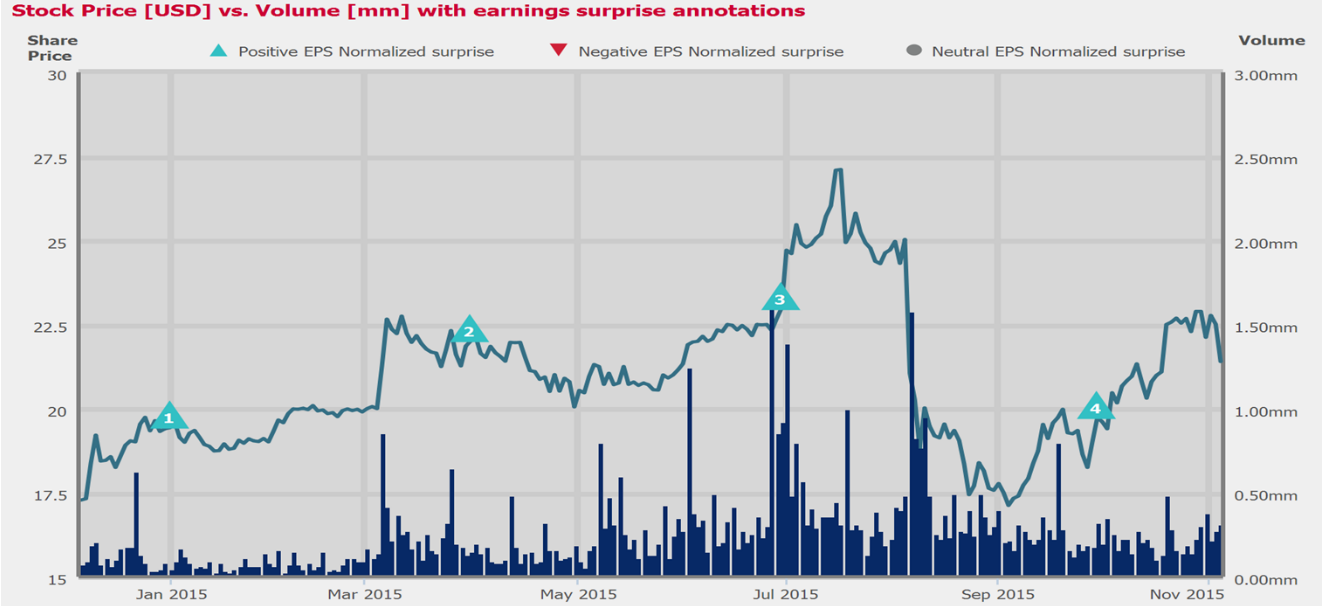
FQ4 2015 Earnings Call Transcripts

Thursday, March 03, 2016 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2015-			-FQ1 2016-	-FY 2015-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.65	0.66	1.54	0.88	3.01	3.05
Revenue (mm)	95.40	101.33	6.22	96.81	387.00	394.79

Currency: USD
Consensus as of Mar-03-2016 9:42 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2014	0.43	0.66	1 53.49 %
FQ1 2015	0.78	1.00	2 28.21 %
FQ2 2015	0.82	0.84	3 2.44 %
FQ3 2015	0.49	0.55	4 12.24 %

Call Participants

EXECUTIVES

Bruce Lucas
Chairman of the Board & CEO

Melanie Skijus

Stephen L. Rohde
Advisory

ANALYSTS

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

Kevin Alloway
SunTrust Robinson Humphrey, Inc., Research Division

Matthew John Carletti
JMP Securities LLC, Research Division

Presentation

Operator

Good morning, and welcome to Heritage Insurance Holdings Fourth Quarter and Full Year 2015 Financial Results Conference Call. My name is Mike, and I will be the operator today. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference call over to Ms. Melanie Skijus. Miss Skijus, the floor is yours, ma'am.

Melanie Skijus

Good morning. The fourth quarter and full year 2015 earnings release can be found in the Investor Relations section of heritagepci.com. The earnings call will be archived and available for replay.

Today's call may contain forward-looking statements. These statements, which we undertake no obligation to update, represent our current judgment and are subject to risks, assumptions and uncertainties. For a description of the risks that could cause our results to differ materially from these described in the forward-looking statements, please refer to our annual report on Form 10-K and other filings made with the SEC from time to time.

With us on the call today are Bruce Lucas, Chairman and CEO; and Steve Rohde, Chief Financial Officer.

I will now turn the call over to Bruce.

Bruce Lucas
Chairman of the Board & CEO

Thank you, Melanie. I would like to welcome all of you to our fourth quarter and full year 2015 earnings call. Before we address the quarterly results, I would like to take a moment to thank all of our employees for their dedication and commitment to the company.

I'd like to start by addressing the acquisition of Zephyr Insurance Company. I am very excited to announce that the Form A acquisition filing with the State of Hawaii Insurance Division has been approved, and we expect to close the Zephyr Insurance transaction very soon. We expect the acquisition to be immediately accretive to the second quarter numbers but not to have any material impact on our first quarter results.

To provide a quick recap, the acquisition provides Heritage with an immediate presence in the state of Hawaii, and we expect it to produce some reinsurance synergies within the year. As we have previously stated, we expect net income contribution of roughly $13 million before reinsurance synergies. The Zephyr team understands the Hawaii market, and we are thrilled to welcome aboard such a solid team as we work together to drive new opportunities with the Zephyr brand.

Now onto the quarterly and annual results. We have continued to post solid financial results, while we focus on growing our voluntary book of business, assuming new policies from Citizens and expanding into new states. We achieved record voluntary production in commercial residential premium in the fourth quarter and added $20.4 million in new business in this line. Premiums and policy count also increased significantly year-over-year in the fourth quarter. And some of our key fourth quarter metrics include a 34% increase in gross premiums earned as compared to the fourth quarter of 2014, a 253% increase in voluntary commercial residential premium as compared to the fourth quarter of 2014, a 23% increase in total policy count compared to the fourth quarter of 2014, and we declared the company's first dividend of $0.05 per share in the fourth quarter.

And for the full year 2015, the company had another record year. We were able to grow gross premiums earned by 68% and, more importantly, grew net operating income by an incredible 96%. Some metrics for the full year are gross premiums written were $586.1 million, which represents an increase of 34%; gross premiums earned were $524.7 million, an increase of 68%; net income for the full year was $92.5 million, an increase of 96%; the combined ratio on a gross basis was 74.9% compared to 79.4% in 2014;

and stockholders' equity at December 31, 2015, was $356.5 million, an increase of 40% compared to December 31 of 2014.

We were fortunate to have a quiet hurricane season, but work has already begun to enhance our reinsurance coverage for the 2016 season. We recently closed on a $250 million catastrophe bond that will drop our Florida hurricane catastrophe fund participation to only 45% and will lock in favorable rates for the next 3 years. We anticipate a reduction in our reinsurance rates, but it is too early to determine the amount of the reduction in 2016.

With respect to daily claims activity, we continue to have success in handling claims by using our water mitigation division and BRC Restoration Specialists. Our internal divisions have responded well to a series of 6 extreme weather events in the first quarter, 5 of which were tornadoes. While these events could add as much as 8 points to our first quarter 2016 loss ratio as compared to the fourth quarter, the impact would have been substantially higher without our vertically integrated mitigation and construction divisions. We believe their rapid response to these events is a great example of our unique ability to capture losses and reduce claims after a severe weather event.

For 2016, we are focused on streamlining our platform and resources to serve new markets. We are encouraged in North Carolina as we sign on new agents and work with our trusted partner, National General Insurance, to penetrate that market. We are pleased with the progress we are making in North Carolina, which is ahead of schedule. We are also licensed in South Carolina and have been approved in Alabama and Mississippi, and we plan to roll out these states later this year. We intend to hit the ground running with Zephyr, and we are working toward a seamless integration with their team.

I look forward to answering your questions at the end of our prepared remarks, and I'll now turn the call over to Steve Rohde to recap our financial results. Steve?

Stephen L. Rohde
Advisory

Thank you, Bruce, and good morning. Gross premiums written for the fourth quarter were $167.5 million, a decrease of 8% year-over-year. This was made up of approximately $136 million of direct premiums written and $32 million of assumed premiums written. Assumed premiums written experienced a sharp decline in the quarter from $103 million in the fourth quarter of 2014 related to fewer Citizens takeouts, while our direct premiums written grew 72% year-over-year.

Related to our assumed business, we participated in Citizens takeouts during October, November and December, resulting in approximately 22,000 personal residential policies and 500 commercial residential policies assumed. We netted approximately $50 million of annualized premiums from these 3 assumptions. As a reminder, we only record the unearned premium that is transferred from Citizens as assumed written premium.

The opt-out rate during the quarter was 67%, reverting back to the higher opt-out rates we experienced earlier in 2015.

Commercial residential assumption opportunities from Citizens were limited this year as expected. While in the fourth quarter of 2014, we assumed approximately $85 million of commercial residential annualized premium, we assumed only $8 million of annualized premiums during the fourth quarter of 2015. Last year, we disclosed that we did not expect there would be a significant number of commercial residential policies in Citizens that would be attractive to us after such a large assumption during the fourth quarter of 2014, and that has proven to be the case. And the commercial policies that we did assume in the fourth quarter of 2015 were smaller in size with an average premium of approximately $15,000 compared to $35,000 for the average premium for our total commercial residential book of business.

Regarding personal residential, for the full year 2015, we assumed approximately 68,200 policies from Citizens, representing $139 million of annualized premiums from 10 takeouts throughout the year. In 2014, we assumed approximately 57,600 policies from Citizens, representing $120 million of annualized premiums from 7 takeouts throughout the year. In 2014, however, approximately 71% of the policies were assumed in the fourth quarter, while in 2015, the takeouts were spread out more evenly, with only 32% assumed during the fourth quarter.

Our total personal lines policy count increased during the quarter to approximately 254,000 policies, an increase of approximately 16,000 policies from last quarter. Our voluntary personal lines policies increased by almost 3,500 policies during the quarter.

Our total premiums in force at December 31, 2015, were $591 million, an increase of almost 20% from the same quarter 1 year ago and an improvement of 9% from the end of the third quarter. Commercial residential premiums in force were approximately $113 million, an increase of almost $23 million from the end of the third quarter. This level of in-force premium resulted in $143 million of gross premiums earned in the fourth quarter of 2015 compared to $107 million for the fourth quarter of 2014.

Our ceded premium ratio was 32.0% for the fourth quarter of 2015 compared to 23.5% for the fourth quarter of 2014. The increase in the ceded premium ratio was primarily attributable to the inclusion of commercial residential in our 2015 reinsurance program, which has a higher cost of reinsurance, and a smaller amount of premiums assumed from Citizens during the quarter relative to the fourth quarter of 2014, $32 million of assumed premiums written versus $103 million written in 2014.

A good measure of the impact of the fourth quarter Citizens assumptions in the ceded premium ratio is to compare the fourth quarter ratio to the third quarter ratio. The third quarter has the best matching of gross premiums earned and ceded premiums earned due to the timing of the annual renewal of our catastrophe reinsurance program on June 1. The fourth quarter 2015 ceded premium ratio was 3.8 percentage points lower than the third quarter of 2015, while the fourth quarter of 2014 ceded premium ratio was 7.0 percentage points lower, resulting from the larger fourth quarter assumptions in 2014.

Our loss ratio as measured against gross premiums earned was 27.2% for the fourth quarter of 2015 compared to 25.7% for the fourth quarter of 2014. The loss ratio was favorably impacted by the inclusion of commercial residential business but was unfavorably impacted by the increase in frequency of losses reported in personal residential business, primarily water-related claims. Frequency was particularly high in Broward and Miami-Dade counties during the quarter.

Commercial residential continues to perform well, and after 1 year of being in the business, our reported loss ratio for commercial remains in the low single digits.

During the quarter, we increased IBNR, our incurred but not reported reserve, by $6.4 million to $46.9 million. IBNR represented approximately 56% of our total loss reserves at December 31 and accounted for 4.4 points of the loss ratio for the quarter compared to 5.9 points for the fourth quarter of 2014.

Our expense ratio as a percentage of gross earned premiums was 20.3% for the fourth quarter of 2015 compared to 25.1% for the fourth quarter of 2014. The year-over-year improvement in our expense ratio is primarily related to 2 items. The first is the Sunshine State Insurance Company policy acquisition fees that amortized during the fourth quarter of 2014. All the fees associated with SSIC were fully amortized as of June 30, 2015, thus, there was no impact to the fourth quarter 2015 ratio, while it increased the fourth quarter 2014 gross expense ratio by 2.8 points. Second, stock-based compensation accounted for 0.5 points of the expense ratio in the quarter compared to 3.0 points for the fourth quarter of 2014. Also impacting the expense ratios for both the fourth quarter of 2015 and '14 were assumed earned premiums from Citizens takeouts, where there are no acquisition expenses associated with the premium. This improved the Q4 expense ratios for 2015 and 2014 by approximately 2.8 points and 3.0 points, respectively.

Our combined ratio as a percentage of gross premiums earned was 79.5% for the fourth quarter of 2015 compared to 74.3% for the fourth quarter of 2014. There are several items I have previously mentioned in the ceded premium expense ratios that resulted in about 3.7 point unfavorable net impact on the combined ratio. The most significant was the impact of the larger Citizens assumptions during the fourth quarter of 2014. In addition, we had approximately 1.5 points unfavorable result from our loss experienced when compared to the fourth quarter of 2014. Our fourth quarter combined ratio of 79.5%, when adjusted for the timing benefits of Citizens assumptions, resulted in an underlying combined ratio of approximately 86%, 1 point higher than the guidance we have given in the past of an expected combined ratio on a gross basis of 85% in years which we have no hurricanes.

Net income for the fourth quarter of 2015 was $20.2 million compared to $19.7 million for the fourth quarter of 2014. Net income for the full year 2015 was $92.5 million compared to $47.1 million for 2014.

On the balance sheet side, stockholders' equity increased to approximately $357 million compared to $255 million at December 31 of 2014, an increase of approximately 40%. Statutory surplus in our insurance company subsidiary at December 31 was approximately $216 million. Our invested assets at December 31 were $400 million, with approximately $364 million invested in bonds with an average credit quality of A and a duration of approximately 4.1 years. Our cash position increased to $235 million in anticipation of the closing of our acquisition of Zephyr Insurance Company as well as reinsurance payments due in the first quarter. Our total assets were $837 million at December 31. We reported a solid quarter and year and believe we are well positioned as we enter 2016.
And with that, Bruce and I are now available to take your questions.

Question and Answer

Operator

[Operator Instructions] The first question we have will come from Mark Hughes of SunTrust.

Kevin Alloway
SunTrust Robinson Humphrey, Inc., Research Division

This is actually Kevin Alloway on for Mark Hughes today. You mentioned that you're enthusiastic about your North Carolina production so far. Is that -- can you give more color on that, if you could, please? Is it your distribution? Is it pricing? And then some future trajectory of this?

Bruce Lucas
Chairman of the Board & CEO

Yes. This is Bruce Lucas. We just rolled out the North Carolina program in early to mid-February. We beta-tested our system with a handful of agents. And as of the end of February, we had just signed up over 100 agents, with probably 150 to 200 more to go. We wrote approximately 100 policies in the month. We were expecting to write about 10 to 20. We are definitely seeing an increase in quoting activity and an increase in bound policies on a daily basis as we continue to roll out the North Carolina initiatives. And we are excited about where we are on that front. We think there's a huge market opportunity there, particularly as it relates to our partnership with National General Insurance. Just for your ratification, National General has a large auto book of business in North Carolina of approximately $300 million in annualized premium. They do not have a companion homeowner product to go with the auto policies, and that's something that we stepped in at Heritage and worked with them to solve. And we are their exclusive homeowners carrier in the state. So we're very excited about the opportunity that cross-selling and increased retention can bring to the table with this partnership.

Kevin Alloway
SunTrust Robinson Humphrey, Inc., Research Division

Okay, great. And then at this one, I know you're not really in other states yet, the ones you're looking at, but do you have any, I guess, outlook on some good prospects with those that you're hoping to enter by the end of the year? Anything in particular?

Bruce Lucas
Chairman of the Board & CEO

Yes. Definitely, the next state that we'll roll out is South Carolina, and we already have a ground game in the process there as well. We're finalizing forms and rates with the South Carolina Department of Insurance. We're looking for a rollout there probably in the next 90 days or so. After that, we'll move to some of the Gulf Coast states where we've been approved, mainly Mississippi and Alabama. And we are also pending right now in Georgia and Massachusetts.

Kevin Alloway
SunTrust Robinson Humphrey, Inc., Research Division

Okay, great. And then one more, if I can. Talking about the strong growth as far as commercial residential, I guess, can you just give a little more color on that, why it's ticking up? What do you think are the prospects there for the rest of the quarter, rest of the year?

Bruce Lucas
Chairman of the Board & CEO

Yes. So commercial residential has definitely been increasing for us. We came into the market originally, if you go back to the IPO days, we saw this great opportunity of Citizens to do what we thought was mainly a onetime opportunity to de-pop post-IPO in the fourth quarter. We did that. We've had some success in taking policies there. There isn't a lot left in Citizens in terms of commercial residential that are attractive to us. We've said that since day 1. It's mainly a onetime opportunity there. But we've been building up our commercial residential division. We have easily the deepest bench in the state of Florida. We have approximately 15 people in that division. We are very active now on quoting. We've had some time to get through growing pains, make sure the system works appropriately, understand the market and where our reinsurance structures fall into place. So we have seen a large increase in our commercial residential voluntary premium. It is well ahead of our internal expectations. It's something that we're very proud of. We're running right now an attritional loss ratio there of less than 5%, so it's a very profitable business for the company. And we're excited about the growth prospects that commercial residential affords.

Stephen L. Rohde
Advisory

This is Steve Rohde. For the first quarter of 2016 through February, we had an additional close to $13 million of premium as well.

Operator

Next, we have John Barnidge of Sandler O'Neill.

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

I have a few questions here, just housekeeping. You said 8 points on the loss ratio from those events you had cited that have already occurred in the first quarter. Did you say that was 8 points as compared to the fourth quarter of 2015 or as compared to the first quarter of 2015? And is that on a gross premium earned basis or net premium earned basis?

Stephen L. Rohde
Advisory

That would be on a gross premium earned basis, and that was compared to the fourth quarter of 2015.

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

Okay. So that would put you at around a 35% gross loss ratio, which is the highest since you've gone public. Am I correct in thinking that?

Stephen L. Rohde
Advisory

That's -- right now, that's what we're thinking.

Bruce Lucas
Chairman of the Board & CEO

Yes. We've had -- and just so you know, John, we have had 5 tornado events in the first quarter, and then we had another severe rain event that took place for several days down in South Florida. The weather in the first quarter has been not the greatest. It's probably an impact of El Niño. I'm sure that every other insurance carrier in the state of Florida is going to experience the exact same results.

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

So then would you anticipate disclosing the catastrophe losses then when you report?

Bruce Lucas
Chairman of the Board & CEO

No, I don't think so because they would go beneath our retentions.

Stephen L. Rohde

Advisory

Yes. These are more -- we're calling them weather-related claims at this point. Through February, it amounted to about 10% of our loss ratio. And in the fourth quarter, it was a little over 2%. So that's kind of, again, the guidance we've given at this point. And these aren't fully developed yet. We're still getting claims reported and so forth. So I'm not sure what the rest of the quarter is going to look like.

Bruce Lucas
Chairman of the Board & CEO

Yes, one thing that's been great from this, John, is that we've been able to really test BRC and get them out to the disaster sites quickly, tarping roofs, signing up homeowners, doing repair work. No doubt, that type of effort will help to mitigate the losses that we experienced versus our peer group. So we're excited to actually be able to take that asset and deploy them after some severe weather events with great success.

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

Okay. And then as we think about the ceded premium ratio prospectively, do you think it'll be closer to, say, 32% that you reported in the fourth quarter on an ongoing basis? Or how should we think about that?

Stephen L. Rohde
Advisory

Yes, I would think it would be -- when we renew our reinsurance program, it will be in the mid -- like mid-33% range. And in the second quarter, I think we'll see some -- I think it would be in that -- and again, kind of similar to what it was for the first quarter of this year.

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

So which was about 20%?

Stephen L. Rohde
Advisory

No. The premium ratio?

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

Yes, you're talking about 33%? Or the first quarter of last year?

Stephen L. Rohde
Advisory

No. The first quarter of this year, so about 32% for the second quarter and going up a little bit to third quarter when we increase our -- or buy our new reinsurance program.

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

Okay. And as we think about your expense ratio, as you build out more states, where do you think that would settle in? And then also, you -- one of your great selling points, as you mentioned, Bruce, was BRC, your vertical integration on claims process. How do you see that developing as you expand out of state, just given the fragmentation in the contractor market?

Bruce Lucas
Chairman of the Board & CEO

Yes, I think as we go out of state, John, the #1 thing that we need to look at is policy concentration if we're going to internally scale that model outside of Florida. So you need to have a certain policy concentration in one geography in order to justify having the vertically integrated services. Until we reach that threshold, that saturation threshold, so to speak, what we need to do is rely on third-party vendors that go through our Contractors' Alliance Network. When those vendors go through CAN, we're able to sign them up, use standardized pricing and get a 10% discount on the work that they perform there. That's what we did early on in the history of the company, and until we acquired BRC last year, that's what we did on billback in the state of Florida, which worked very well. We'll continue with that model outside of the state. Once we hit a large enough policy concentration, we can look to them, go ahead and deploy some resources in those areas so that we have true vertical integration in new markets.

Stephen L. Rohde
Advisory

And regarding the expense ratio, John, I see our expense ratio on a go-forward basis with no benefit of takeouts being about a 23% expense ratio, of which about 14 points would be on the policy acquisition and about 9 points on G&A expenses.

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

And my last question would be M&A has clearly been a part of your strategy for growth prospectively. You have Zephyr that you're going to be closing this quarter. How do you think of M&A going forward as you digest Zephyr?

Bruce Lucas
Chairman of the Board & CEO

Yes, we are definitely still involved in some M&A opportunities. We're going to be selective about the companies that we acquire. Not all of them are going to meet our profile. And it's an issue of, are you getting proper reinsurance synergies? Do they have a good management team? What does the profile of that company look like? How can we scale their operations and increase their top and bottom line? Those are all things that, at the end of the day, probably knock out 90% of the companies that you look at. We're not just going to spend money on M&A just to do it. It has to make sense and be strategic for us. There are opportunities out there in the market. We continue to evaluate them. I think where we are right now, between now and say, storm season, we are focused on locking in our probable maximum loss, locking in our reinsurance ratios and treaties. If we'd look to do another M&A transaction, that transaction will probably be something that closes at the end of wind season into the first quarter of next year. That would be an deal time line for us.

Operator

The next question we have comes from Arash Soleimani of KBW.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Can you -- I don't think I understood before, you said that 8 points of weather losses, that was in the fourth quarter or year-to-date in the first quarter?

Bruce Lucas
Chairman of the Board & CEO

Primarily, it's first quarter loss ratio, we think, will increase as much as 8%. We haven't had -- it's not fully developed yet. We're just giving an estimate through the end of the quarter. But these are events that happened in the first quarter of this year.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And can you talk about the fourth quarter? Because the loss ratio did increase year-over-year in the fourth quarter, and in the press release, you said there was higher frequency. So can you just give a bit more detail around what happened there?

Stephen L. Rohde
Advisory

Sure. Our frequency of losses for personal lines was 5.3% in the fourth quarter of 2015. And that compared to 3.6% in the fourth quarter of 2014, so a significant jump there. And the -- and severity was very close, pretty much unchanged from 1 quarter to the next, both around $10,600. Frequency in -- particularly in Broward and Miami-Dade counties were particularly high in the fourth quarter. Miami-Dade was a little over 9%, and Broward was 8.3%. And so that's where we've really seen -- saw the uptick, in particular...

Bruce Lucas
Chairman of the Board & CEO

We did have -- Arash, it's Bruce. We did have a severe rain event in the fourth quarter in Southeast Florida that lasted several days that caused a lot of claims. Some of those claims are coming in now in the first quarter, and they're included in these 6 extreme weather events. But a portion of those claims also came in, in the fourth quarter as well. So that helps to explain some of the uptick there.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. So was any of this -- was it mostly rain claims? Or were there kind of -- was it just water claims in general? Or -- you know what I mean, was it something specific?

Stephen L. Rohde
Advisory

Yes. If you look at the -- our loss ratio for water claims, excluding water coming through the roof, which we put those into the weather-related claims, the loss ratio quarter-over-quarter increased about 3.5% -- percentage points from water and about 1.5 from weather events.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. So it seems like the water loss is not from weather, or I guess the bigger culprit. So is that something that would be attributable to assignment of benefits? Or is that not related to this uptick?

Bruce Lucas
Chairman of the Board & CEO

I think there's definitely a correlation to assignment of benefits. I mean, there is no doubt that in the state of Florida, every homeowners company is being hit with assignment of benefit fraud. That's something that, as a company, we identified back in 2012 before it was even a problem. Our entire business plan since inception 4 years ago was designed to combat what we thought would be a growing assignment of benefit problem in the state. That's why we went out early and acquired our own internal water division. That's why we acquired BRC. We've been way ahead of the curve on that. But there's no doubt that if the legislature does not take action, you're going to see an increase in AOB. That's why we're really watching what we're taking down in Tri-County. We're credit scoring our book of business on the voluntary front. No doubt that -- what we call it insurance scores here, to be clear, no doubt that there is a correlation between better insurance scores and lower loss ratios. So we're very diligent on what we're taking there. We use predictive AOP modeling on all of our Citizens assumptions, so we're very careful what we take out of Citizens from the Tri-County area. But it is a growing problem down there, and in fact, it's a growing problem throughout the state. I do feel like we're handling it probably better than anyone else because of the vertical integration of our water mitigation contractors and claims department.

Arash Soleimani

Keefe, Bruyette, & Woods, Inc., Research Division

And I know a couple of your competitors have reported already, so I think there was some loss ratio pressure there as well, but it seemed like you had a bit more. Is that, you think, attributable to Citizens, Citizens policies specifically? Or does geographic mix -- I'm just trying to kind of get a sense of what in your book specifically was more pronounced.

Stephen L. Rohde
Advisory

Yes, looking at -- all regions were up generally year-over-year, but it was more pronounced in the Tri-County. But we're seeing upticks all over. However, our best area, Pinellas County -- or counties, Pinellas Counties, it performs very well, has the loss ratio in the teens. But last year, in the fourth quarter, it had an 8% loss ratio. This year, it was 16%. But a 16% loss ratio is extremely good, but it had an unusually low loss ratio in the fourth quarter of 2014. So I think we had an extremely good fourth quarter of 2014. And then also, the impact of the -- as Bruce mentioned, the AOB and so forth had some pressure on it. I think -- and overall, it looks like our loss ratio is about 3 points higher than -- for 2015 compared to 2014. If you look at it quarter-by-quarter, it's about a 3 percentage point difference quarter-over-quarter, and it's pretty consistent. Just in the third quarter, weather-related claims seemed to overshadow our water losses, and this time, the water losses overshadowed the weather-related claims.

Bruce Lucas
Chairman of the Board & CEO

Yes. And Arash, I mean, our historical numbers, when we look at loss ratios by Citizens assumptions and voluntary policies, actually, we've been performing pretty much the same across the board, voluntary or Citizens assumptions. And I think that's a real testament to the way we underwrite policies on the front end. We use predictive modeling for the AOP loss ratio. We're winning the worst of the worst policies of Citizens. We're not going to denigrate that underwriting. And we've got pretty sound underwriting on the front end as well, especially now that we're credit scoring -- or insurance scoring the book of business.

Stephen L. Rohde
Advisory

One thing we had seen, I think, is also impacting this somewhat on the frequency is there's an increased lag in reporting of claims now that we're seeing. I think it goes back to AOB issue. For the last 4 quarters, our average reported lag time was 28 days. And in 2014, it was 17.5 days. So there's been a significant lag in reporting of late claims.

Bruce Lucas
Chairman of the Board & CEO

And I do think, Arash, in terms of rate environment in the state, I think that homeowners premium rates are going higher. There's no doubt in my mind that that's happening. I know Citizens came out and told the public yesterday that they anticipate 10% rate increases across their book every year for the foreseeable future. We do monitor what our competitors are doing in the states in terms of their rate filing activity, and everybody is taking rates. Some companies are taking double-digit rate. But I think the average of the last batch of, say, 25 companies that we follow, the average rate increase was somewhere around 7%. So rates are going higher as claim activity goes higher, and we make it back in the higher premiums.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

So would you -- and for Heritage specifically, for 2016, do you anticipate putting through rate increases in your book? And if so, how would, I guess, Tri-County compare to the state overall?

Bruce Lucas
Chairman of the Board & CEO

Yes, we are anticipating rate increases. We recently went live with our voluntary rate filing, and that happened in February. Overall, that was about a 4% increase statewide. It was a double-digit increase in a lot of the areas in Tri-County. And then we had other areas of the state like Pinellas County where we took a double-digit rate decrease. So we are pricing the book of business to go along with the increased risk just like everybody else in the market is doing. And so if we're going to take a policy in Tri-County, it's going to have a higher rate attached to it, and we are insurance scoring that book of business so we know we're getting better risks. And when it comes to areas where we have better loss ratios such as Pinellas County, we're giving big decreases and shifting the concentration of the book of business more toward the West Coast. And if we're going to take in Tri-County, it's going to have a good insurance score and it's going to have a higher premium.

Stephen L. Rohde
Advisory

And right now, we're in the process of working on our takeout filing. We have 2 separate rating plans, one for our voluntary business and one for the policies that we assumed from Citizens. We will be filing that by the end of March. And we're just starting to work on it right now, but we would expect there will be a rate increase associated with that.

Bruce Lucas
Chairman of the Board & CEO

That's right.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

So the 4% overall rate increase for the state, was that on the Citizens side, the non-Citizens side or for everything?

Bruce Lucas
Chairman of the Board & CEO

That was for the voluntary production. And then our Citizens rate filing, as Steve mentioned, that is in progress right now, so we don't have any filing that's been publicly made with OIR. We're still doing the actuarial analysis. But I do anticipate a fairly substantial rate increase on that book of business.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And given the -- I guess, the losses and the AOB frequency issues we've seen, I think in the past, you've, I think, guided to sort of an 85% run rate on the combined ratio, assuming those Citizens subsidies. Is that something that you still think you can hit? Or do you think that now that we should assume that target's a bit higher?

Stephen L. Rohde
Advisory

I think the 85% is still a reasonable target for us. Like this quarter, if you take out the timing benefits, it was an 86% combined ratio. Look, first quarter, obviously, will be higher than that, but I think second quarter and beyond, I think an 85% is still a reasonable target for us.

Bruce Lucas
Chairman of the Board & CEO

Yes, I would agree with that. In fact, we've had -- it's weird, in the El Niño year, you're definitely getting a lower frequency of Atlantic based and cat activity, so that's very helpful for us for obvious reasons. But we've also seen more kind of one-off extreme weather here in the state. We had a 101[ph] rain event over the summer. That contributed to the loss ratio in 2015. We've had a lot of tornado activity in the first quarter. To give you an example of how rare and how unique this tornado activity is, since our inception through the fourth quarter of 2015, we only paid out about $120,000 in tornado claims, right? And then from first quarter, we get hit with 5 tornadoes. So...

Stephen L. Rohde
Advisory

We have over $4 million in those claims at this point.

Bruce Lucas
Chairman of the Board & CEO

It's really just about $4 million so far. So it is a -- it definitely is a one-off event, and that just happens sometimes, you have odd weather. I would certainly expect every other insurance carrier to be reporting similar results.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Right. And so you mentioned Citizens put out that report last night, and I think they used the term that the losses are at crisis levels due to AOB. So my question is, I saw you guys did a decent number of takeouts also in the first quarter, and it seems you still have an appetite. I guess my question would be what's driving that appetite if Citizens seems to be struggling a lot with the policies that it has?

Bruce Lucas
Chairman of the Board & CEO

Well, Arash, a couple of things to note here. We have said now for the past, I don't know, over a year, that our focus is on new business coming into Citizens. New business comes in at an uncapped rate. So when Citizens talks about their policies, particularly in the Tri-County, and the need for large rate increases there, a lot of those policies have a rate capping mechanism on them because they can only raise their rates there 10% a year. And so if a policy has been there for 5 years, it could be massively underpriced versus the market. We don't look at those policies. We are primarily focused on new business coming in because it comes with that a higher rate, it's got newer underwriting attached to it. And we look at the predictive modeling that we use for AOP loss ratios, and it has been pretty accurate for us since we started this years ago. And those are the policies that we're really looking at. We are looking at the creme de la creme policies that are going into Citizens. A lot of these policies are coming in from State Farm and Allstate and other captive writers. And they're -- it's very good premium, but if you're a State Farm customer, you have 2 choices, you can either take a homeowners product from State Farm. If their belly is full in terms of their concentration in Florida, it automatically goes into Citizens. And so we look at those policies in particular as really good customers, very well underwritten. Loss ratios have performed quite well on them. Those are the things that we're looking at. And we shifted that business plan over a year ago to do smaller, more frequent takeouts to mine new business activity as it comes in the front door. That's why you get some kind of odd-looking stats such as fourth quarter, our premium decreased 8% year-over-year. Well, that makes sense because we did our large takeout in September, not -- and that's in the third quarter and then compared to 2014 in the fourth quarter. And we actually netted more policies from Citizens throughout the year in 2015 than we did in 2014. So we actually grew the number of assumptions we did. And I think the other kind of glaring thing as to why you saw a slight decrease in the fourth quarter year-over-year was because we took a large commercial residential assumption in the fourth quarter of '14, which we told everyone was essentially a onetime opportunity. So overall, I think that we've done a really good job of identifying the market conditions in advance, being ahead of the curve, executing on the business plan, being nimble. And it's produced phenomenal results, and you see it in the increase in net operating income year-over-year, it's up 96%. So we're pretty proud of the results we have. We're going to be very focused on what we do in terms of new business activity in Tri-County, as mentioned, what we do on the takeout side. But what we've been doing has been working.

Stephen L. Rohde
Advisory

And the loss ratio on assumed business -- so the assumed losses against assumed earned premium for the quarter, that was about a 26% loss ratio. So the assumed business had actually a slightly lower loss ratio than policies that are renewed under our paper as well as the voluntary. So the recent assumptions, there's been no deterioration on loss ratio from those policies.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And I think commercial residential is 19% of your earned -- or your annualized policies -- premiums in force as of the end of the fourth quarter. How should we expect that to trend through 2016?

Stephen L. Rohde
Advisory

Well, let me grab my...

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Is that being stable? Or should we...

Bruce Lucas
Chairman of the Board & CEO

Look to the top line. Are you asking for top line growth in that sector? Is that what you're looking for?

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Well, I guess, I'm more just looking for the mix of business. So I think, right now, you have 19% of your premiums in force are from commercial residential. I just wanted to know if that's something that will increase or if that will stay stable around 19% or 20%.

Bruce Lucas
Chairman of the Board & CEO

I think around 20% is a good stable number for now because we're setting our PMLs right now for wind season. So we had great opportunities in the fourth quarter, and we had record production in the fourth quarter. And January was a record month for us compared to any other month we've done. So we've done a great job of identifying those market opportunities, getting them at very attractive combined ratios. They have larger TIVs to them. The AOP is extremely small. And so we're in the mode now in March as we sit here. Wind season is in 3 months, and we're trying to lock in our reinsurance towers. So we're going to be selective on what we take between now and the end of wind season to mitigate risk, keep our reinsurance costs low, protect the franchise, et cetera. And then we'll look in the fourth quarter to continue to increase production as more opportunities come online. And that's the big renewal season this fourth quarter. [indiscernible]

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And that commercial residential loss ratio, you said it was, I think, around 5% or low single digits. Is that -- what's the loss ratio when you include IBNR? Try to think on a GAAP basis.

Stephen L. Rohde
Advisory

It's about 5%, maybe slightly higher than 5%.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

You mean on a GAAP basis? Okay.

Bruce Lucas
Chairman of the Board & CEO

Yes.

Stephen L. Rohde
Advisory

[indiscernible] it's in the 5% range.

Bruce Lucas
Chairman of the Board & CEO

And that is -- just to put that in context, Arash, that is half of what we projected when we launched this line of business at the IPO.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then the last 2 questions. One, can you just remind us what -- I think you may have said this, prior period reserve development was in the fourth quarter? And then second, just what percentage of your personal residential policies are wind-only?

Stephen L. Rohde
Advisory

Regarding wind-only...

Bruce Lucas
Chairman of the Board & CEO

Kind of small.

Stephen L. Rohde
Advisory

It's small. I have the numbers here. It's about 11 8.

Bruce Lucas
Chairman of the Board & CEO

Bear with us here, we have to manually calculate that.

Stephen L. Rohde
Advisory

18,000 -- 19,000 plus -- about 19,000 policies out of our 250,000.

Bruce Lucas
Chairman of the Board & CEO

Thousand...

Stephen L. Rohde
Advisory

Thousand personal lines policies.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then the prior period development in the fourth quarter?

Stephen L. Rohde

Advisory

I don't have the information at hand right now. I know for the year, we had favorable development of $5.3 million from prior year at the end of this year. But on a quarterly basis...

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

$5.3 million favorable for the whole year, you said?

Stephen L. Rohde
Advisory

Yes.

Bruce Lucas
Chairman of the Board & CEO

Yes. And Arash, in terms of percentage, wind-only, it's approximately 7% of our overall policy count.

Arash Soleimani
Keefe, Bruyette, & Woods, Inc., Research Division

So including everything, you're saying, whether it's personal, commercial, so it's 7% of everything? Okay.

Stephen L. Rohde
Advisory

That's net personal line.

Bruce Lucas
Chairman of the Board & CEO

Yes, we don't have wind-only coverage on commercial residential.

Operator

And our last question will come from Matt Carletti of JMP Securities.

Matthew John Carletti
JMP Securities LLC, Research Division

Just had a couple of questions. One, to follow up on the frequency in the quarter, particularly in Broward and Dade. When you take out weather and look at the non-weather frequency, have you seen a change as we've gotten into Q1 now that were 2/3 of the way through the quarter? Has it gotten better, worse or unchanged?

Stephen L. Rohde
Advisory

It is unchanged.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. And then just a numbers question, if you happen to have it. But do you have what assumed premiums were in 2015 for the first 3 quarters? And if not, I can follow up off-line.

Stephen L. Rohde
Advisory

Assumed premiums earned for the...

Matthew John Carletti

JMP Securities LLC, Research Division

The first 3 quarters of '15.

Stephen L. Rohde
Advisory

Yes. They were -- '15, the first quarter was -- this is written. Written or earned?

Matthew John Carletti
JMP Securities LLC, Research Division

Written is fine.

Stephen L. Rohde
Advisory

Written is fine. Okay. $32.5 million for quarter 1, $800,000 for quarter 2, $33.1 million for quarter 3 and $32 million for quarter 4.

Operator

Well, this concludes the question-and-answer portion of the call. I would now like to turn the conference call back over to Mr. Bruce Lucas for any closing remarks. Sir?

Bruce Lucas
Chairman of the Board & CEO

I would just like to thank everyone for participating in our fourth quarter 2015 and full year conference call.

Operator
And we thank you, sir, and to the rest of the management team for your time also today. The conference call is now concluded. At this time, you may disconnect your lines. Thank you, take care, and have a great day, everyone.