UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Year Ended December 31, 2019

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 001-36462

Heritage Insurance Holdings, Inc.

Delaware	**45-5338504**
(STATE OF INCORPORATION)	(I.R.S. ID)

2600 McCormick Drive, Suite 300, Clearwater, Florida 33759
(727) 362-7200

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Trading Symbol(s)	Name of Each Exchange on Which Registered
Common Stock, par value $0.0001 per share	**HRTG**	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

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

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 ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

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

Large accelerated filer	☐	Accelerated filer	☒
Non-accelerated filer	☐	Smaller reporting company	☐
Emerging growth company	☐		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The aggregate market value of the Registrant's common stock held by non-affiliates was $398,540,308 on June 30, 2019, computed on the basis on the closing sale price of the Registrant's common stock on the New York Stock Exchange on that date.

As of March 9, 2020, the number of shares outstanding of the Registrant's common stock was 28,926,048.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for its Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K, provided that if such Proxy Statement is not filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year covered by this Form 10-K, an amendment to this Form 10-K shall be filed no later than the end of such 120-day period.

HERITAGE INSURANCE HOLDINGS, INC.
FORM 10-K
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2019

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FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the federal securities laws. These forward-looking statements include, but are not limited to, statements regarding: our core strategy and ability to fully execute our business plan; our growth, including by geographic expansion, new lines of business, additional policies and new products and services, competitive strengths, proprietary capabilities, processes and technology, results of operations and liquidity; statements concerning projections, predictions, expectations, estimates or forecasts as to our business, financial and operational results and future economic performance; management's efforts; statements of management's goals and objectives, including intentions to pursue certain business and handling of certain claims; projections of revenue, earnings, capital structure, reserves and other financial items; assumptions underlying our critical accounting policies and estimates; assumptions underlying statements regarding us and our business; and other similar expressions concerning matters that are not historical facts. These forward-looking statements are subject to risks and uncertainties that could cause actual results and events to differ. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included throughout this filing and particularly in Item 1A: "Risk Factors" and Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" set forth in this Annual Report on Form 10-K. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to revise or publicly release any revision to any such forward-looking statement, except as may otherwise be required by law.

These statements are based on current expectations, estimates and projections about the industry and market in which we operate, and management's beliefs and assumptions. Without limiting the generality of the foregoing, words such as "may," "will," "expect," "believe," "anticipate," "intend," "could," "would," "estimate," or "continue" or the negative variations thereof or comparable terminology are intended to identify forward-looking statements. Forward-looking statements are not guarantees of future performance and involve certain known and unknown risks and uncertainties that could cause actual results to differ materially from those expressed or implied by such statements. The risks and uncertainties include, without limitation:

- the possibility that actual losses may exceed reserves;
- our exposure to catastrophic weather events, which are more pronounced because the concentration of our business in coastal states;
- inherent uncertainty of our models and our reliance on such model as a tool to evaluate risk;
- our failure to accurately price the risks we underwrite;
- the fluctuation in our results of operations;
- increased costs of reinsurance, non-availability of reinsurance, and non-collectability of reinsurance;
- increased competition, competitive pressures, and market conditions;
- our failure to identify suitable acquisition candidates;
- effectively manage our growth and integrate acquired companies;
- our failure to execute our diversification strategy;
- our reliance on independent agents to write or renew insurance policies;
- the failure of our claims department to effectively manage or remediate claims;
- the failure of our risk mitigation strategies or loss limitation methods;
- low renewal rates and failure of such renewals to meet our expectations;
- our inability to maintain our financial stability rating;
- failure of our information technology systems and unsuccessful development and implementation of new technologies;
- a lack of redundancy in our operations;
- the ability of our subsidiaries to generate and transfer funds;
- our failure to attract and retain qualified employees and independent agents or our loss of key personnel;
- our inability to generate investment income;
- effects of emerging claim and coverage issues relating to legal, judicial, environmental and social conditions;

- changes in regulations and our failure to meet increased regulatory requirements;
- the regulation of our insurance operations; and
- certain characteristics of our common stock.

Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or operating results. The forward-looking statements speak only as of the date on which they are made, and, except as required by law, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrences of anticipated events. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in the forward-looking statements. Consequently, you should not place undue reliance on forward-looking statements.

PART I

Item 1. Business

Our Business

Established in 2012, Heritage Insurance Holdings, Inc., (“we”, “our”, “us” and “Heritage Insurance”) is a super-regional property and casualty insurance holding company that primarily provides personal and commercial residential insurance through our insurance company subsidiaries (see Part II, Item 8, Note 25, "Geographical Information" for a breakdown of our in-force premiums and policies by state). We are vertically integrated and control or manage substantially all aspects of insurance underwriting, customer service, actuarial analysis, distribution and claims processing and adjusting. We are led by an experienced senior management team with an average of 25 years of insurance industry experience.

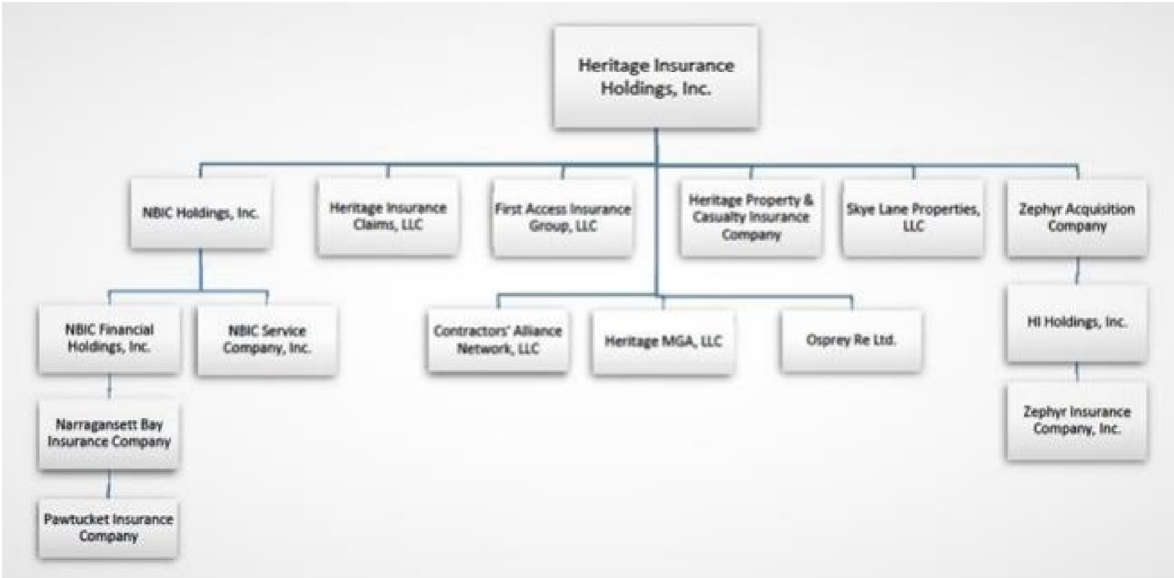
Our financial strength ratings are important to the Company in establishing our competitive position and can impact our ability to write policies. We are rated by both Demotech, Inc. (“Demotech”) and Kroll Bond Rating Agency (“KBRA”). Demotech, a rating agency specializing in evaluating the financial stability of insurers, maintains a letter-scale financial stability rating system (“FSR”) from A’’ (A double prime) to L (licensed by insurance regulatory authorities). KBRA’s ratings assigned to insurance companies ranges from AAA (extremely strong operations to no risk) to R (operating under regulatory supervision).

Demotech and KBRA have assigned the following insurance financial strength ratings (“IFSR”) to our key operating subsidiaries. Additionally, KBRA has assigned an investment grade issuer rating to us. The outlook for all ratings is stable.

Subsidiary	Demotech Rating	KBRA Rating	KBRA Investment Rating
Heritage P&C	A	BBB+	N/A
Zephyr	A'	BBB+	N/A
NBIC	A	A-	N/A
Heritage Insurance	N/A	N/A	BBB-

Our operating subsidiaries include: Heritage Property & Casualty Insurance Company (“Heritage P&C”), which provides personal and commercial residential property insurance as well as an artisan contractor (commercial general liability) insurance; Narragansett Bay Insurance Company (“NBIC”), which provides personal and commercial residential property insurance; Zephyr Insurance Company (“Zephyr”), which provides personal and commercial residential property insurance; Zephyr, which provides residential wind-only property and multi-peril property insurance within the State of Hawaii; Osprey Re Ltd. (“Osprey”), our captive reinsurance subsidiary that may provide a portion of the reinsurance protection purchased by our insurance subsidiaries; Heritage MGA, LLC, our managing general agent; NBIC Service Company, which provides services to NBIC; Contractors’ Alliance Network, LLC (“CAN”), our vendor network manager for claims and provider of restoration, emergency and recovery services; Skye Lane Properties, LLC, our property management subsidiary; and First Access Insurance Group, LLC, our retail agency and reinsurance intermediary.

The following chart depicts our organizational structure:



Our Company

Our primary products are personal and commercial residential property insurance. As of December 31, 2019, our personal residential products were offered in twelve states and our commercial residential products were offered in two of those states, Florida and New Jersey (see Part II, Item 8, Note 25, "Geographical Information" for a breakdown of our in-force premiums and policies by state). Additionally, Heritage P&C, is authorized in Alabama, Delaware, Maryland and Pennsylvania, but has not commenced writing business in those states as of December 31, 2019.

We conduct our operations under one business segment.

As of December 31, 2019, we had 522,442 personal residential policies in force, representing $861.2 million of annualized premium, 2,533 commercial residential policies in force, representing $73.2 million of annualized premium, and 6,970 commercial general liability policies in force, representing $6.2 million of annualized premium, for a total number of policies and annualized premium of 531,945 and $940.6 million, respectively. For the years ended December 31, 2019, 2018 and 2017, we had gross premiums written of $937.9 million, $923.3 million, and $625.6 million, respectively and operating income of $49.6 million, $69.5 million, and $49.5 million respectively. At December 31, 2019 and 2018, we had total assets of $1.9 billion and $1.8 billion, respectively, and total stockholders' equity of $448.8 million and $425.3 million, respectively.

Our Strategy

Our strategy is to grow and geographically diversify our property insurance operations to achieve consistent positive results for our shareholders, while mitigating risk from a single or series of catastrophic weather events. We believe this diversification also increases our supply of risk transfer partners and optimizes reinsurance pricing. We began insurance operations in Florida through selective assumptions of business from Citizens Property Insurance Corporation ("Citizens"), Florida's governmental insurer of last resort, following which we added voluntary distribution and, through a combination of mergers and acquisitions as well as organic growth, expanded into additional states. We have also added commercial residential and artisan contractor (commercial general liability) insurance to our product portfolio. We intend to continue to grow profitably by undertaking the following:

Improve the Profitability of our Florida Portfolio

While we have significantly expanded our Florida marketing efforts exclusive of South Florida, our goal is to improve the profitability of our Florida personal lines business through disciplined underwriting. Due largely to high property insurance litigation rates in Florida, claim frequency and severity for certain perils has increased over the last several years. We have taken underwriting and rate actions to improve the profitability of our Florida business. Our total insured value for personal lines business in Dade and Broward counties decreased by 32.2% from 2017-2019.

Optimize Our Reinsurance Program

We continue to strategically evaluate our reinsurance program to obtain what we believe to be the most appropriate levels and sources of reinsurance. Our reinsurance program includes excess loss, quota share, per risk and facultative coverage. We believe there is sufficient capital to support our reinsurance program and that we have an opportunity to obtain favorable pricing and contract terms and conditions, including multi-year commitments on our catastrophe bond program. We entered into fully collateralized multi-year catastrophe reinsurance agreements funded through the issuance of catastrophe bonds by Citrus Re in years 2014, 2015, 2016, and 2017. We will continue to evaluate cost-efficient alternatives to traditional reinsurance. Each year we evaluate whether to meet a portion of our reinsurance needs through the use of our reinsurance subsidiary, Osprey, which helps to manage our reinsurance expense and reduces our reliance on third-party reinsurance. Osprey Re did not absorb any losses from Hurricane Irma because we used third party reinsurers to cover catastrophe losses beyond the insurance companies' retentions for the 2017 hurricane season. During 2019 and 2018, Osprey Re absorbed approximately $16 million and $20 million, respectively, of combined losses from catastrophic and non-catastrophic weather related events.

Efficiently Manage Losses and Loss Adjustment Expenses

We are committed to proactively managing our loss costs through prudent underwriting and in-source critical aspects of claims adjusting and repair services. While CAN's initial operations were in Florida only, it has expanded to our northeastern and southeastern states and Hawaii. We have additional contracted claims adjusting and loss mitigation resources in all states in which we conduct business and have deployed those additional resources as needed after catastrophic events. We believe our significant internal and external resources allow us to deliver timely service to our policyholders and better manage claims costs.

Develop IT Solutions to More Effectively Service our Customers

We continuously work to enhance our technology in order to better serve our agents and policyholders, streamline our processes, and improve efficiency.

Our Competitive Strengths

We believe that our growth to date and our ability to capitalize on our future growth prospects are a result of the following competitive strengths of our business:

Experienced Management Team With a Long History in the Residential Property Insurance Market

We have an experienced executive management team led by Bruce Lucas, Chairman and Chief Executive Officer, Richard Widdicombe, President, Kirk Lusk, Chief Financial Officer and Ernesto Garateix, Chief Operating Officer. Our senior management team includes twelve insurance professionals, with 25 years of average insurance industry experience and longstanding relationships with key industry participants.

Strong, Conservative Capital Structure

As of December 31, 2019, we had stockholders' equity of $448.8 million and Heritage P&C, NBIC, and Zephyr, had policyholder surplus, as defined by statutory accounting principles, of $158.6 million, $102.2 million, and $86.8 million, respectively. The surplus for each of our insurance subsidiaries is in excess of the minimum capital levels required by our insurance regulators and Demotech.

Selective Underwriting and Policy Acquisition Criteria

We believe our proprietary data analytics capabilities and underwriting processes allow us to make better risk selections leading to profitability and high levels of policy retention. Our data analytics are embedded in the underwriting process and are used for strategic expansion into new product lines and states.

Unique Claims Servicing Model and Superior Customer Service

We believe that the vertical integration of our claims adjusting, water mitigation, and repair services provides us with a competitive advantage. Through our management of both claims adjusting and repair services, we are generally able to begin the adjustment and mitigation process in a timely manner, benefitting loss costs. We also believe our unique model provides a superior level of customer service for our policyholders, enhancing our reputation and increasing the likelihood that our policyholders will renew their policies with us.

Relationships with Highly Rated Reinsurers

We manage our exposure to catastrophic events through, among other things, the purchase of reinsurance. Our relationships with highly rated reinsurers have been developed as a result of our management team's industry experience and our reputation for selective underwriting and effective claims management. Our financial strength, underwriting results and the long-term relationships between our management team and our reinsurance partners help improve the cost-effectiveness of our reinsurance program.

Relationships with Independent Agents and National Underwriters

We have developed relationships with a large network of independent insurance agents. We have partnerships with certain large retail agencies which amplify our production. We believe we have been able to build this network due to our financial stability, disciplined underwriting, claims and mitigation capabilities, customer service, and robust reinsurance program. We have forged strategic relationships with national insurers and agencies that provides us access to their agent and production networks.

Our Competition

The market for residential property insurance is highly competitive in the states in which we conduct business. We compete to varying degrees with insurers including large national carriers, state-sponsored homeowners' insurance entities, and single state or regional carriers. We believe Heritage differentiates itself from many competitors with our service levels, financial resources, streamlined processes, and vertical integration of loss mitigation and repair services.

Products, Distribution, and Catastrophe Loss Management

Heritage P&C writes voluntary personal insurance policies through a network of independent agents in each of the states in which it is licensed. We have more than 2,400 actively writing independent agents in Alabama, Florida, Georgia, North Carolina and South Carolina. Approximately 27.0% of our new premium is written by agents that are affiliated with eight large agency networks with which we have entered into master agency agreements. We market and write commercial residential policies through a network of approximately 400 independent agents in Florida. Additionally, we have expanded our commercial residential product to New Jersey, and we intend to expand to other strategically targeted states.

NBIC writes personal lines policies through a network of retail independent agents, wholesale agents and a partnership with a large direct agency. We maintain master agency agreements with approximately 225 retail independent agents, representing over 600 agency locations, including several large agency networks. We also distribute indirectly to over 1,500 retail locations through 8 wholesale agency relationships. Our three largest independent agency relationships represent approximately $70.0 million, or 19.5% annualized premiums.

Zephyr writes personal and commercial insurance policies through a network of approximately 70 independent agencies in Hawaii. Approximately 52.0% of our voluntary premium is written by agents that are affiliated with three large agency networks with which we have entered into master agency agreements.

In order to limit our potential exposure to individual risks and catastrophic events, we purchase significant reinsurance from third party reinsurers. Purchasing reinsurance is an important part of our risk strategy, and premiums ceded to reinsurers is one of our largest costs. We have strong relationships with reinsurers, which we attribute to our management's industry experience, disciplined underwriting, and claims management capabilities. For each of the twelve months beginning June 1, 2018 and 2019, we purchased reinsurance from the following sources: (i) the Florida Hurricane Catastrophe Fund, a state-mandated catastrophe fund ("FHCF") for Florida policies only, (ii) private reinsurers, all of which were rated "A-" or higher by A.M. Best Company, Inc. ("A.M. Best") or Standard & Poor's Financial Services LLC ("S&P") or were fully collateralized, (iii) sponsorship of multiple catastrophe bonds that provide principal limit, which does not include reinstatements, that can be drawn upon over a three year period, and (iv) our wholly-owned reinsurance subsidiary, Osprey. In addition to purchasing excess of loss catastrophe reinsurance, we also purchased quota share, property per risk and facultative reinsurance. Our quota share programs limit our exposure on catastrophe and non-catastrophe losses and provides ceding commission income. Our per risk program limits our net exposure in the event of a severe non-catastrophe loss impacting a single location or risk. We also utilize facultative reinsurance to supplement our per risk reinsurance program where our capacity needs dictate. See *"-Reinsurance – 2019 – 2020 Reinsurance Program"* of this report for additional information.

Our insurance regulators and ratings agency require all insurance companies, like us, to have a certain amount of capital reserves and reinsurance coverage to cover losses upon the occurrence of a catastrophic event. Our reinsurance programs provide reinsurance in excess of regulatory requirements, which are based on the probable maximum loss that we would incur from an individual catastrophic event estimated to occur once every 100 years based on our portfolio of insured risks. We also purchase reinsurance coverage to protect against the potential for multiple catastrophic events occurring in the same year.

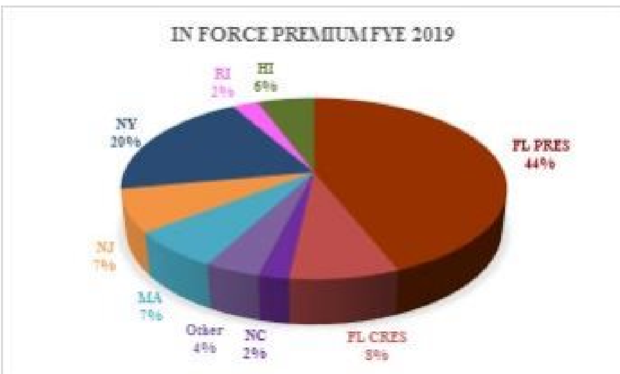
We closely manage all aspects of our claim's adjustment process. Claims are initially reviewed by our managers and staff adjusters, who determine the extent of the loss and the resources needed to adjust each claim. In the case of a catastrophic event, we have contracted with multiple large national claims adjusting firms to assist our adjusters with the increased volume of claims and ensure timely responses to our policyholders. Our CAN subsidiary performs both catastrophe and non-catastrophe related services. We deployed our extensive resources at CAN to perform emergency claim services and repairs in the aftermath of Hurricanes Irma, Florence and Michael. Our CAN network has been expanded to other states in which we conduct business. We believe our approach to claims handling results in a higher level of customer service and reduces our losses and loss adjustment expense.

Seasonality of our Business

Our insurance business is seasonal; hurricanes typically occur during the period from June 1 through November 30 and winter storms generally impact the first and fourth quarters. Because our catastrophe reinsurance program incepts on June 1 annually, any variation in the cost of our reinsurance, whether due to changes to reinsurance rates or changes in the total insured value of our policy base, will be incurred over the twelve month period beginning with that date subject to certain adjustments.

Our Market

The following charts depict the distribution of our in-force premium as of December 31, 2019 and 2018, respectively.



* *Other includes AL, CT, GA, SC & VA*

Underwriting

Our underwriters evaluate and accept only those risks that they believe will enable us to achieve an underwriting profit. To achieve underwriting profitability on a consistent basis, we focus on (1) the suitability of the risk to be assumed or written, (2) the adequacy of the premium with regard to the risk to be assumed or written and (3) the geographic distribution of existing risk relative to the risk to be assumed or written.

All of our underwriting is performed internally. The underwriting team includes actuarial staff, underwriters, our risk management team, and product development personnel. Our underwriting team leverages our proprietary data analytics, which include a number of automated processes, to analyze a number of risk evaluation factors, including the age, construction, location and value of the residence as well as premiums to be received from insuring the residence. New technological advances in computer generated geographical mapping afford us an enhanced perspective as to geographic concentrations of policyholders. When considering the geographic distribution of existing policies, our underwriters may consider the number of other properties we insure within the same region, county, city and zip code. We also consider the cost of reinsurance when assessing the adequacy of the premium with regard to the risk to be assumed or written. The underwriting criteria that we consider will continue to evolve as our business grows.

We also review our expiring policies to determine if those risks continue to meet our underwriting guidelines. If a given policy no longer meets our criteria, we will take appropriate action, including raising premium rates, or, to the extent permitted by applicable law, not offering to renew the policy.

Policy Administration

We have engaged providers of web-based software solutions and insurance personnel, to provide us with policy administration services for our business, including processing, billing and policy maintenance. The software is able to adapt to a variety of forms and rates, handle the administration of an increasing number of policies as our Company grows and expands, and provide detailed information about our book of business to our internal underwriters so that they can adjust our underwriting criteria as necessary. The software provides us with daily updates regarding the insurance policies that we have issued. The systems also allow us to provide renewal notices, late payment notices, cancellation notices, endorsements and policies to our customers on a timely basis.

Claims Administration

We closely manage all aspects of the claims process, from processing the initial claim submission to providing remediation services for claims through our wholly-owned subsidiary, CAN, or preferred vendors. When a policyholder contacts us to report a claim, members of our claims department create a claim file and aggregate the appropriate supporting documentation. Claims are then reviewed by our managers and staff adjusters, who assess the extent of the loss, which may include a thorough on-site investigations, and determine the resources needed to adjust each claim. Our claims are generally adjusted by our staff claims professionals, except in the case of a catastrophic event for which we have contracted with several large national claims adjusting firms and experienced independent contractors to assist our adjusters with the increased volume of claims and ensure timely responses to our policyholders. We currently leverage our CAN vendor network to provide repair and remediation services to our policyholders.

We perform or supervise the services rendered to our policyholders at all stages of the claims process, which we believe allows us to reduce cost and provide a high level of customer service to our policyholders. We have in-house resources as well as outsourced vendor relationships for water mitigation and rebuilding after a loss. To encourage our Florida policyholders to allow us to manage their claims from beginning to end, we developed the Platinum Program, which provides participating customers with a 10% discount on their claim deductible, and we gives us control over inspection, claims adjusting and repair services.

Liability For Losses and Loss Adjustment Expenses

Our liability for losses and loss adjustment expenses represents our preliminary estimated liability of (i) claims that have been incurred, but not yet paid (case reserves), (ii) claims that have been incurred but not yet reported to us ("IBNR"), and (iii) loss adjustment expenses ("LAE") which are intended to cover the ultimate cost of settling claims, including investigation and defense of lawsuits resulting from such claims.

Considerable time can pass between the occurrence of an insured loss, the reporting of the loss and the payment of that loss. Our liability for losses and LAE, which we believe represents the best estimate at a given point in time based on facts, circumstances and historical trends then known, may necessarily be adjusted to reflect additional facts that become available during the loss settlement period. We continually review and adjust our estimated losses as necessary based on industry development trends, evolving claims experience and new information obtained.

For a discussion and summary of the activity in the liability for losses and LAE for the years ended December 31, 2019, 2018 and 2017, see **Note 13** — "*Reserve for Unpaid Losses*" to our consolidated financial statements under Item 8 of this Annual Report on Form 10-K.

Technology

Our business depends upon the use, development and implementation of integrated technology systems. These systems enable us to provide a high level of service to agents and policyholders by processing business efficiently, communicating and sharing data with agents, providing a variety of methods for the payment of premiums and allowing for the accumulation and analysis of information for our management. We believe the availability and use of these technology systems has resulted in improved service to agents and customers, increased efficiencies in processing our multi-state insurance business and lower operating costs.

We license policy and claims administration and catastrophe modeling software from third parties. We also own, or license other technology systems used by our insurance company affiliates. These technology systems consist primarily of an integrated central processing computer, a series of server-based computer networks, a back-up server and various Internet-based communications systems.

Reinsurance

2019-2020 Reinsurance Programs

In order to limit our potential exposure to catastrophic events, we purchase significant reinsurance from third party reinsurers and have sponsored catastrophe bonds issued by Citrus Re. The catastrophe reinsurance may be on an excess of loss or quota share basis. We also purchase reinsurance for non-catastrophe losses on a quota share, per risk or facultative basis. Purchasing a sufficient amount of reinsurance to cover catastrophic losses from single or multiple events or significant non-catastrophe losses is an important part of our risk strategy, and premiums ceded to reinsurers is one of our largest costs. Reinsurance involves transferring, or "ceding", a portion of the risk exposure on policies we write to another insurer, known as a reinsurer. To the extent that our reinsurers are unable to meet the obligations they assume under our reinsurance agreements, we remain liable for the entire insured loss.

Our reinsurance agreements are prospective contracts. We record an asset, prepaid reinsurance premiums, and a liability, reinsurance payable, for the entire contract amount upon commencement of our new reinsurance agreements. We generally amortize our catastrophe reinsurance premiums over the 12-month contract period beginning on June 1 on a straight-line basis. Our quota share reinsurance is amortized over the 12-month contract period and may be purchased on a calendar or fiscal year basis.

In the event that we incur losses and loss adjustment expenses recoverable under our reinsurance program, we record amounts recoverable from our reinsurers on paid losses plus an estimate of amounts recoverable on unpaid losses. The estimate of amounts recoverable on unpaid losses is a function of our liability for unpaid losses associated with the reinsured policies; therefore, the amount changes in conjunction with any changes to our estimate of unpaid losses. As a result, a reasonable possibility exists that an estimated recovery may change significantly in the near term from the amounts included in our consolidated financial statements.

Our insurance regulators require all insurance companies, like us, to have a certain amount of capital and reinsurance coverage in order to cover losses and loss adjustment expenses upon the occurrence of a catastrophic event. Our 2019-2020 reinsurance program provides reinsurance in excess of our state regulator requirements, which are based on the probable maximum loss that we would incur from an individual catastrophic event estimated to occur once in every 100 years based on our portfolio of insured risks. The nature, severity and location of the event giving rise to such a probable maximum loss differs for each insurer depending on the insurer's portfolio of insured risks, including, among other things, the geographic concentration of insured value within such portfolio. As a result, a particular catastrophic event could be a one-in-100-year loss event for one insurance company while having a greater or lesser probability of occurrence for another insurance company. We also purchase reinsurance coverage to protect against the potential for multiple catastrophic events occurring in the same year. We share portions of our reinsurance program coverage among our insurance company affiliates.

Catastrophe Excess of Loss Reinsurance

Effective June 1, 2019, we entered into catastrophe excess of loss reinsurance agreements covering Heritage Property & Casualty Insurance Company ("Heritage P&C"), Zephyr Insurance Company ("Zephyr") and Narragansett Bay Insurance Company ("NBIC"). The catastrophe reinsurance programs are allocated amongst traditional reinsurers, catastrophe bonds issued by Citrus Re Ltd., a Bermuda special purpose insurer formed in 2014 ("Citrus Re"), the Florida Hurricane Catastrophe Fund ("FHCF") and Osprey Re Ltd, our captive reinsurer. The FHCF covers Florida risks only and we participate at 90%. Our third-party reinsurers are either rated "A-" or higher by A.M. Best or S&P or are fully collateralized, to reduce credit risk.

The reinsurance program, which is segmented into layers of coverage, protects the Company for excess property catastrophe losses and loss adjustment expenses. The 2019-2020 reinsurance program provides first event coverage up to $1.5 billion for Heritage P&C, first event coverage up to $708.0 million for Zephyr, and first event coverage up to $936.0 million for NBIC. Our first event retention for each insurance company subsidiary follows: Heritage P&C - $20.0 million; Zephyr - $20.0 million; NBIC – $13.8 million.

Our program was placed on a cascading basis which provides greater horizontal protection in a multiple small events scenario and features additional coverage enhancements. This coverage exceeds the requirements established by the ratings agency of our insurance company affiliates, Demotech, Inc., the Florida Office of Insurance Regulation, the Hawaii Insurance Division, and the Rhode Island Department of Business Regulation.

We are responsible for all losses and loss adjustment expenses in excess of our reinsurance program. For second or subsequent catastrophic events, our total available coverage depends on the magnitude of the first event, as we may have coverage remaining from layers that were not previously fully exhausted. An aggregate of $2.6 billion of limit purchased in 2019 includes reinstatement through the purchase of reinstatement premium protection. In total, we have purchased $2.6 billion of potential reinsurance coverage, including our retention, for multiple catastrophic events. Our ability to access this coverage, however, will be subject to the severity and frequency of such events.

The Company's estimated net cost for the 2019-2020 catastrophe reinsurance programs is approximately $249.2 million.

Gross Quota Share Reinsurance

NBIC did not enter into a gross quota share reinsurance program for its fiscal year beginning June 1, 2019. For its previous fiscal year, NBIC purchased an 8% gross quota share reinsurance treaty effective June 1, 2018 which provided ground up loss recoveries of up to $1.0 billion.

Net Quota Share Reinsurance

NBIC's Net Quota Share coverage is proportional reinsurance for which certain of our other reinsurance inures to the quota share (property catastrophe excess of loss and reinstatement premium protection and the second layer of the general excess of loss). An occurrence limit of $20.0 million for catastrophe losses is in effect on the quota share, subject to certain aggregate loss limits that vary by reinsurer. The amount and rate of ceding commissions slide, within a prescribed minimum and maximum, depending on loss performance. The Net Quota Share program was renewed on December 31, 2019 ceding 56% of the net premiums and losses and 5% of the prior year quota share will run off.

Aggregate Coverage

A $931.0 million of limit is structured on an aggregate basis (Top and Aggregate, Layer 1, Layer 2, Layer 3, Layer 4, Layer 5, Stub layers, Multi-Zonal and 2017-1 Notes). To the extent that this coverage is not fully exhausted in the first catastrophic event, it provides coverage commencing at its reduced retention for second and subsequent events where underlying coverage has been previously exhausted. The Company purchased reinstatement premium protection for $627.0 million of this coverage, which can be reinstated one time. Layers (with exception to FHCF) are "net" of a $40.0 million attachment point. Layers inure to the subsequent layers if the aggregate limit of the preceding layer(s) is exhausted, and the subsequent layer cascades down in its place.

NBIC placed 42.5% of an aggregate contract, which covers all catastrophe losses excluding named storms, on December 1, 2019, expiring March 31, 2020. The limit on the contract is $20.0 million, with a retention of $20.0 million and franchise deductible of $1.0 million.

NBIC placed 100% of an occurrence contract, which covers all catastrophe losses excluding named storms, on December 31, 2019, expiring December 31, 2020. The limit on the contract is $20.0 million with a retention of $20.0 million and has one reinstatement available.

Per Risk Coverage

For southeast losses and northeast commercial residential losses, excluding losses from named storms, the Company purchased property per risk coverage for losses and loss adjustment expenses in excess of $1.0 million per claim. The limit recovered for an individual loss is $9.0 million and total limit for all losses is $27.0 million. There are two reinstatements available with additional premium due based on the amount of the layer exhausted. For Northeast commercial residential losses only, the Company purchased property per risk coverage for losses and loss adjustments expenses in excess of $750,000 per claim. The limit recovered for an individual loss is $250,000 and total limit for all losses is $750,000. There are two reinstatements available with additional premium due based on the amount of the layer exhausted.

In addition, the Company purchased facultative reinsurance for losses in excess of $10.0 million for any properties it insured where the total insured value exceeded $10.0 million. This coverage applies to Southeast losses and Northeast commercial residential losses, excluding losses from named storms.

General Excess of Loss

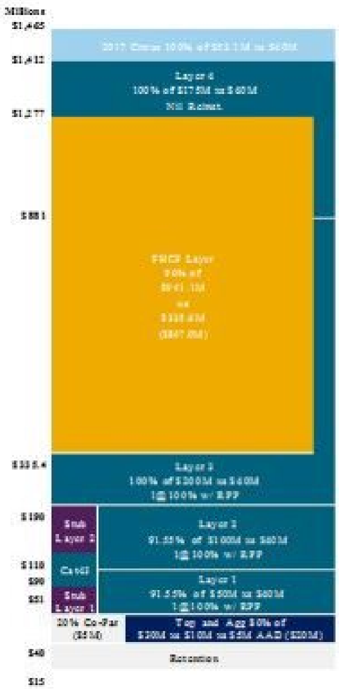
NBIC's general excess of loss reinsurance protects NBIC from single risk losses, both property and casualty. The casualty coverage provided by this reinsurance contract also responds on a "Clash" basis, meaning that multiple policies involved in a single loss occurrence can be aggregated into one loss and applied to the reinsurance contract. The coverage is in two layers in excess of NBIC's retention of the first $400,000 of loss. The first layer is $350,000 excess $400,000 and the second layer is $2.75 million excess $750,000 (Casualty second layer is $1.25 million excess $750,000). Both layers are 100% placed.

Semi-Automatic Facultative Excess of Loss

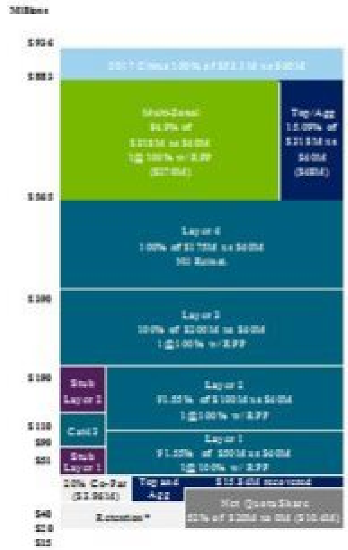
NBIC's automatic property facultative reinsurance protects NBIC from single risk losses, for property risks with a total insured value excess of $3.5 million subject to a limit of $3.75 million, or higher, subject to special acceptance.

The following graphics depict our reinsurance program structure for the 2019 - 2020 hurricane season:

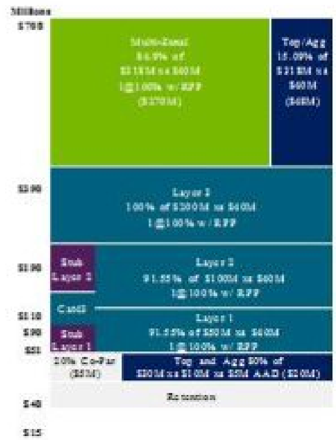
2019 - 2020 Reinsurance Tower



FL 1st Event



NE 1st Event



HI 1st Event

For the twelve months ending May 31, 2020, we purchased catastrophe XOL reinsurance from the following sources: (i) FHCF (i.e. Florida risks only), (ii) Citrus Re Ltd, and (iii) over 50 third-party private reinsurers, all of which were rated “A-” or higher by A.M. Best or S&P or which were fully collateralized. There is no single reinsurer representing more than 10% of the limit purchased for our program, excluding Citrus Re catastrophe bonds and FHCF. The chart below lists our third-party reinsurers with A.M. Best and S&P ratings for all Heritage insurance company subsidiaries as of December 31, 2019.

Reinsurer	AM Best Rating	S&P Rating
Aeolus Re/Keystone PF Seg	Fully Collateralized	NR
Allianz Risk Transfer AG (obo Nephila)	A+	AA
Allied World Assurance Co Ltd	A	A-
Allied World Re Mgmnt/Allied W	A	A-
American Agricultural Ins (OH)	A	NR
American Standard Ins Co of WI	A	NR
Arch Re Co	A+	A+
Arch Re Ltd	A+	A+
Arch Re Ltd obo Quantedge	A+	A+
Ark Underwriting Inc/Synd 4020	A	A+
Ascot Re Co Ltd	A	
Ascot UW Inc./Synd 1414 (ASC)	A	A+
Asia Capital Re Group Pte Ltd	NR	NR
Aspen Bermuda Ltd	A	A

Reinsurer	AM Best Rating	S&P Rating
Aspen Re Amer/Aspen Ins UK Ltd	A	A
AXIS Re Co	A+	A+
AXIS Specialty Ltd	A+	A+
Brit Ins/BRT Syndicate 2987	A	A+
China P&C Re, Beijing	A	A
Chubb Tempest Re Ltd.	A++	AA
Chubb Tempest Re/ACE P and C	A++	AA
Eclipse Re Ltd/Seg EC0020	Fully Collateralized	NR
Employers Mut Cas Co	A	NR
Endurance Assurance Corp	A+	A+
Everest Re Co	A+	A+
Fidelis Ins Bermuda Ltd	A-	A-
Fidelis UW Ltd	A-	A-
General Insurance Corporation of India	A-	NR
Hannover Rueck SE	A+	AA-
Hannover Rueck SE (obo Pillar)	A+	AA-
Hannover Rueck SE(obo Eskatos)	A+	AA-
Harco National Ins Co	A-	NR
Hiscox Ins Co (BDA) Ltd	A	A
Horseshoe Re Ltd/SA CC071	Fully Collateralized	NR
Humboldt Re Ltd	A-	NR
Kelvin Re Ltd	A-	NR
Korean Re Co	A	A
Lloyds Consortium 9840	A	A+
Lloyds Syndicate 0033 (HIS)	A	A+
Lloyd's Syndicate 0623 (AFB)	A	A+
Lloyd's Syndicate 0727 (SAM)	A	A+
Lloyd's Syndicate 1084 (CSL)	A	A+
Lloyd's Syndicate 1183 (TAL)	A	A+
Lloyd's Syndicate 1414 (ASC)	A	A+
Lloyd's Syndicate 1729 (DUW)	A	A+
Lloyd's Syndicate 1856 (ACS)	A	A+
Lloyd's Syndicate 2001 (AML)	A	A+
Lloyd's Syndicate 2003 (XLC)	A	A+
Lloyd's Syndicate 2014 (ACA)	A	A+
Lloyd's Syndicate 2623 (AFB)	A	A+
Lloyd's Syndicate 2987 (BRT)	A	A+
Lloyds Syndicate 2988 (BRT)	A	A+
Lloyd's Syndicate 3000 (MKL)	A	A+
Lloyd's Syndicate 4000 (HAM)	A	A+
Lloyd's Syndicate 4020 (ARK)	A	A+
Markel Bermuda	A	A
MS Amlin AG, Bermuda Branch	A	A
Munich Re America Inc	A+	AA-
Nautical obo Syndicate 2357	A	A+
New India Assur Co Ltd	A-	NR
Odin Re Ltd/Seg Account ODR 3	Fully Collateralized	NR
Odin Re Ltd/Seg Account ODR 6	Fully Collateralized	NR
Odyssey Re Co	A	A-

Reinsurer	AM Best Rating	S&P Rating
Partner Re Co Ltd	A+	A+
PartnerRe US	A+	A+
Prospero Re Ltd.	Fully Collateralized	NR
Qatar Re Ltd.	A	A
Ren Re U.S. Inc.	A+	A+
RenaissanceRe Europe AG (U.S. Branch)	A+	A+
Satec Srl/New Re	A+	AA-
SCOR Re Co	A+	AA-
SCOR SE	A+	AA-
Securis Re IX Ltd/Seg Acct 999	Fully Collateralized	NR
Securis Re V Ltd/Seg Acct 599	Fully Collateralized	NR
Swiss Re America Corp	A+	AA-
Taiping Re Co Ltd (HK)	A	A
Third Point Re (USA) Ltd	A-	
Toa Re Co of America	A	A+
Transatlantic Re	A+	A+
TransRe/Gen Re	A++	AA+
Validus Am/Validus Re (CH) Ltd	A	A
Validus Re Ltd	A	A
XL Re America Inc.	A+	AA-

2018 – 2019 Reinsurance Program

Catastrophe Excess of Loss Reinsurance

Effective June 1, 2018, we entered into catastrophe excess of loss reinsurance agreements covering Heritage P&C, Zephyr and NBIC. The catastrophe reinsurance programs are allocated amongst traditional reinsurers, catastrophe bonds issued by Citrus Re Ltd., a Bermuda special purpose insurer formed in 2014 (“Citrus Re”) and the Florida Hurricane Catastrophe Fund (“FHCF”). The FHCF covers Florida risks only and we participate at 45%. Citrus Re, which provides fully collateralized multi-year coverage, covers catastrophe losses incurred by Heritage P&C only through the 2016 Class D and 2017-1 Notes, and covers catastrophe losses incurred by Heritage P&C, Zephyr and NBIC through the 2016 Class E Note. Our third-party reinsurers are either rated “A- “or higher by A.M. Best or S&P or are fully collateralized, to reduce credit risk.

The reinsurance program, which is segmented into layers of coverage, protects the Company for excess property catastrophe losses and loss adjustment expenses. The 2018-2019 reinsurance program provides first event coverage up to $1.6 billion for Heritage P&C, first event coverage up to $801 million for Zephyr, and first event coverage up to $1.0 billion for NBIC. Our first event retention for each insurance company subsidiary follows: Heritage P&C - $20.0 million; Zephyr - $20.0 million; NBIC – $12.8 million. Our second and third event retentions for each insurance company subsidiary follows: Heritage P&C - $16.0 million; Zephyr - $16 million; NBIC – $8.8 million.

Our program was placed on a cascading basis which provides greater horizontal protection in a multiple small events scenario and features additional coverage enhancements. This coverage exceeds the requirements established by the Companies’ rating agency, Demotech, Inc., the Florida Office of Insurance Regulation, the Hawaii Insurance Division, and the Rhode Island Department of Business Regulation. For the twelve months ending May 31, 2019, no single uncollateralized private reinsurer represented more than 10% of the overall limit purchased from our total reinsurance coverage.

We are responsible for all losses and loss adjustment expenses in excess of our reinsurance program. For second or subsequent catastrophic events, our total available coverage depends on the magnitude of the first event, as we may have coverage remaining from layers that were not previously fully exhausted. An aggregate of $3.4 billion of limit purchased in 2018 includes reinstatement through the purchase of reinsurance reinstatement premium. In total, we have purchased $3.5 billion of potential reinsurance coverage, including our retention, for multiple catastrophic events. Our ability to access this coverage, however, will be subject to the severity and frequency of such events.

The Company's estimated net cost for the 2018-2019 catastrophe reinsurance programs is approximately $252.0 million.

Gross Quota Share Reinsurance

NBIC purchased an 8% gross quota share reinsurance treaty effective June 1, 2018 which provides ground up loss recoveries of up to $1.0 billion. Prior to this treaty, NBIC’s gross quota share treaty was 18.75%.

Net Quota Share Reinsurance

NBIC's Net Quota Share coverage is proportional reinsurance for which certain of our other reinsurance inures to the quota share (property catastrophe excess of loss and reinstatement premium protection and the second layer of the general excess of loss.) An occurrence limit of $20.0 million for catastrophe losses is in effect on the quota share, subject to certain aggregate loss limits that vary by reinsurer. The amount and rate of reinsurance commissions slide, within a prescribed minimum and maximum, depending on loss performance. NBIC ceded 49.5% of net premiums and losses during 2018 to the Net Quota Share and 8% of the 2017 Net Quota Share was runoff. The Net Quota Share program was renewed on December 31, 2018 ceding 52.0% of the net premiums and losses and 10% of the prior year quota share will runoff.

Aggregate Coverage Heritage P&C and Zephyr

$1.1 billion of limit is structured on an aggregate basis (Top and Aggregate, Layer 1, Layer 2, Layer 3, Layer 4, Stub layers, Multi-Zonal, 2017-1 Notes and 2016 Class E Notes). To the extent that this coverage is not fully exhausted in the first catastrophic event, it provides coverage commencing at its reduced retention for second and subsequent events where underlying coverage has been previously exhausted. The Company paid a reinsurance reinstatement premium for $669.0 million of this coverage, which can be reinstated one time. Layers (with exception to FHCF and 2016 Class D Notes) are "net" of a $40.0 million attachment point. Layers inure to the subsequent layers if the aggregate limit of the preceding layer(s) is exhausted, and the subsequent layer cascades down in its place.

NBIC placed 42.50% of an aggregate contract, which covers all catastrophe losses excluding named storms, on May 31, 2018, expiring December 31, 2018. The limit on the contract is $20.0 million, retention of $3.0 million and franchise deductible of $1.5 million.

NBIC placed 92.00% of an occurrence contract, which covers all catastrophe losses excluding named storms, on May 31, 2018, expiring December 31, 2018. The limit on the contract is $20.0 million with a retention of $20.0 million.

NBIC placed 40.00% of an aggregate contract, which covers all catastrophe losses excluding named storms, on December 31, 2018, expiring May 31, 2019. The limit on the contract is $20.0 million, retention of $20.0 million and franchise deductible of $1.0 million.

NBIC placed 100.00% of an occurrence contract, which covers all catastrophe losses excluding named storms, on December 31, 2018, expiring December 31, 2019. The limit on the contract is $20.0 million with a retention of $20.0 million and has 1 reinstatement available.

Per Risk Coverage

The Company also purchased property per risk coverage for losses and loss adjustment expenses in excess of $1.0 million per claim. The limit recovered for an individual loss is $9.0 million and total limit for all losses is $27.0 million. There are two reinstatements available with additional premium due based on the amount of the layer exhausted. In addition, the Company purchased facultative reinsurance in excess of $10.0 million for any commercial properties it insured where the total insured value exceeded $10.0 million.

General Excess of Loss

NBIC's general excess of loss reinsurance protects NBIC from single risk losses, both property and casualty. The casualty coverage provided by this contract also responds on a "Clash" basis, meaning that multiple policies involved in a single loss occurrence can be aggregated into one loss and applied to the reinsurance contract. The coverage is in two layers in excess of NBIC's retention of the first $300,000 of loss. The first layer is $450,000 excess $300,000 and the second layer is $2.75 million excess $750,000 (Casualty second layer is $1.25 million excess $750,000). Both layers are 92% placed with the gross quota share providing the additional 8% coverage.

Semi-Automatic Facultative Excess of Loss

NBIC's automatic property facultative reinsurance protects NBIC from single risk losses, for property risks with a total insured value excess of $3.5 million subject to a limit of $3.75 million.

Investments

Our investments are managed by three third-party asset managers. We have designed our investment policy to provide a balance between current yield, conservation of capital and the liquidity requirements of our operations. As such, our invested assets are primarily held in cash and bonds of high credit quality with relatively short durations. Our investment policy sets guidelines that provide for a well-diversified investment portfolio that is compliant with insurance regulations applicable to the states in which we operate. Our investment objectives include liquidity, safety and security of principal, and returns. The investment policy limits investments in common and preferred stocks and requires a minimum weighted average portfolio quality of A for our bond portfolio with an overall duration of 2-5 years. No more than 2% of admitted assets can be invested in any one issuer, with slightly higher limits for highly rated securities, excluding government-related securities. Investments in commercial mortgages cannot exceed 10% of admitted assets. Prohibited investments include short sales and margin purchases, oil, gas, mineral or other types of leases, speculative uses of futures and options, unrated corporate securities, non-US denominated securities, convertible securities, high risk CMO instruments, repurchase agreements, securities lending transactions and speculative foreign currency valuation transactions. Our investment policy, which may change from time to time, is approved by our Investment Committee and is reviewed on a regular basis in order to ensure that our investment policy evolves in response to changes in the financial markets. See **Note 3** "*Investments*" to our consolidated financial statements under Item 8 of this Annual Report on Form 10-K.

As of December 31, 2019, we held $268.4 million in cash and cash equivalents and $595.2 million in securities, which were comprised of $587.3 million in fixed maturities, $1.6 million in common stock and $6.4 million other invested assets. From the $587.3 million of fixed maturities, $22.0 million of U.S. government agency securities were pledged to the Federal Home Loan Bank ("FHLB") in connection with a FHLB loan to Heritage P&C. See **Note 14**. *Long-Term Debt* to our consolidated financial statements under Item 8 of this Annual Report on Form 10-K.

Government Regulation

The insurance industry is extensively regulated. Our insurance company subsidiaries are subject to the laws and regulations of the states in which they conduct business. The insurance regulatory statutes and rules provide for regulation of virtually all aspects of the business of insurance companies. The states in which we conduct business, like many states, have adopted several model laws and regulations as promulgated by the National Association of Insurance Commissioners ("NAIC"). State statutes and administrative rules generally require each insurance company that is part of a holding company group to register with the department of insurance in its state of domicile and to furnish information concerning the operations of the companies within the holding company system which may materially affect the operations, management or financial condition of the insurers within the group. As part of its registration, each insurance company must identify material agreements, relationships and transactions with affiliates, including without limitation loans, investments, asset transfers, transactions outside of the ordinary course of business, certain management, service, and cost sharing agreements, reinsurance transactions, dividends and consolidated tax allocation agreements. In some instances, individual state insurance laws and regulations are even more stringent that those promulgated by the NAIC or other states.

We are subject to regulations administered by a department of insurance in each state in which we do business. These regulations relate to, among other things:

- the content and timing of required notices and other policyholder information;
- the amount of premiums the insurer may write in relation to its surplus (writing ratios);
- the amount and nature of reinsurance a company is required to purchase;
- participation in guaranty funds and other statutorily created markets or organizations;
- business operations and claims practices;
- approval of policy forms and premium rates;
- standards of solvency, including risk-based capital measurements;
- licensing of insurers and their products;
- restrictions on the nature, quality and concentration of investments;
- restrictions on the ability of insurance company subsidiaries to pay dividends to insurance holding companies;
- approval of and restrictions on transactions between insurance companies and their affiliates;
- restrictions on the size of risks insurable under a single policy;
- requiring deposits for the benefit of policyholders;

- requiring certain methods of accounting;
- periodic examinations of our operations and finances;
- the form and content of records of financial condition required to be filed; and
- requiring reserves.

Over the past several years, various regulatory and legislative bodies have adopted or proposed new laws or regulations to address the cyclical nature of the insurance industry, catastrophic events and insurance capacity and pricing. These regulations include (i) the creation of “market assistance plans” under which insurers are induced to provide certain coverages, (ii) restrictions on the ability of insurers to rescind or otherwise cancel certain policies in mid-term or to nonrenew policies at their scheduled expirations, (iii) advance notice requirements or limitations imposed for certain policy non-renewals, (iv) limitations upon or decreases in rates permitted to be charged, (v) expansion of governmental involvement in the insurance market and (vi) increased regulation of insurers’ policy administration and claims handling practices. Further regulatory authorities have relatively broad discretion to deny or revoke licenses for various reasons, including the violation of regulations. In some instances, we follow practices based on our interpretations of regulations or practices that we believe may be generally followed by the industry. These practices may turn out to be different from the interpretations of regulatory authorities. If we do not have the requisite licenses and approvals or do not comply with applicable regulatory requirements, insurance regulatory authorities could preclude or temporarily suspend us from carrying on some or all of our activities or otherwise penalize us.

Our insurance subsidiaries are subject to risk-based capital standards and other minimum capital and surplus requirements imposed under applicable state laws. The risk-based capital standards, based upon the Risk-Based Capital Model Act adopted by the NAIC, require our insurance subsidiaries to report the results of risk-based capital calculations to state regulators and the NAIC. These risk-based capital standards provide for different levels of regulatory attention depending upon the ratio of an insurance company’s total adjusted capital, as calculated in accordance with NAIC guidelines, to its authorized control level risk-based capital. Authorized control level risk-based capital is determined using the NAIC’s risk-based capital formula, which measures the minimum amount of capital that an insurance company needs to support its overall business operations.

The State of Florida Office of Insurance Regulation (“FLOIR”) imposed certain additional solvency related requirements as a condition of receiving a certificate of authority for our Florida insurance company subsidiary. Finally, our insurance company affiliates are subject to state regulations or consent orders setting conditions related to various transactions, including intercompany transactions. We are in full compliance with all consent orders.

State regulators where we are and may become licensed and offer insurance products conduct periodic examinations of the affairs of insurance companies and require the filing of annual and other reports related to financial condition, holding company issues and other matters. These regulatory authorities also conduct periodic examinations into insurers’ business practices. Additionally, we are subject to assessments levied by governmental and quasi-governmental entities from the states in which we conduct business.

Employees

As of December 31, 2019, we had 530 employees. We are not a party to any collective bargaining agreement and have not experienced any work stoppages or strikes as a result of labor disputes. We consider relations with our employees to be satisfactory.

Available Information

We make available free of charge on our website, www.heritagepci.com, all materials that we file electronically with the Securities and Exchange Commission (“SEC”), including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports, filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after electronically filing such materials with, or furnishing them to, the SEC. During the period covered by this Form 10-K, we made all such materials available through our website as soon as reasonably practicable after filing such materials with the SEC. To access these filings, go to the Company’s website at **https://investors.heritagepci.com/** and under the “Investors” heading, click on “Financial Information” then “SEC Filings”.

The SEC maintains an Internet website, www.sec.gov that contains reports, proxy and information statements and other information that we file electronically with the SEC. Our principal executive offices are located at 2600 McCormick Drive, Suite 300, Clearwater, Florida 33759.

Financial Information by Geographical Area

For financial information by geographic area, see Part II, Item 8, Note 25, "Geographical Information – (unaudited)".

Item 1A. Risk Factors

Set forth below are certain risk factors that could harm our business, results of operations and financial condition. You should carefully read the following risk factors, together with the financial statements, related notes and other information contained in this Annual Report on Form 10-K. Our business, financial condition and operating results may suffer if any of the following risks are realized. If any of these risks or uncertainties occur, the trading price of our common stock could decline and you might lose all or part of your investment. This Annual Report on Form 10-K contains forward-looking statements that contain risks and uncertainties. Please refer to the discussion of "Forward-Looking Statements" of this Annual Report in connection with your consideration of the risk factors and other important factors that may affect future results described herein.

Risks Related to Our Business

Our loss reserves are estimates and may be inadequate to cover our actual liability for losses, causing our results of operations to be adversely affected.

We maintain reserves to cover our estimated ultimate liabilities for losses and loss adjustment expenses, also referred to as loss reserves. Our current loss reserves are based primarily on our historical data and statistical projections of what we believe the resolution and administration of claims will cost based on facts and circumstances then known to us. Our claims experience and our experience with the risks related to certain claims is inherently limited. We use company historical data to the extent it is available and rely on industry historical data which may not be indicative of future periods. As a result, our projections and our estimates may be inaccurate, which in turn may cause our actual losses to exceed our loss reserves. If our actual losses exceed our loss reserves, our financial results, our ability to expand our business and to compete in the property and casualty insurance industry may be negatively affected.

Factors that affect unpaid losses and loss adjustment expenses include the estimates made on a claim-by-claim basis known as "case reserves" coupled with bulk estimates known as "incurred but not yet reported" (or "IBNR"). Periodic estimates by management of the ultimate costs required to resolve all claims are based on our analysis of historical data and estimations of the impact of numerous factors such as (i) per claim information, (ii) industry and company historical loss experience and development patterns, (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages and changes in political attitudes, and (iv) trends in general economic conditions, including the effects of inflation. Management revises its estimates based on the results of its analysis. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate resolution of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves because the eventual redundancy or deficiency is affected by multiple factors.

Because of the inherent uncertainties in the reserving process, we cannot be certain that our reserves will be adequate to cover our actual losses and loss adjustment expenses. If our reserves for unpaid losses and loss adjustment expenses are less than actual losses and loss adjustment expenses, we will be required to increase our reserves with a corresponding reduction in our net income in the period in which the deficiency is identified. Future loss experience substantially in excess of our reserves for unpaid losses and loss adjustment expenses could substantially harm our results of operations and financial condition.

We have exposure to unpredictable catastrophes, which can materially and adversely affect our financial results, which are more pronounced because a large portion of our insurance business is conducted in coastal states.

We write insurance policies that cover homeowners, condominium owners and commercial residential buildings for losses that result from, among other things, catastrophes. We are therefore subject to losses, including claims under policies we have assumed or written, arising out of catastrophes that may have a significant effect on our business, results of operations and financial condition. A significant catastrophe, or a series of catastrophes, could also have an adverse effect on our reinsurers. Catastrophes can be caused by various events, including hurricanes, tropical storms, snowstorms, tornadoes, earthquakes, hailstorms, explosions, power outages, fires and by man-made events, such as terrorist attacks. Climate change, to the extent it produces extreme changes in temperatures and changes in weather patterns could affect the frequency or severity of weather-related catastrophes. The incidence and severity of catastrophes are inherently unpredictable. The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected and the severity of the event. As of December 31, 2019, all of our premium in force related to business in coastal states, which are especially subject to adverse weather conditions such as hurricanes, tropical storms, and winter storms. A single catastrophic event, or a series of such events, destructive weather patterns, general economic trend, regulatory development or other condition specifically affecting the states in which we conduct business, particularly the more densely populated areas of those states, could have a disproportionately adverse impact on our business, financial condition and results of operations. Therefore, although we attempt to manage our exposure to catastrophes through our underwriting process and the purchase of reinsurance protection, an especially severe catastrophe or series of catastrophes could exceed our reinsurance protection and may have a material adverse impact on our results of operations and financial condition. In total, for the period from June 1, 2019 through May 31, 2020, we have purchased up approximately $3.5 billion of catastrophe reinsurance coverage for Heritage P&C, Zephyr, and NBIC, for multiple catastrophic events. Our ability to access this coverage, however, is subject to the severity and frequency of such events. We may experience significant losses and loss adjustment expenses in excess of our retention.

The inherent uncertainty of models and our reliance on such models as a tool to evaluate risk may have an adverse effect on our financial results.

We license analytic and modeling software from third parties to facilitate our pricing, assess our risk exposure and determine our reinsurance needs. Given the inherent uncertainty of modeling techniques and the application of such techniques, these models and databases may not accurately address the emergence of a variety of matters which might impact our exposure to losses. Accordingly, these models may understate the exposures we are assuming, and our financial results may be adversely impacted, perhaps significantly.

Our results of operations may fluctuate significantly based on industry factors.

The insurance business historically has been a cyclical industry characterized by periods of intense price competition due to excess underwriting capacity, as well as periods when shortages of capacity permitted an increase in pricing. As premium levels increase, there may be new entrants to the market, which could then lead to increased competition, a significant reduction in premium rates, less favorable policy terms and fewer opportunities to underwrite insurance risks, which could have a material adverse effect on our results of operations and cash flows. In addition to these considerations, changes in the frequency and severity of losses suffered by insureds and insurers, including changes resulting from multiple and/or catastrophic weather events, may affect the cycles of the insurance business significantly. We cannot predict whether market conditions will improve, remain constant or deteriorate. Negative market conditions may impair our ability to write insurance at rates that we consider appropriate relative to the risk assumed. If we cannot write insurance at appropriate rates, our business would be materially and adversely affected.

In addition, the uncertainties inherent in the reserving process, together with the potential for unforeseen developments, including changes in laws and the prevailing interpretation of policy terms, may result in losses and loss adjustment expenses materially different from the reserves initially established. Changes to prior year reserves will affect current underwriting results by increasing net income if the prior year reserves prove to be redundant or by decreasing net income if the prior year reserves prove to be insufficient. We are not allowed to record contingency reserves to account for expected future losses. As a result, we expect volatility in operating results in periods in which significant loss events occur because generally accepted accounting principles do not permit insurers or reinsurers to reserve for loss events until they have occurred and are expected to give rise to a claim. We anticipate that claims arising from future events may require the establishment of substantial reserves from time to time.

We may not be able to collect reinsurance amounts due to us from the reinsurers with which we have contracted.

Reinsurance is a method of transferring part of an insurance company's risk under an insurance policy to another insurance company. To the extent that our reinsurers are unable to meet the obligations they assume under our reinsurance agreements, we remain liable for the entire insured loss. We use reinsurance arrangements to limit and manage the amount of risk we retain, to stabilize our underwriting results and to increase our underwriting capacity. Our ability to recover amounts due from reinsurers under the reinsurance treaties we currently have in effect is subject to the reinsurance company's ability and willingness to pay and to meet its obligations to us. We attempt to select financially strong reinsurers with an A.M. Best or S&P rating of "A-" or better or we require the reinsurer to fully collateralize its exposure. While we monitor from time to time their financial condition, we also rely on our reinsurance broker and rating agencies in evaluating our reinsurers' ability to meet their obligations to us.

Our reinsurance coverage in any given year may be concentrated with one or a limited group of reinsurers. No single uncollateralized private reinsurer represented more than 10% of the overall limit purchased from our total reinsurance coverage. Any failure on the part of any one reinsurance company to meet its obligations to us could have a material adverse effect on our financial condition or results of operations.

All residential insurance companies that write business in Florida, including Heritage P&C, are required to obtain reinsurance through the FHCF, and this coverage comprises a substantial portion of the Heritage P&C reinsurance program for our Florida insured properties. The limit and retention of the FHCF coverage is subject to upward or downward adjustment based on, among other things, submitted exposures to FHCF by all participants. We have purchased private reinsurance alongside our FHCF layer to fill in gaps in coverage that may result from the adjustment of the limit or retention of our FHCF coverage; however, such reinsurance would not cover any losses we may incur as a result of FHCF's inability to pay the full amount of our claims. If a catastrophic event occurs in Florida, the FHCF may not have sufficient funds to pay all of its claims from insurance companies in full or in a timely manner. This could result in significant financial, legal and operational challenges to our Company. In the event of a catastrophic loss, FHCF's ability to pay may be dependent upon its ability to issue bonds in amounts that would be required to meet its reinsurance obligations. There can be no assurance that FHCF will be able to do this. While we believe FHCF currently has adequate capital and financing capacity to meet its reinsurance obligations, there can be no assurance that it will be able to meet its obligations in the future, and any failure to do so could have a material adverse effect on our liquidity, financial condition and results of operations.

Reinsurance coverage may not be available to us in the future at commercially reasonable rates or at all.

The cost of reinsurance is subject to prevailing market conditions beyond our control such as the amount of capital in the reinsurance market, as well as the frequency and magnitude of natural and man-made catastrophes. We cannot be assured that reinsurance will remain continuously available to us in the amounts we consider sufficient and at prices acceptable to us. As a result, we may determine to increase the amount of risk we retain or look for other alternatives to reinsurance, which could in turn have a material adverse effect on our financial position, results of operations and cash flows.

Increased competition, competitive pressures, industry developments and market conditions could affect the growth of our business and adversely impact our financial results.

The property and casualty insurance industry in the states in which we do business is cyclical and, during times of increased capacity, highly competitive. We compete not only with other stock companies, but also with state governmental insurance entities, mutual companies, other underwriting organizations and alternative risk sharing mechanisms. Our principal lines of business are written by numerous other insurance companies. Competition for any one account may come from very large, well-established national companies, smaller regional companies, other specialty insurers in our field and other companies that write insurance. Some of these competitors have greater financial resources, larger agency networks and greater name recognition than we do. We compete for business not only on the basis of price, but also on the basis of financial strength, types of coverages offered, and availability of coverage desired by customers, commission structure and quality of service. We may have difficulty continuing to compete successfully on any of these bases in the future. Competitive pressures coupled with market conditions may affect our rate of premium growth and financial results.

In addition, industry developments could further increase competition in our industry. These developments could include:

- an influx of new capital in the marketplace as existing companies attempt to expand their businesses and new companies attempt to enter the insurance business as a result of better premium pricing and/or policy terms;
- an increase in programs in which state-sponsored entities provide property insurance in catastrophe-prone areas;
- changes in state regulatory climates; and
- the passage of federal proposals for an optional federal charter that would allow some competing insurers to operate under regulations different or less stringent than those applicable to us.

These developments and others could make the property and casualty insurance marketplace more competitive by increasing the supply of insurance available. If competition limits our ability to write new business at adequate rates, our future results of operations would be adversely affected.

Our results of operations and financial condition depend on our ability to underwrite and set premium rates accurately for a wide variety of risks. Rate adequacy is necessary to generate sufficient premiums to pay losses, loss adjustment expenses, reinsurance costs and underwriting expenses and to earn a profit. In order to price our products accurately, we must collect and properly analyze a substantial amount of data; develop, test and apply appropriate rating formulas; closely monitor and timely recognize changes in trends; and project both severity and frequency of losses with reasonable accuracy. Our ability to successfully perform these tasks, and as a result price our products accurately, is subject to a number of risks and uncertainties, some of which are outside our control, including:

- the availability of sufficient reliable data and our ability to properly analyze available data;
- regulatory delays in approving filed rate changes;
- the uncertainties that inherently characterize estimates and assumptions;
- our selection and application of appropriate rating and pricing techniques;
- changes in legal standards, claim resolution practices, and restoration costs; and
- legislatively imposed consumer initiatives.

In addition, we could underprice risks, which would negatively affect our profit margins. We could also overprice risks, which could reduce the number of policies we write and our competitiveness. In either event, our profitability could be materially and adversely affected.

We may not be able to identify suitable acquisition candidates, effectively integrate newly acquired businesses or achieve expected profitability from acquisitions.

Part of our growth strategy is to expand through the acquisition of complementary businesses. There can be no assurance that suitable candidates for acquisitions can be identified or, if suitable candidates are identified, that acquisitions can be completed on acceptable terms, if at all. Even if suitable candidates are identified, any future acquisitions may entail a number of risks that could adversely affect our business and the market price of our common stock, including the integration of the acquired operations and information systems, diversion of management's attention, risks of entering new market regions in which we have limited experience, adverse short-term effects on our reported operating results, the potential loss of key employees of acquired businesses and risks associated with unanticipated liabilities.

We may use our common stock to pay for acquisitions. If the owners of potential acquisition candidates are not willing to receive our common stock in exchange for their businesses, our acquisition prospects could be limited. Future acquisitions could also result in accounting charges, potentially dilutive issuances of equity securities and increased debt and contingent liabilities, including liabilities related to unknown or undisclosed circumstances, any of which could have a material adverse effect on our business and the market price of our common stock.

We may not be able to effectively execute our growth and diversification strategy.

We have and intend to continue to invest significant time and resources to develop and market geographic expansion, new lines of business and/or products and services and we may not achieve the return on our investment that we expect. Initial timetables for the introduction and development of geographic expansion, new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting customer preferences may also impact the successful implementation of our business plan. Such external factors and requirements may increase our costs and potentially affect the speed with which we will be able to pursue new market opportunities. There can be no assurance that we will be successful in bringing new insurance products or geographic expansion to our marketplace. Additionally, any geographic expansion, new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks could have a material adverse effect on our business, results of operations and financial condition.

Our growth and diversification strategy involves expansion of our business to states outside of our existing markets. Geographic diversification may be hindered by the fact that our operating history is less than the operating history of our competitors, and we may be unable to satisfy requirements imposed by state regulators and other third parties.

We rely on independent agents to write voluntary insurance policies for us, and if we are not able to attract and retain independent agents, our revenues would be negatively affected.

We write personal and commercial insurance policies through a network of independent agents. Of our network of 2,400 southeast US independent agents, approximately 27.0% of new business is affiliated with eight large agency networks with which we have entered into master agency agreements, which are generally terminable with notice. Of our network of approximately 225 retail independent agents for business in the northeastern United States, our eight largest relationships represent approximately $70.0 million in annualized premiums. Of our network of approximately 70 Hawaiian independent agencies, approximately 52.0% are affiliated with three large multi-producer agencies.

Our strategic focus is to grow the number of policies written, which meet our underwriting criteria, throughout the states in which we are licensed, which will further increase our reliance on our network of independent agents. If any of our independent agents cease writing policies for us, or if any of our master agency agreements are terminated, we may suffer a reduction in the amount of products we are able to sell, which would negatively impact our results.

Many of our competitors also rely on independent agents. As a result, we must compete with other insurers for independent agents’ business. Our competitors may offer a greater variety of insurance products, lower premiums for insurance coverage, or higher commissions to their agents. If our products, pricing and commissions do not remain competitive, we may find it more difficult to attract business from independent agents to sell our products.

The failure of our claims department to effectively manage or remediate claims could adversely affect our insurance business, financial results and capital requirements.

We rely on our claims department and any outsourced claims resources to facilitate and oversee the claims adjustment process for our policyholders. Many factors could affect the ability of our claims department to effectively manage claims by our policyholders, including:

- the accuracy of our adjusters as they make their assessments and submit their estimates of damages;
- the training, background and experience of our claims representatives;
- the ability of our claims department to ensure consistent claims handling;
- the ability of our claims department to translate the information provided by adjusters into acceptable claims resolutions; and
- the ability of our claims department to maintain and update its claims handling procedures and systems as they evolve over time based on claims and geographical trends in claims reporting.

Any failure to effectively manage the claims adjustment process, including failure to pay claims accurately, could lead to material litigation, undermine our reputation in the marketplace, impair our corporate image and negatively affect our financial results.

Additionally, in the final stage of the claims process, we leverage CAN’s vendor network to provide repair and remediation services to the policyholder. If such services are not performed properly, we may face liability. Although we maintain professional liability insurance to cover losses arising from our repair and remediation services, there can be no assurances that such coverage is adequate. In addition, our failure to timely and properly remediate claims, or the perception of such failure, may damage our reputation and adversely affect our ability to renew existing policies or write new policies.

If actual renewals of our existing contracts do not meet expectations, our premiums written in future years and our future results of operations could be materially adversely affected.

Our insurance policies are written for a one-year term. We make assumptions about the renewal of our prior year’s contracts, including for purposes of determining the amount of reinsurance we purchase. If actual renewals do not meet expectations or if we choose not to write on a renewal basis because of pricing conditions, our premiums written in future years and our future operations would be materially adversely affected, and we may purchase reinsurance beyond what we believe is the most appropriate level.

Our inability to maintain our financial stability rating may have a material adverse effect on our competitive position, the marketability of our product offerings, and our liquidity, operating results and financial condition.

Financial stability ratings are important factors in establishing the competitive position of insurance companies and can have a significant effect on an insurance company’s business. Many insurance buyers, agents, brokers and secured lenders use the ratings assigned by rating agencies to assist them in assessing the financial stability and overall quality of the companies from which they are considering purchasing insurance or in determining the financial stability of the company that provides insurance. Each of our insurance company affiliates currently maintain a Demotech rating of “A” (“Exceptional”) or higher. Our insurance company subsidiaries and our parent company are also rated BBB- or better by KBRA. These financial stability ratings provide an objective baseline for assessing solvency and should not be interpreted as (and are not intended to serve as) an assessment of, a recommendation to buy, sell, or hold, any securities of an insurance company or its parent holding company, including shares of our common stock.

On an ongoing basis, rating agencies review the financial performance and condition of insurers and can downgrade or change the outlook on an insurer’s ratings due to, for example, a change in an insurer’s statutory capital, a reduced confidence in management or a host of other considerations that may or may not be under the insurer’s control. All ratings are subject to continuous review; therefore, the retention of these ratings cannot be assured. A downgrade in any of these ratings could have a material adverse effect on our competitive position, the marketability of our product offerings and our ability to grow in the marketplace.

If we are unable to expand our business because our capital must be used to pay greater than anticipated claims, our financial results may suffer. Further, we may require additional capital in the future which may not be available or may only be available on unfavorable terms.

Our future growth and future capital requirements will depend on our ability to expand the number of insurance policies we write, to expand the kinds of insurance products we offer and to expand the geographic markets in which we do business, all balanced by the business risks we choose to assume and cede. These growth initiatives require capital. Our existing sources of funds include possible sales of common or preferred stock, incurring debt and our earnings from operations and investments. Unexpected catastrophic events in our coverage areas, such as the hurricanes, may result in greater claims losses than anticipated, which could require us to limit or halt our growth while we redeploy our capital to pay these unanticipated claims unless we are able to raise additional capital.

To the extent that our present capital is insufficient to meet future operating requirements or to cover losses, we may need to raise additional funds through financing or curtail our growth. Based on our current operating plan, we believe that our current capital together with our anticipated retained income will support our operations. However, we cannot provide any assurance in that regard, since many factors will affect the amount and timing of our capital needs, including our growth and profitability, the availability and cost of reinsurance, as well as possible acquisition opportunities, market disruptions and other unforeseeable developments. If we require additional capital, it is possible that equity or debt financing may not be available on acceptable terms or at all. In the case of equity financings, dilution to our stockholders could result, and in any case such securities may have rights, preferences and privileges that are senior to those of existing stockholders. If we cannot obtain adequate capital on favorable terms or at all, our business, financial condition or results of operations could be materially adversely affected.

Our information technology systems, or those of our key service providers, may fail or suffer a loss of security which could adversely affect our business.

Our insurance business is highly dependent upon the successful and uninterrupted functioning of our computer and data processing systems. We rely on these systems to perform actuarial and other modeling functions necessary for writing business, as well as to handle our policy administration process (i.e., handling and adjusting claims, the billing, printing and mailing of our policies, endorsements, renewal notices, etc.). The successful operation of our systems depends on a continuous supply of electricity. The failure of these systems or disruption in the supply of electricity could interrupt our operations and result in a material adverse effect on our business.

The development and expansion of our insurance business is dependent upon the successful development and implementation of advanced technology, including modeling, underwriting and information technology systems. Because we intend to expand our business by writing additional voluntary policies, expanding to new geographic areas and entering into new lines of business, we are enhancing our information technology systems to handle and process an increased volume of policies. Additionally, we have engaged service providers to provide us with policy and other administration services for certain policies and we intend to continue to utilize third party systems as our policy count grows. The failure of any of these systems to function as planned could slow our growth and adversely affect our future business volume and results of operations. In addition, we have licensed certain systems and data from third parties. We cannot be certain that we will have access to these, or comparable systems, or that our technology or applications will continue to operate as intended. Moreover, we cannot be certain that we would be able to replace these systems without slowing our underwriting response time. A major defect or failure in our internal controls or information technology systems could result in management distraction, harm to our reputation, a loss or delay of revenues or increased expense.

We may be subject to information technology failures, including data protection breaches and cyber-attacks, that could disrupt our operations, damage our reputation and adversely affect our business, operations, and financial results.

We rely on our information technology systems for the effective operation of our business and for the secure maintenance and storage of confidential data relating to our business and for our policyholders. We have implemented security controls to protect our information technology systems, but experienced programmers or hackers may be able to penetrate our security controls, and develop and deploy viruses, worms and other malicious software programs that compromise our confidential information or that of third parties and cause a disruption or failure of our information technology systems. In addition, we have in the past and may in the future be subject to "phishing" attacks in which third parties send emails purporting to be from reputable companies in order to obtain personal information and infiltrate our systems to initiate wire transfers or otherwise obtain proprietary or confidential information.

The Company's customers provide personal information that we store and maintain in our data warehouse and policy and claims systems. The Company has implemented systems and processes to protect against unauthorized access to or use of such personal information, but there is no guarantee that these procedures are adequate to safeguard against all security breaches or misuse of the information. Furthermore, the Company relies on encryption and authentication technology to provide security and authentication to effectively secure transmission of confidential information, including customer bank account, credit card information and other personal information. However, there is no guarantee that these systems or processes will address all of the cyber threats that continue to evolve in addition, many of the third parties who provide products, services, or support to the Company could also experience any of the above cyber risks or security breaches, which could impact the Company's policyholders and its business and could result in a loss of customers, suppliers or revenue.

Any compromise of our information technology systems could result in the unauthorized publication of our confidential business or proprietary information, result in the unauthorized release of customer, supplier or employee data, result in a violation of privacy or other laws, expose us to a risk of litigation, cause us to incur direct losses if attackers access our actuarial and other models, bank or investment accounts. Any breach in our information systems could result in interruptions to our operations and damage to our reputation, and the misappropriation of confidential information could result in regulatory enforcement actions, substantial fines and penalties, litigation or other liability or actions which could have a material adverse effect on our business, cash flows, financial condition and results of operations. Any interruption to the use or access of our information systems at critical points in time could adversely affect the timely and efficient operation of our business. Any delay in our business growth, significant costs or lost policyholders resulting from such information technology failures could adversely affect our business, operations and financial results.

The cost and operational consequences of implementing additional data protection measures either as a response to specific breaches or as a result of evolving changes in technology or risks, could be significant and negatively affect our business.

The development and implementation of new technologies will require an additional investment of our capital resources in the future.

Frequent technological changes, new products and services and evolving industry standards are all influencing the insurance business. We believe that the development and implementation of new technologies will require additional investment of our capital resources in the future. We have not determined, however, the amount of resources and the time that this development and implementation may require, which may result in short-term, unexpected interruptions to our business, or may result in a competitive disadvantage in price and/or efficiency, as we endeavor to develop or implement new technologies.

We do not have significant redundancy in our operations.

Despite system redundancy, our security measures and disaster recovery plan for our internal information technology may not be effective. Our systems are vulnerable to damage from a number of sources, including energy blackouts, natural disasters and other catastrophic events, terrorism, war, telecommunication failures and malicious software programs or cyber security attacks. We conduct our business primarily from offices located in Florida, Hawaii, and Rhode Island where catastrophic weather events could damage our facilities or interrupt our power supply. The loss or significant impairment of functionality in these facilities for any reason could have a material adverse effect on our business, as we do not have significant redundancies to replace our facilities if functionality is impaired. We contract with a third-party vendor to maintain complete daily backups of our systems; however, we have not fully tested our plan to recover data in the event of a disaster.

Furthermore, our disaster recovery and business continuity plans involve arrangements with our off-site, secure data centers. In the event of a catastrophic weather event or cyber security attack, we cannot assure that we will be able to access our systems from these facilities in the event that our primary systems are unavailable. While we have established infrastructure and geographic redundancy for our critical systems, our ability to utilize these redundant systems requires further testing and we cannot be assured that such systems are fully functional.

We depend on the ability of our subsidiaries to generate and transfer funds to meet debt obligations.

We do not have significant revenue generating operations of its own. Our ability to make scheduled payments on our debt obligations and dividends depends on the financial condition and operating performance of our subsidiaries. If the funds we receive from our subsidiaries, some of which are subject to regulatory restrictions on the payment of distributions, are insufficient to meet our debt obligations, we may be required to raise funds through the issuance of additional debt or equity securities, reduce or suspend dividend payments, or sell assets.

We are dependent on our executives, key employees and the ability to hire and retain a qualified workforce

Our future success depends on the efforts of our executives and senior management.

Currently, we maintain key man life insurance with respect to Bruce Lucas, our Chairman and Chief Executive Officer. If any other member of senior management dies or becomes incapacitated, or leaves the company to pursue employment opportunities elsewhere, we would be solely responsible for locating an adequate replacement for such senior management and for bearing any related cost. To the extent that we are unable to locate an adequate replacement or are unable to do so within a reasonable period of time, our business may be significantly and negatively affected.

Additionally, our future success is also based on our ability to develop the talent and skills of our human resources and attract and retain experienced and qualified employees. For example, if the quality of our underwriters, claims or other personnel decreases, we may be unable to maintain our current competitive position in the specialized markets in which we operate and be unable to expand our operations, which could adversely affect our results. There is strong competition within the insurance industry and from businesses outside the insurance industry for qualified employees. The unexpected loss of key employees in any of our could have a material adverse impact on our business because of the loss of such skills, knowledge of our products and years of industry experience.

Our financial results may be negatively affected by the fact that a portion of our income is generated by the investment of our company's capital, premiums and loss reserves.

A portion of our income is, and likely will continue to be, generated by the investment of our capital, premiums and loss reserves. The amount of income so generated is a function of our investment policy, available investment opportunities and the amount of available cash invested. We are also constrained by investment limitations required by our state insurance regulators. At December 31, 2019, approximately 68.0% of our total investments, cash and cash equivalents was invested in fixed-maturity securities. We may, under certain circumstances, be required to liquidate our investments in securities at prices below book value, which may adversely affect our financial results. We currently hold all of our cash in accounts with four financial institutions and, as a result of this concentration, a portion of the balances in such accounts exceeds the FDIC insurance limits. While we monitor and adjust the balances in our accounts as appropriate, these balances could be impacted if any of these financial institutions fail and could be subject to other adverse conditions in the financial markets.

We may alter our investment policy to accept higher levels of risk with the expectation of higher returns. Fluctuating interest rates and other economic factors make it impossible to estimate accurately the amount of investment income that will be realized. In fact, we may realize losses on our investments.

The effects of emerging claim and coverage issues on our business are uncertain.

Loss frequency and severity in the property and casualty insurance industry in general and for our multi-peril personal lines business has continued to increase in recent years, principally driven by litigation and assignment of benefits ("AOB") in the State of Florida. For example, in recent years, Florida homeowners have been assigning the benefit of their insurance recovery to third parties, which has resulted in increases in the size and number of claims and the amount of litigation, interference in the adjustment of claims, the assertion of bad faith actions and one-way rights to claim attorney fees. However, in July 2019, the Florida legislature enacted an AOB reform bill that intends to limit AOB litigation by creating requirements for the execution of an AOB and allowing an insurance policy to prohibit any AOB. There can be no assurance that this new legislation will reduce the future impact of AOB practices.

Many legal actions and proceedings have been brought on behalf of classes of complainants, which can increase the size of judgments. The propensity of policyholders and third-party claimants to litigate and the willingness of courts to expand causes of loss and the size of awards may render the loss reserves of our insurance subsidiaries inadequate for current and future losses. In addition, as industry practices and social and other environmental conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the number or size of claims. In some instances, these changes may not become apparent until sometime after we have issued insurance policies that are affected by the changes. As a result, the full extent of liability under our insurance policies may not be known at the time such policies are issued or renewed, and our financial position and results of operations may be adversely affected.

The failure of the risk mitigation strategies we utilize could have a material adverse effect on our financial condition or results of operations.

We utilize a number of strategies to mitigate our risk exposure including:

- employing proper underwriting procedures;
- carefully evaluating the terms and conditions of our policies;
- geographic diversification; and
- ceding insurance risk to reinsurance companies.

However, there are inherent limitations in these tactics. No assurance can be given that an event or series of unanticipated events will not result in loss levels which could have a material adverse effect on our financial condition or results of operations.

Lack of effectiveness of exclusions and other loss limitation methods in the insurance policies we assume or write could have a material adverse effect on our financial condition or our results of operations.

Various provisions of our policies, such as limitations or exclusions from coverage which are designed to limit our risks, may not be enforceable in the manner we intend. In addition, the policies we issue contain conditions requiring the prompt reporting of claims to us and our right to decline coverage in the event of a violation of that condition. While our insurance product exclusions and limitations reduce the loss exposure to us and help eliminate known exposures to certain risks, it is possible that a court or regulatory authority could nullify or void an exclusion or limitation, or legislation could be enacted modifying or barring the use of such endorsements and limitations in a way that would adversely affect our loss experience, which could have a material adverse effect on our financial condition or results of operations.

Our variable rate indebtedness subjects us to interest rate risk, which could cause our annual debt service obligations to increase significantly.

Borrowings under our 2019 Senior Credit Facility are at variable rates of interest and expose us to interest rate risk. If the rates on which our borrowings are based were to increase from current levels, our debt service obligations on our variable rate indebtedness would increase even though the amount borrowed remained the same, and our net income and cash available to service our other obligations would decrease.

Our financing costs may be adversely affected by changes in LIBOR.

LIBOR, the London interbank offered rate, is the basic rate of interest used in lending between banks on the London interbank market and is widely used as a reference for setting the interest rate on loans globally. We use LIBOR as a reference rate in our revolving credit facility to calculate interest due to our lender. On July 27, 2017, the United Kingdom's Financial Conduct Authority, which regulates LIBOR, announced its intention to phase out LIBOR by the end of 2021. It is unclear if LIBOR will cease to exist at that time or if new methods of calculating LIBOR will be established such that it continues to exist after 2021. If LIBOR ceases to exist, we may need to renegotiate our credit agreement with our lender. This could have an adverse effect on our financing costs.

Risks Related to Regulation of our Insurance Operations

We are subject to extensive regulation which may reduce our profitability or limit our growth. Moreover, if we fail to comply with these regulations, we may be subject to penalties, including fines and suspensions, which may adversely affect our financial condition and results of operations.

We are subject to extensive state regulation. The National Association of Insurance Carriers ("NAIC") and state insurance regulators regularly examine existing laws and regulations, generally focusing on modifications to holding company regulations, interpretations of existing laws and the formation of new laws. Our insurance company affiliates are subject to supervision and regulation that is primarily designed to protect our policyholders rather than our stockholders, and such regulation is imposed by the states in which we are domiciled and the states in which our insurance subsidiaries do business. These regulations relate to, among other things, the approval of policy forms and premium rates, our conduct in the marketplace, our compliance with solvency and financial reporting requirements, transactions with our affiliates, and limitations on the amount of business we can write, the amount of dividends we can pay to stockholders, and the types of investments we can make. Insurance holding company regulations generally provide that transactions between an insurance company and its affiliates must be fair and reasonable and must be clearly and accurately disclosed in the records of the respective parties, with expenses and payments allocated between the parties in accordance with customary accounting practices. Many types of transactions between an insurance company and its affiliates, such as transfers of assets, loans, reinsurance agreements, service agreements, certain dividend payments by the insurance company and certain other material transactions, may be subject to prior approval by, or prior notice to, state regulatory authorities. If we are unable to obtain the requisite prior approval for a specific transaction, we would be precluded from taking the action, which could adversely affect our operations. These regulatory requirements may adversely affect or inhibit our ability to achieve some or all of our business objectives. In addition, regulatory authorities also may conduct periodic examinations into insurers' business practices. These reviews may reveal deficiencies in our insurance operations or differences between our interpretations of regulatory requirements and those of the regulators.

State insurance regulations also frequently impose notice or approval requirements for the acquisition of specified levels of ownership in the insurance company or insurance holding company. Additionally, state legislation can impact our results of operations. For example, in 2007, Florida enacted legislation that led to rate levels in the private insurance market that we believe, in many instances in the past, were inadequate to cover the related underwriting risk. This same legislation required Citizens Property Insurance ("Citizens") to reduce its premium rates and begin competing against private insurers in the Florida residential property insurance market. Florida lawmakers may continue to enact or retain legislation that suppresses the rates of Citizens, further adversely impacting the private insurance market and increasing the likelihood that it must levy assessments on private insurance companies and ultimately on Florida consumers. These and other aspects of the political environment in jurisdictions where we operate may reduce our profitability, limit our growth, or otherwise adversely affect our operations.

During the past several years, various regulatory and legislative bodies have adopted or proposed new laws or regulations to address the cyclical nature of the insurance industry, catastrophic events and insurance capacity and pricing. These regulations include (i) the creation of "market assistance plans" under which insurers are induced to provide certain coverages, (ii) restrictions on the ability of insurers to rescind or otherwise cancel certain policies in mid-term or to nonrenew policies at their scheduled expirations, (iii) advance notice requirements or limitations imposed for certain policy non-renewals, (iv) limitations upon or decreases in rates permitted to be charged, (v) expansion of governmental involvement in the insurance market and (vi) increased regulation of insurers' policy administration and claims handling practices. Further, regulatory authorities have relatively broad discretion to deny or revoke licenses for various reasons, including the violation of regulations. In some instances, we follow practices based on our interpretations of regulations or practices that we believe may be generally followed by the industry. These practices may turn out to be different from the interpretations of regulatory authorities. If we do not have the requisite licenses and approvals or do not comply with applicable regulatory requirements, insurance regulatory authorities could preclude or temporarily suspend us from carrying on some or all of our activities or otherwise penalize us. This could adversely affect our ability to operate our business.

We cannot predict with certainty the effect any enacted, proposed or future state or federal legislation or NAIC initiatives may have on the conduct of our business. Furthermore, there can be no assurance that the regulatory requirements applicable to our business will not become more stringent in the future or result in materially higher costs than current requirements, or that creation of a federal insurance regulatory system will not adversely affect our business or disproportionately benefit our competitors. Changes in the regulation of our business may reduce our profitability, limit our growth or otherwise adversely affect our operations.

Our insurance subsidiaries are subject to minimum capital and surplus requirements, and our failure to meet these requirements could subject us to regulatory action.

Our insurance subsidiaries are subject to risk-based capital standards and other minimum capital and surplus requirements imposed under applicable state laws. The risk-based capital standards, based upon the Risk-Based Capital Model Act adopted by the NAIC, require our insurance subsidiaries to report the results of risk-based capital calculations to state regulators and the NAIC. These risk-based capital standards provide for different levels of regulatory attention depending upon the ratio of an insurance company's total adjusted capital, as calculated in accordance with NAIC guidelines, to its authorized control level risk-based capital. Authorized control level risk-based capital is determined using the NAIC's risk-based capital formula, which measures the minimum amount of capital that an insurance company needs to support its overall business operations.

An insurance company with total adjusted capital that is less than 200% of its authorized control level risk-based capital is at a company action level, which would require the insurance company to file a risk-based capital plan that, among other things, contains proposals of corrective actions the company intends to take that are reasonably expected to result in the elimination of the company action level event. Additional action level events occur when the insurer's total adjusted capital falls below 150%, 100%, and 70% of its authorized control level risk-based capital. The lower the percentage, the more severe the regulatory response, including, in the event of a mandatory control level event (total adjusted capital falls below 70% of the insurer's authorized control level risk-based capital), placing the insurance company into receivership. As of December 31, 2019, our insurance subsidiaries each maintained a risk-based capital ratio of over 300%. Our Florida subsidiary, HPCI, has agreed to maintain a risk-based capital ratio of at least 300%. In connection with our acquisition of NBIC, we agreed to maintain a risk-based capital ratio of 375%.

In addition, our insurance subsidiaries are required to maintain certain minimum capital and surplus and to limit its written premiums to specified multiples of its capital and surplus. Our insurance subsidiaries could exceed these ratios if their volume increases faster than anticipated or if their surplus declines due to catastrophe or non-catastrophe losses or excessive underwriting and operational expenses.

Any failure by our insurance subsidiaries to meet the applicable risk-based capital or minimum statutory capital requirements or the writings ratio limitations imposed by state law could subject our insurance subsidiaries to further examination or corrective action imposed by state regulators, including limitations on our writing of additional business, state supervision or liquidation.

Any changes in existing risk-based capital requirements, minimum statutory capital requirements, or applicable writings ratios may require us to increase our statutory capital levels, which we may be unable to do.

Litigation or regulatory actions could have a material adverse impact on us

From time to time, we are subject to civil or administrative actions and litigation. Civil litigation frequently results when we do not pay insurance claims in the amounts or at the times demanded by policyholders or their representatives. We also may be subject to litigation or administrative actions arising from the conduct of our business and the regulatory authority of state insurance departments. Further, we are subject to other types of litigation inherent in operating our businesses, employing personnel, contracting with vendors and otherwise carrying out our affairs. As industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended issues related to claims and coverage may arise, including judicial expansion of policy coverage and the impact of new theories of liability, plaintiffs targeting property and casualty insurers in purported class-action litigation relating to claims-handling and other practices, and adverse changes in loss cost trends, including inflationary pressures in home repair costs. Multiparty or class action claims may present additional exposure to substantial economic, non-economic or punitive damage awards. Current and future litigation or regulatory matters may negatively affect us by resulting in the payment of substantial awards or settlements, increasing legal and compliance costs, requiring us to change certain aspects of our business operations, diverting management attention from other business issues, harming our reputation with agents and customers or making it more difficult to retain current customers and to recruit and retain employees or agents.

Regulation limiting rate increases and requiring us to participate in loss sharing may decrease our profitability.

From time to time, political dispositions affect the insurance market, including efforts to effectively suppress rates at a level that may not allow us to reach targeted levels of profitability. Despite efforts to remove politics from insurance regulation, facts and history demonstrate that public policymakers, when faced with untoward events and adverse public sentiment, can act in ways that impede a satisfactory correlation between rates and risk. Such acts may affect our ability to obtain approval for rate changes that may be required to attain rate adequacy along with targeted levels of profitability and returns on equity. Our ability to afford reinsurance required to reduce our catastrophe risk may be dependent upon the ability to adjust rates for our cost.

Additionally, we are required to participate in guaranty funds for insolvent insurance companies. The funds periodically assess losses against all insurance companies doing business in the state. Our operating results and financial condition could be adversely affected by any of these factors.

Our revenues and operating performance will fluctuate due to statutorily approved assessments that support property and casualty insurance pools and associations

We operate in a regulatory environment where certain entities and organizations have the authority to require us to participate in assessments. Currently these entities and organizations include, but are not limited to, state guaranty funds, state joint underwriting associations, fair plans, wind pools, or the FHCF.

Insurance companies currently pass these assessments on to holders of insurance policies in the form of a policy surcharge and reflect the collection of these assessments as fully earned credits to operations in the period collected. The collection of these fees, however, may adversely affect our overall marketing strategy due to the competitive landscape of our business. As a result, the impact of possible future assessments on our balance sheet, results of operations or cash flow are indeterminable at this time.

Risks Relating to Ownership of Our Common Stock

Certain provisions of our certificate of incorporation and our bylaws may make it difficult for stockholders to change the composition of our board of directors and may discourage hostile takeover attempts that some of our stockholders may consider to be beneficial.

Certain provisions of our certificate of incorporation and bylaws may have the effect of delaying or preventing changes in control if our board of directors determines that such changes in control are not in the best interests of us and our stockholders. The provisions in such certificate of incorporation and bylaws include, among other things, the following:

- the ability of our board of directors to issue shares of preferred stock and to determine the price and other terms, including preferences and voting rights, of those shares without stockholder approval;
- stockholder action can only be taken at a special or regular meeting and not by written consent;
- advance notice procedures for nominating candidates to our board of directors or presenting matters at stockholder meetings; and
- allowing only our board of directors to fill vacancies on our board of directors.

We have elected in our certificate of incorporation not to be subject to Section 203 of the DGCL, an anti-takeover law. In general, Section 203 prohibits a publicly held Delaware corporation from engaging in a business combination, such as a merger, with a person or group owning 15% or more of the corporation’s voting stock for a period of three years following the date the person became an interested stockholder, unless (with certain exceptions) the business combination or the transaction in which the person became an interested stockholder is approved in a prescribed manner. Accordingly, we will not be subject to any anti-takeover effects of Section 203.

While these provisions have the effect of encouraging persons seeking to acquire control of our company to negotiate with our board of directors, they could enable the board of directors to hinder or frustrate a transaction that some, or a majority, of the stockholders might believe to be in their best interests, including an acquisition that would result in a price per share at a premium over the market price, and, in that case, may prevent or discourage attempts to remove and replace incumbent directors.

These provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management.

Certain provisions of our certificate of incorporation and our bylaws may make it difficult for stockholders to change the composition of our board of directors and may discourage hostile takeover attempts that some of our stockholders may consider to be beneficial.

Certain provisions of our certificate of incorporation and bylaws may have the effect of delaying or preventing changes in control if our board of directors determines that such changes in control are not in the best interests of us and our stockholders. The provisions in such certificate of incorporation and bylaws include, among other things, the following:

- the ability of our board of directors to issue shares of preferred stock and to determine the price and other terms, including preferences and voting rights, of those shares without stockholder approval;
- stockholder action can only be taken at a special or regular meeting and not by written consent;
- advance notice procedures for nominating candidates to our board of directors or presenting matters at stockholder meetings; and
- allowing only our board of directors to fill vacancies on our board of directors.

We have elected in our certificate of incorporation not to be subject to Section 203 of the DGCL, an anti-takeover law. In general, Section 203 prohibits a publicly held Delaware corporation from engaging in a business combination, such as a merger, with a person or group owning 15% or more of the corporation's voting stock for a period of three years following the date the person became an interested stockholder, unless (with certain exceptions) the business combination or the transaction in which the person became an interested stockholder is approved in a prescribed manner. Accordingly, we will not be subject to any anti-takeover effects of Section 203.

While these provisions have the effect of encouraging persons seeking to acquire control of our company to negotiate with our board of directors, they could enable the board of directors to hinder or frustrate a transaction that some, or a majority, of the stockholders might believe to be in their best interests, including an acquisition that would result in a price per share at a premium over the market price, and, in that case, may prevent or discourage attempts to remove and replace incumbent directors.

These provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management.

Applicable insurance laws may make it difficult to effect a change of control of our company.

State insurance holding company laws require prior approval by the state insurance department of any change of control of an insurer that is domiciled in that respective state. "Control" is generally defined as the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a company, whether through the ownership of voting securities, by contract or otherwise. Control is generally presumed to exist through the direct or indirect ownership of 10% or more of the voting securities of a domestic insurance company or any entity that controls a domestic insurance company. These laws may discourage potential acquisition proposals and may delay, deter or prevent a change of control of us, including through transactions, and in particular unsolicited transactions, that some or all of our stockholders might consider to be desirable.

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

The following is a summary of our offices and locations:

Location	Business Use	Square Footage	Lease Expiration Dates
Clearwater, Florida	Corporate Headquarters	75,736	Company owned
Safety Harbor, Florida	Restoration Center	16,367	Company owned
Honolulu, Hawaii	Insurance Company HI Operations	4,405	Leased
Johnston, Rhode Island	Insurance Company NE Operations	28,098	Leased

Approximately 44% of the building in Clearwater is leased to unaffiliated tenants.

Item 3. Legal Proceedings

We are subject to routine legal proceedings in the ordinary course of business. We believe that the ultimate resolution of these matters will not have a material adverse effect on our business, financial condition or results of operations.

Item 4. Mine Safety Disclosures

Not applicable

PART II

Item 5. Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock has been listed on the New York Stock Exchange ("NYSE") under the symbol "HRTG" since May 2014.

Holders of Record

As of March 4, 2020, we had 28,978,952 shares of common stock outstanding, including 320,534 shares of restricted stock for which restrictions have not lapsed, and by a total of approximately 30 stockholders of record.

Dividends

In 2019, we declared dividends in the amount of $7.1 million, while we have historically declared dividends the declaration and payment of dividends will be at the discretion of our Board of Directors and will depend on profits, financial requirements and other factors, such as legal and regulatory restrictions on the payment of dividends, overall business condition and other elements the Board of Directors considers relevant. See **Note 22**. *Equity* to our consolidated financial statements under Item 8 of this Annual Report on Form 10-K.

Securities Authorized for Issuance under Equity Compensation Plan.

For information regarding the securities authorized for issuance under our equity compensation plans, refer to "Security Ownership of Certain Beneficial Owners and Management and Related Stockholders Matters" included in Part III, Item 12 of this Annual Report.

Stock Repurchase Program

In November 2019, the Company acquired 225,000 shares for a total cost of $3.3 million that were not part of the publicly announced share repurchase program authorization. These shares were delivered to the Company by employees to satisfy tax withholding obligations in connection with the vesting of restricted stock awards.

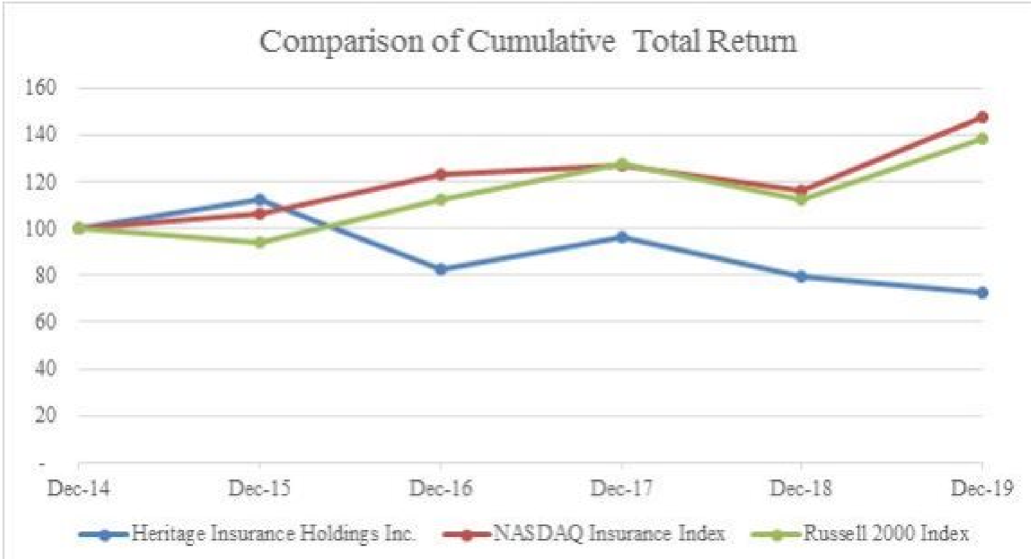
Shares repurchased for during the three months ended December 31, 2019 are summarized in the table below (in thousands, except per share data). Average price paid per share excludes fees and commissions.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs
October 1 - October 31, 2019	—	$ —	—	$ 38,106
November 1 - November 30, 2019	371,040	$ 14.34	146,040	$ 36,008
December 1 - December 31, 2019	166,883	$ 13.09	166,883	$ 33,816
Total	537,923		312,923	

Refer to **Note 22** Equity to the accompanying consolidated financial statements for future discussions on the Share Repurchase Program.

Stock Performance Graph

The following five year graph and table compare the cumulative total stockholder return of our common stock for the quarterly periods of December 31, 2015 through 2019, assuming an initial investment of $100 and reinvestment of dividends with the performance among Heritage Insurance Holdings Inc of, NASDAQ Insurance Index and Russell 2000 Index. We are a component of the Russell 2000 index and it provides small and mid-cap benchmark index. The NASDAQ Insurance Index consists of all publicly traded insurance underwriters in the property and casualty sector in the United States.



	May-14	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18
Heritage Insurance Holdings, Inc	100	169	190	139	162	135
NASDAQ Insurance Index	100	108	115	133	138	126
Russell 2000 Index	100	107	101	121	136	120

Item 6. Selected Financial Data

The following selected consolidated financial data should be read in conjunction with Item 7 – Management's Discussion and Analysis of Financial Condition Results of Operations and our consolidated financial statements and the related notes appearing in Item 8 – Financial Statements and Supplementary Data of this Annual Report. The consolidated statement of operations data for the years ended December 31, 2019, 2018 and 2017 and the consolidated balance sheet data at December 31, 2019 and 2018 are derived from our audited consolidated financial statements appearing in Item 8 of this Annual Report on Form 10-K. The consolidated statement of operations data for the years ended December 31, 2016 and 2015 and the consolidated balance sheet data at December 31, 2017, 2016 and 2015 are derived from our audited consolidated financial statements that are not included in this Annual Report on Form 10-K. The historical results are not necessarily indicative of the results to be expected in any future period.

Statements of Operations Data:

	Year Ended December 31,				
	2019	2018	2017	2016	2015
	(In thousands, except per share data)				
Revenue:					
Gross premiums written	$ 937,937	$ 923,349	$ 625,565	$ 626,704	$ 586,098
Gross premiums earned	924,247	926,326	643,304	640,518	524,740
Ceded premiums	(445,534)	(472,144)	(263,740)	(228,797)	(148,472)
Net premiums earned	478,713	454,182	379,564	411,721	376,268
Net investment income and realized gains/losses	18,595	10,803	11,896	10,914	8,929
Other revenue	13,997	15,186	15,163	16,323	9,595
Total revenue	511,305	480,171	406,623	438,958	394,792
Expenses:					
Loss and loss adjustment expenses	273,288	237,425	201,482	238,862	141,191
Other operating expenses	188,450	173,210	155,606	143,331	103,311
Total expenses	461,738	410,635	357,088	382,193	244,502
Operating income	49,567	69,536	49,535	56,765	150,290
Other non-operating expenses	8,571	30,542	55,427	362	—
Income (loss) before income taxes	40,996	38,994	(5,892)	56,403	150,290
Provision for income taxes	12,360	11,839	(4,773)	22,538	57,778
Net income (loss)	$ 28,636	$ 27,155	$ (1,119)	$ 33,865	$ 92,512
Earnings (loss) per share:					
Basic earnings (loss) per share	$ 0.98	$ 1.05	$ (0.04)	$ 1.14	$ 3.08
Diluted earnings (loss) per share	$ 0.98	$ 1.04	$ (0.04)	$ 1.14	$ 3.05
Ratios to net premiums earned:					
Net loss ratio	57.1%	52.3%	53.1%	58.0%	37.5%
Operating expense ratio	39.4%	38.1%	41.0%	34.8%	27.5%
Combined ratio	96.5%	90.4%	94.1%	92.8%	65.0%

Balance Sheet Data

	As of December 31,				
	2019	2018	2017	2016	2015
			(in thousands)		
Cash and invested assets	$ 863,600	$ 778,710	$ 720,710	$ 708,799	$ 636,373
Reinsurance recoverable	$ 428,903	$ 317,930	$ 357,357	$ —	$ —
Prepaid reinsurance premiums	$ 224,102	$ 233,071	$ 227,764	$ 106,609	$ 78,517
Deferred policy acquisition costs	$ 77,211	$ 73,055	$ 41,678	$ 42,779	$ 34,800
Intangibles	$ 68,642	$ 76,850	$ 101,626	$ 26,542	$ 2,120
Goodwill	$ 152,459	$ 152,459	$ 152,459	$ 46,454	$ 8,028
Total Assets	$ 1,939,670	$ 1,768,713	$ 1,771,210	$ 1,033,244	$ 837,398
Unpaid loss and loss adjustment expense	$ 613,533	$ 432,359	$ 470,083	$ 140,137	$ 83,722
Unearned premiums	$ 486,220	$ 472,357	$ 475,334	$ 318,024	$ 302,493
Long-term debt, net of issuance costs	$ 129,248	$ 148,794	$ 184,405	$ 72,905	$ —
Reinsurance premium payable	$ 156,351	$ 166,975	$ 17,577	$ 96,667	$ 60,210
Deferred ceding commission	$ 37,464	$ 44,819	$ 51,109	$ —	$ —
Commission payable	$ 14,798	$ 11,654	$ 12,609	$ 6,179	$ —
Outstanding checks	$ —	$ 15,360	$ 79,665	$ —	$ —
Total Liabilities	$ 1,490,871	$ 1,343,380	$ 1,391,394	$ 675,285	$ 480,845
Total Stockholders' Equity	$ 448,799	$ 425,333	$ 379,816	$ 357,959	$ 356,553

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Please read the following discussion and analysis of our financial condition and results of operations together with our consolidated financial statements and related notes included under Part II, Item 8 of this Annual Report on Form 10-K.

Overview

Heritage Insurance Holdings, Inc., is a super-regional property and casualty insurance holding company that primarily provides personal and commercial residential insurance products across its multi-state footprint. We provide personal residential insurance in twelve states and commercial residential insurance in two of those states, while maintaining licenses in four additional states. As a vertically integrated insurer, we control or manage substantially all aspects of underwriting, customer service, actuarial analysis, distribution and claims processing and adjusting. Our financial strength ratings are important to the Company in establishing our competitive position and can impact our ability to write policies. We are rated by both Demotech, Inc. ("Demotech") and Kroll Bond Rating Agency ("KBRA").

Demotech and KBRA have assigned the following insurance financial strength rating ("IFSR") to our key operating subsidiaries. Additionally, KBRA has assigned an investment grade issuer rating to the parent company, Heritage Insurance Holdings. The outlook for all ratings is stable. Demotech maintains a letter-scale financial stability rating system ("FSR") from A'' (A double prime) to L (licensed by insurance regulatory authorities). KBRA's ratings assigned to insurance companies ranges from AAA (extremely strong operations to no risk) to R (operating under regulatory supervision).

Subsidiary	Demotech Rating	KBRA Rating	KBRA Investment Rating
Heritage P&C	A	BBB+	N/A
Zephyr	A'	BBB+	N/A
NBIC	A	A-	N/A
Heritage Insurance	N/A	N/A	BBB-

The discussion of our financial condition and results of operations that follows provides information that will assist the reader in understanding our consolidated financial statements, the changes in certain key items in those financial statements from year to year, and the primary factors that accounted for those changes, as well as how certain accounting principles, policies and estimates affect our consolidated financial statements. This discussion should be read in conjunction with our consolidated financial statements and the related notes that appear elsewhere in this document.

Acquisitions and Financings

On December 14, 2018, we entered into a five-year, $125 million credit agreement (the "Credit Agreement") with a banking syndicate. Pursuant to the Credit Agreement, the participating Lenders agreed to provide (1) a senior secured term loan facility in an aggregate principal amount of $75 million and (2) a senior secured revolving credit facility in an aggregate principal amount of $50 million (inclusive of a $5 million sublimit for the issuance of letters of credit and a $10 million sublimit for swingline loans) (the "Credit Facilities").

At our option, borrowings under the Credit Facilities bear interest at rates equal to either (1) a rate determined by reference to LIBOR (based on one, two, three or six-month interest periods), adjusted for statutory reserve requirements, plus an applicable margin (equal to 3.25% as of the Closing Date) or (2) a base rate determined by reference to the greatest of (a) the "prime rate" of Regions Bank, (b) the federal funds rate plus 0.50%, and (c) the LIBOR index rate applicable for an interest period of one month plus 1.00%, plus an applicable margin (equal to 2.25%). The applicable margin for loans under the Credit Facilities varies from 3.25% per annum to 3.75% per annum (for LIBOR loans) and 2.25% to 2.75% per annum (for base rate loans) based on our consolidated leverage ratio.

We used the net proceeds of the 2018 Credit Facilities (1) to redeem all $79.5 million outstanding aggregate principal amount of our Senior Notes due 2023, (2) to purchase $72.7 million of our outstanding 5.875% Convertible Notes due 2037, and (3) for general corporate purposes.

In the fourth quarter of 2018 and the first quarter of 2019, we exchanged $81.6 million of principal of Convertible Notes for a combination of cash and the issuance of 3,880,653 shares of common stock.

Key Components of our Results of Operations

Revenue

Gross premiums written represent, with respect to a period, the sum of direct premiums written (premiums from policies written during the period, net of any midterm cancellations and renewals of voluntary policies) and assumed premiums written (primarily premiums from state fair plan policies), in each case prior to ceding premiums to reinsurers.

Gross premiums earned represent the total premiums earned during a period from policies written. Premiums associated with voluntary and renewed policies are earned ratably over the twelve-month term of the policy and premiums associated with assumed policies are earned ratably over the remaining term of the policy.

Ceded premiums represent the cost of our reinsurance during a period. We recognize the cost of our reinsurance program ratably over the twelve-month term of the arrangement. Our catastrophe XOL reinsurance generally incepts June 1 and runs through May 31 of the following year. Our net quota share treaty incepts December 31. Our other reinsurance programs may be purchased on a calendar or fiscal year basis.

Net premiums earned reflect gross premiums earned less ceded premiums during the period.

Net investment income represents interest earned on fixed maturity securities, short term securities and other investments, dividends on equity securities, realized gains or losses on investment sales and unrealized gains or losses on equity securities.

Other revenue includes rental income due under non-cancelable leases for space at the Company’s commercial property in Clearwater, Florida, and all policy and pay-plan fees. Our regulators have approved a policy fee on each policy written for certain states; these fees are not subject to refund, and the Company recognizes the income immediately when collected. The Company also charges pay-plan fees to policyholders that pay premiums in more than one installment and record the fees as income when collected.

Expenses

Losses and loss adjustment expenses (“LAE”) reflect losses paid, expenses paid to resolve claims, such as fees paid to adjusters, attorneys and investigators, and changes in our reserves for unpaid losses and loss adjustment expenses during the period, in each case net of losses ceded to reinsurers. Our reserves for unpaid losses and loss adjustment expenses represent the estimated ultimate cost of resolving all reported claims plus all losses we incurred related to insured events that we assume have occurred as of the reporting date, but that policyholders have not yet reported to us (which are commonly referred to as incurred but not reported, or “IBNR”). We estimate our reserves for unpaid losses using individual case-based estimates for reported claims and actuarial estimates for IBNR losses. We continually review and adjust our estimated losses as necessary based on our evolving claims experience, new information obtained and industry development trends. If our unpaid losses and loss adjustment expenses are considered deficient or redundant, we increase or decrease the liability in the period in which we identify the difference and reflect the change in our current period results of operations.

Policy acquisition costs (“PAC”) consist of: (i) commissions paid to outside agents at the time of policy issuance, (ii) policy administration fees paid to a third-party administrator at the time of policy issuance, (iii) premium taxes and (iv) inspection fees. We recognize policy acquisition costs ratably over the term of the underlying policy or, for policies assumed, over the term of the unearned premium acquired. We also earn ceding commissions on NBIC’s net quota share reinsurance contract and certain other reinsurance contracts, which are reported as a reduction to policy acquisition costs and general and administrative expenses based upon the proportion these costs bear to production of new business. See Note 11 - *Deferred Policy Acquisition Costs* to our consolidated financial statements under Item 8 of this Annual Report on Form 10K. Ceding commission income is deferred and earned over the contract period. The amount and rate of ceding commissions earned on the net quota share contract can slide within a prescribed minimum and maximum, depending on loss performance and how future losses develop.

General and administrative expenses (“G&A”) include compensation and related benefits, professional fees, office lease and related expenses, information system expenses, corporate insurance, and other general and administrative costs. As noted above, a certain portion of our ceding commissions are allocated to general and administrative expenses.

Provision for income taxes consists of federal and state corporate level income taxes, with a 30.1% effective tax rate for the current year. The effective tax rate can fluctuate throughout the year as estimates used in the quarterly tax provision are updated with additional information throughout the year. The effective tax rate can vary from the 26.5% statutory federal and state blended rate depending on the amount of pretax income in proportion to permanent tax differences as well as state tax apportionment.

Ratios

Ceded premium ratio represents ceded premiums earned as a percentage of gross premiums earned.

Net loss ratio represents net losses and LAE as a percentage of net premiums earned.

Net expense ratio represents PAC and G&A expenses as a percentage of net premiums earned. Ceding commission income is reported as a reduction of policy acquisition costs and G&A expenses.

Net combined ratio represents the sum the net loss and expense ratio. The net combined ratio is a key measure of underwriting performance traditionally used in the property and casualty insurance industry. A net combined ratio under 100% generally reflects profitable underwriting results.

Financial Results Highlights for the Year Ended December 31, 2019

- Net income was $28.6 million, or $0.98 per diluted share
- Book value per share increased to $15.66, up 8.5% from year-end 2018.
- Gross premiums written of $937.9 million, up 1.6% year-over-year, including 8.1% growth outside Florida that was partly offset by a 3.9% decline in Florida related to exposure management efforts in the state.
- Gross premiums-in-force of $940.6 million, up 1.8% year-over-year, including 8.7% growth outside Florida. Policies-in-force of 531,945, up 3.2% year-over-year.
- Favorable prior year reserve development of $3.7 million.
- Repurchased 1,134,686 shares for $16.2 million at an average price of $14.22 per share, 8.9% below year-end 2019 book value per share. Total capital returned to shareholders of $23.3 million, including $0.06 per share regular quarterly dividend.

<u>Consolidated Results of Operations</u>

The following table summarizes our results of operations for the periods indicated (in thousands, except per share amounts):

	Year Ended December 31,			
	2019	*2018*	*$ Change*	*% Change*
	(in thousands, expect per share amounts)			
REVENUE:				
Gross premiums written	$ 937,937	$ 923,349	$ 14,588	1.6%
Change in gross unearned premiums	(13,690)	2,977	(16,667)	NM
Gross premiums earned	924,247	926,326	(2,079)	-0.2%
Ceded premiums	(445,534)	(472,144)	26,610	-5.6%
Net premiums earned	478,713	454,182	24,531	5.4%
Net investment income	14,432	13,280	1,152	8.7%
Net realized gains	4,163	(2,477)	6,640	NM
Other revenue	13,997	15,186	(1,189)	-7.8%
Total revenue	$ 511,305	$ 480,171	$ 31,134	6.5%
OPERATING EXPENSES:				
Losses and loss adjustment expenses	273,288	237,425	35,863	15.1%
Policy acquisition costs	107,906	84,666	23,240	27.4%
General and administrative expenses	80,544	88,544	(8,000)	-9.0%
Total operating expenses	461,738	410,635	51,103	12.4%
Operating income	49,567	69,536	(19,969)	-28.7%
Interest expense, net	8,523	20,015	(11,492)	-57.4%
Other non-operating expense, net	48	10,527	(10,479)	NM
Income (loss) before income taxes	40,996	38,994	2,002	5.1%
Provision for income taxes	12,360	11,839	521	4.4%
Net income (loss)	$ 28,636	$ 27,155	$ 1,481	5.5%
Basic net income (loss) per share	$ 0.98	$ 1.05	$ (0.07)	-6.7%
Diluted net income (loss) per share	$ 0.98	$ 1.04	$ (0.06)	-5.8%

NM – not meaningful

<u>Results of Operations – Year Ended December 31, 2019 Compared to Year Ended December 31, 2018</u>

Revenue

<u>Gross premiums written</u>

Gross premiums written were $937.9 million for the year ended December 31, 2019, up 1.6% compared to $923.3 million for the prior year. The increase relates to growth in all states other than Florida, partly offset by an exposure management driven decline in Florida during the first nine months of 2019.

<u>Gross premiums earned</u>

Gross premiums earned were $924.2 million for the year ended December 31, 2019, down 0.2% compared to $926.3 million in the prior year.

<u>Ceded premiums</u>

Ceded premiums were $445.5 million for the year ended December 31, 2019, down 5.6% compared to $472.1 million in the prior year. The decrease is primarily attributable to a continued reduction in our Florida total insured value ("TIV"), which benefited the cost of our 2019-2020 catastrophe reinsurance program, reinsurance synergies associated with the 2019 renewal of remaining legacy NBIC reinsurance coverage on a consolidated basis, and an overall reduction to our gross quota share reinsurance coverage in the northeast.

<u>Net premiums earned</u>

Net premiums earned were $478.7 million for the year ended December 31, 2019, up 5.4% compared to $454.2 million in the prior year. The increase primarily stems from lower ceded premiums earned.

<u>Net investment income</u>

Net investment income, inclusive of realized investment gains (losses) and unrealized gains (losses) on equity securities, was $18.6 million for the year ended December 31, 2019, up 72.1% compared to $10.8 million in the prior year. The increase relates primarily to improved pricing on invested assets, a higher average invested asset balance and higher realized gains, partly offset by a lower yield on invested assets, a function of the low interest rate environment.

<u>Other revenue</u>

Other revenue was $14.0 million for the year ended December 31, 2019, down 7.8% compared to $15.2 million in the prior year. The decline primarily stems from premium adjustments.

<u>Total revenue</u>

Total revenue was $511.3 million for the year ended December 31, 2019, up 6.5% compared to $480.2 million in the prior year. The increase primarily stems from higher net premiums earned and net investment income, as described above.

Expenses

	Year Ended December 31,			
	2019	*2018*	*$ Change*	*% Change*
OPERATING EXPENSES:				
Losses and loss adjustment expenses	$ 273,288	$ 237,425	$ 35,863	15.1%
Policy acquisition costs	107,906	84,666	23,240	27.4%
General and administrative expenses	80,544	88,544	(8,000)	-9.0%
Total operating expenses	$ 461,738	$ 410,635	$ 51,103	12.4%

Losses and loss adjustment expenses

Losses and LAE were $273.3 million for the year ended December 31, 2019, up 15.1% compared to $237.4 million in the prior year. The increase primarily stems from lower income from vertically integrated operations and reduced overall quota share reinsurance coverage, partly offset by better prior year reserve development and lower current accident year weather losses.

Policy acquisition costs

Policy acquisition costs were $107.9 million for the year ended December 31, 2019, up 27.4% compared to $84.7 million in the prior year. The increase primarily reflects the favorable impact of NBIC-related purchase accounting on the prior year period. The favorable purchase accounting impact occurred predominantly in the first two quarters of 2018 and was limited thereafter, as acquisition costs increased with new business. Policy acquisition costs also increased due to reduced ceding commission income in the current year period associated with a reduction to our gross quota share reinsurance program in the northeast. The gross quota share reinsurance program was reduced from 18.75% to 8.0% effective June 1, 2018 and was eliminated effective June 1, 2019, while the net quota share reinsurance program increased from 49.5% to 52.0% effective December 31, 2018 and was increased to 56% effective December 31, 2019.

General and administrative expenses

General and administrative expenses were $80.5 million for the year ended December 31, 2019, down 9.0% compared to $88.5 million in the prior year. The decrease is primarily attributable to the prior year's inclusion of non-core business acquisition related expenses, costs associated with infrastructure growth and post-acquisition costs associated with NBIC-related systems implementation, partly offset by reduced ceding commission income in the current year, as described above.

	Year Ended December 31,			
	2019	***2018***	***$ Change***	***% Change***
Operating income	$ 49,567	$ 69,536	$ (19,969)	-28.7%
Interest expense, net	8,523	20,015	(11,492)	-57.4%
Other non-operating expense, net	48	10,527	(10,479)	NM
Income before income taxes	40,996	38,994	2,002	5.1%
Provision for income taxes	12,360	11,839	521	4.4%
Net income	$ 28,636	$ 27,155	$ 1,481	5.5%
Basic net income per share	$ 0.98	$ 1.05	$ (0.07)	-6.7%
Diluted net income per share	$ 0.98	$ 1.04	$ (0.06)	-5.8%

Interest expense and amortization of debt issuance costs

Interest expense and amortization of debt issuance costs were $8.5 million for the twelve months ended December 31, 2019, down 28.7% from $20.0 million in the prior year. The decrease primarily reflects a significant reduction in long-term debt and a lower blended interest rate on outstanding debt associated with 2018 debt refinancing transactions.

Other non-operating expense, net

Other non-operating expense was down meaningfully for the twelve months ended December 31, 2019, as the prior year period included $9.8 million associated with debt refinancing, described in Note 14 – *Long-Term Debt* to our audited consolidated financial statements appearing elsewhere in this Form 10-K. In 2018, these non-core costs included a pre-payment penalty, the write off of unamortized debt issuance costs associated with retired senior notes, fees associated with debt refinancing and a loss on early debt extinguishment. Additionally, we recorded a permanent decline in the value of real estate during the year

Provision for income taxes

Provision for income taxes was $12.4 million and $11.8 million for the twelve months ended December 31, 2019 and 2018, respectively. The effective tax rate for the current year is 30.1% compared to 30.4% for the prior year. The effective tax rate can fluctuate throughout the year as estimates used in the quarterly tax provision are updated with additional information throughout the year.

Net income

Net income for the twelve months ended December 31, 2019 was $28.6 million ($0.98 per diluted share), up 5.5% from $27.2 million ($1.04 per diluted share) in the prior year. The increase primarily reflects higher net premiums earned and net investment income and lower interest expense, partly offset by higher net loss and expense ratios.

Ratios

	Year Ended December 31,	
	2019	*2018*
Ceded premium ratio	48.2%	51.0%
Net loss and LAE ratio	57.1%	52.3%
Net expense ratio	39.4%	38.1%
Net combined ratio	96.5%	90.4%

Ceded premium ratio

The ceded premium ratio was 48.2% for the twelve months ended December 31, 2019, down 2.8 points from 51.0% in the prior year. The decrease primarily stems from lower ceded premiums, as described above.

Net loss ratio

The net loss and LAE ratio was 57.1% for the twelve months ended December 31, 2019, up 4.8 points from 52.3% in the prior year. The increase relates to lower income from vertically integrated operations, partly offset by better prior year reserve development, lower weather-related losses and a lower attritional loss ratio.

Net expense ratio

The net expense ratio was 39.4% for the twelve months ended December 31, 2019, up 1.3 points from 38.1% in the prior year. The increase primarily stems from the favorable impact of NBIC-related purchase accounting on the prior year period, partly offset by non-core business acquisition related expenses in the prior year period.

Net combined ratio

The net combined ratio was 96.5% for the twelve months ended December 31, 2019, up 6.1 points from 90.4% in the prior year. The increase stems from higher net loss and expense ratios, as described above.

Year Ended December 31, 2018 Compared to Year Ended December 31, 2017

For a comparison of our results of operations for the fiscal years ended December 31, 2018 and December 31, 2017, see "Part II, Item 7. Managements' Discussion and Analysis of Financial Condition and Results of Operations" of our Form 10-K for the fiscal 2018 with the SEC on March 12, 2019.

Liquidity and Capital Resources

Our principal sources of liquidity include cash flows generated from operations, our cash, cash equivalents, our marketable securities balances and borrowings available under our credit facilities. As of December 31, 2019, we held $268.4 million in cash and cash equivalents and $595.2 million in investments, compared to $250.1 million and $528.6 million as of December 31, 2018 and $153.7 million and $567.0 million as of December 31, 2017. The increase in cash and cash equivalents in 2019 was due primarily to timing of cash flow for premiums and loss payments as well as funds allocated for our investment portfolio.

In 2019, we completed the following activities related to our debt structure:

- We repaid $10 million on our revolving credit loan that was originally used for the repurchase of the company's outstanding convertible notes.
- We paid $5.6 million in principal on our term note.
- We paid $2.9 million for the repurchase of convertible debt.

We believe that our sources of cash are adequate to meet our cash requirements for at least the next twelve months.

We may continue to pursue the acquisition of complementary businesses and make strategic investments. We may increase capital expenditures consistent with our investment plans and anticipated growth strategy. Cash and cash equivalents may not be sufficient to fund such expenditures. As such, in addition to the use of our existing Credit Facility, we may need to utilize additional debt to secure funds for such purposes.

Statement of Cash Flows

The net increases (decreases) in cash and cash equivalents are summarized in the following table:

	For the Year Ended December 31,				
	2019	*2018*	*2017*	*2019 vs 2018 Change*	*2018 vs 2017 Change*
Net cash provided by (used in):			*(in thousands)*		
Operating activities	$ 119,657	$ 96,338	$ 7,489	$ 23,319	$ 88,849
Investing activities	(53,585)	23,455	(7,242)	(77,040)	30,697
Financing activities	(45,434)	(31,953)	47,556	(13,481)	(79,509)
Net change in cash, cash equivalents, and restricted cash	$ 20,638	$ 87,840	$ 47,803	$ (67,202)	$ 40,037

Operating Activities

Net cash provided by operating activities for December 31, 2019 was $119.7 million as compared to net cash provided of $96.3 million during the prior year. The increase was primarily due to a reduction in the cost of our reinsurance program as well as timing of cash flow from receipt of premiums and payment of claims.

Investing Activities

Net cash used by investing activities for the year ended December 31, 2019 was $53.6 million as compared to net cash provided of $23.5 million in the prior year. The variance relates primarily to an increase in our investment portfolio.

Financing Activities

Net cash used in financing activities for the year ended December 31, 2019 was $45.4 million, as compared net cash used to $32.0 million in the prior year. The cash outflows in 2019 resulted from repayments of long-term debt, purchase of treasury stock and payment of cash dividends.

Credit Facilities

On December 14, 2018, Heritage Insurance Holdings, Inc. (the “Company”), as borrower, entered into a credit agreement (the “Credit Agreement”) by and among the Company, certain subsidiaries of the Company from time to time party thereto as guarantors, the lenders from time to time party thereto (the “Lenders”), Regions Bank, as Administrative Agent and Collateral Agent, BMO Harris Bank N.A., as Syndication Agent, Hancock Whitney Bank and Canadian Imperial Bank of Commerce, as Co-Documentation Agents, and Regions Capital Markets and BMO Capital Markets Corp., as Joint Lead Arrangers and Joint Bookrunners.

Pursuant to the Credit Agreement, the participating Lenders agreed to provide (1) a five-year senior secured term loan facility in an aggregate principal amount of $75 million (the “Term Loan Facility”) and (2) a five-year senior secured revolving credit facility in an aggregate principal amount of $50 million (inclusive of a $5 million sublimit for the issuance of letters of credit and a $10 million sublimit for swingline loans) (the “Revolving Credit Facility” and together with the Term Loan Facility, the “Credit Facilities”). As of December 31, 2019, the Company had in aggregate $69.4 million principal outstanding under the Term Loan Facility and $10.0 million of borrowings outstanding under the Revolving Credit Facility.

At our option, borrowings under the Credit Facilities bear interest at rates equal to either (1) a rate determined by reference to LIBOR (based on one, two, three or six-month interest periods), adjusted for statutory reserve requirements, plus an applicable margin (equal to 3.25% as of the Closing Date) or (2) a base rate determined by reference to the greatest of (a) the “prime rate” of Regions Bank, (b) the federal funds rate plus 0.50%, and (c) the LIBOR index rate applicable for an interest period of one month plus 1.00%, plus an applicable margin (equal to 2.25%).

The applicable margin for loans under the Credit Facilities varies from 3.25% per annum to 3.75% per annum (for LIBOR loans) and 2.25% to 2.75% per annum (for base rate loans) based on our consolidated leverage ratio. Interest payments with respect to the Credit Facilities are required either on a quarterly basis (for base rate loans) or at the end of each interest period (for LIBOR loans) or, if the duration of the applicable interest period exceeds three months, then every three months. As of December 31, 2019, the borrowing under our Credit Facilities were accruing interest at a rate of 5.0625% per annum.

In addition to paying interest on outstanding borrowings under the Revolving Credit Facility, we are required to pay a quarterly commitment fee based on the unused portion of the Revolving Credit Facility, which is determined by our consolidated leverage ratio.

Each of the Revolving Credit Facility and the Term Loan Facility mature on December 14, 2023. The principal amount of the Term Loan Facility amortizes in quarterly installments, which began with the close of the fiscal quarter ended March 31, 2019, in an amount equal to $1,875,000 per quarter, payable monthly or quarterly, with the balance payable at maturity.

The Company may prepay the loans under the Credit Facilities, in whole or in part, at any time without premium or penalty, subject to certain conditions including minimum amounts and reimbursement of certain costs in the case of prepayments of LIBOR loans. In addition, the Company is required to prepay the loan under the Term Loan Facility with the proceeds from certain financing transactions, involuntary dispositions or asset sales (subject, in the case of asset sales, to reinvestment rights).

All obligations under the Credit Facilities are or will be guaranteed by each existing and future direct and indirect wholly owned domestic subsidiary of the Company, other than all of the Company's current and future regulated insurance subsidiaries (collectively, the "Guarantors").

The Company and the Guarantors entered into a Pledge and Security Agreement, on December 14, 2018 (the "Security Agreement"), in favor of Regions Bank, as collateral agent. Pursuant to the Security Agreement, amounts borrowed under the Credit Facilities are secured on a first priority basis by a perfected security interest in substantially all of the present and future assets of the Company and each Guarantor (subject to certain exceptions), including all of the capital stock of the Company's domestic subsidiaries, other than its regulated insurance subsidiaries.

The Credit Agreement contains, among other things, covenants, representations and warranties and events of default customary for facilities of this type. The Company is required to maintain, as of each fiscal quarter (1) a maximum consolidated leverage ratio of 3.25 to 1.00 for each fiscal quarter ending on or before December 31, 2019, stepping down on each of the three anniversaries thereafter; (2) a minimum consolidated fixed charge coverage ratio of 1.20 to 1.00 and (3) a minimum consolidated net worth for the Company and its subsidiaries. Events of default include, among other events, (i) nonpayment of principal, interest, fees or other amounts; (ii) failure to perform or observe certain covenants set forth in the Credit Agreement; (iii) breach of any representation or warranty; (iv) cross-default to other indebtedness; (v) bankruptcy and insolvency defaults; (vi) monetary judgment defaults and material nonmonetary judgment defaults; (vii) customary ERISA defaults; (viii) a change of control of the Company; and (ix) failure to maintain specified catastrophe retentions in each of the Company's regulated insurance subsidiaries.

Convertible Notes

On August 10, 2017, the Company and Heritage MGA, LLC (the "Guarantor") entered into a purchase agreement (the "Purchase Agreement") with Citigroup Global Markets Inc., as the initial purchaser (the "Initial Purchaser"), pursuant to which the Company agreed to issue and sell, and the Initial Purchaser agreed to purchase, $125.0 million aggregate principal amount of the Company's 5.875% Convertible Senior Notes due 2037 (the "Convertible Notes") in a private placement transaction pursuant to Rule 144A under the Securities Act, as amended (the "Securities Act") (the "Offering"). The Purchase Agreement contained customary representations, warranties and agreements of the Company and the Guarantor and customary conditions to closing, indemnification rights and obligations of the parties and termination provisions. The net proceeds from the Offering, after deducting discounts and commissions and estimated offering expenses payable by the Company, were approximately $120.5 million. The Offering was completed on August 16, 2017.

The Company issued the Convertible Notes under an Indenture (the "Convertible Note Indenture"), dated August 16, 2017, by and among the Company, as issuer, the Guarantor, as guarantor, and Wilmington Trust, National Association, as trustee (the "Trustee").

The Convertible Notes bear interest at a rate of 5.875% per year. Interest began accruing on August 16, 2017 and is payable semi-annually in arrears, on February 1 and August 1 of each year, starting on February 1, 2018. The Convertible Notes are senior unsecured obligations of the Company that rank senior in right of payment to the Company's future indebtedness that is expressly subordinated in right of payment to the Convertible Notes; equal in right of payment to the Company's unsecured indebtedness that is not so subordinated; effectively junior to any of the Company's secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all indebtedness or other liabilities incurred by the Company's subsidiaries other than the Guarantor, which fully and unconditionally guarantee the Convertible Notes on a senior unsecured basis.

The Convertible Notes mature on August 1, 2037, unless earlier repurchased, redeemed or converted.

Holders may convert their Convertible Notes at any time prior to the close of business on the business day immediately preceding February 1, 2037, other than during the period from, and including, February 1, 2022 to the close of business on the second business day immediately preceding August 5, 2022, only under the following circumstances: (1) during any calendar quarter commencing after the calendar quarter ending on September 30, 2017, if the closing sale price of the Company's common stock, for at least 20 trading days (whether or not consecutive) in the period of 30 consecutive trading days ending on the last trading day of the calendar quarter immediately preceding the calendar quarter in which the conversion occurs, is more than 130% of the conversion price of the Convertible Notes in effect on each applicable trading day; (2) during the ten consecutive business-day period following any five consecutive trading-day period in which the trading price for the Convertible Notes for each such trading day was less than 98% of the closing sale price of the Company's common stock on such date multiplied by the then-current conversion rate; (3) if the Company calls any or all of the Convertible Notes for redemption, at any time prior to the close of business on the second business day immediately preceding the redemption date; or (4) upon the occurrence of specified corporate events.

During the period from and including February 1, 2022 to the close of business on the second business day immediately preceding August 5, 2022, and on or after February 1, 2037 until the close of business on the second business day immediately preceding August 1, 2037, holders may surrender their Convertible Notes for conversion at any time, regardless of the foregoing circumstances.

The conversion rate for the Convertible Notes was initially 67.0264 shares of common stock per $1,000 principal amount of Convertible Notes (equivalent to an initial conversion price of approximately $14.92 per share of common stock). The conversion rate is subject to adjustment in certain circumstances and is subject to increase for holders that elect to convert their Convertible Notes in connection with certain corporate transactions (but not, at the Company's election, a public acquirer change of control (as defined in the Convertible Note Indenture) that occur prior to August 5, 2022.

Upon the occurrence of a fundamental change (as defined in the Convertible Note Indenture) (but not, at the Company's election, a public acquirer change of control (as defined in the Convertible Note Indenture), holders of the Convertible Notes may require the Company to repurchase for cash all or a portion of their Convertible Notes at a fundamental change repurchase price equal to 100% of the principal amount of the Convertible Notes to be repurchased, plus accrued and unpaid interest to, but excluding, the fundamental change repurchase date.

Except as described below, the Company may not redeem the Convertible Notes prior to August 5, 2022. On or after August 5, 2022 but prior to February 1, 2037, the Company may redeem for cash all or any portion of the Convertible Notes, at the Company's option, at a redemption price equal to 100% of the principal amount of the Convertible Notes to be redeemed, plus accrued and unpaid interest to, but excluding, the redemption date. No sinking fund is provided for the Convertible Notes, which means that the Company is not required to redeem or retire the Convertible Notes periodically. Holders of the Convertible Notes are able to cause the Company to repurchase their Convertible Notes for cash on any of August 1, 2022, August 1, 2027 and August 1, 2032, in each case at 100% of their principal amount, plus accrued and unpaid interest to, but excluding, the relevant repurchase date.

The Convertible Note Indenture contains customary terms and covenants and events of default. If an Event of Default (as defined in the Indenture) occurs and is continuing, the Trustee by notice to the Company, or the holders of at least 25% in aggregate principal amount of the Convertible Notes then outstanding by notice to the Company and the Trustee, may declare 100% of the principal of, and accrued and unpaid interest, if any, on, all the Convertible Notes to be immediately due and payable. In the case of certain events of bankruptcy, insolvency or reorganization (as set forth in the Convertible Note Indenture) with respect to the Company, 100% of the principal of, and accrued and unpaid interest, if any, on, the Notes automatically become immediately due and payable.

In the second quarter of 2018, the Company repurchased $10.6 million principal amount of Convertible Notes for cash. In the fourth quarter of 2018 and first quarter of 2019, the Company repurchased Convertible Notes in the aggregate principal amount of $81.6 million for a combination of cash and the issuance of an aggregate of 3,880,653 shares of the Company's common stock, leaving $23.4 million in aggregate principal amount outstanding. There were no repurchases of Convertible Notes in the third and fourth quarters of 2019.

FHLB Loan Agreements

In December 2018, a subsidiary of the Company pledged U.S. government and agency fixed maturity securities with an estimated fair value of $31.0 million as collateral and received $19.2 million in a cash loan under an advance agreement with the Federal Home Loan Bank ("FHLB") Atlanta. The loan originated on December 12, 2018 and bears a fixed interest rate of 3.094% with interest payments due quarterly commencing in March 2019. The principal balance on the loan has a maturity date of December 13, 2023. In connection with the agreement, the subsidiary became a member of FHLB. Membership in the FHLB required an investment in FHLB's common stock which was purchased on December 31, 2018 and valued at $1.4 million. The subsidiary is permitted to withdraw any portion of the pledged collateral over the minimum collateral requirement at any time, other than in the event of a default by the subsidiary. The proceeds from the loan was used to prepay the Company's Senior Secured Notes due 2023 ("Senior Notes") in 2018.

Registration Statements

On February 2, 2018, we filed with the SEC a shelf registration statement on amended Form S-3. This registration statement enables us to issue shares of our common stock, preferred stock, debt securities, warrants, subscription rights, stock purchase contracts and stock purchase units as well as stock purchase contracts and stock purchase units that include any of these securities. Under the rules governing shelf registration statements, we will file a prospectus supplement and advise the SEC of the amount and type of securities each time we issue securities under this registration statement.

Contractual Obligations and Commitments

The following table summarizes our material contractual obligations and commitments as of December 31, 2019:

Contractual Obligations and Commercial Commitments	Total	Less Than 1 Year	1-3 Years	3-5 Years	More than 5 - Years
			(in thousands)		
Term loans, notes and interest (1)	$ 104,659	$ 12,504	$ 23,654	$ 68,501	$ —
Convertible debt (1)	48,010	1,713	3,427	3,427	39,443
Mortgage loan (1)	20,389	893	1,787	1,786	15,923
FHLB agreement (1)	21,611	604	1,205	19,802	—
Operating lease obligations	10,334	1,442	2,827	2,380	3,685
Total Contractual Obligations	$ 205,003	$ 17,156	$ 32,900	$ 95,896	$ 59,051

(1) Amounts present principal payments to all debt obligations and interest payments for fixed-rate obligations. Debt obligations are classified based on their stated maturity date. For further information on long-term debt, refer to **Note 14** of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K.

The expected timing of payments of the obligations in the preceding table is estimated based on current information. Timing of payments and actual amounts paid may be different due to changes to agreed-upon amounts for some obligations.

Critical Accounting Policies and Estimates

The following discussion and analysis presents the more significant factors that affected our financial conditions as of December 31, 2019 and 2018 and results of operations for each of the years then ended. The preparation of financial statements in conformity with accounting principles of generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. While we base estimates on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates.

We consider accounting estimates to be critical to reported financial results if (i) the accounting estimate requires management to make assumptions about matters that are highly uncertain and (ii) different estimates that management reasonably could have used for the accounting estimates in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, could have a material impact on our consolidated financial statements.

Premiums. We recognize direct and assumed premiums written as revenue, net of ceded amounts, on a daily pro rata basis over the contract period of the related policies that are in force. For any portion of premiums not earned at the end of the reporting period, we record an unearned premium liability.

Premiums receivable represents amounts due from our policyholders for billed premiums and related policy fees. Our billing system is equity based such that policies are cancelled if the unpaid premium exceeds the amount of premium earned. We then age any resulting exposure based on the last date the policy was billed to the policyholder, and we establish an allowance account for credit losses for any amounts outstanding for more than 90 days. When we receive payments on amounts previously charged off, we credit bad debt expense in the period we receive the payment. Balances in premiums receivable and the associated allowance account are removed upon cancellation of the policy due to non-payment. We recorded approximately $290,000 allowance for uncollectible premiums in 2019, and we recorded no allowance in the years ended 2018 and 2017.

When we receive premium payments from policyholders prior to the effective date of the related policy, we record an advance premium liability. On the policy effective date, we reduce the advance premium liability and record the premiums as described above.

Reserves for Unpaid Losses and Loss Adjustment Expenses. Reserves for unpaid losses and loss adjustment expenses, also referred to as loss reserves, represent the most significant accounting estimate inherent in the preparation of our financial statements. These reserves represent management's best estimate of the amount we will ultimately pay for losses and loss adjustment expenses and we base the amount upon the application of various actuarial reserve estimation techniques as well as considering other material facts and circumstances known at the balance sheet date. We establish two categories of loss reserves as follows:
Case reserves—When a claim is reported, we establish an initial estimate of the losses that will ultimately be paid on the reported claim. Our initial estimate for each claim is based upon the judgment of our claims professionals who are familiar with property and liability losses

associated with the coverage offered by our policies. Then, our claims personnel perform an evaluation of the type of claim involved, the circumstances surrounding each claim and the policy provisions relating to the loss and adjust the reserve as necessary. As claims mature, we increase or decrease the reserve estimates as deemed necessary by our claims department based upon additional information we receive regarding the loss, the results of on-site reviews and any other information we gather while reviewing the claims. **IBNR reserves**—Our IBNR reserves include true IBNR reserves plus "bulk" reserves. True IBNR reserves represent amounts related to claims for which a loss occurred on or before the date of the financial statements, but which have not yet been reported to us. Bulk reserves represent additional amounts that cannot be allocated to particular claims, but which are necessary to estimate ultimate losses on known claims. We estimate our IBNR reserves by projecting our ultimate losses using industry accepted actuarial methods and then deducting actual loss payments and case reserves from the projected ultimate losses. We review and adjust our IBNR reserves on a quarterly basis based on information available to us at the balance sheet date.

When we establish our reserves, we analyze various factors such as the evolving historical loss experience of the insurance industry as well as our experience, claims frequency and severity, our business mix, our claims processing procedures, legislative enactments, judicial decisions and legal developments in imposition of damages, and general economic conditions, including inflation. A change in any of these factors from the assumptions implicit in our estimates will cause our ultimate loss experience to be better or worse than indicated by our reserves, and the difference could be material. Due to the interaction of the foregoing factors, there is no precise method for evaluating the impact of any one specific factor in isolation, and an element of judgment is ultimately required. Due to the uncertain nature of any future projections, the ultimate amount we will pay for losses will be different from the reserves we record.

We determine our ultimate loss reserves by selecting an estimate within a relevant range of indications that we calculate using generally accepted actuarial techniques. Our selection of the point estimate is influenced by the analysis of our paid losses and incurred losses since inception, as well as industry information relevant to the population of exposures drawn from Citizens.

Our external reserving actuaries evaluated the adequacy of our reserves as of December 31, 2019 and concluded that our reported loss reserves would meet the requirements of the insurance laws of the states in which our insurance subsidiaries are domiciled, be consistent with reserves computed in accordance with accepted loss reserving standards and principles, and make a reasonable provision for all unpaid loss and loss adjustment expense obligations under the terms of our contracts and agreements. In addition to $123.3 million of recorded case reserves, we recorded $490.3 million of IBNR reserves as of December 31, 2019 to achieve overall gross reserves of $613.5 million. Gross IBNR for hurricane claims was $285.3 million at December 31, 2019. At December 31, 2019, ceded IBNR and net IBNR were $321.6 million and $168.7 million, respectively.

The process of establishing our reserves is complex and inherently imprecise, as it involves using judgment that is affected by many variables. We believe a reasonably likely change in almost any of the factors we evaluate as part of our loss reserve analysis could have an impact on our reported results, financial position and liquidity.

The following table quantifies the pro forma impact of hypothetical changes in our net loss reserves on our net income and stockholders' equity as of and for the year ended December 31, 2019 (in thousands):

	Actual	Low Estimate	% Change from Actual	High Estimate	% Change from Actual
Net Loss Reserves	$ 219,903	$ 178,144		$ 233,782	
Impact on:					
Net income	$ 28,636	$ 57,805	101.9%	$ 18,942	-33.9%
Stockholders' equity	$ 448,799	$ 477,967	6.5%	$ 439,104	-2.2%
Cash, cash equivalents and investments	$ 863,600	$ 863,600	—	$ 863,600	—

Policy Acquisition Costs. We incur policy acquisition costs that vary with, and are directly related to, the production of new business. Policy acquisition costs consist of the following four items: (i) commissions paid to outside agents at the time of policy issuance, (ii) policy administration fees paid to a third-party administrator at the time of policy issuance, (iii) premium taxes and (iv) inspection fees. We capitalize policy acquisition costs to the extent recoverable, then we amortize those costs over the contract period of the related policy. We also earn ceding commission on our quota share reinsurance contracts, which is presented as a reduction of policy acquisition costs with any excess unearned ceding commission recognized as a liability. Ceding commission income is deferred and earned over the contract period. The amount and rate of ceding commissions earned on the net quota share contract can slide within a prescribed minimum and maximum, depending on loss performance and how future losses develop.

We earn ceding commission on its gross and net quota share reinsurance contracts. Our accounting policy is to allocate ceding commission between policy acquisition costs and general and administrative expenses for financial reporting purposes. Ceding commission is allocated between policy acquisition costs and general and administrative expenses based upon the proportion these costs bear to production of new business. For the years ended December 31, 2019, 2018 and 2017, we earned ceding commission income of $62.4 million, $73.0 million and $8.6 million of which $47.0 million, $54.9 million and $8.6 million was allocable to policy acquisition costs

Provision for Premium Deficiency. At each reporting date, we determine whether we have a premium deficiency. A premium deficiency would result if the sum of our expected losses, deferred policy acquisition costs and policy maintenance costs (such as costs to store records and costs incurred to collect premiums and pay commissions) exceeded our related unearned premiums plus investment income. Should we determine that a premium deficiency exists, we would write off the unrecoverable portion of deferred policy acquisition costs. No accruals for premium deficiency were considered necessary as of December 31, 2019 and 2018.

Reinsurance. We follow industry practice of reinsuring a portion of our risks. Reinsurance involves transferring, or "ceding", all or a portion of the risk exposure on policies we write to another insurer, known as a reinsurer. To the extent that our reinsurers are unable to meet the obligations they assume under our reinsurance agreements, we remain liable for the entire insured loss.

Our reinsurance agreements are prospective contracts. We record an asset, prepaid reinsurance premiums, and a liability, reinsurance payable, for the entire contract amount upon commencement of our new reinsurance agreements. We amortize our prepaid reinsurance premiums over the 12-month contract period.

In the event that we incur losses recoverable under our reinsurance program, we record amounts recoverable from our reinsurers on paid losses plus an estimate of amounts recoverable on unpaid losses. The estimate of amounts recoverable on unpaid losses is a function of our liability for unpaid losses associated with the reinsured policies; therefore, the amount changes in conjunction with any changes to our estimate of unpaid losses. In the event that we incur losses recoverable under the reinsurance program, the estimate of amounts recoverable from reinsurers on unpaid losses may change at any point in the future because of its relation to our reserves for unpaid losses.

We estimate uncollectible amounts receivable from reinsurers based on an assessment of factors including the creditworthiness of the reinsurers and the adequacy of collateral obtained, where applicable. We had no uncollectible amounts under our reinsurance program or bad debt expense related to reinsurance for the years ended December 31, 2019, 2018 and 2017.

Recent Accounting Pronouncements Not Yet Effective

The Company describes the recent pronouncements that have had or may have a significant effect on its financial statements or on its disclosures. The Company does not discuss recent pronouncements that a) are not anticipated to have an impact on, or b) are unrelated to its financial condition, results of operations, or related disclosures. For accounting pronouncements not yet adopted, refer to "Note 1. *Basis of Presentation, Nature of Business and Significant Accounting Policies and Practices"* in the notes to the consolidated financial statements.

Off-Balance Sheet Arrangements

As of December 31, 2019, we did not have any off-balance sheet arrangements, as defined in item 303(a)(4)(ii) of Regulation S-K, that have or are reasonably likely to have a current or future effect on our financial condition, changes in our financial condition, revenues, or expenses, results of operations, liquidity or capital resources that is material to investors.

Seasonality of our Business

Our insurance business is seasonal; hurricanes typically occur during the period from June 1 through November 30 and winter storms generally impact the first and fourth quarters each year. With our catastrophe reinsurance program effective on June 1 each year, any variation in the cost of our reinsurance, whether due to changes to reinsurance rates or changes in the total insured value of our policy base will occur and be reflected in our financial results beginning June 1 of each year, subject to certain adjustments.

Impact of Inflation and Changing Prices

The consolidated financial statements and related data presented herein have been prepared in accordance with generally accepted accounting principles which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. Our primary assets are monetary in nature. As a result, interest rates have a more significant impact on our performance than the effects of the general levels of inflation. Interest rates do not necessarily move in the same direction or with the same magnitude as the cost of paying losses and LAE.

Insurance premiums are established before we know the amount of loss and LAE and the extent to which inflation may affect such expenses. Consequently, we attempt to anticipate the future impact of inflation when establishing rate levels. While we attempt to charge adequate rates, we may be limited in raising our premium levels for competitive and regulatory reasons. Inflation also affects the market value of our investment portfolio and the investment rate of return. Any future economic changes which result in prolonged and increasing levels of inflation could cause increases in the dollar amount of incurred loss and LAE and thereby materially adversely affect future liability requirements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Our investment portfolios at December 31, 2019 included fixed-maturity and equity securities, the purposes of which are not for trading or speculation. Our main objective is to maximize after-tax investment income and maintain sufficient liquidity to meet policyholder obligations while minimizing market risk which is the potential economic loss from adverse fluctuations in securities' prices. We consider many factors including credit ratings, investment concentrations, regulatory requirements, anticipated fluctuation of interest rates, durations and market conditions in developing investment strategies. Investment securities are managed by a group of nationally recognized asset managers and are overseen by the investment committee appointed by our board of directors. Our investment portfolios are primarily exposed to interest rate risk, credit risk and equity price risk. We classify our fixed-maturity and equity securities as available-for-sale and report any unrealized gains or losses, net of deferred income taxes, as a component of other comprehensive income within our stockholders' equity. As such, any material temporary changes in their fair value can adversely impact the carrying value of our stockholders' equity.

Interest Rate Risk

Our debt under the senior secured credit facility and notes payable bears interest at variable rates. As a result, we are exposed to changes in market interest rates that could impact the cost of servicing our debt and notes payable. Approximately 41% of our total debt outstanding at December 31, 2019 is at a fixed rate.

Our fixed-maturity securities are sensitive to potential losses resulting from unfavorable changes in interest rates. We manage the risk by analyzing anticipated movement in interest rates and considering our future capital needs.

The following table illustrates the impact of hypothetical changes in interest rates to the fair value of our fixed-maturity securities at December 31, 2019 (in thousands):

Hypothetical Change in Interest rates	Estimated Fair Value After Change	Change In Estimated Fair Value	Percentage Increase (Decrease) in Estimated Fair Value
300 basis point increase	$ 526,467	$ (60,789)	(10)%
200 basis point increase	$ 546,754	$ (40,502)	(7)%
100 basis point increase	$ 567,017	$ (20,239)	(3)%
100 basis point decrease	$ 607,467	$ 20,211	3 %
200 basis point decrease	$ 624,060	$ 36,804	6 %
300 basis point decrease	$ 631,077	$ 43,821	8 %

Credit risk can expose us to potential losses arising principally from adverse changes in the financial condition of the issuer of our fixed maturities. We mitigate this risk by investing in fixed-maturities that are generally investment grade and by diversifying our investment portfolio to avoid concentrations in any single issuer or market sector.

The following table presents the composition of our fixed-maturity portfolio by rating at December 31, 2019 (in thousands):

Comparable Rating	Amortized Cost	% of Total Amortized Cost	Fair Value	% of Total Fair Value
AAA	$ 60,096	10 %	$ 60,778	10%
AA+	$ 193,629	34%	$ 195,741	34%
AA	$ 59,085	10 %	$ 60,086	10%
AA-	$ 49,616	9 %	$ 50,454	9%
A+	$ 34,738	6 %	$ 35,405	6%
A	$ 45,633	8 %	$ 46,515	8%
A-	$ 46,588	8 %	$ 47,587	8%
BBB+	$ 30,714	5 %	$ 31,624	5%
BBB	$ 13,409	2 %	$ 13,824	2%
BBB-	$ 808	0 %	$ 850	0%
No rating available	$ 43,473	8 %	$ 44,392	8%
Total	**$ 577,789**	**100%**	**$ 587,256**	**100%**

Our equity investment portfolio at December 31, 2019 consists of common stocks. We may incur potential losses due to adverse changes in equity security prices. We manage this risk primarily through industry and issuer diversification and asset allocation techniques.

The following table illustrates the composition of our equity portfolio at December 31, 2019 (in thousands):

	Estimated Fair Value		% of Total Estimated Fair value
Stocks by sector:			
Financial	$	—	0%
Energy		—	0%
Other		1,618	100%
Subtotal	$	1,618	100%
Mutual Funds and ETF by type:			
Equity	$	—	0%
Subtotal	$	—	0%
Total	$	1,618	100%

Foreign Currency Exchange Risk

At December 31, 2019, we did not have any material exposure to foreign currency related risk.

Item 8. Financial Statements and Supplementary Data

HERITAGE INSURANCE HOLDINGS, INC.

INDEX OF CONSOLIDATED FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors of
Heritage Insurance Holdings, Inc.

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying balance sheets of Heritage Insurance Holdings, Inc. and Subsidiaries (the "Company") as of December 31, 2019 and 2018, the related statements of operations, comprehensive income, stockholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2019, and the related notes and schedules (collectively referred to as the "financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control-Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO framework").

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2019, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in the COSO framework.

Basis for Opinion

The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying "Management's Report on Internal Control over Financial Reporting." Our responsibility is to express an opinion on the Company's financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control over Financial Reporting

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

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Plante & Moran, PLLC

We have served as the Company's auditor since 2018.

East Lansing, MI
March 10, 2020

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Heritage Insurance Holdings, Inc.

Opinion on the financial statements
We have audited the accompanying consolidated statements of operations and comprehensive income (loss), changes in stockholders' equity, and cash flows of Heritage Insurance Holdings, Inc. (a Delaware corporation) and subsidiaries (the "Company") for the year ended December 31, 2017, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the results of the Company's operations and its cash flows for the year ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

Basis for opinion
These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audit. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audit included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

/s/ GRANT THORNTON LLP
We served as the Company's auditor from 2013 to 2017.

Tampa, Florida
March 15, 2018

HERITAGE INSURANCE HOLDINGS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

	December 31,	
	2019	2018
ASSETS		
Fixed maturities, available-for-sale, at fair value (amortized cost of $577,789 and $518,391)	$ 587,256	$ 509,649
Equity securities, at fair value, (cost $1,618 and $18,698)	1,618	16,456
Other investments	6,375	2,488
Total investments	595,249	528,593
Cash and cash equivalents	268,351	250,117
Restricted cash	14,657	12,253
Accrued investment income	4,377	4,468
Premiums receivable, net	63,685	57,000
Reinsurance recoverable on paid and unpaid claims	428,903	317,930
Prepaid reinsurance premiums	224,102	233,071
Income taxes receivable	3,171	35,586
Deferred policy acquisition costs, net	77,211	73,055
Property and equipment, net	20,753	17,998
Intangibles, net	68,642	76,850
Goodwill	152,459	152,459
Other assets	18,110	9,333
Total Assets	$ 1,939,670	$ 1,768,713
LIABILITIES AND STOCKHOLDERS' EQUITY		
Unpaid losses and loss adjustment expenses	$ 613,533	$ 432,359
Unearned premiums	486,220	472,357
Reinsurance payable	156,351	166,975
Long-term debt, net	129,248	148,794
Deferred income tax	12,623	7,705
Advance premiums	16,504	20,000
Accrued compensation	5,347	9,226
Accounts payable and other liabilities	71,045	85,964
Total Liabilities	$ 1,490,871	$ 1,343,380
Commitments and contingencies (Note 17)		
Stockholders' Equity:		
Common stock, $0.0001 par value, 50,000,000 shares authorized, 28,996,452 shares issued and 28,650,918 outstanding at December 31, 2019 and 30,083,559 shares issued and 29,477,756 outstanding at December 31, 2018	3	3
Additional paid-in capital	329,568	325,292
Accumulated other comprehensive income (loss)	7,330	(6,527)
Treasury stock, at cost, 8,349,483 shares and 7,214,797 shares	(105,368)	(89,185)
Retained earnings	217,266	195,750
Total Stockholders' Equity	448,799	425,333
Total Liabilities and Stockholders' Equity	$ 1,939,670	$ 1,768,713

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

HERITAGE INSURANCE HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(In thousands, except share and per share data)

	For the Year Ended December 31, 2019	2018	2017
REVENUES:			
Gross premiums written	$ 937,937	$ 923,349	$ 625,565
Change in gross unearned premiums	(13,690)	2,977	17,739
Gross premiums earned	924,247	926,326	643,304
Ceded premiums	(445,534)	(472,144)	(263,740)
Net premiums earned	478,713	454,182	379,564
Net investment income	14,432	13,280	11,332
Net realized and unrealized gains (losses)	4,163	(2,477)	564
Other revenue	13,997	15,186	15,163
Total revenues	511,305	480,171	406,623
EXPENSES:			
Losses and loss adjustment expenses	273,288	237,425	201,482
Policy acquisition costs, net of ceding commission income of $47.0, $54.9, and $8.6 (1)	107,906	84,666	83,892
General and administrative expenses, net of ceding commission income of $15.4, $18.1, and $0 (1)	80,544	88,544	71,714
Total expenses	461,738	410,635	357,088
Operating income	49,567	69,536	49,535
Interest expense, net	8,523	20,015	13,210
Other non-operating loss, net	48	10,527	42,217
Income (loss) before income taxes (benefit)	40,996	38,994	(5,892)
Provision for income taxes (benefit)	12,360	11,839	(4,773)
Net income (loss)	$ 28,636	$ 27,155	$ (1,119)
OTHER COMPREHENSIVE INCOME			
Change in net unrealized gains (losses) on investments	19,765	(5,700)	5,688
Reclassification adjustment for net realized investment gains (losses)	(1,734)	163	(564)
Income tax (expense) benefit related to items of other comprehensive income	(4,174)	2,232	(3,170)
Total comprehensive income	$ 42,493	$ 23,850	$ 835
Weighted average shares outstanding			
Basic	29,213,910	25,941,253	26,798,465
Diluted	29,232,981	26,095,874	26,798,465
Earnings (loss) per share			
Basic	$ 0.98	$ 1.05	$ (0.04)
Diluted	$ 0.98	$ 1.04	$ (0.04)

(1) *Parenthetical values are presented in millions.*

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

HERITAGE INSURANCE HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands, except share and per share data)

	Common shares		Additional	Retained		Accumulated Other Comprehensive Income	Total Stockholders'
	Shares	Amount	Paid-in-Capital	Earnings	Treasury Stock	(Deficit)	Equity
Balance at December 31, 2016	28,840,443	$ 3	$ 205,727	$ 182,809	$ (25,562)	$ (5,018)	$ 357,959
Net unrealized change in investments, net of tax	—	—	—	—	—	1,954	1,954
Repurchase of common stock	(5,340,267)	—	—	—	(61,623)	—	(61,623)
Shares tendered for income tax withholding	(87,067)	—	(1,599)	—	—	—	(1,599)
Restricted stock award withholdings	225,000	—	4,815	—	—	—	4,815
Stock issued in connection with acquisition of business	2,222,215	—	40,000	—	—	—	40,000
Reclassification of derivative liability to equity	—	—	51,641	—	—	—	51,641
Deferred tax on convertible debt	—	—	(6,165)	—	—	—	(6,165)
Cash dividends declared ($0.30 per share of common stock)	—	—	—	(6,464)	—	—	(6,464)
Exercise of stock options	24,680	—	417	—	—	—	417
Net loss	—	—	—	(1,119)	—	—	(1,119)
Balance at December 31, 2017	25,885,004	3	294,836	175,226	(87,185)	(3,064)	379,816
Cumulative effect of change in accounting principle (ASU 2016-01), net of tax	—	—	—	(267)	—	267	—
Balance at December 31, 2017, as adjusted	25,885,004	3	294,836	174,959	(87,185)	(2,797)	379,816
Repurchase of common stock	(115,200)	—	—	—	(2,000)	—	(2,000)
Restricted stock award withholdings	112,500	—	(1,839)	—	—	—	(1,839)
Stock-based compensation on restricted stock	—	—	5,273	—	—	—	5,273
Convertible Option debt extinguishment, net of tax	—	—	(26,011)	—	—	—	(26,011)
Convertible notes converted into common stock	3,595,452	—	53,044	—	—	—	53,044
Reclassification of income taxes upon early adoption of ASU 2018-02	—	—	—	424	—	(424)	—
Deferred tax change rate	—	—	(11)	(408)	—	—	(419)
Cash dividends declared ($0.24 per share of common stock)	—	—	—	(6,380)	—	—	(6,380)
Net unrealized change in investments, net of tax	—	—	—	—	—	(3,306)	(3,306)
Net income	—	—	—	27,155	—	—	27,155
Balance at December 31, 2018	29,477,756	3	325,292	195,750	(89,185)	(6,527)	425,333
Net unrealized change in investments, net of tax	—	—	—	—		13,857	13,857
Repurchase of common stock	(1,134,686)	—	—	—	(16,183)	—	(16,183)
Restricted stock award withholdings	22,647	—	(3,521)	—	—	—	(3,521)
Convertible Option debt extinguishment, net of tax	—	—	(1,792)	—	—	—	(1,792)
Stock-based compensation on restricted stock	—	—	5,379	—	—	—	5,379
Stock issued on convertible note conversion	285,201	—	4,210	—	—	—	4,210
Cash dividends declared ($0.24 per share of common stock)	—	—	—	(7,120)	—	—	(7,120)
Net income	—	—	—	28,636	—	—	28,636
Balance at December 31, 2019	28,650,918	$ 3	$ 329,568	$ 217,266	$ (105,368)	$ 7,330	$ 448,799

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

HERITAGE INSURANCE HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	For the Year Ended December 31,		
	2019	*2018*	*2017*
OPERATING ACTIVITIES			
Net income (loss)	$ 28,636	$ 27,155	$ (1,119)
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:			
Stock-based compensation	5,379	5,273	4,815
Bond amortization and accretion	5,087	6,247	8,810
Amortization of original issuance discount on debt	1,419	3,885	2,314
Depreciation and amortization	10,436	27,070	7,742
Allowance for bad debt	290	—	—
Net realized loss (gain)	(1,734)	399	(564)
Net change in unrealized losses of equity securities	(2,429)	2,078	—
Change in fair value of option feature	—	—	41,013
Net loss on property held for sale	—	737	—
Net loss (gain) on repurchase of debt	48	9,790	1,203
Deferred income taxes, net of acquired	(898)	(21,563)	19,619
Changes in operating assets and liabilities:			
Accrued investment income	91	589	303
Premiums receivable, net	(6,685)	10,757	(910)
Prepaid reinsurance premiums	8,969	(5,307)	16,223
Reinsurance premiums receivable and recoverable	(110,973)	39,427	(284,284)
Income taxes receivable	32,415	1,752	(28,598)
Deferred policy acquisition costs, net	(4,156)	(31,377)	1,101
Operating lease right-of-use assets	(6,645)	—	—
Other assets	(1,728)	8,972	(4,907)
Unpaid losses and loss adjustment expenses	181,174	(37,724)	236,142
Unearned premiums	13,863	(2,977)	(17,740)
Reinsurance payable	(10,624)	149,398	(79,106)
Accrued interest	175	(1,993)	3,217
Income taxes payable	12,624	—	—
Advance premiums	(3,496)	(7,251)	3,355
Accrued compensation	(3,879)	(3,648)	3,155
Operating lease liabilities	8,369	—	—
Other liabilities	(36,071)	(85,351)	75,705
Net cash provided by operating activities	119,657	96,338	7,489
INVESTING ACTIVITIES			
Fixed maturity securities sales, maturities and paydowns	161,160	241,497	338,180
Fixed maturity securities purchases	(228,047)	(211,963)	(210,070)
Equity securities sales	26,766	4,820	11,726
Equity securities purchases	(4,583)	(5,992)	(5,774)
Other investment purchases	(24,250)	(1,716)	—
Proceeds from other investments sold	19,995	—	—
Acquisition of a business, net of cash acquired	—	—	(140,919)
Collection of (issued) promissory note receivable	358	(910)	—
Cost of property and equipment acquired	(4,984)	(2,281)	(385)
Net cash provided by (used in) investing activities	(53,585)	23,455	(7,242)
FINANCING ACTIVITIES			
Proceeds from convertible notes	—	—	136,750
Proceeds from long-term debt	—	114,200	—
Repurchase of convertible notes	(2,869)	(52,739)	(25,189)
Debt acquisition costs	—	(3,431)	(5,609)
Proceeds from mortgage loan	—	—	12,658
Proceeds from exercise of stock options	—	—	417
Mortgage loan payments	(277)	(264)	—
Repayments of long-term debt	(15,625)	(79,500)	—
Tax withholding on share-based compensation awards	(3,521)	(1,839)	(1,599)
Purchase of treasury stock	(16,183)	(2,000)	(61,623)
Dividends	(6,959)	(6,380)	(8,249)
Net cash (used in) provided by financing activities	(45,434)	(31,953)	47,556
Increase in cash, cash equivalents, and restricted cash	20,638	87,840	47,803
Cash, cash equivalents and restricted cash, beginning of period	262,370	174,530	126,727
Cash, cash equivalents and restricted cash, end of period	$ 283,008	$ 262,370	$ 174,530

Supplemental Cash Flows Information:	For the Year Ended December 31, 2019	2018	2017
Income taxes paid, net	$ 14,165	$ 31,289	$ 4,500
Interest paid	$ 7,298	$ 17,573	$ 4,054
Supplemental Disclosure of Non-Cash Investing and Financing Activities			
Original issue discount on convertible notes	$ —	$ —	$ 16,838
Issuance of shares on conversion of convertible notes	$ —	$ 53,044	$ —
Issuance of shares for consideration in the acquisition of a business	$ —	$ —	$ 40,000

Reconciliation of cash, cash equivalents, and restricted cash to the condensed consolidated balance sheets:

	December 31, 2019	December 31, 2018
	(in thousands)	
Cash and cash equivalents	$ 268,351	$ 250,117
Restricted cash	14,657	12,253
Total cash, cash equivalents and restricted cash shown in the condensed consolidated statements of cash flows	$ 283,008	$ 262,370

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

Note 1. Basis of Presentation, Nature of Business and Significant Accounting Policies and Practices

Business Description

Heritage Insurance Holdings, Inc. is an insurance holding company. Our insurance subsidiaries are Heritage Property & Casualty Insurance Company (“Heritage P&C”), Zephyr Insurance Company (“Zephyr”), Narragansett Bay Insurance Company (“NBIC”) and Pawtucket Insurance Company (“PIC”). PIC is currently inactive and has no policies in force or outstanding claims. Our other subsidiaries include: Heritage MGA, LLC (“MGA”), the managing general agent that manages substantially all aspects of our insurance subsidiaries’ business; Contractors’ Alliance Network, LLC, our vendor network manager; Skye Lane Properties, LLC, our property management subsidiary; First Access Insurance Group, LLC, our retail agency; Osprey Re Ltd., our reinsurance subsidiary that may provide a portion of the reinsurance protection purchased by our insurance subsidiaries; Heritage Insurance Claims, LLC, an inactive subsidiary reserved for future development; Zephyr Acquisition Company (“ZAC”); NBIC Holdings, Inc., NBIC Service Company which provides services to NBIC and Westwind Underwriters, Inc., an inactive subsidiary of NBIC Holdings, Inc.

Our primary products are personal and commercial residential insurance, which we currently offer in Alabama, Connecticut, Florida, Georgia, Hawaii, Massachusetts, New Jersey, New York, North Carolina, Rhode Island, South Carolina, and Virginia. We conduct our operations under a single reporting segment.

Basis of Presentation

The consolidated financial statements include the accounts of Heritage Insurance Holdings, Inc. and its wholly-owned subsidiaries. The accompanying consolidated financial statements include the accounts of the Company and all other entities in which the Company has a controlling financial interest (none of which are variable interest entities). All intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with United States Generally Accepted Accounting Principles (“U.S. GAAP”) requires us to make estimates and assumptions about future events that affect the amounts reported in our consolidated financial statements and accompanying notes. We evaluate our estimates on an ongoing basis when updated information related to such estimates becomes available. We base our estimates on historical experience and information available to us at the time these estimates are made. Actual results could differ materially from these estimates.

Cash and Cash Equivalents

The Company’s cash and cash equivalents include demand deposits with financial institutions and short-term, highly-liquid financial instruments with original maturities of three months or less when purchased. The carrying amounts reported in the consolidated balance sheets for interest bearing deposits approximate their fair value because of the short maturity of these financial instruments.

The Company excludes from cash and cash equivalents negative cash balances that the Company has with an individual financial institution. The liability presents outstanding checks not yet presented to the financial institution and is reported in accounts payable and other liabilities.

Restricted Cash

As of December 31, 2019, and 2018, restricted cash was $14.7 million and $12.3 million, respectively. For the years ended December 31, 2019 and 2018, Heritage P&C held approximately $9.0 million and $9.0 million relating to a reinsurance agreement with an entity that issued catastrophe (“CAT”) bonds, as Heritage P&C is contractually required to deposit certain installments of reinsurance premiums into a trust account and $5.7 million and $3.2 million in restricted cash relating to individual regulatory state deposits, respectively. The Company earned interest income of $28,969 and $36,532 on its restricted cash deposits.

Investments

The Company classifies all of its investments in debt securities as available-for-sale and reports them at fair value. Subsequent to its acquisition of debt securities available-for-sale, the Company records changes in value through the date of disposition as unrealized holding gains and losses, net of tax effects, and includes them as a component of other comprehensive income. Equity securities are recorded at fair value with changes in fair value reflected in net income and presented with realized gains and losses. The Company includes realized gains and losses, which it calculates using the specific-identification method for determining the cost of securities sold, in net income. The Company amortizes any premium or discount on fixed maturities over the remaining maturity period of the related securities using the effective interest method and reports the amortization in net investment income. The Company recognizes dividends and interest income when earned.

Quarterly, the Company performs an assessment of its debt securities available-for-sale to determine if any are "other-than-temporarily" impaired. An investment is impaired when the fair value of the investment declines to an amount less than the cost or amortized cost of that investment. As part of the assessment process, the Company determines whether the impairment is temporary or "other-than-temporary". The Company bases its assessment on both quantitative criteria and qualitative information, considering a number of factors including, but not limited to: how long the security has been impaired; the amount of the impairment; the Company intends to sell the investment or it is more likely than not that the Company will have to sell the investment before it recovers the amortized cost or cost; the financial condition and near-term prospects of the issuer; whether the issuer is current on contractually-obligated interest and principal payments; key corporate events pertaining to the issuer and whether the market decline was affected by macroeconomic conditions.

If the Company were to determine that a debt security or participation in a commercial mortgage loan was impaired and the Company either intends to sell the investment or it is more likely than not that the Company will have to sell the investment before it is able to recover the amortized cost or cost, then the Company would record the full amount of the impairment in its consolidated statement of operations and other comprehensive income.

A large portion of the Company's investment portfolio consists of debt securities available-for-sale, which may be adversely affected by changes in interest rates as a result of governmental monetary policies, domestic and international economic and political conditions and other factors beyond its control. A rise in interest rates would decrease the net unrealized holding gains of our investment portfolio, offset by the Company's ability to earn higher rates of return on funds reinvested. Conversely, a decline in interest rates would increase the net unrealized holding gains of our investment portfolio, offset by lower rates of return on funds reinvested.

Accumulated other comprehensive income consists solely of unrealized gains and losses on debt securities available-for-sale, net of income tax.

Fair Value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (an exit price). When reporting the fair values of the Company's financial instruments, the Company prioritizes those fair value measurements into one of three levels based on the nature of the inputs, as follows:

- Level 1—Assets and liabilities with values based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company is able to access.
- Level 2—Asset and liabilities with values based on quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets in markets that are not active; or valuation models with inputs that are observable, directly or indirectly for substantially the term of the asset or liability.
- Level 3—certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect the Company's best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date based on the best information available in the circumstances.

The Company estimates the fair value of its investments using the closing prices on the last business day of the reporting period, obtained from active markets such as the NYSE and NASDAQ. For securities for which quoted prices in active markets are unavailable, the Company uses observable inputs such as quoted prices in inactive markets, quoted prices in active markets for similar instruments, benchmark interest rates, broker quotes and other relevant inputs. The Company does not have any investments in its portfolio which require the use of unobservable inputs. The Company's estimate of fair value reflects the interest rate environment that existed as of the close of business on December 31, 2019. Changes in interest rates after December 31, 2019 may affect the fair value of the Company's investments.

The Company believes the carrying amounts of its cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, and other current liabilities approximate their fair values at December 31, 2019 and 2018, due to the immediate or short-term maturity of these instruments.

The Company's non-financial assets, such as goodwill and property, plant and equipment are carried at cost until there are indicators of impairment and are recorded at fair value only when an impairment charge is recognized. Long term debt is recorded at carrying value, see **Note 14** – *Long-Term Debt* for addition information.

Premiums

The Company records direct and assumed premiums written as revenue net of ceded amounts on a daily pro rata basis over the contract period of the related in force policies or reinsurance contract. For any portion of premiums not earned at the end of the reporting period, the Company records an unearned premium liability.

Premiums receivable represents amounts due from our policyholders for billed premiums and related policy fees. We perform a policy-level evaluation to determine the extent to which the balance of premiums receivable exceeds the balance of unearned premiums. We then age any resulting exposure based on the last date the policy was billed to the policyholder, and we establish an allowance for credit losses for any amounts outstanding for more than 90 days. When we receive payments on amounts previously charged off, we reduce bad debt expense in the period we receive the payment. Balances in premiums receivable and the associated allowance account are removed upon cancellation of the policy due to non-payment. We recorded $290,300 allowance for the year ended December 31, 2019. We recorded no allowance for the years ended December 31, 2018 and 2017, respectively. Bad debt expense related to uncollectible premiums was $290,300, $0 and $0 for the years ended December 31, 2019, 2018 and 2017, respectively.

When the Company receives premium payments from policyholders prior to the effective date of the related policy, the Company records an advance premiums liability. On the policy effective date, the Company reduces the advance premium liability and records the premiums as described above.

Policy Acquisition Costs

The Company incurs policy acquisition costs that vary with, and are directly related to, the production of new business. Policy acquisition costs consist of the following four items: (i) commissions paid to outside agents at the time of policy issuance; (ii) policy administration fees paid to a third-party administrator at the time of policy issuance; (iii) premium taxes; and (iv) inspection fees. The Company capitalizes policy acquisition costs to the extent recoverable, then the Company amortizes those costs over the contract period of the related policy.

At each reporting date, the Company determines whether it has a premium deficiency. A premium deficiency would result if the sum of the Company's expected losses, deferred policy acquisition costs, and policy maintenance costs (such as costs to store records and costs incurred to collect premiums and pay commissions) exceeded the Company's related unearned premiums plus investment income. Should the Company determine that a premium deficiency exists, the Company would write off the unrecoverable portion of deferred policy acquisition cost.

We earn ceding commission on its gross and net quota share reinsurance contracts. Our accounting policy is to allocate ceding commission between policy acquisition costs and general and administrative expenses for financial reporting purposes. Ceding commission is allocated between policy acquisition costs and general and administrative expenses based upon the proportion these costs bear to production of new business. For the years ended December 31, 2019 and 2018, we earned ceding commission income of $62.4 million and $73.0 million of which $47.0 million and $54.9 million was allocable to policy acquisition costs.

Ceding commission income is deferred and recognized over the quota share contract period. The amount and rate of ceding reinsurance commissions earned on the net quota share contract can slide within a prescribed minimum and maximum, depending on loss performance and how future losses develop.

Reinsurance

The Company follows industry practice of reinsuring a portion of our risks. Reinsurance involves transferring, or "ceding", all or a portion of the risk exposure on policies the Company writes to another insurer, known as a reinsurer. To the extent that the Company's reinsurers are unable to meet the obligations they assume under the Company's reinsurance agreements, the Company remains liable for the entire insured loss.

The Company's reinsurance agreements are generally short-term, prospective contracts. The Company records an asset, prepaid reinsurance premiums, and a liability, reinsurance payable, for the entire contract amount upon commencement of new reinsurance agreements. The Company amortizes its prepaid reinsurance premiums over the 12-month contract period.

When the Company incurs losses recoverable under its reinsurance program, the Company records amounts recoverable from its reinsurers on paid losses plus an estimate of amounts recoverable on unpaid losses. The estimate of amounts recoverable on unpaid losses is a function of the Company's liability for unpaid losses associated with the reinsured policies; therefore, the amount changes in conjunction with any changes to the estimate of unpaid losses. Given that an estimate of amounts recoverable from reinsurers on unpaid losses may change at any point in the future because of its relation to the Company's reserves for unpaid losses, a reasonable possibility exists that an estimated recovery may change significantly from initial estimates.

The Company estimates uncollectible amounts receivable from reinsurers based on an assessment of factors including the creditworthiness of the reinsurers and the adequacy of collateral obtained, where applicable. The Company recorded no uncollectible amounts under its reinsurance program or bad debt expense related to reinsurance for the years ended December 31, 2019, 2018 and 2017.

The Company remains liable for claims payments if any reinsurer is unable to meet its obligations under the reinsurance agreements. Failure of reinsurers to honor their obligations could result in losses to the Company. The Company evaluates the financial condition of its reinsurers and monitors concentration of credit risk arising from similar geographic regions, activities or economics characteristics of the reinsurers to minimize its exposure to significant loses from reinsurers insolvencies. The Company contracts with several reinsurers to secure its annual reinsurance coverage, which the excess of loss treaties generally becomes effective June 1st each year. The Company purchases reinsurance each year taking into consideration probable maximum losses and reinsurance market condition.

Long-Lived Assets—Property and Equipment

Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation is calculated on a straight-line basis over the estimated useful lives as follows: building—40 years; computer hardware and software 3—years; office and furniture equipment—3 to 7 years. Leasehold improvements are amortized over the shorter of the lease term or the asset's useful life. Expenditures for improvements are capitalized to the property accounts. Replacements and maintenance and repairs that do not improve or extend the life of the respective assets are expensed as incurred.

Leases

We lease office space under operating leases with expiration dates through 2023. We determine whether an arrangement constitutes a lease and record lease liabilities and right-of-use assets on our consolidated balance sheets at lease commencement. We primarily use our incremental borrowing rates for our operating leases (rates are not readily determinable) and implicit rates for our financing leases in determining the present value of lease payments. We measure right-of-use assets based on the corresponding lease liability adjusted for (i) payments made to the lessor at or before the commencement date, (ii) initial direct costs we incur and (iii) tenant incentives under the lease. We begin recognizing rent expense when the lessor makes the underlying asset available to us, we do not assume renewals or early terminations unless we are reasonably certain to exercise these options at commencement, and we do not allocate consideration between lease and non-lease components.

For short-term leases, we record rent expense in our consolidated statements of operations on a straight-line basis over the lease term and record variable lease payments as incurred.

Business Acquisition

The application of the purchase method of accounting for business combinations requires the use of significant estimates and assumptions in determining the fair value of assets acquired and liabilities assumed in order to properly allocate the fair value of the acquired business. The estimates of the fair value of the assets acquired and liabilities assumed are based upon assumptions believed to be reasonable using established valuation techniques that consider a number of factors and when appropriate, valuations performed by independent third-party appraisers. Assets acquired, and liabilities assumed in connection with business combinations are recorded based on their respective fair values at the date of acquisition.

Goodwill and Intangible Assets

Goodwill represents the excess of costs over the fair value of net assets acquired. Goodwill is subject to evaluation for impairment using a fair value-based test. This evaluation is performed annually, during the fourth quarter or more frequently if facts and circumstances warrant. The Company uses a qualitative approach to test goodwill for impairment by first assessing qualitative factors to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The Company applies this qualitative approach as of October 1 annually to any and all reporting units. If required following the qualitative assessment, the first step in the goodwill impairment test involves comparing the fair value of each of a reporting unit to the carrying value of a reporting unit. If the carrying value of a reporting unit exceeds the fair value of the reporting unit, the Company is required to proceed to the second step. In the second step, the fair value of the reporting unit would be allocated to the assets (including unrecognized intangibles) and liabilities of the reporting unit, with any residual representing the implied fair value of goodwill. An impairment loss would be recognized if, and to the extent that, the carrying value of goodwill exceeded the implied value. The Company reviews amortizable intangible assets for impairment whenever events or circumstances indicate that carrying amounts may not be recoverable. If the Company concludes that impairment exists, the carrying amount is reduced to fair value. No impairment was recognized in any period presented.

Impairment of Long-Lived Assets Including Intangible Assets Subject to Amortization

The Company assesses the recoverability of long-lived assets when events or circumstances indicate that the assets might have become impaired. The Company determines whether the assets can be recovered from undiscounted future cash flows and, if not recoverable, the Company recognizes impairment to reduce the carrying value to fair value. Recoverability of long-lived assets is dependent upon, among other things, the Company's ability to maintain profitability, so as to be able to meet its obligations when they become due. No impairment was recognized in any period presented.

Unpaid Losses and Loss Adjustment Expenses

The Company's reserves for unpaid losses and loss adjustment expenses represent the estimated ultimate cost of settling all reported claims plus all claims we incurred related to insured events that have occurred as of the reporting date, but that policyholders have not yet reported to the Company (incurred but not reported, or "IBNR").

The Company estimates its reserves for unpaid losses and loss adjustment expenses using individual case-based estimates for reported claims and actuarial estimates for IBNR losses. The Company continually reviews and adjusts its estimated losses as necessary based on industry development trends, the Company's evolving claims experience and new information obtained. If the Company's unpaid losses and loss adjustment expenses are considered to be deficient or redundant, the Company increases or decreases the liability in the period in which it identifies the difference and reflects the change in its current period results of operations. Though the Company's estimate of the ultimate cost of settling all reported and unreported claims may change at any point in the future, a reasonable possibility exists that its estimate may vary significantly in the near term from the estimated amounts included in the Company's consolidated financial statements.

The Company reports its reserves for unpaid losses and loss adjustment expenses gross of the amounts related to unpaid losses recoverable from reinsurers and reports loss and loss adjustment expenses net of amounts ceded to reinsurers. The Company does not discount its loss reserves for financial statement purposes.

Other revenue

Our insurance affiliates may charge policyholders a policy fee on each policy written; to the extent these fees are not subject to refund, and the Company recognizes the income immediately when collected. The Company also charges pay-plan fees to policyholders that pay its premiums in more than one installment and records the fees as income when collected. Other income also includes rental income due under non-cancelable leases for space at the Company's commercial property.

Assessment

Guaranty fund and other insurance-related assessments imposed upon the Company's insurance company affiliates are recorded as policy acquisition costs in the period the regulatory agency imposes the assessment. To recover guaranty or other insurance-related assessments, the Company in turn submits a plan for recoupment to the Insurance Commissioner for approval and upon approval, begins collecting a policy surcharge that will allow it to collect the prior year's assessments. There were no assessments during the periods presented.

The Company collects other assessments imposed upon policyholders as a policy surcharge and records the amounts collected as a liability until the Company remits the amounts to the regulatory agency that imposed the assessment.

Convertible Notes

In August 2017 and September 2017, the Company issued collectively $136.8 million of 5.875% Convertible Senior Notes (the "Convertible Notes") due August 1, 2037. The Convertible notes are accounted for in accordance with ASC 470-20. At the time of issuance and until December 1, 2017, the Company recorded the fair value of the derivatives on its balance sheet at fair value with changes in the values of these derivatives reflected in the consolidated statement of operations. As of December 31, 2019, the Company has $23.4 million of the Convertible Notes outstanding.

Beginning December 1, 2017, the conversion option of the Convertibles Notes qualifies for the equity classification and will no longer be accounted for as a separate derivative instrument liability in accordance with applicable U.S. GAAP guidance. The Company separately accounts for the liability and equity components of Convertible Notes that can be settled in cash by allocating the proceeds from issuance between the liability component and the embedded conversion option, or equity component, in accordance with accounting for convertible debt instruments that may be settled in cash (including partial cash settlement) upon conversion. The value of the equity component is calculated by first measuring the fair value of the liability component, using the interest rate of a similar liability that does not have a conversion feature, as of the issuance date. The difference between the proceeds from the convertible debt issuance and the amount measured as the liability component is recorded as the equity component with a corresponding discount recorded on the debt. The Company recognizes the accretion of the resulting discount using the effective interest method as part of interest expense in its consolidated statements of operations.

Debt Extinguishment

The Company has reacquired convertible senior notes over a series of transactions. In accordance with ASC 470 " *Debt* ", the Company evaluated the accounting treatment to determine if the repurchase of the Convertible Notes constituted a debt extinguishment. ASC 405-20-40-1 provides implementation guidance in order to determine if the Company is legally released from being the primary obligor under the liability, either judicially or by the creditor. Based on the reacquisition of the Convertible Notes, the Company should derecognize the related debt and conversion option liability. Upon extinguishment, the Company performed a discounted cash flow ("DCF") analysis for each transaction based on its date and principal amount, leveraging market debt yield data as of each trade date to estimate the costs of the debt.

Debt Issuance and Discount Costs

In connection with the issuance of debt, any debt issuance and discount costs are reflected on the balance sheet as an offset to long-term debt and amortized using the effective interest method over the life of the underlying debt instrument.

Stock-Based Compensation

The Company measures stock-based compensation at the grant date based on the fair value of the award and recognizes stock-based compensation expense over the requisite vesting period. Determining the fair value of stock option awards requires judgment, including estimating stock price volatility, forfeiture rates and expected option life. Restricted stock awards are valued based on the fair value of the stock on the grant date and the related compensation expense is recognized over the vesting period.

Earnings Per Share

The Company reports both basic earnings per share and diluted earnings per share. To calculate basic earnings per share, the Company divides net income attributable to common shareholders by the weighted-average number of shares outstanding during the period, including vested restricted shares. The Company calculates diluted earnings per share by dividing net income attributable to common shareholders by the weighted-average number of shares, and the effect of share equivalents, vested and unvested restricted shares and convertible notes outstanding during the period using the treasury stock method to calculate common stock equivalents.

Income tax

Income taxes are accounted for under the asset and liability method, that recognizes the amount of income taxes payable or refundable for the current year and recognizes deferred tax assets and liabilities based on the tax rates expected to be in effect during the periods in which the temporary differences reverse. Temporary differences arise when income or expenses are recognized in different periods in the consolidated financial statements than on the tax returns. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that all, or some portion, of the benefits related to deferred tax assets will not be realized. Income taxes includes both, estimated federal and state income taxes.

Concentrations of Risk

The Company's current operations subject us to the following concentrations of risk:

- Revenue—The Company writes residential property and liability policies exclusively.
- Geographic—The Company writes its premium in coastal states in the southeastern and northeastern United States and Hawaii
- Group concentration of credit risk—All of the Company's reinsurers engage in similar activities and have similar economic characteristics that could cause their ability to repay us to be similarly affected by changes in economic or other conditions.
- Credit risk—The Company chooses to deposit all its cash at twelve financial institutions.

The Company mitigates its geographic and group concentrations of risk by entering into reinsurance contracts with highly rated, financially-stable reinsurers, and by securing irrevocable letters of credit from reinsurers when necessary.

With regard to cash, the Company had $267.4 million and $244.6 million in excess of Federal Deposit Insurance Corporation ("FDIC") insurance limits at December 31, 2019 and 2018, respectively. Deposits held in non- interest-bearing transaction accounts are combined with interest-bearing accounts and are insured up to $250,000.

Reclassification

Certain prior year amounts have been reclassified to conform to the current year presentation.

Recently Adopted Accounting Pronouncements

In February 2016, the FASB updated guidance on the accounting for leases that requires lessees to recognize a right-to-use asset and a lease liability for leases with terms of more than 12 months and retains the two classifications of a lease as either an operating or finance lease. The updated guidance was effective for reporting periods after December 31, 2018 and required that the earliest comparative period presented include the measurement and recognition of exiting leases with an adjustment to equity as if the updated guidance had always been applied. Alternatively, an entity may elect to recognize a cumulative effect adjustment to the opening balance of retained earnings in the year adopted. Early adoption was permitted.

We adopted the guidance prospectively during the first quarter of 2019. As part of our adoption, we elected not to reassess historical lease classification or recognize short-term leases on our balance sheet. At implementation, we recorded approximately $2.5 million as right-of-use operating and financing leased assets in other assets and approximately $2.6 million of lease liabilities in accounts payable and other liabilities. We did not recognize an opening adjustment to retained earnings. Adoption of this standard did not materially impact the Company's Condensed Consolidated Statements of Operations and Other Comprehensive Income and Statements of Cash Flows. See **Note 8** to the consolidated financial statements.

Accounting Pronouncements Not Yet Adopted

The Company describes below recent pronouncements that may have a significant effect on its consolidated financial statements or on its disclosures upon future adoption. The Company does not discuss recent pronouncements that are not anticipated to have an impact on, or are unrelated to, its financial condition, results of operations, or related disclosures.

In December 2019, The FASB issued ASU 2019-12—*Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes,* which removes certain exceptions for recognizing deferred taxes for investments, performing intra-period allocation and calculating income taxes in interim periods. The amendments also improve consistent application of and simplify GAAP for other areas of *Topic 740* by clarifying and amending existing guidance. For public business entities, the amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Early adoption of the amendments is permitted, including adoption in any interim period for which financial statements have not yet been issued. An entity that elects to early adopt the amendments in an interim period should reflect any adjustments as of the beginning of the annual period that includes that interim period. Additionally, an entity that elects early adoption must adopt all the amendments in the same period.

In November 2019, the FASB issued ASU 2019-11, *Codification Improvements to Topic 326, Financial Instruments-Credit Losses,* which made certain changes solely to the guidance on measuring credit losses. In May 2019, the FASB issued ASU 2019-05, *Financial Instruments-Credit Losses (Topic 326): Targeted Transition Relief*, ASU 2019-04, *Codification Improvements to Topic 326, Financial Instruments-Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*, which provided certain improvements to ASU 2016-01, *Financial Instruments-Overall* (Subtopic 825-10): *Recognition and Measurement of Financial Assets and Financial Liabilities* (ASU 2016-01) and ASU 2016-13. These ASUs do not change the core principles of the guidance in ASU 2016-13. Instead these amendments are intended to clarify and improve operability of certain topics included within the credit losses standard. These ASUs will have the same effective date and transition requirement as ASU 2016-13.

In August 2018, the FASB issued ASU 2018-12*, Financial Services – Insurance (Topic 944) Targeted Improvements to the Accounting for Long-Duration Contracts*, which amends the accounting and disclosure model for certain long-duration insurance contracts under U.S. GAAP. The goal of the ASU amendments is to (1) improve the timeliness of recognizing changes in the liability for future policy benefits and modify the rate used to discount future cash flows; (2) simplify and improve the accounting for certain market-based or guarantees associated with deposit (or account balances) contracts; (3) simplify the amortization of deferred acquisition costs; and (4) improve the effectiveness of the required disclosures. The amendments in ASU 2018-12 will be effective for the Company in the first quarter of 2021. The Company has determined that this pronouncement is not applicable to its insurance contracts and will not have a material impact on its consolidated financial statements.

In March 2018, the FASB issued ASU 2018-04, *Investments-Debt Securities (Topic 320) and Regulated Operations (Topic 980)*. Pursuant to SEC Staff Accounting Bulletin No. 177 and SEC Release No 33-9273, the amendment of ASU 2018-04 adds, amends and supersedes various paragraphs that contain SEC guidance in ASC 320, *Investments-Debt Securities* and ASC 980, *Regulated Operations*. The Company does not anticipate the adoption of ASU 2018-04 will have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles-Goodwill and Other*. The amendments in ASU 2017-04 intend to simplify the subsequent measurement of goodwill, eliminating Step 2 from the goodwill impairment test. In computing the implied fair value of goodwill under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities (including unrecognized assets and liabilities) following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, under the amendments in ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. The standard is effective for the Company in the first quarter of 2020 on a prospective basis with early adoption permitted. The Company does not expect the adoption of this standard will have a material impact on its consolidated financial statements.

FASB ASU 2016-13 *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, introduces new guidance for the accounting for credit losses on financial instruments in with its scope. The updated guidance applies a new credit loss model (current expected credit losses or "CECL") for determining credit-related impairments for financial instruments measured at amortized costs, including reinsurance recoverables and requires an entity to estimate the credit losses expected over the life of an exposure or poll of exposures. The estimate of expected credit losses should consider historical information, current information, as well as reasonable and supportable forecasts, including estimates or prepayments. The expected credit losses, and subsequent adjustments to such losses, are recorded through an allowance account that is deducted from the amortized cost basis of the financial asset, with the net carrying value of the financial asset presented on the consolidated balance sheet at the amount expected to be collected.

The updated guidance also amends the current other-than-temporary impairment model for available-for-sale debt securities by requiring the recognition of impairments relating to the credit losses through an allowance account and limits the amount of credit loss to the difference between a security's amortized costs basis and its fair value. Any adjustments identified will be recorded in net realized and unrealized gains (losses) on the Company's Consolidated Statement of Operations and Other Comprehensive Income. In addition, the Company will no longer use as a measurement the length of time a security has been in an unrealized loss position in determining if a credit loss exists.

The updated guidance is effective for the quarter ended March 31, 2020. The implementation primarily impacts the Company's debt securities and reinsurance recoverable. The cumulative effect adjustment, if any will be recognized to the Company's retained earnings. The adoption of this standard is not expected to be material to our financial position, results of operations or cash flows.

No other new accounting pronouncement issued or effective during the fiscal year had or is expected to have a material impact on our consolidated financial statements or disclosures.

Note 2. Business Acquisitions

Acquisition of NBIC

On November 30, 2017, the Company completed the acquisition of all the outstanding capital stock of NBIC Holdings, Inc., the parent company of Narragansett Bay Insurance Company, a leading specialty underwriter of personal residential insurance products and services in several states in the northeastern United States for $250.0 million, including $210.0 million in cash, plus 2,222,215 shares of the Company's common stock with an aggregate fair value of $40.0 million. The completion of the NBIC acquisition represents a significant advancement in executing the Company's geographic diversification strategy by leveraging our combined platform to accelerate growth along the Eastern region. The transaction was accounted for using the acquisition method of accounting, which requires, assets acquired, and liability assumed be recognized at their fair values as of the acquisition date. The Company recognized goodwill of $106 million, attributable to expected growth and profitability, none of which is expected to be deductible for income tax purposes.

Note 3.Investments

The amortized cost, gross unrealized gains and losses, and fair value of the Company's debt securities available-for-sale are as follows:

December 31, 2019	Cost or Adjusted / Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
Debt Securities Available-for-sale				
U.S. government and agency securities (1)	$ 53,836	$ 383	$ 28	$ 54,191
States, municipalities and political subdivisions	74,755	1,641	41	76,355
Special revenue	246,791	3,689	254	250,226
Hybrid securities	100	1	—	101
Industrial and miscellaneous	202,307	4,097	21	206,383
Total	$ 577,789	$ 9,811	$ 344	$ 587,256

(1) U.S. government and agency securities include pledged debt securities with an estimated fair value of $20.2 million under the terms and condition of the advance agreement entered into with a financial institution in 2018. The Company is permitted to withdraw or exchange any portion of the pledged collateral over the minimum requirement at any time.

December 31, 2018	Cost or Adjusted / Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
Debt Securities Available-for-sale				
U.S. government and agency securities	$ 48,739	$ 40	$ 738	$ 48,041
States, municipalities and political subdivisions	60,028	46	785	59,289
Special revenue	249,026	210	3,881	245,355
Industrial and miscellaneous	155,678	81	3,302	152,457
Redeemable preferred stocks	4,920	—	413	4,507
Total	$ 518,391	$ 377	$ 9,119	$ 509,649

The following table presents debt securities available-for-sale by contractual maturity for the periods presented:

	December 31, 2019			
Debt Securities Available-for-sale	Cost or Amortized Cost (in thousands)	Percent of Total	Fair Value (in thousands)	Percent of Total
Due in one year or less	$ 63,989	11%	$ 64,197	11%
Due after one year through five years	206,657	36%	209,211	35%
Due after five years through ten years	117,266	20%	121,378	21%
Due after ten years	189,877	33%	192,470	33%
Total	$ 577,789	100%	$ 587,256	100%

	December 31, 2018			
Debt Securities Available-for-sale	Cost or Amortized Cost (in thousands)	Percent of Total	Fair Value (in thousands)	Percent of Total
Due in one year or less	$ 41,529	8%	$ 41,382	8%
Due after one year through five years	177,298	34%	175,227	34%
Due after five years through ten years	134,057	26%	130,921	26%
Due after ten years	165,507	32%	162,119	32%
Total	$ 518,391	100%	$ 509,649	100%

The following table presents realized gains (losses) on the Company's debt securities available-for-sale as of December 31, 2019, 2018 and 2017, respectively:

	2019		2018		2017	
For the years ended December 31,	Gains (Losses)	Fair Value at Sale	Gains (Losses)	Fair Value at Sale	Gains (Losses)	Fair Value at Sale
			(in thousands)			
Debt Securities Available-for-sale						
Realized gains	$ 2,119	$ 157,125	$ 85	$ 25,647	$ 2,732	$ 705,138
Realized losses	(211)	14,580	(249)	58,971	(363)	56,354
Net realized gain (losses)	**$ 1,908**	**$ 171,705**	**$ (164)**	**$ 84,618**	**$ 2,369**	**$ 761,492**

Equity Investments

The components of realized gains (losses) on equity investment and other non-marketable equity securities for the periods presented below:

	2019		2018		2017	
For the years ended December 31,	Gains (Losses)	Fair Value at Sale	Gains (Losses)	Fair Value at Sale	Gains (Losses)	Fair Value at Sale
			(in thousands)			
Equity securities	$ 2,703	$ 21,386	$ 1	$ 169	$ 2,131	$ 31,231
Other investments	1,050	—	—	—	—	—
Total realized gains	3,753	21,386	1	169	2,131	31,231
Equity securities	(1,441)	3,613	(236)	4,840	(3,936)	11,806
Other investments	(57)	—	—	—	—	—
Total realized losses	(1,498)	3,613	(236)	4,840	(3,936)	11,806
Unrealized losses on equity securities (1)	—	—	(2,078)	—	—	—
Net realized gain (losses)	**$ 2,255**	**$ 24,999**	**$ (2,313)**	**$ 5,009**	**$ (1,805)**	**$ 43,037**

(1) Represents unrealized loss on securities held pursuant to ASU 2016-01 Recognition and Measurement of Financial Assets and Financial Liabilities, effective January 1, 2018

The following table summarizes the Company's net investment income by major investment category for the years ended December 31, 2019, 2018 and 2017, respectively:

Net Investment Income

	For the Year Ended December 31,		
	2019	2018	2017
		(in thousands)	
Debt securities available-for-sale	$ 13,761	$ 9,591	$ 10,368
Equity securities	1,436	1,333	1,922
Cash and cash equivalents	1,470	1,703	960
Other investments	505	2,767	197
Net investment income	17,172	15,394	13,447
Investment expenses	2,740	2,114	2,115
Net investment income, less investment expenses	$ 14,432	$ 13,280	$ 11,332

The following tables present, for all debt securities available-for-sale in an unrealized loss position (including securities pledged), the aggregate fair value and gross unrealized by length of time the security has continuously been in an unrealized loss position:

December 31, 2019	Less Than Twelve Months			Twelve Months or More		
	Number of Securities	Gross Unrealized Losses	Fair Value	Number of Securities	Gross Unrealized Losses	Fair Value
			(in thousands)			
Debt Securities Available-for-sale						
U.S. government and agency securities	9	$ 10	$ 1,476	23	$ 18	$ 4,288
States, municipalities and political subdivisions	6	38	7,613	3	3	1,440
Special revenue	62	145	24,862	95	109	13,159
Industrial and miscellaneous	25	13	12,601	16	8	3,202
Total	102	$ 206	$ 46,552	137	$ 138	$ 22,089

December 31, 2018	Less Than Twelve Months			Twelve Months or More		
	Number of Securities	Gross Unrealized Losses	Fair Value	Number of Securities	Gross Unrealized Losses	Fair Value
			(in thousands)			
Debt Securities Available-for-sale						
U.S. government and agency securities	17	$ 129	$ 10,485	66	$ 609	$ 20,488
States, municipalities and political subdivisions	13	103	12,864	42	682	39,979
Special revenue	105	1,260	76,335	323	2,621	108,319
Industrial and miscellaneous	214	1,479	70,156	232	1,822	70,375
Redeemable preferred stock	55	193	2,541	27	221	1,965
Total	404	$ 3,164	$ 172,381	690	$ 5,955	$ 241,126

The Company is required to maintain assets on deposits with various regulatory authorities to support its insurance and reinsurance operations.

As of December 31, 2019, the Company evaluated its fixed maturity securities for impairment and determined that none of its investments in fixed maturity securities that reflected an unrealized loss position were other-than-temporarily impaired. The issuers of the fixed maturity securities in which the Company invests continue to make interest payments on a timely basis and have not suffered any credit rating reductions. The Company does not intend to sell, nor is it likely that it would be required to sell, the fixed maturity securities before the Company recovers its amortized cost basis.

Limited Partnerships, REIT's and Limited Liability Company Investments

The Company has interest in limited partnerships (LPs), Partnership Real Estate Investment Trust (REITs) and Limited Liability Companies ("LLCs") totaling $6.4 million and $2.5 million at December 31, 2019 and 2018, respectively that are not registered or readily tradable on a securities exchange. The Company is not the primary beneficiary and does not consolidate these investments. These investments are carried at net asset value, which approximates fair value with changes in fair value recorded in net unrealized gains (losses) on the Company's consolidated statement of income and comprehensive income. Realized gains (losses) on sales of these investments are reported within net realized and unrealized gains (losses) on the Company's consolidated statement of income and comprehensive income.

During 2019 the Company invested in a LP fund in the amount of $20.0 million. In November 2019, the Company was notified the Fund was terminating and in December received 95%, net of allocated costs of $275,900 of its total distribution. Upon completion of the funds audit the Company would receive the remaining 5% or $1.1 million. In January 2020, the Company received the $1.1 million representing the full holdback from the investment. The Company recorded the 5% hold back to other assets and the original unrealized gains from the fund in the amount of $1.1 million to realized gains, there was no change in the consolidated statement of operations and comprehensive income from this transaction.

During the fourth quarter of 2019, Company invested in aggregate $4.0 million at $10 per share in a newly formed LP that conducts its business through an umbrella REIT. The REIT is a self-managed and self-administered company focusing on the purchase development and leasing of specialized agricultural, industrial and retail properties. The portfolio was 100% leased and had lease expirations through October 2029.

Note 4. Goodwill and Other Intangible Assets

For both years ended December 31, 2019 and 2018 goodwill was $152.5 million and intangible assets were $68.6 million and $76.9 million, respectively. The Company has recorded $1.3 million relating to insurance licenses classified as an indefinite lived intangible.

Goodwill

	Goodwill (in thousands)
Balance as of December 31, 2017	$ 152,459
Goodwill acquired	—
Impairment	—
Balance as of December 31, 2018	$ 152,459
Goodwill acquired	—
Impairment	—
Balance as of December 31, 2019	$ 152,459

Other Intangible Assets

Our intangible assets resulted primarily from the acquisitions of Zephyr Acquisition Company and NBIC Holdings, Inc. and consist of brand, agent relationships, renewal rights, customer relations, trade names, non-competes and insurance licenses. Finite-lived intangibles assets are amortized over their useful lives from one to fifteen years.

The tables below detail the finite-lived intangible assets, net as of December 31, 2019 and 2018, respectively (amounts in thousands):

December 31, 2019	Weighted -average Amortization (years)	Gross Carrying Amount	Accumulated Amortization	Intangible Assets, net (1)
Amortizing intangible assets				
Brand	8	$ 17,810	$ (4,506)	$ 13,304
Agent relationships	8	15,500	(3,729)	11,771
Renewal rights	13	40,600	(5,639)	34,961
Customer relations	5	870	(384)	486
Trade names	6	9,000	(2,208)	6,792
Value of business acquired	1	25,400	(25,400)	—
Non-compete	1	4,790	(4,776)	14
Total intangible assets		$ 113,970	$ (46,642)	$ 67,328

(1) Excludes insurance license valued at $1.3 million and classified as an indefinite lived intangible which is subject to annual impairment testing and not amortized.

December 31, 2018	Weighted -average Amortization (years)	Gross Carrying Amount	Accumulated Amortization	Intangible Assets, net (1)
Amortizing intangible assets				
Brand	8	$ 17,810	$ (3,319)	$ 14,491
Agent relationships	9	15,500	(2,259)	13,241
Renewal rights	14	40,600	(2,932)	37,668
Customer relations	7	870	(297)	573
Trade names	8	9,000	(1,308)	7,692
Value of business acquired	1	25,400	(25,400)	—
Non-compete	1	4,790	(2,920)	1,870
Total intangible assets		$ 113,970	$ (38,435)	$ 75,535

(1) Excludes insurance license valued at $1.3 million and classified as an indefinite lived intangible which is subject to annual impairment testing and not amortized.

Estimated annual pretax amortization of intangible assets for each of the next five years and thereafter is as follows (in thousands):

Year		Amount
2020	$	6,375
2021	$	6,365
2022	$	6,351
2023	$	6,351
2024	$	6,351
Thereafter	$	35,535
	$	67,328

Amortization expense of intangible assets was $8.2 million, $24.8 million and $6.2 million for the years ended December 31, 2019, 2018 and 2017 respectively.

Note 5. Earnings (Loss) Per Share

The following table sets forth the computation of basic and diluted net income (loss) per share for the periods indicated:

	For the Year Ended December 31,					
		2019		*2018*		*2017*
Basic earnings (loss) per share:						
Net income (loss) attributable to common stockholders (000's)	$	28,636	$	27,155	$	(1,119)
Weighted average shares outstanding		29,213,910		25,941,253		26,798,465
Basic earnings (loss) per share:	**$**	**0.98**	**$**	**1.05**	**$**	**(0.04)**
Diluted earnings (loss) per share:						
Net income (loss) attributable to common stockholders (000's)	$	28,636	$	27,155	$	(1,119)
Weighted average shares outstanding		29,213,910		25,941,253		26,798,465
Weighted average dilutive shares		19,071		154,621		—
Total weighted average dilutive shares		29,232,981		26,095,874		26,798,465
Diluted earnings (loss) per share:	**$**	**0.98**	**$**	**1.04**	**$**	**(0.04)**

Due to the net loss for 2017, dilutive loss per share is the same as basic due to the antidilutive impact of the convertible debt and restricted stock under the if-converted method. The Company had 1,914,770, 2,563,777 and 8,424,598 of antidilutive shares for the three years ended December 31, 2019, 2018 and 2017, respectively.

Note 6. Fair Value Measurements

The Company performs fair value measurements in accordance with FASB Accounting Standards Codification (ASC) 820, *Fair Value Measurement*. ASC 820 defines fair values as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required to be recorded at the fair values, the Company considers the principal or most advantageous market in which it would transact and consider assumptions that market participants would use when pricing the asset or liabilities, such as inherent risk transfer restrictions and risk of nonperformance. ASC 820 establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. An asset's or liability's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

For the Company's investments in U.S. government securities that do not have prices in active markets, agency securities, state and municipal governments, and corporate bonds, the Company obtains the fair values from its third-party valuation service and evaluates the relevant inputs, assumptions, methodologies and conclusions associated with such valuations. The valuation service calculates prices for the Company's investments in the aforementioned security types on a month-end basis by using several matrix-pricing methodologies that incorporate inputs from various sources. The model the valuation service uses to price U.S. government securities and securities of states and municipalities incorporates inputs from active market makers and inter-dealer brokers. To price corporate bonds and agency securities, the valuation service calculates non-call yield spreads on all issuers, uses option-adjusted yield spreads to account for any early redemption features, then adds final spreads to the U.S. Treasury curve as of quarter end. The inputs the valuation service uses in their calculations are not quoted prices in active markets, but are observable inputs, and therefore represent Level 2 inputs.

The following table presents information about the Company's assets measured at fair value on a recurring basis. The Company assesses the levels for the investments at each measurement date, and transfers between levels are recognized on the actual date of the event or change in circumstances that caused the transfer in accordance with the Company's accounting policy regarding the recognitions of transfers between levels of the fair value hierarchy.

For the years ended December 31, 2019 and 2018, there were no transfers in or out of Level 1, 2, and 3.

Investments excluded from the fair value hierarchy

The Company also invests in LPs, REITs and LLCs. This investment categorization has the potential for higher returns but also the potential for higher degrees of risk, including less than stable rates of returns and may provide less liquidity. These investments are carried at net asset value, as reported by the managers of the funds, and are excluded from the fair value hierarchy.

December 31, 2019	***Total***	***Level 1***	***Level 2***	***Level 3***
Invested Assets:		***(in thousands)***		
Debt Securities Available-for-sale				
U.S. government and agency securities	$ 54,191	$ 366	$ 53,825	$ —
States, municipalities and political subdivisions	76,355	—	76,355	—
Special revenue	250,226	—	250,226	—
Hybrid securities	101	—	101	—
Industrial and miscellaneous	206,383	—	206,383	—
Total debt securities	587,256	366	586,890	—
Investment reported at NAV	7,993	—	—	—
Total investments	$ 595,249	$ 366	$ 586,890	$ —

December 31, 2018	***Total***	***Level 1***	***Level 2***	***Level 3***
Invested Assets:		***(in thousands)***		
Debt Securities Available-for-sale				
U.S. government and agency securities	$ 48,041	$ 354	$ 47,687	$ —
States, municipalities and political subdivisions	59,289	—	59,289	—
Special revenue	245,355	—	245,355	—
Industrial and miscellaneous	152,457	—	152,457	—
Redeemable preferred stock	4,507	4,507	—	—
Total debt securities	509,649	4,861	504,788	—
Equity Securities				
Common stock	3,686	3,686	—	—
Non-redeemable preferred stock	12,770	12,770	—	—
Total equity securities	16,456	16,456	—	—
Investment reported at NAV	2,488	—	—	—
Total investments	$ 528,593	$ 21,317	$ 504,788	$ —

Non-recurring fair value measurements

Assets and liabilities that are measured at fair value on a non-recurring basis include intangible assets and goodwill which are recognized at fair value during the period in which an acquisition is completed, from updated estimates and assumptions during the measurement period, or when they are considered to be impaired. These non-recurring fair value measurements, primarily for intangible assets acquired, were based on Level 3 unobservable inputs. For the years ended December 31, 2019 and 2018, these non-recurring fair values inputs consisted of brand, agent relationships, renewal rights, customer relations, trade names, non-compete and goodwill. To evaluate such assets for a potential impairment, we determine the fair value of the goodwill and intangible assets using a combination of a discounted cash flow approach and market approaches, which contain significant unobservable inputs and therefore are considered a Level 3 fair value measurement. The unobservable inputs in the analysis generally include future cash flow projections and a discount rate.

There were no non-recurring fair value adjustments to intangible assets and goodwill during 2019, 2018 and 2017. The measurement period may be up to one year from the acquisition date. We record any measurement period adjustments to the fair value of assets acquired and liabilities assumed, with the corresponding offset to goodwill.

Note 7. Other Comprehensive Income

The following table is a summary of other comprehensive income (loss) and discloses the tax impact of each component of other comprehensive income for the years ended December 31, 2019, 2018 and 2017, respectively:

	For the Year Ended December 31,								
	2019			2018			2017		
	Pre-tax	Tax	After-tax	Pre-tax	Tax	After-tax	Pre-tax	Tax	After-tax
	(in thousands)								
Other comprehensive income									
Change in unrealized losses on investments, net	$ 19,765	(4,575)	$ 15,190	$ (5,700)	$ 2,281	$ (3,419)	$ 5,688	$ (2,713)	$ 2,975
Reclassification adjustment of realized losses (gains) included in net income	(1,734)	401	(1,333)	163	(49)	$ 114	(564)	(457)	$ (1,021)
Effect on other comprehensive income	$ 18,031	$ (4,174)	$ 13,857	$ (5,537)	$ 2,232	$ (3,305)	$ 5,124	$ (3,170)	$ 1,954

Note 8. Leases

The Company has entered into operating and financing leases primarily for real estate and vehicles. The Company will determine whether an arrangement is a lease at inception of the agreement. The operating leases have terms of one to ten years, and often include one or more options to renew. These renewal terms can extend the lease term from two to ten years and are included in the lease term when it is reasonably certain that the Company will exercise the option. The Company considers these options in determining the lease term used in establishing our right-of-use assets and lease obligations. Our lease agreements do not contain any material residual value guarantees or material restrictive covenants.

Because the rate implicit in each operating lease is not readily determinable, the Company uses its incremental borrowing rate to determine present value of the lease payments. The Company used the implicit rates within the finance leases.

The components of lease costs were as follows:

	For the Year Ended December 31, 2019	For the Year Ended December 31, 2018
Amortization of ROU assets - Finance leases	$ 21	$ 79
Interest on lease liabilities - Finance leases	6	23
Variable lease cost (cost excluded from lease payments)	114	451
Operating lease cost (cost resulting from lease payments)	332	1,250
Total lease cost	$ 473	$ 1,803

Supplemental balance sheet information related to leases was as follows:

	Balance Sheet Classification	December 31, 2019
Right-of-use assets - operating	Other assets	$ 6,342
Right-of-use assets - finance	Other assets	$ 303
Lease Liability (1) - operating	Accounts payable and other liabilities	$ (8,045)
Lease Liability - finance	Accounts payable and other liabilities	$ (324)

1. Includes $1.3 million in lease incentives received in the first quarter of 2019.

Weighted-average remaining lease term and discount rate for our operating and financing leases was as follows:

	December 31, 2019
Weighted average lease term - Finance leases	3.66 yrs.
Weighted average lease term - Operating leases	8.01 yrs.
Weighted average discount rate - Finance leases	7.09%
Weighted average discount rate - Operating leases	5.33%

Supplemental disclosure of cash flow information related to leases were as follows:

		For the Year Ended December 31, 2019
Finance lease - Operating cash flows	$	27
Finance lease - Financing cash flows	$	83
Operating lease - Operating cash flows (fixed payments)	$	970
Operating lease - Operating cash flows (liability reduction)	$	713

Maturities of lease liabilities were as follows as of December 31, 2019:

		December 31, 2019
2020	$	1,442
2021		1,401
2022		1,425
2023		1,371
2024		1,010
2025 and thereafter		3,685
Total lease payments		10,334
Less: imputed interest		(1,965)
Present value of lease liabilities	$	8,369

Note 9. Property and Equipment

Property and equipment, net consists of the following at December 31, 2019 and 2018 (in thousands):

		December 31, 2019		December 31, 2018
		(in thousands)		
Land	$	2,582	$	2,582
Building		11,390		11,390
Computer hardware and software		5,712		4,901
Office furniture and equipment		2,007		1,397
Tenant and leasehold improvements		8,105		4,477
Vehicle fleet		789		854
Total, at cost		30,585		25,601
Less: accumulated depreciation and amortization		(9,832)		(7,603)
Property and equipment, net	$	20,753	$	17,998

Depreciation expense for the years ended December 31, 2019, 2018 and 2017 was $2.2 million, $2.3 million, $1.6 million, respectively. The Company's real estate consists of 15 acres of land, five buildings with a gross area of 229,000 square feet and a parking garage.

Expected annual rental income due under non-cancellable operating leases for our real estate properties is as follows (in thousands):

Year		Amount
January 1 to December 31, 2020	$	2,883
January 1 to December 31, 2021		2,954
January 1 to December 31, 2022		3,021
January 1 to December 31, 2023		3,144
January 1 to December 31, 2024		2,250
Thereafter		14,254
Total	$	28,506

Note 10. Deferred Reinsurance Ceding Commission

The Company defers certain income in connection with its quota share treaties, the ceded reinsurance commissions income, called deferred reinsurance ceding commissions ("DRCC"), which are deferred and earned over the terms of the reinsurance agreements. Ceding commission on quota share agreements call for provisional ceding rate, subject sliding scale adjustments based on the loss experience of the reinsurers. Adjustments are reflected in current operations. The Company allocates 75% of total ceding commission income to policy acquisition costs and 25% of total ceding commission income to general and administrative expense.

The Company defers reinsurance ceding commission income, which is amortized over the effective period of the related insurance policies. For the year ended December 31, 2019, 2018 and 2017 the Company allocated ceding commission income of $47.0 million and $54.9 million and $8.6 million to policy acquisition costs and $15.4 million and $18.1 million and $0 to general and administrative expense, respectively.

The table below depicts the activity with regard to deferred reinsurance ceding commission during the years ended December 31, 2019, 2018 and 2017.

	For the Year Ended December 31,		
	2019	*2018*	*2017*
		(in thousands)	
Beginning balance of deferred ceding commission income	$ 44,819	$ 51,109	$ 57,808
Ceding commission deferred	55,095	67,867	1,901
Less: ceding commission earned	(62,450)	(74,157)	(8,600)
Ending balance of deferred ceding commission income	$ 37,464	$ 44,819	$ 51,109

Note 11. Deferred Policy Acquisition Costs

The Company defers certain costs in connection with written policies, called deferred policy acquisition costs ("DPAC"), which are amortized over the effective period of the related insurance policies

The Company anticipates that its DPAC costs will be fully recoverable in the near term. The table below depicts the activity with regard to DPAC for the years ended December 31, 2019, 2018 and 2017:

	For the Year Ended December 31,		
	2019	*2018*	*2017*
		(in thousands)	
Beginning Balance	$ 73,055	$ 41,678	$ 42,779
Policy acquisition costs deferred	149,095	171,007	82,791
Amortization	(144,939)	(139,630)	(83,892)
Ending Balance	$ 77,211	$ 73,055	$ 41,678

Note 12. Reinsurance

Our insurance regulators require all insurance companies, like us, to have a certain amount of capital and reinsurance coverage in order to cover losses and loss adjustment expenses upon the occurrence of a catastrophic event. Our reinsurance program provides reinsurance in excess of our state regulator requirements, which are based on the probable maximum loss that we would incur from an individual catastrophic event estimated to occur once in every 100 years based on our portfolio of insured risks. The nature, severity and location of the event giving rise to such a probable maximum loss differs for each insurer depending on the insurer's portfolio of insured risks, including, among other things, the geographic concentration of insured value within such portfolio. As a result, a particular catastrophic event could be a one-in-100-year loss event for one insurance company while having a greater or lesser probability of occurrence for another insurance company. We also purchase reinsurance coverage to protect against the potential for multiple catastrophic events occurring in the same year. We share portions of our reinsurance program coverage among our insurance company affiliates.

Significant Reinsurance Contracts

2019-2020 Reinsurance Programs

Catastrophe Excess of Loss Reinsurance

Effective June 1, 2019, we entered into catastrophe excess of loss reinsurance agreements covering Heritage Property & Casualty Insurance Company ("Heritage P&C"), Zephyr Insurance Company ("Zephyr") and Narragansett Bay Insurance Company ("NBIC"). The catastrophe reinsurance programs are allocated amongst traditional reinsurers, catastrophe bonds issued by Citrus Re Ltd., a Bermuda special purpose insurer formed in 2014 ("Citrus Re"), the Florida Hurricane Catastrophe Fund ("FHCF") and Osprey Re Ltd, our captive reinsurer. The FHCF covers Florida risks only and we participate at 90%. Our third-party reinsurers are either rated "A-" or higher by A.M. Best or S&P or are fully collateralized, to reduce credit risk.

The reinsurance program, which is segmented into layers of coverage, protects the Company for excess property catastrophe losses and loss adjustment expenses. The 2019-2020 reinsurance program provides first event coverage up to $1.5 billion for Heritage P&C, first event coverage up to $708.0 million for Zephyr, and first event coverage up to $936.0 million for NBIC. Our first event retention for each insurance company subsidiary follows: Heritage P&C - $20.0 million; Zephyr - $20.0 million; NBIC – $13.8 million.

Our program was placed on a cascading basis which provides greater horizontal protection in a multiple small events scenario and features additional coverage enhancements. This coverage exceeds the requirements established by the ratings agency of our insurance company affiliates, Demotech, Inc., the Florida Office of Insurance Regulation, the Hawaii Insurance Division, and the Rhode Island Department of Business Regulation.

We are responsible for all losses and loss adjustment expenses in excess of our reinsurance program. For second or subsequent catastrophic events, our total available coverage depends on the magnitude of the first event, as we may have coverage remaining from layers that were not previously fully exhausted. An aggregate of $2.6 billion of limit purchased in 2019 includes reinstatement through the purchase of reinstatement premium protection. In total, we have purchased $2.6 billion of potential reinsurance coverage, including our retention, for multiple catastrophic events. Our ability to access this coverage, however, will be subject to the severity and frequency of such events.

The Company's estimated net cost for the 2019-2020 catastrophe reinsurance programs is approximately $249.2 million.

Gross Quota Share Reinsurance

NBIC did not enter into a gross quota share reinsurance program for its fiscal year beginning June 1, 2019. For its previous fiscal year, NBIC purchased an 8% gross quota share reinsurance treaty effective June 1, 2018 which provided ground up loss recoveries of up to $1.0 billion.

Net Quota Share Reinsurance

NBIC's Net Quota Share coverage is proportional reinsurance for which certain of our other reinsurance inures to the quota share (property catastrophe excess of loss and reinstatement premium protection and the second layer of the general excess of loss). An occurrence limit of $20.0 million for catastrophe losses is in effect on the quota share, subject to certain aggregate loss limits that vary by reinsurer. The amount and rate of reinsurance commissions slide, within a prescribed minimum and maximum, depending on loss performance. The Net Quota Share program was renewed on December 31, 2019 ceding 56% of the net premiums and losses and 5% of the prior year quota share will run off.

Aggregate Coverage

A $931.0 million of limit is structured on an aggregate basis (Top and Aggregate, Layer 1, Layer 2, Layer 3, Layer 4, Layer 5, Stub layers, Multi-Zonal and 2017-1 Notes). To the extent that this coverage is not fully exhausted in the first catastrophic event, it provides coverage commencing at its reduced retention for second and subsequent events where underlying coverage has been previously exhausted. The Company purchased reinstatement premium protection for $627.0 million of this coverage, which can be reinstated one time. Layers (with exception to FHCF) are "net" of a $40.0 million attachment point. Layers inure to the subsequent layers if the aggregate limit of the preceding layer(s) is exhausted, and the subsequent layer cascades down in its place.

NBIC placed 42.5% of an aggregate contract, which covers all catastrophe losses excluding named storms, on December 1, 2019, expiring March 31, 2020. The limit on the contract is $20.0 million, with a retention of $20.0 million and franchise deductible of $1.0 million.

NBIC placed 100% of an occurrence contract, which covers all catastrophe losses excluding named storms, on December 31, 2019, expiring December 31, 2020. The limit on the contract is $20.0 million with a retention of $20.0 million and has one reinstatement available.

Per Risk Coverage

For southeast losses and northeast commercial residential losses, excluding losses from named storms, the Company purchased property per risk coverage for losses and loss adjustment expenses in excess of $1.0 million per claim. The limit recovered for an individual loss is $9.0 million and total limit for all losses is $27.0 million. There are two reinstatements available with additional premium due based on the amount of the layer exhausted. For Northeast personal residential losses only, the Company purchased property per risk coverage for losses and loss adjustments expenses in excess of $750,000 per claim. The limit recovered for an individual loss is $250,000 and total limit for all losses is $750,000. There are two reinstatements available with additional premium due based on the amount of the layer exhausted.

In addition, the Company purchased facultative reinsurance for losses in excess of $10.0 million for any properties it insured where the total insured value exceeded $10.0 million. This coverage applies to Southeast losses and Northeast commercial residential losses, excluding losses from named storms.

General Excess of Loss

NBIC's general excess of loss reinsurance protects NBIC from single risk losses, both property and casualty. The casualty coverage provided by this reinsurance contract also responds on a "Clash" basis, meaning that multiple policies involved in a single loss occurrence can be aggregated into one loss and applied to the reinsurance contract. The coverage is in two layers in excess of NBIC's retention of the first $400,000 of loss. The first layer is $350,000 excess $400,000 and the second layer is $2.75 million excess $750,000 (Casualty second layer is $1.25 million excess $750,000). Both layers are 100% placed.

Semi-Automatic Facultative Excess of Loss

NBIC's automatic property facultative reinsurance protects NBIC from single risk losses, for property risks with a total insured value excess of $3.5 million subject to a limit of $3.75 million, subject to special acceptance.

2018 – 2019 Reinsurance Programs

Catastrophe Excess of Loss Reinsurance

Effective June 1, 2018, we entered into catastrophe excess of loss reinsurance agreements covering Heritage P&C, Zephyr and NBIC. The catastrophe reinsurance programs are allocated amongst traditional reinsurers, catastrophe bonds issued by Citrus Re and FHCF. The FHCF covers Florida risks only and we participate at 45%. Citrus Re, which provides fully collateralized multi-year coverage, covers catastrophe losses incurred by Heritage P&C only through the 2016 Class D and 2017-1 Notes, and covers catastrophe losses incurred by Heritage P&C, Zephyr and NBIC through the 2016 Class E Note. Our third-party reinsurers are either rated "A-" or higher by A.M. Best or S&P or are fully collateralized, to reduce credit risk.

The reinsurance program, which is segmented into layers of coverage, protects the Company for excess property catastrophe losses and loss adjustment expenses. The 2018-2019 reinsurance program provides first event coverage up to $1.6 billion for Heritage P&C, first event coverage up to $801.0 million for Zephyr, and first event coverage up to $1.0 billion for NBIC. Our first event retention for each insurance company subsidiary follows: Heritage P&C - $20.0 million; Zephyr - $20.0 million; NBIC – $12.8 million. Our second and third event retentions for each insurance company subsidiary follows: Heritage P&C - $16.0 million; Zephyr - $16.0 million; NBIC – $8.8 million.

Our program was placed on a cascading basis which provides greater horizontal protection in a multiple small events scenario and features additional coverage enhancements. This coverage exceeds the requirements established by the Companies' rating agency, Demotech, Inc., the Florida Office of Insurance Regulation, the Hawaii Insurance Division, and the Rhode Island Department of Business Regulation. For the twelve months ending May 31, 2019, no single uncollateralized private reinsurer represented more than 10% of the overall limit purchased from our total reinsurance coverage.

We are responsible for all losses and loss adjustment expenses in excess of our reinsurance program. For second or subsequent catastrophic events, our total available coverage depends on the magnitude of the first event, as we may have coverage remaining from layers that were not previously fully exhausted. An aggregate of $3.4 billion of limit purchased in 2018 includes reinstatement through the purchase of reinstatement premium protection. In total, we have purchased $3.5 billion of potential reinsurance coverage, including our retention, for multiple catastrophic events. Our ability to access this coverage, however, will be subject to the severity and frequency of such events.

The Company's estimated net cost for the 2018-2019 catastrophe reinsurance programs is approximately $252.0 million.

Gross Quota Share Reinsurance

NBIC purchased an 8% gross quota share reinsurance treaty effective June 1, 2018 which provides ground up loss recoveries of up to $1.0 billion. Prior to this treaty, NBIC's gross quota share treaty was 18.75%.

Net Quota Share Reinsurance

NBIC's Net Quota Share coverage is proportional reinsurance for which certain of our other reinsurance inures to the quota share (property catastrophe excess of loss and reinstatement premium protection and the second layer of the general excess of loss). An occurrence limit of $20.0 million for catastrophe losses is in effect on the quota share, subject to certain aggregate loss limits that vary by reinsurer. The amount and rate of reinsurance commissions slide, within a prescribed minimum and maximum, depending on loss performance. NBIC ceded 49.5% of net premiums and losses during 2018 to the Net Quota Share and 8% of the 2017 Net Quota Share was in runoff. The Net Quota Share program was renewed on December 31, 2018 ceding 52% of the net premiums and losses and 10% of the prior year quota share will run off.

Aggregate Coverage

A $1.1 billion of limit is structured on an aggregate basis (Top and Aggregate, Layer 1, Layer 2, Layer 3, Layer 4, Stub layers, Multi-Zonal, 2017-1 Notes and 2016 Class E Notes). To the extent that this coverage is not fully exhausted in the first catastrophic event, it provides coverage commencing at its reduced retention for second and subsequent events where underlying coverage has been previously exhausted. The Company purchased reinstatement premium protection for $669.0 million of this coverage, which can be reinstated one time. Layers (with exception to FHCF and 2016 Class D Notes) are "net" of a $40.0 million attachment point. Layers inure to the subsequent layers if the aggregate limit of the preceding layer(s) is exhausted, and the subsequent layer cascades down in its place.

NBIC placed 42.5% of an aggregate contract, which covers all catastrophe losses excluding named storms, on May 31, 2018, expiring December 31, 2018. The limit on the contract is $20.0 million, with a retention of $3.0 million and franchise deductible of $1.5 million.

NBIC placed 92% of an occurrence contract, which covers all catastrophe losses excluding named storms, on May 31, 2018, expiring December 31, 2018. The limit on the contract is $20.0 million with a retention of $20.0 million.

NBIC placed 40% of an aggregate contract, which covers all catastrophe losses excluding named storms, on December 31, 2018, expiring May 31, 2019. The limit on the contract is $20.0 million, with a retention of $20.0 million and franchise deductible of $1.0 million.

NBIC placed 100% of an occurrence contract, which covers all catastrophe losses excluding named storms, on December 31, 2018, expiring December 31, 2019. The limit on the contract is $20.0 million with a retention of $20.0 million and has one reinstatement available.

Per Risk Coverage

For southeast losses and northeast commercial residential losses, excluding losses from named storms, the Company purchased property per risk coverage for losses and loss adjustment expenses in excess of $1.0 million per claim. The limit recovered for an individual loss is $9.0 million and total limit for all losses is $27.0 million. There are two reinstatements available with additional premium due based on the amount of the layer exhausted. In addition, the Company purchased facultative reinsurance in excess of $10.0 million for any properties it insured where the total insured value exceeded $10.0 million. This coverage applied to Southeast losses and Northeast commercial residential losses, excluding losses from name storms.

General Excess of Loss

NBIC's general excess of loss reinsurance protects NBIC from single risk losses, both property and casualty. The casualty coverage provided by this contract also responds on a "Clash" basis, meaning that multiple policies involved in a single loss occurrence can be aggregated into one loss and applied to the reinsurance contract. The coverage is in two layers in excess of NBIC's retention of the first $300,000 of loss. The first layer is $450,000 excess $300,000 and the second layer is $2.75 million excess $750,000 (Casualty second layer is $1.25 million excess $750,000). Both layers are 92% placed with the gross quota share providing the additional 8% coverage.

Semi-Automatic Facultative Excess of Loss

NBIC's automatic property facultative reinsurance protects NBIC from single risk losses, for property risks with a total insured value excess of $3.5 million subject to a limit.

2017 – 2018 Reinsurance Programs

Heritage P&C and Zephyr Program

The Company placed its reinsurance program for the period from June 1, 2017 through May 31, 2018 during the second quarter of 2017. This reinsurance program incorporated the catastrophe risk of our two insurance subsidiaries, Heritage P&C, a Florida based insurer writing property insurance in multiple states, and Zephyr, a Hawaii based insurer. The programs are allocated amongst traditional reinsurers, catastrophe bonds issued by Citrus Re Ltd., a Bermuda special purpose insurer formed in 2014 ("Citrus Re"), and the Florida Hurricane Catastrophe Fund ("FHCF"). Coverage is specific to each insurer unless otherwise noted. The 2017-2018 reinsurance program provides, including retention, first event coverage up to $1.75 billion in Florida, first event coverage up to $731 million in Hawaii, and multiple event coverage up to $2.6 billion. This coverage exceeds the requirements established by the Company's rating agency, Demotech, Inc., the Florida Office of Insurance Regulation, and the Hawaii Insurance Division. For the twelve months ending May 31, 2018, no single uncollateralized private reinsurer represented more than 10% of the overall limit purchased from our total reinsurance coverage.

The reinsurance program, which was segmented into layers of coverage, protects the Company for excess property catastrophe losses and loss adjustment expenses. The Company's 2017-2018 reinsurance program incorporates the mandatory coverage required by law to be placed with FHCF, which was available only for Florida catastrophe risk. For the 2017 hurricane season, the Company maintained the prior year selected participation percentage in the FHCF at 45%. The Company also purchased private reinsurance below and alongside the FHCF layer, as well as aggregate reinsurance coverage. The Company did not utilize its captive, Osprey, for any catastrophe risk for the 2017 hurricane season. The Company had a primary retention of the first $20 million of losses and loss adjustment expenses. Additionally, the December 1, 2016 treaty between Heritage P&C and Osprey was commuted effective June 1, 2017.

Heritage P&C provided property insurance coverage for states other than Hawaii. The following describes the various layers of its June 1, 2017 to May 31, 2018 reinsurance program:

- *Heritage P&C's Retention*. If a first catastrophic event strikes a Heritage P&C risk, its primary retention is the first $20 million ($15 million plus $5 million co-participation on the Top and Aggregate layer described below) of losses and loss adjustment expenses. If a second catastrophic event strikes a Heritage P&C risk, its primary retention decreases to $16 million and the remainder of the losses are ceded to third parties. In a first event exceeding approximately $878 million, there was an additional co-participation of 20% subject to a maximum co-participation of $727,000. Assuming a 1-100yr 1st event, a second event exceeding approximately $420 million, results in an additional Company co-participation of 11.5% subject to a maximum co-participation of $36 million. Heritage P&C had a $16 million (including 20% co-participation) primary retention after a 1-100 yr. 1st event for events beyond the second catastrophic event.
- *Shared Layers*. Immediately above the retention, the Company had purchased $372 million of reinsurance from third party reinsurers. This coverage included the following layers: Top and Aggregate layer, Underlying layer, Layer 1, Layer 2 and a private sliver alongside those layers. Through the payment of a reinstatement premium, Heritage P&C and Zephyr was able to reinstate $352 million of this reinsurance one time. There was $20 million of shared coverage subject to a seasonal aggregate of $68 million.
- *FHCF Layer*. Heritage P&C's FHCF program provided coverage for Florida events only and included an estimated maximum provisional limit of 45% of $1.3 billion, in excess of its retention of $414 million. The limit and retention of the FHCF coverage was subject to upward or downward adjustment based on, among other things, submitted exposures to FHCF by all participants. Heritage P&C had purchased coverage alongside from third party reinsurers and through reinsurance agreements with Citrus Re. To the extent the FHCF coverage was adjusted, this private reinsurance with third party reinsurers and Citrus Re would adjust to fill in any gaps in coverage up to the reinsurers' aggregate limits for this layer. The FHCF coverage could not be reinstated once exhausted, but it provided coverage for multiple events.
- *Layers alongside the FHCF*. The Heritage P&C reinsurance program included third party layers alongside the FHCF. These include 2015 B and 2015 C series catastrophe bonds, 2016 D and 2016 E catastrophe bonds and 2017-2 catastrophe bonds issued by Citrus Re, which total $412.5 million of coverage, as discussed below, as well as a traditional reinsurance layer providing $5 million of coverage.
- ***2017-2 Notes:*** During May 2017, Heritage P&C entered into a catastrophe reinsurance agreement with Citrus Re. The agreements provided for three years of coverage from catastrophic losses caused by named storms, including hurricanes, beginning on June 1, 2017. Heritage P&C pays a periodic premium to Citrus Re during this three-year risk period. Citrus Re issued an aggregate of $35 million of principal-at-risk variable notes due March 2019 to fund the reinsurance trust account and its obligations to Heritage P&C for $35 million of coverage under the reinsurance agreements. The limit of coverage was fully collateralized by a reinsurance trust account for the benefit of Heritage P&C. The maturity date of the notes may be extended up to two additional years to satisfy claims for catastrophic events occurring during the three-year term of the reinsurance agreements.

- ***2016 Class D and E Notes:*** During February 2016, Heritage P&C and Zephyr entered into two catastrophe reinsurance agreements with Citrus Re. The agreements provided for three years of coverage from catastrophic losses caused by named storms, including hurricanes, beginning on June 1, 2016. For the 2017 hurricane seasons these notes provided coverage only to Heritage P&C who pays a periodic premium to Citrus Re during this three-year risk period. Citrus Re issued an aggregate of $250 million of principal-at-risk variable notes due February 2019 to fund the reinsurance trust account and its obligations to Heritage P&C under the reinsurance agreements. The Class D notes provided $150 million of coverage and the Class E notes provided $100 million of coverage. The Class D and Class E notes provided reinsurance coverage for a sliver of the catastrophe coverage that had previously been provided by the FHCF. The limit of coverage was fully collateralized by a reinsurance trust account for the benefit of Heritage P&C. The maturity date of the notes may be extended up to two additional years to satisfy claims for catastrophic events occurring during the three-year term of the reinsurance agreements.
- ***2015 Class B and C Notes***: During April 2015, Heritage P&C entered into catastrophe reinsurance agreements with Citrus Re. The agreements provided for three years of coverage from catastrophic losses caused by named storms, including hurricanes, beginning on June 1, 2015. Heritage P&C pays a periodic premium to Citrus Re during this three-year risk period. Citrus Re issued principal-at-risk variable notes due April 2018 to fund the reinsurance trust account and its obligations to Heritage P&C under the reinsurance agreements. The Class B notes provided $97.5 million of coverage, and the Class C notes provide $30 million of coverage. The Class B and Class C notes provided reinsurance coverage for a sliver of the catastrophe coverage that had previously been provided by the FHCF. The limit of coverage was fully collateralized by a reinsurance trust account for the benefit of Heritage P&C. The maturity date of the notes could have been extended up to two additional years to satisfy claims for catastrophic events occurring during the three-year term of the reinsurance agreements.

Layers above the FHCF - Florida program

- ***2017-1 Notes:*** During March 2017, Heritage P&C entered into catastrophe reinsurance agreements with Citrus Re. The agreements provided for three-years of coverage from catastrophic losses caused by named storms, including hurricanes, beginning on June 1, 2017. Heritage P&C pays a periodic premium to Citrus Re during this three-year risk period. Citrus Re issued principal-at-risk variable notes due March 2019 to fund the reinsurance trust account and its obligations to Heritage P&C under the reinsurance agreements. The notes provided $125 million of coverage for a layer above the FHCF. The limit of coverage was fully collateralized by a reinsurance trust account for the benefit of Heritage P&C. The maturity date of the notes may be extended up to two additional years to satisfy claims for catastrophic events occurring during the three-year term of the reinsurance agreements.
- ***2015 Class A Notes:*** During April 2015, Heritage P&C entered into catastrophe reinsurance agreements with Citrus Re. The agreements provide for three-years of coverage from catastrophic losses caused by named storms, including hurricanes, beginning on June 1, 2015. Heritage P&C pays a periodic premium to Citrus Re during this three-year risk period. Citrus Re issued principal-at-risk variable notes due April 2018 to fund the reinsurance trust account and its obligations to Heritage P&C under the reinsurance agreements. The Class A notes provided $150 million of coverage for a layer above the FHCF. The limit of coverage was fully collateralized by a reinsurance trust account for the benefit of Heritage P&C. The maturity date of the notes may be extended up to two additional years to satisfy claims for catastrophic events occurring during the three-year term of the reinsurance agreements.
- *Multi-Zonal Layers*. The Company purchased additional layers which provide coverage for Heritage P&C for a second event and both first and second event coverage for Hawaii. The first event coverage for Hawaii is a counterpart to the multi-state catastrophe bond layers and FHCF layer. There was a total of $254 million of reinsurance coverage purchased on this basis, which the Company was able to reinstate one time through the payment of a reinsurance reinstatement premium.
- *Aggregate Coverage*. In addition to what was described above, much of the reinsurance was structured in a way to provide aggregate coverage. $984 million of limit was structured on this basis (Top and Aggregate, Underlying, Layer 1, Layer 2, Private layers, Multi-Zonal, 2017-1 Notes, 2017-2 Notes, and 2015 Class A Notes). To the extent that this coverage was not fully exhausted in the first catastrophic event, it provided coverage commencing at its reduced retention for second and subsequent events where underlying coverage had been previously exhausted The Company paid a reinsurance reinstatement premium for $606 million of this coverage, which can be a reinstated one time. Layers (with exception to FHCF, 2016 Class D & E Notes, and 2015 Class B & C Notes) are “net” of a $40 million attachment point. Layers inure to the subsequent layers if the aggregate limit of the preceding layer(s) is exhausted, and the subsequent layer cascades down in its place.

Zephyr provides property insurance coverage for Hawaii. The various layers of its 2017-2018 reinsurance program area as follows:

- *Zephyr's Retention*. If a first catastrophic event strikes Hawaii, Zephyr has a primary retention of the first $20 million ($15 million plus $5 million co-participation on the Top and Aggregate layer) of losses and loss adjustment expenses. If a second event strikes Hawaii, Zephyr's primary retention decreases to $16 million and the remainder of losses are ceded to third parties. In a first event exceeding approximately $386 million, there is an additional co-participation of 3.8% subject to a maximum co-participation of $12 million. Assuming a 1-100-year event, a second event exceeding approximately $386 million results in an additional co-participation of 117.7%, subject to a maximum co-participation of $56 million. Zephyr has a $16 million primary retention for events beyond the second catastrophic event.
- *Shared Layers above retention*. Immediately above the retention, the Company has purchased $372 million of reinsurance from third party reinsurers. This coverage includes the following layers: Top and Aggregate layer, Underlying layer, Layer 1, Layer 2 and a private sliver alongside those layers. Through the payment of a reinsurance reinstatement premium, Heritage P&C and Zephyr are able to reinstate $352 million of this reinsurance one time. There is $20 million of shared coverage subject to a seasonal aggregate of $68 million.
- *Multi-Zonal Layers*. The Company purchased additional layers which provide coverage for Florida for a second event and both first and second event coverage for Hawaii. The first event coverage for Hawaii is a counterpart to the multi-state catastrophe bond layers and FHCF layer. There is a total of $302 million of reinsurance coverage purchased on this basis, of which $254 million can be reinstated through the payment of reinsurance restatement premium. The multi-zonal occurrence layer provides first and second event coverage of $254 million for Hawaii and second event coverage of $254 million for Florida. A Top and Aggregate multi-zonal layer provides first event coverage of $48 million for Hawaii and second or subsequent event coverage of $48 million for Florida.
- *Top Hawaii only layer*. Zephyr has an additional layer purchased from third party reinsurers which provides $26 million of coverage for Hawaii only losses. This layer has one free reinstatement.
- *Aggregate Coverage*. In addition to what is described above, much of the reinsurance is structured in a way to provide aggregate coverage. An aggregate of $700 million of limit is structured on this basis (Top and Aggregate, Underlying, Layer 1, Layer 2, Private Layers, Multi-Zonal, Hawaii Only). To the extent that this coverage is not fully exhausted in the first catastrophic event, it provides coverage commencing at its reduced retention for second and subsequent events where underlying coverage has been previously exhausted. $632 million can be reinstated through the payment of a reinsurance premium.

For a first catastrophic event striking Florida, our reinsurance program provided coverage up to $1.75 billion of losses and loss adjustment expenses, including our retention, and we are responsible for all losses and loss adjustment expenses in excess of such amount. For a first catastrophic event striking Hawaii, our reinsurance program provided coverage up to $731 million of losses and loss adjustment expenses, including our retention, and we are responsible for all losses and loss adjustment expenses in excess of such amount. For subsequent catastrophic events, our total available coverage depends on the magnitude of the first event, as we may have coverage remaining from layers that were not previously fully exhausted. An aggregate of $632 million of limit purchased in 2017 includes reinstatement through the purchase of reinsurance reinstated premium. In total, we have purchased $2.6 billion of potential reinsurance coverage, including our retention, for multiple catastrophic events. Our ability to access this coverage, however, will be subject to the severity and frequency of such events. Hurricane losses in states other than Hawaii would be covered under the Heritage P&C program with the exception of the FHCF coverage and the series 2015, 2016 and 2017 catastrophe bonds. Management deemed this reinsurance protection to be sufficient given the level of catastrophe exposure in 2017 for Alabama, Georgia, North Carolina and South Carolina. In placing our 2017-2018 reinsurance program, we sought to capitalize on favorable reinsurance pricing and mitigate uncertainty surrounding the future cost of our reinsurance by negotiating multi-year arrangements. The $687.5 million of aggregate coverage we have purchased from Citrus Re Ltd, which includes the 2015 Class A, B, and C notes, the 2016 Class D & E notes, and the 2017 Series notes extends $277.5 million of coverage until May 2018, $250 million of coverage for two-year period and $160 million of coverage for a three-year period. To the extent coverage was all or partially exhausted before the end of three years, it cannot be reinstated. In the aggregate, multi-year coverage from Citrus Re Ltd accounts for approximately 26% of our purchases of private reinsurance for the 2017 hurricane season. The terms of each of the multi-year coverage arrangements described above are subject to adjustment depending on, among other things, the size and composition of our portfolio of insured risks in future periods.

Per Risk Coverage: The Company also purchased property per risk coverage for losses and loss adjustment expenses in excess of $1 million per claim. The limit recovered for an individual loss is $9 million and total limit for all losses is $27 million. There are two reinstatements available with additional premium due based on the amount of the layer exhausted. In addition, the Company purchased facultative reinsurance in excess of $10 million for any commercial properties it insured where the total insured value exceeded $10 million.

NBIC Program

NBIC, our insurance subsidiary located in Rhode Island, provides property insurance coverage in the states of Connecticut, Massachusetts, New Jersey, New York and Rhode Island. NBIC's catastrophe reinsurance program provides coverage for loss occurrences up to $1 billion (1:100-year event) on the first event and includes automatic reinstatement protection. The program includes coverage for catastrophic events such as severe winter storms, hurricanes and tornadoes. During 2017, NBIC's net retention for a catastrophic event of up to $1.0 billion is $1.3 million. NBIC's reinsurance program also covers non-catastrophic losses. A summary of NBIC's combined reinsurance protection follows. The reinsurance program is placed with strong participation from leading reinsurers across global markets with no one reinsurer exceeding 10%. The reinsurance partners are all rated A- to A+ by Standard and Poor's.

Property Catastrophe Excess of Loss

NBIC's property catastrophe program protects NBIC from the aggregation of losses in a single occurrence. Reinstatement provisions (one reinstatement at 100% of premium) on the first three layers and a portion of the fourth layer provides protection for NBIC from a second catastrophic event. The program is 81.25% placed, with the remaining 18.75% of catastrophe protection coming from NBIC's gross quota share contract. NBIC's net retention of $20 million is further reduced with a net quota share reinsurance contract described below.

Reinstatement Premium Protection

NBIC's Reinstatement Premium Protection locks in the cost of a potential reinstatement premium charge that would occur should an event trigger catastrophe reinsurance. NBIC buys reinstatement premium protection for the first three layers and a portion of the fourth catastrophe excess of loss layers.

Aggregate Contract

For the year ended December 31, 2017, NBIC had 25% of an Aggregate contract, in two sections:

- Section 1: $20 million excess $21.5 million in the aggregate for all catastrophe losses excluding named tropical storms.
- Section 2: $12 million excess $8 million for named tropical storm losses.

NBIC placed 25% of an aggregate contract on December 31, 2017, expiring May 31, 2018. The limit on the contract is $13.5 million, retention of $18.5 million and franchise deductible of $1.0 million.

Gross Quota Share

NBIC purchased an 18.75% gross account quota share reinsurance treaty which provides ground up loss recoveries of up to $1 billion.

Net Lines Quota Share

NBIC's net lines quota share is proportional reinsurance for which certain of our other reinsurance inures to the quota share (property catastrophe excess of loss and reinstatement premium protection and the second layer of the general excess of loss.) An occurrence limit of $20 million for catastrophe losses is in effect on the quota share, subject to certain aggregate loss limits that vary by reinsurer. The amount and rate of reinsurance commissions slide, within a prescribed minimum and maximum, depending on loss performance. NBIC ceded 60% of net premiums and losses during 2017 to the Net Quota Share. The net quota share program was renewed on December 31, 2017 ceding 49.5% of the net premiums and losses and 8% of the prior year quota share will runoff.

General Excess of Loss

NBIC's general excess of loss reinsurance protects NBIC from single risk losses, both property and casualty. The casualty coverage provided by this contract also responds on a "Clash" basis, meaning that multiple policies involved in a single loss occurrence can be aggregated into one loss and applied to the reinsurance contract. The coverage is in two layers in excess of NBIC's retention of the first $300,000 of loss. The first layer is $450,000 excess $300,000 and the second layer is $2.75 million excess $750,000 (Casualty second layer is $1.25 million excess $750,000). Both layers are 81.25% placed with the gross quota share providing the additional 18.75% coverage.

Semi-Automatic Facultative Excess of Loss

NBIC's automatic property facultative reinsurance protects NBIC from single risk losses, for property risks with a total insured value excess of $3.5 million subject to a limit of $2.5 million.

Product specific reinsurance for Umbrella and Home Systems Protection

NBIC's umbrella facultative program protects NBIC's Umbrella Liability business through the quota share reinsurance contract. NBIC has limits of liability of up to $1 million with 90% quota share, subject to an additional limit of liability of up to $4 million with 100% quota share. The home system protection (HSP) product is designed to protect customers from sudden and accidental mechanical breakdowns to furnaces, boilers, HVAC systems, home entertainment systems, pool heating and filtering equipment, and other mechanical systems that are not covered by standard homeowners' insurance policies. The coverage is included in NBIC's base policy and is 100% reinsured through Hartford Steam Boiler.

Property Per Risk Coverage

The Company also purchased property per risk coverage for losses and loss adjustment expenses in excess of $1 million per claim. The limit recovered for an individual loss is $9 million and total limit for all losses is $27 million. There are two reinstatements available with additional premium due based on the amount of the layer exhausted. In addition, the Company purchased facultative reinsurance in excess of $10 million for any commercial properties it insured that the total insured value exceeded $10 million.

Effect of Reinsurance

The Company's reinsurance arrangements had the following effect on certain items in the Consolidated Statement of Income for the year ended December 31, 2019 and 2018:

	For the Year Ended December 31, 2019		
	Premiums Written	**Premiums Earned**	**Losses and Loss Adjustment Expenses**
		(in thousands)	
Direct	$ 937,937	$ 924,247	$ 696,289
Ceded	(436,564)	(445,534)	(423,001)
Net	$ 501,373	$ 478,713	$ 273,288

	For the Year Ended December 31, 2018		
	Premiums Written	**Premiums Earned**	**Losses and Loss Adjustment Expenses**
		(in thousands)	
Direct	$ 923,349	$ 926,326	$ 855,780
Ceded	(477,451)	(472,144)	(618,355)
Net	$ 445,898	$ 454,182	$ 237,425

Note 13. Reserve For Unpaid Losses

The Company determines the reserve for unpaid losses on an individual-case basis for all incidents reported. The liability also includes amounts which are commonly referred to as incurred but not reported, or "IBNR", claims as of the balance sheet date. We estimate our IBNR reserves by projecting our ultimate losses using industry accepted actuarial methods and then deducting actual loss payments and case reserves from the projected ultimate losses.

The table below summarizes the activity related to the Company's reserve for unpaid losses:

	For the Year Ended December 31,		
	2019	2018	2017
		(in thousands)	
Balance, beginning of period	$ 432,359	$ 470,083	$ 140,137
Less: reinsurance recoverable on unpaid losses	250,507	315,353	589
Net balance, beginning of period	181,852	154,730	139,548
Incurred related to:			
Current year	276,985	224,080	188,914
Prior years	(3,696)	13,345	12,567
Total incurred	273,289	237,425	201,481
Paid related to:			
Current year	137,764	104,368	114,344
Prior years	97,474	105,935	107,479
Total paid	235,238	210,303	221,823
Total unpaid claims assumed from acquisitions	—	—	35,524
Net balance, end of period	219,903	181,852	154,730
Plus: reinsurance recoverable on unpaid losses	393,630	250,507	315,353
Balance, end of period	$ 613,533	$ 432,359	$ 470,083

The Company writes insurance in the coastal states of Alabama, Connecticut, Florida, Georgia, Hawaii, Massachusetts, New Jersey, New York, North Carolina, Rhode Island, South Carolina, and Virginia, which could be exposed to hurricanes or other natural catastrophes. Although the occurrence of a major catastrophe could have a significant effect on our monthly or quarterly results, such an event is unlikely to be so material as to disrupt our overall normal operations. However, the Company is unable to predict the frequency or severity of any such events that may occur in the near term or thereafter. The Company believes that the reserve for unpaid losses reasonably represents the amount necessary to pay all claims and related expenses which may arise from incidents that have occurred as of the balance sheet date.

The reserve for unpaid losses is the estimate of amounts necessary to settle all reported and unreported incurred claims for the ultimate cost of insured losses, based upon the facts of each case and the Company's experience with similar cases. Estimated amounts of salvage and subrogation are deducted from the reserve for claims and claims expense. The establishment of appropriate reserves, including reserves for catastrophe losses, is an inherently uncertain and complex process. Reserve estimates are primarily derived using an actuarial estimation process in which historical loss patterns are applied to actual paid losses and reported losses (paid losses plus individual case reserves established by claim adjusters) for an accident or report year to create an estimate of how losses are likely to develop over time. Development factors are calculated quarterly and periodically throughout the year for data elements such as claims reported and settled, paid losses, and paid losses combined with case reserves. The historical development patterns for these data elements are used as the assumptions to calculate reserve estimates, including the reserves for reported and unreported claims. Reserve estimates are regularly reviewed and updated, using the most current information available. Any resulting re-estimates are reflected in current results of operations.

The Company's losses incurred for the years ended December 31, 2019, 2018 and 2017 reflect prior year favorable development of $3.7 million and unfavorable development of $13.3 million and $12.6 million, respectively, associated with management's best estimate of the actuarial loss and LAE reserves with consideration given to Company specific historical loss experience. While a portion of the 2018 development includes additional retention for hurricane losses, the majority of the 2018 loss development related to personal lines litigated and AOB claims from 2016 and 2017 accident years. Development in 2017 included $6.5 million for hurricane claims and strengthening of reserves for personal lines non-hurricane losses.

The following is information about incurred and paid claims development as of December 31, 2019, net of reinsurance, as well as cumulative claim frequency and the total of incurred-but-not-reported liabilities plus expected development on reported claims included within the net incurred claims amounts.

Incurred Loss and Allocated Loss Adjustment Expenses, Net of Reinsurance
(in thousands, except number of claims)

	Unaudited									
Accident year	**2012 & prior**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**Net IBNR Reserves**	**Reported Claims**
2012 & prior	$ 102,723	$ 105,765	$ 107,842	$ 106,493	$ 106,331	$ 106,654	$ 106,446	$ 106,628	$ 74	53,353
2013		61,157	61,483	62,969	62,166	62,354	62,378	62,564	359	13,095
2014			118,991	114,899	113,847	114,984	115,838	115,234	975	18,477
2015				179,255	197,744	203,792	205,164	206,011	4,106	26,054
2016					237,207	242,611	250,990	250,235	7,105	27,495
2017						189,163	195,240	192,749	8,374	69,967
2018							199,565	193,672	30,125	33,482
2019								258,876	110,019	23,098
							Total	$ 1,385,969	$ 161,137	

Cumulative Paid Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance

	Unaudited							
Accident year	**2012 & prior**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
2012 & prior	$ 92,909	$ 101,323	$ 102,750	$ 104,093	$ 104,362	$ 105,053	$ 105,875	$ 106,475
2013		35,771	50,716	55,589	57,647	59,395	60,581	61,191
2014			68,732	95,076	101,456	108,509	112,518	113,609
2015				103,918	162,654	181,672	192,967	197,524
2016					132,679	211,512	233,540	238,868
2017						103,148	169,743	178,622
2018							84,552	152,592
2019								124,664
				Total				$ 1,173,545

Reconciliation of Reserve Balances to Liability for Unpaid Loss and Loss Adjustment Expenses

Unpaid Loss and Allocated Loss Adjustment Expense, Net of Reinsurance	$ 212,424
Ceded Unpaid Loss and Allocated Loss Adjustment Expense	393,630
Unpaid Unallocated Loss Adjustment Expense	7,479
Unpaid losses and loss adjustment expenses	$ 613,533

Average Annual Percentage Payout of Incurred Claims by Age, Net of Reinsurance as of December 31, 2019 (Unaudited)

	Year - 1	**Year - 2**	**Year - 3**	**Year - 4**	**Year - 5**	**Thereafter**
Percentage	55%	30%	7%	3%	2%	3%

Note 14. Long-Term Debt

Convertible Senior Notes

In August 2017 and September 2017, the Company issued in aggregate $136.8 million of 5.875% Convertible Senior Notes ("Convertible Notes") maturing on August 1, 2037, unless earlier repurchased, redeemed or converted. The Convertible Notes were issued in a private placement transaction pursuant to Rule 144A under the Securities Act, as amended. The Convertible Notes are senior unsecured obligations of the Company that will rank senior in right of payment to the Company's future indebtedness that is expressly subordinated in right of payment to the Convertible Notes; equal in right of payment to the Company's unsecured indebtedness that is not so subordinated; effectively junior to any of the Company's secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all indebtedness or other liabilities by the Company's subsidiaries other than the Guarantor, which will fully and unconditionally guarantee the Convertible Notes on a senior unsecured basis.

Holders may convert their Convertible Notes at any time prior to the close of business on the business day immediately preceding February 1, 2037. On or after August 5, 2022 but prior to February 1, 2037, the Company may redeem for cash all or any portion of the Convertible Notes, at the Company's option, at a redemption price equal to 100% of the principal amount of the Convertible Notes to be redeemed, plus accrued and unpaid interest to , but excluding, the redemption date. Holders of the Convertible Notes will be able to cause the Company to repurchase their Convertible Notes for cash on any of August 1, 2022, August 1, 2027 and August 1, 2032, in each case at 100% of their principal amount, plus accrued unpaid interest to, but excluding, the relevant repurchase date.

Interest accrues from August 16, 2017 and is payable semi-annually in arrears, on February 1 and August 1 of each year, beginning in 2018.

At December 31, 2019, the Company had $21.3 million of the Convertible Notes outstanding, net of issuance and debt discount costs in aggregate of approximately, $2.1 million. For the year ended December 31, 2019, the Company made interest payments, net of affiliated Convertible Notes of approximately $1.5 million, on the outstanding Convertible Notes.

As of December 31, 2018, the Company had $25.6 million of the Convertible Notes outstanding, net of debt issuance and debt discount costs which totaled approximately, $3.6 million. For the year ended December 31, 2018, the Company made interest payments of approximately $8.1 million on the Convertible Notes.

During the fourth quarter of 2018, the Company exchanged Convertible Notes in the aggregate principal amount of $75.8 million for a combination of cash and the issuance of an aggregate of 3,595,452 shares of the Company's common stock.

Debt Extinguishment

The Company has reacquired convertible senior notes over a series of transactions in 2019, 2018 and 2017. In accordance with ASC 470 " *Debt* ", the Company evaluated the accounting treatment to determine if the repurchase of the Convertible Notes constituted a debt extinguishment. ASC 405-20-40-1 provides implementation guidance in order to determine if the Company is legally released from being the primary obligor under the liability, either judicially or by the creditor. Based on the reacquisition of the Convertible Notes, the Company should derecognize the related debt and conversion option liability. Upon extinguishment, the Company performed a discounted cash flow ("DCF") analysis for each transaction based on its date and principal amount, leveraging market debt yield data as of each trade date to estimate the costs of the debt.

On February 19, 2019, the Company reacquired $5.8 million of its outstanding Convertible Notes, payment was made in cash of approximately $2.9 million and issuance of 285,201 shares of the Company's common stock valued at $4.2 million. The repurchase resulted in a $48,000 non-operating loss.

In October 2018, the Company reacquired $3.1 million of its outstanding Convertible Notes in the open market at a cost of $3.6 million. The repurchase resulted in a $73,000 non-operating loss. In December 2018, the Company repurchased in aggregate $72.7 million of its outstanding Convertible Notes. As consideration for the repurchase, the Company paid in cash $35.9 million and converted $53.0 million into 3,595,452 shares of the Company's common stock. The Company recorded a $572,000 non-operating loss on the extinguishment and a reduction in debt discount liability of $6.2 million. In January 2019, in connection with the October 2018 settlement, the Company retired the repurchased $3.1 million Convertible Notes.

In April 2018, the Company reacquired $10.6 million of its outstanding Convertible Notes in the open market at a cost of $13.4 million. The Company recognized a non-operating loss of $383,000 on extinguishment. In August 2018, in connection with the April 2018 settlement of the open market repurchase, the Company retired the repurchased $10.6 million Convertible Notes.

The impact of the purchase of convertible notes during 2018 resulted in a net increase to additional paid-in capital from issuance of common stock on conversion of the Convertible Notes valued at $53.0 million reduced by the impact from the extinguishment of the allocated portion of the convertible option of $26.0 million.

For 2019 and 2018 debt repurchases, the Company removed the respective net debt amount and the related portion of the derivative that was included in shareholders' equity. The extinguishment of debt was measured at the then-current fair value at the time of purchase, with any difference recorded as a gain or loss on the extinguishment. In accordance with the purchase agreement governing the Company's offer and sale of convertible debt, the Company or its affiliates are prohibited from reselling the notes once acquired. The repurchased Convertible Notes hold no registration rights.

In December 2017, the conversion option of the Convertible Notes for equity classification no longer accounted for a separate derivative instruments' liability in accordance with U.S. GAAP. The Company valued the embedded derivative and recorded additional paid-in-capital of $51.6 million. In connection with the change in the fair value, the Company recognized a fair value change in the year ended December 31, 2017 of $41.0 million as non-operating expenses in the consolidated statements of operations and comprehensive income (loss).

On December 1, 2017, the Company held a Special Meeting of Stockholders, at which the Company's stockholders approved, as required by Rule 312 of the New York Stock Exchange Listed Company Manual, the issuance of the Company's common stock upon conversion of the Convertible Notes. Pursuant to the approval, the Company has the ability to settle the conversion option in shares of common stock, cash or a combination thereof. Upon conversion of the Convertible Notes, the Company intends to pay cash in respect of only the principal amount of the Convertible Notes being converted or (if lower) the conversion value thereof, and to settle any amounts in excess thereof in cash, shares of common stock or a combination thereof, at the Company's election.

In October and November 2017, the Company, through our subsidiary Heritage P&C, reacquired $21.1 million of its outstanding Convertible Notes in the open market at a cost of $25.2 million. The Company recognized a non-operating loss of $1.2 million on extinguishment. In connection with the repurchase, the Company removed the net debt of $17.7 million and liability derivative at the carrying amount of $6.2 million

Mortgage Loan

In October 2017, the Company and its subsidiary, Skye Lane Properties LLC, jointly obtained a commercial real estate mortgage loan in the amount of $12.7 million, bearing interest of 4.95% per annum and maturing on October 30, 2027. On October 30, 2022, the interest rate shall adjust to an interest rate equal to the annualized interest rate of the United States 5-year Treasury Notes as reported by Federal Reserve on a weekly average basis plus 3.10%. The Company makes monthly principal and interest payments against the loan. For each of the respective years ended December 31, 2019 and 2018, the Company made principal and interest payments of $892,850 on the mortgage loan.

Senior Secured Credit Facility

In December 2018, the Company entered into a five-year, $125.0 million credit agreement (the "Credit Agreement") with a syndicate of lenders consisting of $75.0 million senior secured term loan facility (the "Term Loan Facility") and a $50.0 million senior secured revolving credit facility (the "Revolving Credit Facility" and together with the Term Loan Facility, the "Credit Facilities").

Term Loan Facility: The principal amount of the Term Loan Facility amortizes in quarterly installments, beginning with the close of the fiscal quarter ending March 31, 2019, in an amount equal to $1.9 million per quarter, with the remaining balance payable at maturity. As of December 31, 2018, there was $75.0 million in aggregate principal outstanding on the Term Loan Facility. As of December 31, 2019, the balance of the term loan was $69.4 million. For the year ended December 31, 2019, the Company made interest payments of approximately $4.0 million on the term loan.

Revolving Credit Facility: The Revolving Credit Facility allows for borrowings of up to $50.0 million inclusive of a $5.0 million sublimit for the issuance of letters of credit and a $10.0 million sublimit for swingline loans. As of December 31, 2018, there was $20.0 million in aggregate principal outstanding under the Revolving Credit Facility. As of December 31, 2019, the Company had $10.0 million of borrowings and no letters of credit outstanding under the Revolving Credit Facility. For the year ended December 31, 2019, the Company made interest payments of $564,600 under the credit facility, respectively.

At December 31, 2019, the Company's effective interest rate for the Term Loan Facility was 5.0625% and 5.0625% for the Revolving Credit Facility. The Company monitors the rates prior to the reset date which allows it to establish if the payment is monthly or quarterly payment based on the most beneficial rate used to calculate the interest payment.

FHLB Loan Agreements

In December 2018, a subsidiary of the Company received a fixed interest rate 3.094% cash loan of $19.2 million from the Federal Home Loan Bank ("FHLB") Atlanta, with a maturity date of December 13, 2023. In connection with the agreement, the subsidiary became a member of FHLB. Membership in the FHLB required an investment in FHLB's common stock which was purchased in December 2018 and valued at $1.4 million. Additionally, the transaction required securities be pledged as collateral. As of December 31, 2019, the fair value of the collateralized securities was $20.2 million and the equity investment in FHLB common stock was $1.4 million. As of December 31, 2019, the Company made quarterly interest payments of approximately $602,300 per the terms of the agreement.

The following table summarizes the Company's long-term debt:

	December 31, 2019		December 31, 2018	
	(in thousands)			
Convertible debt	$	23,413	$	29,163
Mortgage loan		12,117		12,394
Term loan facility		69,375		75,000
Revolving credit facility		10,000		20,000
FHLB loan agreement		19,200		19,200
Total principal amount	$	134,105	$	155,757
Deferred finance costs	$	4,857	$	6,963
Total long-term debt	$	129,248	$	148,794

As of the date of this report, we were in compliance with the applicable terms of all our covenants and other requirements under the Revolving agreement, Term Note, Convertible Debt, cash borrowings and other loans. Our ability to secure future debt financing depend, in part, on our ability to remain in such compliance. As long as there is no default or an event of default exist, we are allowed to payout dividends in an aggregate amount not to exceed $10.0 million in any fiscal year.

The covenants and other requirements under the revolving agreement represent the most restrictive provisions that we are subject to with respect to our long-term debt.

The schedule of principal payments on long-term debt is as follows:

December 31,	Amount (in thousands)	
2020	$	9,665
2021		7,806
2022		7,822
2023		74,539
2024		354
Thereafter		33,919
Total principal payments	$	134,105

Note 15. Income Taxes

The following table summarizes the provision for income taxes:

	For the Year Ended December 31, 2019		2018		2017	
			(in thousands)			
Federal:						
Current	$	9,674	$	28,891	$	(24,380)
Deferred		584		(20,636)		18,383
Provision for Federal income tax expense (benefit)		10,258		8,255		(5,997)
State:						
Current		1,785		4,162		(20)
Deferred		317		(578)		1,244
Provision for State income tax expense		2,102		3,584		1,224
Provision for income taxes expense (benefit)	$	12,360	$	11,839	$	(4,773)

The income tax (benefit) expense differs from the amounts computed by applying the U.S. federal income tax rate of as indicated below to pretax income as a result of the following (in thousands):

	For the Year Ended December 31, 2019	2018	2017
Expected income tax expense at federal rate	21.0%	21.0%	35.0%
State tax expense	3.6%	5.5%	(22.8)%
Permanent items	0.9%	0.7%	(2.3)%
Non-deductible conversion option liability	—	—	(255.0)%
Non-deductible stock compensation	(0.4)%	2.1%	(26.0)%
Tax exempt interest	(1.6)%	(1.6)%	27.0%
Non-deductible acquisition costs	0.0%	0.4%	(15.2)%
Executive compensation 162(m)	6.1%	4.3%	(11.5)%
Political contributions	0.3%	0.5%	(7.8)%
Tax rate change	0.6%	(2.3)%	362.3%
Other	(0.4)%	(0.2)%	(2.7)%
Reported income tax expense	30.1%	30.4%	81.0%

The effective tax rate for 2019 and 2018 was affected by various permanent tax differences, predominately disallowed executive compensation deductions which were further limited in 2018 and future years upon the enactment of H.R.1, commonly referred to as the Tax Cuts and Jobs Act ("Tax Act"). The 2017 effective tax rate was affected by the valuation change for the conversion option liability (refer to **Note 14 -** *Long Term Debt)*, which is permanently non-deductible, creating a significant adverse impact to the rate. This item was offset by a favorable impact on the effective tax rate associated with enactment of the Tax Act. The effective tax rate can fluctuate throughout the year as estimates used in the tax provision for each quarter are updated as more information becomes available throughout the year.

The Tax Act was signed into law on December 22, 2017 and contains several key provisions that impact the Company's business, including the reduction of the U.S. federal corporate tax rate from 35% to 21% effective January 1, 2018, the reduction in the amount of executive compensation that could qualify as a tax deduction, and a change in how property and casualty taxpayers discount loss reserves. Under current accounting guidance, the effects of changes in tax rates and laws are recognized in the period in which the new legislation is enacted. However, due to the timing of the enactment of the Tax Act and its proximity to December 31, 2017, the SEC issued SAB 118 which provides a framework for companies to account for uncertainties in applying the provisions of the Tax Act. SAB 118 allows companies to record a provisional amount in situations where a company does not have the necessary information available but can make a reasonable estimate. In situations where companies cannot make a reasonable estimate due to various factors, including lack of information, a provisional amount is not recorded. Instead, companies will continue to apply current accounting guidance based on the provision of the tax laws that were in effect immediately prior to the Tax Act being enacted. The measurement period, as defined in SAB 118 for the Tax Act, begins on the enactment date of the Tax Act and ends when a company has obtained, prepared and analyzed the information that was needed in order to complete the accounting requirements under current accounting guidance. However, under no circumstances will the measurement period extend beyond one year from the enactment date of the Tax Act.

The Company's accounting for all elements of the Tax Act is now complete, consistent with the closing of the SAB 118 measurement period on December 22, 2018. As a result of guidance released by the IRS, namely Revenue Procedures 2019-06, the Company recorded the following adjustments to the accounting for the Tax Act during 2018:

Property and Casualty Reserves: The Act changes the discount rate and payment patterns utilized to discount certain lines of business when computing the allowable tax reserve deduction. In July 2019, the IRS issued Revenue Procedure 2019-31 to finalize the revised unpaid loss discount factors. As a result of this additional guidance, the Company recorded an increase to its gross deferred tax asset for loss reserve discounting of $702,861 and an increase to its gross deferred tax liabilities for reserve transition liability of $702,861 during 2018. The recorded adjustment had no impact on the Company's effective tax rate.

The significant components of deferred tax assets and liabilities included in the consolidated balance sheets as December 31 were as follows:

	For the Year Ended December 31,	
	2019	2018
Deferred tax assets:	(in thousands)	
Unearned premiums	$ 12,585	$ 12,090
Unearned commission	8,671	10,733
Net operating loss	—	109
Tax-related discount on loss reserve	2,716	2,329
Unrealized loss	—	2,631
Stock-based compensation	297	297
Accrued expenses	757	2,321
Leases	331	—
Other	1,890	1,443
Total deferred tax asset	27,247	31,953
Deferred tax liabilities:		
Deferred acquisition costs	17,871	17,494
Prepaid expenses	153	112
Unrealized gain	2,195	—
Property and equipment	1,029	664
Note discount	478	710
Basis in purchased investments	100	163
Basis in purchased intangibles	16,977	18,982
Other	1,067	1,533
Total deferred tax liabilities	39,870	39,658
Net deferred tax liability	$ (12,623)	$ (7,705)

As of December 31, 2019, the Company has net operating loss carryforwards for federal and state income tax purposes of $450,000 and $0, respectively. The losses will expire in 2031. In addition, the Company had a $400,000 capital loss carryforward which will expire in 2023.

In assessing the net carrying amount of deferred tax assets, we consider whether it is more likely than not that we will not realize some portion or all of the deferred tax assets. The ultimate realization of deferred tax assets depends upon the generation of future taxable income during the periods in which those temporary differences become deductible. We consider the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. The remaining goodwill from asset purchases that is deductible for tax purposes over the future years totaled $6.0 million and $6.0 million for the years ended December 31, 2019 and 2018, respectively. We had non-deductible goodwill of $144.4 million and $144.4 million for the years ended December 31, 2019 and 2018, respectively.

The statute of limitations related to our federal and state income tax returns remains open from our filings for 2016 through 2018. For the 2014 tax year, the federal income tax return was examined by the tax authority resulting in no material adjustments. In April 2019, the Company was notified by the tax authority that the federal income tax returns for the years 2015, 2016 and 2017 will be examined. The Company does not believe the examination will have an adverse impact on our consolidated financial statements.

Our reinsurance affiliate, Osprey Re, Ltd., which is based in Bermuda, made an irrevocable election under section 953(d) of the U.S. Internal Revenue Code of 1986, as amended, to be treated as a domestic insurance company for U.S. Federal income tax purposes. As a result of this election, our reinsurance subsidiary is subject to United States income tax as if it were a U.S. corporation.

As of December 31, 2019, the Company had no uncertain tax positions or unrecognized tax benefits that, if recognized, would impact the effective income tax rate.

Note 16. Statutory Accounting and Regulations

State laws and regulations, as well as national regulatory agency requirements, govern the operations of all insurers such as our insurance subsidiaries. The various laws and regulations require that insurers maintain minimum amounts of statutory surplus and risk-based capital; restrict insurers' ability to pay dividends; restrict the allowable investment types and investment mixes and subject the Company's insurers to assessments.

The Company's insurance subsidiaries are required to file with state insurance regulatory authorities an "Annual Statement" which reports, among other items, net income and surplus as regards policyholders, which is called stockholder's equity under GAAP. Combined results of the Company's insurance subsidiaries reported statutory net loss of $16.3 million and $64.5 for the years ended December 31, 2019 and 2018, respectively. The Company's insurance subsidiaries must maintain capital and surplus ratios or balances as determined by the regulatory authority of the states in which they are domiciled. Heritage P&C is required to maintain capital and surplus equal to the greater of $15 million or 10% of their respective liabilities. Zephyr is required to maintain a deposit of $750,000 in a federally insured financial institution. NBIC is required to maintain capital and surplus of $3.0 million. The combined statutory surplus for Heritage P&C, NBIC, and Zephyr was $351.8 million at December 31, 2019. The combined statutory surplus for Heritage P&C, NBIC, and Zephyr was $375.1 million at December 31, 2018. State laws also require the Company's insurance subsidiaries to adhere to prescribed premium-to-capital surplus ratios, with which the Company's insurance affiliates are complying. At December 31, 2019, our insurance subsidiaries met the financial and regulatory requirements of the states in which they do business.

The legislatures of the states of domicile of our insurance affiliates have adopted the National Association of Insurance Commissioners ("NAIC") recommendations with regard to expansion of the regulation of insurers to include non-insurance entity affiliates. Specifically, the new law permits the state insurance regulators to examine affiliated entities within an insurance holding company system in order to ascertain the financial condition of the insurer. The law also provides for certain disclosures regarding enterprise risk, which are satisfied by the provision of related information filed with the SEC.

The NAIC published risk-based capital guidelines for insurance companies that are designed to assess capital adequacy and to raise the level of protection that statutory surplus provides for policy holders. Most states, including Florida, Hawaii, and Rhode Island, have enacted the NAIC guidelines as statutory requirements, and insurers having less statutory surplus than required will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy. State insurance regulatory authorities could require an insurer to cease operations in the event the insurer fails to maintain the required statutory capital.

The level of required risk-based capital ("RBC") is calculated and reported annually. There are five outcomes to the RBC calculation set forth by the NAIC which are as follows:

1. No Action Level—If RBC is greater than 200%, no further action is required.
2. Company Action Level—If RBC is between 150%-200%, the insurer must prepare a report to the regulator outlining a comprehensive financial plan that identifies conditions that contributed to the insurer's financial condition and proposes corrective actions.
3. Regulatory Action Level—If RBC is between 100%-150%, the state insurance commissioner is required to perform any examinations or analyses to the insurer's business and operations that he or she deems necessary as well as issuing appropriate corrective orders.
4. Authorized Control Level—If RBC is between 70%-100%, this is the first point that the regulator may take control of the insurer even if the insurer is still technically solvent and is in addition to all the remedies available at the higher action levels.
5. Mandatory Control Level—If RBC is less than 70%, the regulator is required to take steps to place the insurer under its control regardless of the level of capital and surplus.

At December 31, 2019, the ratio of adjusted capital to authorized control level risk based capital for each of our insurance company subsidiaries was above 300%.

State laws for Florida, Hawaii, and Rhode Island permit an insurer to pay dividends or make distributions out of that part of statutory surplus derived from net operating profit and net realized capital gains. The applicable laws pertain to the state of domicile of each insurance company affiliate and provide calculations to determine the amount of dividends or distributions that can be made without the prior approval of the insurance regulatory authority and the amount of dividends or distributions that would require prior approval of the insurance regulatory authority. In the state of Florida, a dividend may be taken without regulatory approval if the dividend is equal to or less than the greater of 10% of the insurer's surplus or the insurer's net income. In the state of Rhode Island, a dividend may be taken without regulatory approval if the dividend is equal to or less than the lesser of 10% of the insurer's surplus or the insurer's net income excluding realized capital gains. The state of Hawaii restricts dividends without regulatory approval to the smaller of prior years' net income or 10% of prior year's surplus. Heritage P&C and NBIC have not paid dividends in any of the last three years. Zephyr paid dividends of $6.9 million and $7.6 million for the years ended December 31, 2019 and 2018.

Statutory risk-based capital requirements may further restrict our insurance subsidiaries ability to pay dividends or make distributions if the amount of the intended dividend or distribution would cause statutory surplus to fall below minimum risk-based capital requirements. However, the consent order authorizing commencement of operations for Heritage P&C precluded payment of dividends without the prior approval of FLOIR until July 31, 2017.

State insurance laws limits an insurer's investment in equity instruments and also restricts investments in medium to low quality debt instruments. The Company's insurance affiliates were in compliance with all investment restrictions at December 31, 2019 and 2018.

Governmental agencies or certain quasi-governmental entities can levy assessments upon the Company in the states in which the Company writes policies. See **Note 1** "*Basis of Presentation, Nature of Business and Significant Accounting Policies and Practices"* for a description of how the Company recovers assessments imposed upon it. Governmental agencies or certain quasi-governmental entities can also levy assessments upon policyholders, and the Company collects the amount of the assessments from policyholders as surcharges for the benefit of the assessing agency. There are currently no assessments to be collected from policyholders and remitted to any governmental or quasi-governmental entities. If an assessment becomes levied the Company would multiply the premium written on each policy by these assessment percentages to determine the additional amount that it will collect from the policyholder and remit to the assessing agencies.

The Company reported its insurance subsidiaries' assets, liabilities and results of operations in accordance with GAAP, which varies from statutory accounting principles prescribed or permitted by state laws and regulations, as well as by general industry practices. The following items are principal differences between statutory accounting and GAAP:

- Statutory accounting requires that the Company excluded certain assets, called non-admitted assets, from the balance sheet.
- Statutory accounting requires the Company to expense policy acquisition costs when incurred, while GAAP allows the Company to defer and amortize policy acquisition costs over the estimated life of the policies.
- Statutory accounting dictates how much of a deferred income tax asset the Company can admit on a statutory balance sheet.
- Statutory accounting requires that the Company record certain investments at cost or amortized cost, while the Company records other investments at fair value; however, GAAP requires that we record all available for sale investments at fair value.
- Statutory accounting requires that surplus notes, also known as surplus debentures, be recorded in statutory surplus, while GAAP requires the Company to record surplus notes as a liability.
- Statutory accounting allows bonds to be carried at amortized cost or fair value based on the rating received from the Securities Valuation Office of the NAIC, while they are recorded at fair value for GAAP if designated as available for sale.
- Statutory accounting requires unrealized gains and losses from equity securities to be reported as direct adjustments to surplus, but under GAAP ASU 2016-01 the reporting of unrealized gains and losses on equity securities are reported in net income
- Statutory accounting allows ceding commission income to be recognized when written if the cost of acquiring and renewing the associated business exceeds the ceding commissions, but under GAAP such income is deferred and recognized over the coverage period.
- Statutory accounting requires that unearned premiums and loss reserves be presented net of related reinsurance rather than on a gross basis under GAAP.
- Statutory accounting requires a provision for reinsurance liability be established for reinsurance recoverable on paid losses aged over ninety days and for unsecured amounts recoverable from unauthorized reinsurers. Under GAAP there is no charge for uncollateralized amounts ceded to a company not licensed in the insurance affiliate's domiciliary state and a reserve for uncollectable reinsurance is charged through earnings rather than surplus or equity.
- Statutory accounting requires an additional admissibility test outlined in Statements on Statutory Accounting Principles, No. 101 and the change in deferred income tax is reported directly in capital and surplus, rather than being reported as a component of income tax expense under GAAP.

The table below reconciles the Company's consolidated GAAP net (loss) income to statutory net income of its insurance subsidiaries (in thousands):

	For the Year Ended December 31,		
	2019	2018	2017
Consolidated GAAP net income (loss)	$ 28,636	$ 27,155	$ (1,119)
(Decrease) increase due to:			
Deferred income taxes	(339)	(16,868)	32,644
Deferred acquisition costs	(4,156)	(31,377)	1,101
Surplus note interest	—	—	(4)
Non-statutory subsidiaries	(37,005)	(31,158)	5,410
Investment basis difference	247	335	446
Pre-acquisition income	—	—	20,839
Equity compensation	(1,265)	(2,408)	(2,408)
Convertible notes	(1,613)	(1,570)	1,051
Commission revenue	1,394	(6,289)	(6,700)
Change in fair value income statement	(2,429)	2,078	—
Lease accounting standard	137	—	—
Other	94	(4,372)	(709)
Statutory net (loss) income of insurance subsidiaries	$ (16,299)	$ (64,474)	$ 50,553

The Company's reinsurance subsidiary, Osprey, which was incorporated on April 23, 2013, is licensed as a Class 3a Insurer under The Bermuda Insurance Act 1978 and related regulations. Osprey is required to maintain statutory capital and surplus of at least $1.0 million and maintain liquid resources or have access to liquid resources equal to its maximum obligation for which it is responsible under the terms of any reinsurance arrangement to which it is a party. Osprey maintains sufficient collateral to comply with regulatory requirements as of December 31, 2019. Bermuda's standard for financial statement reporting is U.S. GAAP.

Note 17. Commitments and Contingencies

The Company is involved in claims-related legal actions arising in the ordinary course of business. The Company accrues amounts resulting from claims-related legal actions in unpaid losses and loss adjustment expenses during the period that it determines an unfavorable outcome becomes probable and it can estimate the amounts. Management makes revisions to its estimates based on its analysis of subsequent information that the Company receives regarding various factors, including: (i) per claim information; (ii) company and industry historical loss experience; (iii) judicial decisions and legal developments in the awarding of damages; and (iv) trends in general economic conditions, including the effects of inflation.

Note 18. Accounts Payable and Other Liabilities

Other liabilities consist of the following as of December 31, 2019 and 2018:

Description	*December 31, 2019*	*December 31, 2018*
	(in thousands)	
Deferred ceding commission	37,464	$ 44,819
Outstanding claim checks	—	15,360
Accounts payable and other payables	7,225	8,556
Accrued dividends	1,750	1,589
Accrued interest and issuance costs	1,052	1,285
Lease obligations	8,369	—
Premium tax	—	2,241
Other liabilities	387	460
Commission payables	14,798	11,654
Total other liabilities	$ 71,045	$ 85,964

Note 19. Accrued Bonus Compensation

At December 31, 2019, the Company recognized employee bonus compensation expense in aggregate of $7.6 million, which the Company paid out in cash approximately $6.0 million during 2019, the remainder is expected to be paid in 2020. At December 31, 2018, the Company recognized employee bonus compensation expense of approximately $8.2 million, which the Company paid out in cash of approximately $2.2 million for 2018, the remainder was paid in 2019.

Note 20. Related Party Transactions

In January 2017, the Company entered into a consulting agreement with Mrs. Shannon Lucas, the wife of the Chairman and CEO, in which she agreed to provide consulting services related to the Company's catastrophe reinsurance and risk management program at a rate of $400 per hour. The consulting agreement has no specific term and either party may terminate the agreement upon providing written notice. Additionally, she serves as a director of Heritage P&C and NBIC with an annual compensation of $150,000. For the years ended December 31, 2019 and 2018, the Company paid consulting fees to Ms. Lucas of approximately $344,400 and $628,800, respectively.

In July 2019, the Board of Directors appointed Mark Berset to the Board of Directors of the Company. Mr. Berset will be entitled to an annual compensation of $150,000. Mr. Berset is also the Chief Executive Officer of Comegys Insurance Agency, Inc. ("Comegys"), an independent insurance agency that writes policies for Company. The Company pays commission to Comegys based upon standard industry rates consistent with those provided to the Company's other insurance agencies. There are no arrangements or understandings between Mr. Berset and any other persons with respect to his appointment as a director. For the years ended December 31, 2019 and 2018, the Company paid agency commission to Comegy of approximately $589,800 and $509,900, respectively.

Note 21. Employee Benefit Plan.

The Company provides a 401(k) plan for substantially all employees. The Company provides a matching contribution of 100% on the first 3% of employees' contribution and 50% on the next 2% of the employees' contribution to the plan. The maximum match is 4%. For the years ended December 31, 2019 and 2018, the contributions made to the plan on behalf of the participating employees were approximately $1.0 and $1.1 million, respectively.

The Company provides for its employees a partially self-insured healthcare plan and benefits. For years ended December 31, 2019 and 2018, incurred medical premium and related costs amounted to an aggregate of $3.8 million and $3.2 million, respectively. An additional liability of approximately $418,000 and $368,000 was recorded for unpaid claims as of December 31, 2019 and 2018, respectively. A stop loss reinsurance policy caps the maximum loss that could be incurred by the Company under the self-insured plan. The Company's stop loss coverage per employee is $150,000 for which any excess cost would be covered by the reinsurer subject to an aggregate limit for losses in excess of $1.5 million which would provide up to $1.0 million of coverage. Any excess of the $1.5 million retention and the $1 million of aggregate coverage would be borne by the Company. The aggregate stop loss commences once our expenses exceed 125% of the annual aggregate expected claims.

Note 22. Equity

The total amount of authorized capital stock consists of 50,000,000 shares of common stock and 5,000,000 shares of preferred stock. As of December 31, 2019, the Company had 28,650,918 shares of common stock outstanding, 8,349,483, treasury shares of common stock and 345,534 unvested restricted common stock issued reflecting total paid-in capital of $329.6 million as of such date.

Common Stock

Holders of common stock are entitled to one vote for each share held on all matters subject to a vote of stockholders, subject to the rights of holders of any outstanding preferred stock. Accordingly, holders of a majority of the shares of common stock entitled to vote in any election of directors may elect all of the directors standing for election, subject to the rights of holders of any outstanding preferred stock. Holders of common stock will be entitled to receive ratably any dividends that the board of directors may declare out of funds legally available therefor, subject to any preferential dividend rights of outstanding preferred stock. Upon the Company's liquidation, dissolution or winding up, the holders of common stock will be entitled to receive ratably its net assets available after the payment of all debts and other liabilities and subject to the prior rights of holders of any outstanding preferred stock. Holders of common stock have no preemptive, subscription, redemption or conversion rights. There is no redemption or sinking fund provisions applicable to the common stock. All outstanding shares of the Company's capital stock (excluding restricted stock) are fully paid and nonassessable.

Stock Repurchase Program

On August 1, 2018, the Company announced that its Board of Directors authorized a stock repurchase program authorizing the Company to repurchase up to $50.0 million of its common stock through December 31, 2020 under our current Rule 10b5-1 trading plan, which allows the Company to purchase shares below a predetermined price per share. As of December 31, 2019, the Company repurchased in aggregate 1,134,686 shares of its common stock since authorizing the stock repurchase program for $16.2 million.

At December 31, 2019, the Company has the capacity to repurchase $33.8 million of its common shares until December 31, 2020. In addition, the Company acquired 237,620 shares for approximately $3.5million for the year ended December 31, 2019, that were not part of the publicly announced share repurchase authorization. These shares consisted of shares retained to cover payroll withholding taxes in connection with the vesting of restricted stock awards.

Dividends

The declaration and payment of any future dividends will be subject to the discretion of the Board of Directors and will depend on a variety of factors including the Company's financial condition and results of operations.

Dividends

For the year ended December 31, 2019, we recorded quarterly cash dividends of approximately $7.1 million as follows:

	Quarter Ended			
	March 31, 2019	June 30, 2019	September 30, 2019	December 31, 2019
Cash dividend per common share	$ 0.06	$ 0.06	$ 0.06	$ 0.06
Total cash dividends paid	$ 1,806,944	$ 1,791,323	$ 1,772,063	$ 1,749,800
Record date	March 15, 2019	June 14, 2019	September 16, 2019	December 16, 2019
Payment date	April 3, 2019	July 3, 2019	October 3, 2019	January 6, 2020

Note 23. Stock-Based Compensation

Common Stock

The Company has adopted the Heritage Insurance Holdings, Inc., Omnibus Incentive Plan (the "Plan") effective on May 22, 2014. The Plan authorized 2,981,737 shares of common stock for issuance under the Plan for future grants.

At December 31, 2019 there were 1,551,018 shares available for grant under the Plan. The Company recognizes compensation expense under ASC 718 for its stock-based payments based on the fair value of the awards.

In 2018, the Company granted 155,801 restricted shares vesting over three to five years, to the Company's executives and other key employees. No restricted stock was granted during the year ended December 31, 2019.

The Plan authorizes the Company to grant stock options at exercise prices equal to the fair market value of the Company's stock on the dates the options are granted. Any options granted would typically have a maximum term of ten years from the date of grant and vest primarily in equal annual installments over a range of one to five-year periods following the date of grant for employee options. If a participant's employment relationship ends, the participant's vested awards would remain exercisable for the shorter of a period of 30 days or the period ending on the latest date on which such award could have been exercisable. The fair value of each option grant is separately estimated for each grant date. The fair value of each option is amortized into compensation expense on a straight-line basis between the grant date for the award and each vesting date. The Company estimates the fair value of all stock option awards as of the date of the grant by applying the Black-Scholes-Merton multiple-option pricing valuation model. The application of this valuation model involves assumptions that are judgmental and highly sensitive in the determination of compensation expense. The Company has not granted any stock options since 2015 and all unexercised stock options have since been forfeited.

Restricted Stock

The Company has also granted shares of its common stock subject to certain restrictions under the Plan. Restricted stock awards granted to employee's vest in equal installments generally over a five-year period from the grant date subject to the recipient's continued employment. The fair value of restricted stock awards is estimated by the market price at the date of grant and amortized on a straight-line basis to expense over the period of vesting. Recipients of restricted stock awards have the right to receive dividends.

Restricted stock activity for the three years ended December 31, 2019, 2018 and 2017 is as follows:

	Number of shares	Weighted-Average Grant-Date Fair Value per Share
Non-vested, at December 31, 2016	900,000	$ 18.42
Granted	—	—
Vested	(137,935)	16.53
Canceled and surrendered	(87,065)	17.41
Non-vested, at December 31, 2017	675,000	$ 21.40
Granted	155,801	16.10
Vested	(112,500)	16.35
Canceled and surrendered	(112,500)	16.35
Non-vested, at December 31, 2018	605,801	$ 20.41
Granted	—	—
Vested	(22,647)	14.28
Canceled and surrendered	(237,620)	14.82
Non-vested, at December 31, 2019	345,534	$ 19.56

Awards are being amortized to expense over the three to five year vesting period. Relating to the restricted stock the Company recognized $5.4 million, $5.3 million and $4.8 million of compensation expense for the years ended December 31, 2019, 2018 and 2017, respectively. At December 31, 2019, there was approximately $5.6 million, representing unrecognized compensation expense related to the non-vested restricted stock, substantially all of which is expected to be recognized over the next one-year period. During the year ended December 31, 2019, restricted shares were vested and released, of which 260,267 shares had been granted to employees. Of the shares released to employees, 237,620 shares were withheld by the Company to cover withholding taxes of $3.5 million. During 2018 and 2017, 112,500 and 87,065 shares, respectively, were withheld to cover withholding taxes of $1.8 million and $1.6 million respectively, arising from the vesting of restricted shares. We recognized no tax benefit from the restricted stock awards and related paid dividends for the years 2019, 2018 and 2017, respectively.

Note 24. Quarterly Results for 2019 and 2018 (unaudited)

The following table provides a summary of unaudited quarterly results for the periods presented (in thousands, except per share data):

For the year ended December 31, 2019	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
Net premiums earned	$	109,691	$	114,083	$	123,862	$	131,077
Investment income	$	3,672	$	3,830	$	3,655	$	3,275
Total revenues	$	118,261	$	122,843	$	131,699	$	138,502
Total operating expenses	$	106,763	$	119,770	$	118,215	$	116,990
Operating income	$	11,498	$	3,073	$	13,484	$	21,512
Income (loss) from continuing operations	$	6,964	$	721	$	8,133	$	12,818
Basic net income (loss) per share	$	0.24	$	0.02	$	0.28	$	0.44
Diluted net income (loss) per share	$	0.24	$	0.02	$	0.28	$	0.44

For the year ended December 31, 2018	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
Net premiums earned	$	106,108	$	111,204	$	118,238	$	118,632
Investment income	$	3,075	$	2,470	$	3,852	$	1,407
Total revenues	$	112,026	$	117,972	$	125,295	$	124,878
Total operating expenses	$	87,209	$	109,822	$	111,079	$	102,525
Operating income	$	24,817	$	8,150	$	14,216	$	22,353
Income (loss) from continuing operations	$	14,829	$	2,408	$	5,989	$	3,929
Basic net income (loss) per share	$	0.58	$	0.09	$	0.23	$	0.15
Diluted net income (loss) per share	$	0.55	$	0.09	$	0.23	$	0.15

The sum of quarterly amounts, including per share amounts, may not equal amounts reported for year-to-date periods. This is due to the effects of rounding and changes in the number of weighted-average shares outstanding for each period.

Note 25. Condensed Financial Information Heritage Insurance Holdings, Inc.

The following summarizes the major categories of Heritage Insurance Holdings, Inc.'s financial statements for the year ended December 31, 2017. Refer to Schedule II of the Condensed Financial Information of Registrant for the years ended December 31, 2019 and 2018.

	For the Year Ended December 31, 2017	
	(In thousands)	
Revenue:		
Other revenue	$	1,949
Total revenue		1,949
Expenses:		
General and administrative expense		17,792
Amortization of debt issuance cost		2,314
Interest expense, net		11,158
Other non-operating expense, net		41,013
Total expenses	$	72,277
Loss before income taxes and equity in net income of subsidiaries		(70,328)
Benefit from income taxes		(6,120)
Loss before equity in net income of subsidiaries		(64,208)
Equity in net income of subsidiaries		—
Net loss	$	(64,208)

Statement of Cash Flows

		For the Year Ended December 31, 2017
		(in thousands)
Net loss	$	(64,208)
Net cash provided by (used in) operating activities		27,154
Investing Activities		
Purchases of investment available for sale		78,213
Dividends received from subsidiaries		57,575
Acquisition of a business		(210,000)
Net cash provided by investing activities		(74,212)
Financing Activities		
Proceeds from exercise of stock options and warrants		417
Proceeds from issuance of note payable, net of issuance costs		114,335
Proceeds from mortgage loan		12,658
Shares tendered for income tax withholdings		(1,599)
Purchase of treasury stock		(61,623)
Dividends paid		(8,249)
Net cash used in financing activities		55,939
Decrease in cash and cash equivalents		8,881
Cash and cash equivalents, beginning of period		7,368
Cash and cash equivalents, end of year	$	16,249

Note 26. Geographical Information (unaudited)

Our primary products are personal and commercial residential property insurance, which at December 31, 2018 was offered in Alabama, Connecticut, Florida, Georgia, Hawaii, Massachusetts, New York, New Jersey, North Carolina, Rhode Island, South Carolina and Virginia. Our Florida domiciled insurance company, Heritage P&C, is authorized by each of the respective state insurance departments in Alabama, Georgia, Florida, Mississippi, North Carolina and South Carolina. Our Hawaii domiciled insurance company, Zephyr, writes business only in Hawaii and is authorized by the Hawaii Insurance Division. Our Rhode Island domiciled insurance company, NBIC, is authorized by each of the respective state insurance departments in Connecticut, Delaware, Maryland, Massachusetts, New Jersey, New York, Pennsylvania, Rhode Island, and Virginia.

Our other operating subsidiaries include: Heritage MGA, LLC, our managing general agent; Pawtucket Insurance Company (PIC), which is a property insurance company no longer writing insurance policies; Osprey Re Ltd. (“Osprey”), our reinsurance subsidiary that may provide a portion of the reinsurance protection purchased by our insurance subsidiaries; Contractors’ Alliance Network, LLC (“CAN”), our vendor network manager for Florida claims and our provider of restoration, emergency and recovery services; Skye Lane Properties, LLC, our property management subsidiary; First Access Insurance Group, LLC, our retail agency; Westwind Underwriters, Inc., and Heritage Insurance Claims, LLC, both inactive subsidiaries reserved for future development.

The Company is a single reportable segment. None of the individual subsidiaries meet the quantitative thresholds to qualify as reportable segment.

The following table depicts the distribution of our in-force premium as of December 31, 2019 and 2018, respectively.

State	At December 31, 2019			At December 31, 2018		
	In Force Premiums		Policies In Force	In Force Premiums		Policies In Force
	(in thousands)			*(in thousands)*		
Florida	$	486,520	220,154	$	505,992	230,937
New York		184,924	92,057		179,650	92,431
New Jersey		71,492	50,013		70,322	51,576
Massachusetts		62,810	32,464		59,592	32,629
Hawaii		53,493	65,008		53,480	67,181
Rhode Island		24,106	14,826		20,784	13,189
North Carolina		20,422	22,948		14,685	14,280
South Carolina		13,804	9,926		9,502	6,411
Connecticut		12,461	7,537		6,864	4,370
Alabama		7,041	7,044		1,571	1,543
Georgia		3,050	2,753		1,238	1,139
Virginia		473	245		—	—
Total	$	940,594	524,975	$	923,680	515,686

Note 27. Subsequent Events

On February 26, 2020, the Company announced that its Board of Directors declared a $0.06 per share quarterly dividend payable on April 3, 2020 to stockholders of record as of March 16, 2020.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) that are designed to assure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

As required by Exchange Act Rule 13a-15(b), as of the end of the period covered by this Annual Report, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2019.

Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, do not expect that our disclosure controls and procedures will prevent all errors and fraud. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable, not absolute, assurance of achieving the desired control objectives. Further, the design of a control system must reflect the fact that there are resource constraints, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management's override of the control.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Internal control over financial reporting is a process designed under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

As of December 31, 2019, our management assessed the effectiveness of our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework, or 2013 Framework. Based on this assessment, our management concluded that, as of December 31, 2019, our internal control over financial reporting was effective based on those criteria.

Plante & Moran, PLLC, the independent registered public accounting firm who also audited the Company's consolidated financial statements included in this Form 10-K, has issued their attestation report on the Company's internal control over financial reporting presented in Part IV, Item 15 of this report under "Report of Independent Registered Public Accounting Firm."

Changes in Internal Control Over Financial Reporting

There has been no change in our internal controls over financial reporting during our most recent quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

Not applicable

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The items required by Part III, Item 10 are incorporated herein by reference from the Registrant’s Proxy Statement for its 2020 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended December 31, 2019.

Item 11. Executive Compensation

The items required by Part III, Item 11 are incorporated herein by reference from the Registrant’s Proxy Statement for its 2020 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended December 31, 2019.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The items required by Part III, Item 12 are incorporated herein from the Registrant’s Proxy Statement for its 2020 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended December 31, 2019.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The items required by Part III, Item 13 are incorporated herein from the Registrant’s Proxy Statement for its 2020 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended December 31, 2019.

Item 14. Principal Accountant Fees and Services

The items required by Part III, Item 14 are incorporated herein from the Registrant’s Proxy Statement for its 2020 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended December 31, 2019.

PART IV

Item 15. Exhibits, Financial Statements Schedules

The following documents are filed as part of this Annual Report on Form 10-K:

(a) The following documents are filed as part of this report.

(1) Financial Statements

The following consolidated financial statements of the Company and the reports of independent auditors thereon are filed with this report:

Report of Independent Registered Public Accounting Firm (Plant Moran)
Consolidated Balance Sheets
Consolidated Statements of Operations and Comprehensive Income
Consolidated Statements of Changes in Stockholders' Equity
Consolidated Statements of Cash Flows
Notes to Consolidated Financial Statements

(2) *Financial Statement Schedules*

The following additional financial schedules are furnished herewith pursuant to requirements of Form 10-K.

Schedules required to be filed under the provisions of Regulations S-X Article 7:

(3) List of Exhibits

The Following is a list of exhibits filed or incorporated by reference as part of this Annual Report on Form 10-K

Exhibit Number	Description
2.1	Agreement and Plan of Merger, dated as of August 8, 2017, by and among Heritage Insurance Holdings, Inc., Gator Acquisition Merger Sub, Inc. and NBIC Holdings, Inc. and PBRA, LLC, in its capacity as Stockholder Representative, incorporated by reference to Exhibit 2.1 to our Form 8-K filed on August 9, 2017
3.1	Certificate of Incorporation of Heritage Insurance Holdings, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2014)
3.2	By-laws of Heritage Insurance Holdings, Inc. (incorporated by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2014)
4.1	Form of Stock Certificate (Incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1/A (File No. 333-195409) filed on May 13, 2014)
4.2	Form of Warrant (Incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-1/A (File No. 333-195409) filed on May 16, 2014)
4.3	Form of 5.875% Convertible Senior Notes due 2037 (included in Exhibit 4.1), incorporated by reference to 1.1 to our Form 8-K filed on August 16, 2017
4.4	Indenture, date as of August 16, 2017, by and among the Company. Heritage MGA, LLC as guarantor, and Wilmington Trust, National Association, as trustee, incorporated by reference to Exhibit 4.1 to our Form 8-K filed on August 16, 2017
4.5	Description of Capital Stock *
10.1	Insurance Policy Acquisition and Transition Agreement, dated as of June 13, 2014, by and among Heritage Property & Casualty Insurance Company, the Florida Department of Financial Services, as Receiver for Sunshine State Insurance Company, and the Florida Insurance Guaranty Association (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on June 19, 2014)

Exhibit Number	Description
10.2	Amended and Restated Employment Agreement, dated November 04, 2015, by and between Heritage Insurance Holdings, Inc. and Bruce Lucas. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on November 6, 2015)
10.3	Amended and Restated Employment Agreement, dated November 04, 2015, by and between Heritage Insurance Holdings, Inc. and Richard Widdicombe. (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on November 6, 2015)
10.4	Indenture, dated December 15, 2016, by and among Heritage Insurance Holdings, Inc., The Bank of New York Mellon, The Bank of New York Mellon, London Branch, and The Bank of New York Mellon (Luxembourg) S.A. (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on December 16, 2016)
10.5	Employment Agreement, dated January 30, 2018 by and between Heritage Insurance Holdings, Inc. and Kirk H. Lusk. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 2, 2018)
10.6	Separation Agreement, dated January 30, 2018 by and between Heritage Insurance Holdings, Inc. and Steven C Martindale. (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on February 2, 2018)
10.7	Credit Agreement, dated December 14, 2018, among Heritage Insurance Holdings, Inc., certain subsidiaries of Heritage Insurance Holdings, Inc. from time to time party thereto as guarantors, the lenders from time to time party thereto, Regions Bank, as Administrative Agent and Collateral Agent, BMO Harris Bank N.A., as Syndication Agent, Hancock Whitney Bank and Canadian Imperial Bank of Commerce, as Co-Documentation Agents, and Regions Capital Markets and BMO Capital Markets Corp., as Joint Lead Arrangers and Joint Bookrunners (incorporated by reference to Exhibit 10.8 to the Company's Annual Report on Form 10-K, filed on March 12, 2019)
10.8	Employment Agreement, dated November 14, 2015 by and between Heritage Insurance Holdings, Inc. and Ernesto Garateix *
21	Subsidiaries of the Registrant *
23.1	Consent of Plante Moran, PLLC *
23.2	Consent of Grant Thornton LLP *
24.1	Power of Attorney (included on signature page)
31.1	Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *
31.2	Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.SC. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**
101.INS	XBRL Instance Document *
101.SCH	XBRL Taxonomy Extension Schema. *
101.CAL	XBRL Taxonomy Extension Calculation Linkbase. *
101.DEF	XBRL Taxonomy Extension Definition Linkbase. *
101.LAB	XBRL Taxonomy Extension Label Linkbase. *
101.PRE	XBRL Taxonomy Extension Presentation Linkbase. *

* Filed herewith

** Furnished herewith

\+ Portions of this exhibit (indicated by asterisks) have been omitted pursuant to a request for confidential treatment, and this exhibit has been filed separately with the SEC.

Item 16. FORM 10-K SUMMARY

None

SIGNATURES

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

HERITAGE INSURANCE HOLDINGS, INC. (Registrant)

Date: March 10, 2020

By: /s/ BRUCE LUCAS
Chairman and Chief Executive Officer
(on behalf of the Registrant and as Principal Executive Officer)

By: /s/ KIRK LUSK
Chief Financial Officer
(on behalf of the Registrant and as Principal Financial Officer)

POWERS OF ATTORNEY

KNOW ALL BY THESE PRESENT, that each person whose signature appears below constitutes and appoints Bruce Lucas or Kirk Lusk as his true and lawful attorney-in-fact and agent, he with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this report, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, full power and authority to do and perform each and every act and thing requisite or necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ BRUCE LUCAS Bruce Lucas	Chairman and Chief Executive Officer (Principal Executive Officer)	March 10, 2020
/s/ KIRK LUSK Kirk Lusk	Chief Financial Officer/Treasurer (Principal Financial Officer and Principal Accounting Officer)	March 10, 2020
/s/ RICHARD WIDDICOMBE Richard Widdicombe	President and Director	March 10, 2020
/s/ PANAGIOTIS APOSTOLOU Panagiotis Apostolou	Director	March 10, 2020
/s/ IRINI BARLAS Irini Barlas	Director	March 10, 2020
/s/ MARK BERSET Mark Berset	Director	March 10, 2020
/s/ STEVEN MARTINDALE Steven Martindale	Director	March 10, 2020
/s/ JAMES MASIELLO James Masiello	Director	March 10, 2020
/s/ NICHOLAS PAPPAS Nicholas Pappas	Director	March 10, 2020
/s/ JOSEPH VATTAMATTAM Joseph Vattamattam	Director	March 10, 2020
/s/ VIJAY WALVEKAR Vijay Walvekar	Director	March 10, 2020

SCHEDULE II – CONDENSED FINANCIAL INFORMATION OF REGISTRANT

Condensed Balance Sheet

The following summarizes the major categorizes of Heritage Insurance Holdings, Inc.'s financial statements (in thousands, except per share data):

	As of December 31, 2019	As of December 31, 2018
	(in thousands)	
ASSETS		
Fixed maturity securities, available for sale, at fair value	$ —	$ —
Cash and cash equivalents	12,671	13,892
Investment in and advances to subsidiaries	594,141	598,525
Other assets	2,813	3,324
Total Assets	$ 609,625	$ 615,741
LIABILITIES AND STOCKHOLDERS' EQUITY		
Other liabilities	160,826	190,408
Total Liabilities	$ 160,826	$ 190,408
Common stock	$ 3	$ 3
Paid-in-capital	329,568	325,292
Treasury	(105,368)	(89,185)
Accumulated other comprehensive income	7,330	(6,527)
Retained earnings	217,266	195,750
Total Stockholders' Equity	$ 448,799	$ 425,333
Total Liabilities and Stockholders' Equity	$ 609,625	$ 615,741

	For the Years Ended December 31, 2019	For the Years Ended December 31, 2018
	(In thousands, except share and per share amounts)	
Revenue:		
Other revenue	$ 6,180	$ 1,858
Total revenue	6,180	1,858
Expenses:		
General and administrative expense	11,699	19,005
Amortization of debt issuance cost	2,190	4,623
Interest expense, net	7,609	17,277
Other non-operating expense, net	48	9,791
Total expenses	$ 21,546	$ 50,696
Loss before income taxes and equity in net income of subsidiaries	(15,366)	(48,838)
Benefit from income taxes	(511)	(9,545)
Loss before equity in net income of subsidiaries	(14,855)	(39,293)
Equity in net income of subsidiaries	—	—
Net loss	$ (14,855)	$ (39,293)

The accompanying note is an integral part of condensed financial statements

SCHEDULE II – CONDENSED FINANCIAL INFORMATION OF REGISTRANT
Condensed Statement of Cash Flows

	For the Years Ended December 31, 2019	2018
	(in thousands)	
Net loss	$ (14,855)	$ (39,293)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Stock-based compensation	5,379	5,273
Net realized gains	49	9,790
Valuation on conversion feature	—	3,252
Amortization of debt issuance cost	—	4,623
Deferred income taxes	334	(1,325)
Changes in operating assets and liabilities		
Prepaid	(659)	121
Income taxes payable	351	(5,080)
Dividends payable	—	1,589
Accrued interest on debt	444	(3,771)
Other assets	2,182	(3,521)
Other liabilities	(4,094)	7,338
Net cash used in operating activities	(10,869)	(20,094)
Investing Activities		
Dividends received from subsidiaries	70,590	92,800
Collection (issue) of principle note receivable	358	(910)
Investments and advances to subsidiaries	(15,865)	(42,200)
Net cash provided by investing activities	55,083	49,690
Financing Activities		
Proceeds from issuance of note payable, net of issuance costs	—	110,769
Repayment of secured senior notes	—	(79,500)
Mortgage loan payments	(277)	(264)
Repurchase of convertible notes	(2,869)	(52,739)
Repayment of long-term debt	(15,625)	—
Shares tendered for income tax withholdings	(3,521)	(1,839)
Purchase of treasury stock	(16,183)	(2,000)
Dividends paid	(6,959)	(6,380)
Net cash used in financing activities	(45,434)	(31,953)
Decrease in cash and cash equivalents	(1,221)	(2,357)
Cash and cash equivalents, beginning of period	13,892	16,249
Cash and cash equivalents, end of year	$ 12,671	$ 13,892

The accompanying note is an integral part of condensed financial statements

SCHEDULE II – CONDENSED FINANCIAL INFORMATION OF REGISTRANT

Notes to Condensed Financial Statements

(1) Organization and Basis of Presentation

Heritage Insurance Holdings, Inc., (“we”, “our”, “us” and “Heritage Insurance”), established in 2012 and incorporated in the state of Delaware in 2014, is a property and casualty insurance holding company that provides personal and commercial residential property insurance. We are headquartered in Clearwater, Florida and, through our insurance company subsidiaries, Heritage Property & Casualty Insurance Company (“Heritage P&C”), Narragansett Bay Insurance Company (“NBIC”) and Zephyr Insurance Company (“Zephyr”), we write personal residential property insurance for single-family homeowners and condominium owners, and rental property insurance in the states of Alabama, Connecticut, Florida, Georgia, Hawaii, Massachusetts, New Jersey, New York, North Carolina, Rhode Island and South Carolina. We also provide commercial residential insurance for Florida properties and are also licensed in the states of Delaware, Maryland, Mississippi, Pennsylvania, and Virginia. In order to limit our potential exposure to catastrophic events, we purchase significant reinsurance from third party reinsurers and sponsor catastrophe bonds issued by Citrus Re.

The accompanying condensed financial statements included the activity of the Parent Company and the equity basis of its consolidated subsidiaries. Accordingly, these condensed financial statements have been presented for the parent company only. These condensed financial statements should be read in conjunction with the consolidated financial statements and related notes of HIH and subsidiaries set forth in Part II, Item 8 Financial Statements and Supplemental Data of this Annual Report.

In applying the equity method to our consolidated subsidiaries, we record the investment at cost and subsequently adjust for additional capital contributions, distributions and proportionate share of earnings or losses.

SCHEDULE V – VALUATION ALLOWANCES AND QUALIFYING ACCOUNTS

The following table summarizes activity in the Company's allowance for doubtful accounts for the year ended December 31, 2019.

Description	Beginning balance	Charges in earnings	Charges to other accounts	Deductions	Ending balance
			(in thousands)		
Year ended December 31, 2019					
Allowance for doubtful accounts	$ —	290	—	—	$ 290
Year ended December 31, 2018					
Allowance for doubtful accounts	$ —	—	—	—	$ —

SCHEDULE VI – SUPPLEMENTAL INFORMATION CONCERNING CONSOLIDATED PROPERTY AND CASUALTY INSURANCE OPERATIONS

The following table provides certain information related to the Company's property and casualty operations as of, and for the periods presented (in thousands):

	As of December 31,	For the Year Ended December 31,			
Year	Reserves for Unpaid Losses and LAE	Incurred Losses and LAE Current Year	Incurred Losses and LAE Prior Years	Paid losses and LAE	Net Investment Income
2019	$ 613,533	$ 276,985	$ (3,696)	$ 235,238	$ 14,432
2018	$ 432,359	$ 224,080	$ 13,345	$ 210,303	$ 13,280

	As of December 31,	For the Year Ended December 31,			
Year	Deferred Policy Acquisition Costs ("DPAC")	Amortization of DPAC, Net	Net Premiums Written	Net Premiums Earned	Unearned Premiums
			(in thousands)		
2019	$ 77,211	$ 144,939	$ 501,373	$ 478,713	$ 486,220
2018	$ 73,055	$ 139,630	$ 445,898	$ 454,182	$ 472,357

Plante & Moran, PLLC
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East Lansing, MI 48823
Tel: 517.332.6200
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plantemoran.com

<u>Supplemental Information Opinion</u>:

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
Heritage Insurance Holdings, Inc.
Clearwater, Florida

We have audited the financial statements of **Heritage Insurance Holdings, Inc.** (the "Company") as of December 31, 2019 and 2018 and the related consolidated statements of operations, comprehensive income, stockholders' equity and cash flows for the years ended December 31, 2019 and 2018, and the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in the 2013 Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO); such consolidated financial statements and report are included elsewhere in this Form 10-K and are incorporated herein by reference. Our audits also included the consolidated financial statement schedules of the Company listed in the accompanying index at Item 15. These consolidated financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion based on our audits. In our opinion, such consolidated financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

Plante & Moran, PLLC

Certified Public Accountants

East Lansing, Michigan

March 10, 2020

Exhibit 4.5

DESCRIPTION OF CAPITAL STOCK

The following is a summary of the Heritage Insurance Holdings, Inc. (the "Company") capital stock and provisions of its Certificate of Incorporation and Bylaws, and certain provisions of Delaware law. This summary does not purport to be complete and is qualified in its entirety by the provisions of our Certificate of Incorporation and Bylaws, each of which are incorporated by reference as an exhibit to the Company's Annual Report on Form 10-K of which this Exhibit 4.5 is a part.

General

The total amount of our authorized capital stock consists of 50,000,000 shares of common stock, $0.0001 par value, and 5,000,000 shares of preferred stock, $0.0001 par value. As of December 31, 2019 we had [ ] shares of common stock outstanding and no shares of preferred stock outstanding.

Common Stock

Voting. Holders of common stock are entitled to one vote for each share held on all matters subject to a vote of stockholders, subject to the rights of holders of any outstanding preferred stock. Accordingly, holders of a majority of the shares of common stock entitled to vote in any election of directors may elect all of the directors standing for election, subject to the rights of holders of any outstanding preferred stock.

Dividends. Holders of common stock will be entitled to receive ratably any dividends that the Board of Directors (the "Board") may declare out of funds legally available therefor, subject to any preferential dividend rights of outstanding preferred stock.

Liquidation, Dissolution or Winding Up. Upon our liquidation, dissolution or winding up, the holders of common stock will be entitled to receive ratably our net assets available after the payment of all debts and other liabilities and subject to the prior rights of holders of any outstanding preferred stock. Holders of common stock have no preemptive, subscription, redemption or conversion rights. There are no redemption or sinking fund provisions applicable to the common stock. All outstanding shares of our capital stock are fully paid and nonassessable.

Preferred Stock

Our Board, without further approval of the stockholders, is authorized to fix the number of shares constituting any series, as well as the dividend rights and terms, conversion rights and terms, voting rights and terms, redemption rights and terms, liquidation preferences and any other rights, preferences, privileges and restrictions applicable to each series of preferred stock. The issuance of preferred stock, while providing flexibility in connection with possible acquisitions and other corporate purposes, could also adversely affect the voting power and dividend and liquidation rights of the holders of common stock. The issuance of preferred stock could also, under certain circumstances, have the effect of making it more difficult for a third-party to acquire, or discouraging a third-party from acquiring, a majority of our outstanding voting stock or otherwise adversely affect the market price of our common stock. It is not possible to state the actual effect of the issuance of any shares of preferred stock on the rights of holders of common stock until the Board determines the specific rights of that series of preferred stock.

Authorized but Unissued Shares

The authorized but unissued shares of common stock will be available for future issuance without stockholder approval. These additional shares may be utilized for a variety of corporate purposes, including future public offerings to raise additional capital, corporate acquisitions and employee benefit plans. The existence of authorized but unissued shares of common stock could render it more difficult or discourage an attempt to obtain control of us by means of a proxy contest, tender offer, merger or otherwise.

Listing

The common stock is currently listed on the New York Stock Exchange under the symbol "HRTG."

Transfer Agent and Registrar

The transfer agent and registrar for our common stock is Computershare Trust Company, N.A.

Exhibit 10.8

Heritage Insurance Holdings, Inc.

A DELAWARE CORPORATION

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT ("Agreement") is made and entered into as of November 4, 2015 by and between HERITAGE INSURANCE HOLDINGS, INC., and its subsidiary companies (collectively, the "Company"), and Ernie Garateix (the "Executive").

RECITALS

1. The Company is engaged in the insurance and financial services industry;

2. The Executive will serve as the Chief Operating Officer of the Company;

3. The Company and the Executive are parties to an employment agreement. as amended from time to time (the "Prior Agreement"). and now desire to amend and restate the terms of the Prior Agreement to provide for the continued employment of the Executive;

4. The Board of Directors *(the* "Board") approved the employment of the Executive upon the terms and conditions set forth herein.

NOW. therefore, in consideration of the mutual promises contained herein, and for other good and valuable consideration, the Company and Executive agree as follows:

AGREEMENT

NOW, THEREFORE, in consideration of the premises and mutual covenants set forth herein, the parties hereby agree as follows:

Section I. Employment

1. Employment. The Company shall employ Executive as its Chief Operating Officer and Executive accepts such employment and agrees to perform the services and duties specified herein or as assigned to Executive from time to time by the Board.

2. Term of Employment. The Company shall continue to employ the Executive and the Executive shall continue to serve the Company and its Subsidiaries, on the terms and conditions set forth herein, until December 31, 2020, unless terminated as hereinafter set forth, or as mutually agreed to by the parties (the "Term").

Section II. Compensation and Benefits

1. Base Salary. During the Employment Term, the Executive shall receive a base salary at the annual rate of $750,000 for 2016, which shall be increased as necessary to reflect reasonable cost of living and inflation-based adjustments on January 1st of each calendar year during the Term. The base salary shall be payable in substantially equal installments consistent with the Company's normal payroll schedule, subject to applicable withholding and other taxes, and may be increased by the Board in its discretion.

2. Bonus. The Executive shall receive an annual cash bonus of up to $100,000 by December 31st of each calendar year during the Term based on and subject to available funds in the Company's EBITDA bonus pool as approved by the Board.

3. Award of Restricted Stock. Executive shall receive a grant of 125,000 restricted shares granted on November 4, 2015 and vesting in equal installments of 25,000 shares on November 4th of each calendar year beginning on the first anniversary of the grant date.

No grant shall occur unless Executive has remained in the continuous full-time employ of the Company through the applicable grant date unless otherwise provided herein. The grant shall be subject to the terms and conditions of the applicable restricted stock award and shall be governed by the Heritage Insurance Holdings, Inc. Omnibus Incentive Plan.

4. Options and Warrants. From time to time, the Company may grant to Executive options or warrants to purchase the Company's common stock. The Company shallenter into an option or warrant agreement for the issuance of such options or warrants in such event.

5. Expense Reimbursement. During the Employment Term, the Company, upon the submission of supporting documentation by the Executive, and in accordance with Company policies for its executives, shall reimburse the Executive for all expenses actually paid or incurred by the Executive in the course of and pursuant to the business of the Company and the Subsidiaries, including reimbursement of moving expenses and a reasonable car allowance and expenses for travel and entertainment, for which the Executive shall have an expense allowance as set by the Board from time to time.

6. Insurance. During the Employment Term, the Company shall obtain comprehensive major medical, hospitalization and disability insurance coverage, either group or individual, for the Executive and his dependents, and may obtain or may continue in force life ("key man") insurance on the Executive for the benefit of the Company/Executive (collectively, the "Policies"), which Policies the Company shall keep in effect at its sole expense throughout the Term. The Policies to be provided by the Company shall be on tem1s as determined by the Board. Within 30 days following any termination of this Agreement, at the Executive's option, the Company shall assign to the Executive all insurance policies on the life of the Executive then owned by the Company in consideration of the payment by the Executive of the premiums accruing after the date of such termination.

7. Working Facilities. During the Employment Term, the Company shall furnish the Executive with an office, and such other facilities and services suitable to his position and adequate for the performance of his duties hereunder.

8. Vacation. Executive shall receive up to thirty paid vacation days every calendar year. Any portion of the unused annual vacation days shall be accrued and will accumulate, and may be used by the Executive at any time during its employment.

Section III. Termination.

1. At Will Employee. Notwithstanding anything contained in this Agreement to the contrary, Executive is an at will employee and may be terminated for any reason as determined by the Company in its sole discretion.

2. Voluntary. Notwithstanding anything contained in this Agreement to the contrary, this Agreement may be terminated by the Executive for any reason by giving no less than 90 days' notice. The Company shall not be responsible for any further compensation of any kind to the Executive beyond 90 days from the date the Executive provides notice of his intent to terminate his employment.

Section IV. Restrictive Covenants

1. Confidentiality/Non-Disclosure. "Confidential Information" shall mean any intellectual property, information, or trade secrets (whether or not specifically labeled or identified as "confidential" or "private"), in any forn1 or medium, that is disclosed to, or developed or learned by, the Executive, and that relates to the business plan, underwriting, products, services, research, or development of or by the Company or its Subsidiaries, suppliers, distributors, customers, investors, partners, and/or other business associates, and that has not become publicly known. Confidential Information includes, but is not limited to, the following:

a. Internal business information (including but not limited to information relating to strategy, staffing, financial data, training, marketing, promotional and sales plans and practices, costs, bidding activities and strategies, rate and pricing structures, and accounting and business methods);

b. Identities of, negotiations with, individual requirements of, specific contractual arrangements with, and information about, the Company's or its Subsidiaries' suppliers, distributors, customers, investors, partner and/or other business associates, their contact information, and their confidential information;

c. Compilations of data and analyses, underwriting process and parameters, material processes, technical data, specific program information, trade or industrial practices, computer programs, formulae, systems, research, records, reports, manuals, documentation, customer and supplier lists, data and databases relating thereto, and technology and methodology regarding specific projects; and;

d. Intellectual Property not generally available to the public, or published by the Company or its Subsidiaries. "Intellectual Prope1iy,11 or "IP," shall mean (1) inventions or devices, whether patentable or not; (2) original works of authorship produced by or on behalf of the Company or its Subsidiaries; (3) trade secrets; (4) know-how; (5) customer lists and confidential information; and (6) any other intangible property protectable under federal, state or foreign law. Other examples of Intellectual Property include, but are not limited to, patent applications, patents, copyrighted works, technical data, computer software, knowledge of suppliers or business partnerships, documentation, processes, and methods and results of research.

a.

2. Acknowledgements.

a. The Executive acknowledges and agrees with the representations of the Company that Confidential Information and IP is proprietary and valuable to the Company, and that any disclosure or unauthorized use thereof may cause irreparable harm and loss to the Company. It is further acknowledged by the Executive that if the general public or competitors (now existing or to be created in the future) learn of these ongoing discussions and negotiations with potential investors and of the formation of the Company, the Insurance Entity and other Subsidiaries as a result of the Executive's failure to comply hereunder, irreparable harm and substantial financial loss may occur to the Company's, the Insurance Entity or other Subsidiary's viability and future revenues. The Executive acknowledges and agrees that the knowledge and experience the Executive shall acquire by virtue of assisting with the formation of the Insurance Entity and application to the FOIR for approval of the Insurance Entity to write homeowner's insurance coverage in the State of Florida during the Employment Term and by virtue of employment by the Company during the Employment Te1m is of a special, unique and extraordinary character and that such position allows the Executive access to Confidential Information and Intellectual Property.

b. The Executive acknowledges and agrees that (a) the nature and periods of restrictions imposed by the covenants contained in this Agreement are fair, reasonable and necessary to protect and preserve for the Company and its Subsidiaries their viability and future revenues; (b) the Company or its Subsidiaries would sustain great and irreparable loss and damage if the Executive were to breach any of such covenants set forth herein; (c) the Company and its Subsidiaries intend to conduct business actively in the entire territory that is the subject of this Agreement (as defined below) and beyond; and (d) the covenants herein set forth are made as an inducement to and have been relied upon by the Company in entering into this Agreement. The Executive acknowledges and agrees this Agreement is binding on the Executive's heirs, executors, successors, administrators, representatives and agents.

c. The Executive agrees to receive and to treat Confidential Information and the knowledge of IP on a confidential and restricted basis and to undertake the Following additional obligation with respect thereto:

i. To use the Confidential Information for the singular purpose of benefiting the Company and its Subsidiaries, and specifically not use the Company's and its Subsidiaries' customer or prospective customer data to conduct marketing, or otherwise undertake personal contacts, to solicit, divert or appropriate customers or prospective customers of the Company or its Subsidiaries, whether for the benefit of the Executive or any Person;

ii. Not to disclose Confidential Information, except to the extent the Executive is required to disclose or use such Confidential Information in the performance of the Executive's assigned duties for the Company or its Subsidiaries, to any Person without the prior express written consent of the Member-Managers of the Company, or their successors, including Manager(s), as an action permitted under the operating agreement of the Company;

iii. To tender all Confidential Information to the Company, and destroy any of the Executive's additional notes or records made from such Confidential Infom1ation, immediately upon request by the Company or upon termination of this Agreement either during the Initial Term or Employment Term;

iv. To promptly disclose and assign any right, title and interest to the Company all IP authored, made, conceived or actually reduced to practice, alone or jointly with others, (a) while performing duties for the Company or its Subsidiaries, or (b) during the Initial Term or Employment Term of this Agreement, or (c) which results or is suggested by any work done for or at the request of the Company or its Subsidiaries, or (d) which was aided by the use of trade secret information, whether or not during working hours and regardless of location;

v. To use best efforts to safeguard the Confidential Information and protect it against disclosure, misuse, espionage, loss, misappropriation and theft;

vi. Immediately notify the Members and Manager(s) of the Company of any breach of this Agreement; and

vii. Assist the Company or its Subsidiaries, both during and after the termination of this Agreement, in obtaining and enforcing any legal rights in IP of the Company or its Subsidiaries or assigned or to be assigned by the Executive to the Company or its Subsidiaries.

3. Non-Solicitation. For a period of five years after the Executive leaves the employment of the Company, the Executive covenants and agrees with the Company that the Executive will not, directly or indirectly, attempt to employ, divert away an employee, or enter into any contractual arrangement with any employee or former employee, of the Company or its Subsidiaries, unless such employee or former employee has not been employed by the Company or its Subsidiaries for a period in excess of one (1) year.

4. Non-Compete. For a period of two years after the Executive leaves the employment of the Company, the Executive covenants and agrees with the Company that the Executive will not, directly or indirectly, work for or consult with any competing insurance companies that do write the same insurance products in the states in which the Company does business. The non-compete covenant will not apply to the Executive if the Company terminates the Executive without "Cause." As used in this Agreement "Cause" shall only mean (i) any action or omission of the Executive which constitutes a breach of this Agreement, or (ii) fraud, breach of fiduciary duty, gross negligence, embezzlement or misappropriation as against the Company.

Section V. Miscellaneous

1. Severability. In the event that the provisions of this Agreement should ever be deemed to exceed the time or geographic limitations permitted by applicable law, then the provisions will be reformed to the maximum time or geographic limitations permitted by applicable law. Every provision of this Agreement is intended to be severable, and, if any term or provision is determined to be illegal, invalid or unenforceable for any reason whatsoever, and cannot be reformed, such illegal, invalid or unenforceable provision shall be deemed severed here from and shall not affect the validity, legality or enforceability of the remainder of this Agreement.

2. Books and Records. All books, records, accounts and similar repositories of Confidential Information of the Company and its Subsidiaries, whether prepared by the Executive or otherwise coming into the Executive's possession, shall be the exclusive property of the Company and shall be returned immediately to the Company and its Subsidiaries on termination of this Agreement or on the Board's request at any time.

3. Survival. The restrictions and obligations of this Section IV shall survive any expiration, termination, or cancellation of either the Initial Term or Employment Term of this Agreement and shall continue to bind the Executive and the Executive's respective heirs, executors, successors, administrators, representatives and agents.

4. Consolidation. Merger or Sale of Assets. Nothing in this Agreement shall preclude the Company from consolidating or merging into or with, or transferring all or substantially all of its assets to, another corporation which assumes this Agreement, and all obligations of the Company hereunder, in writing. Upon such consolidation, merger, or transfer of assets and assumption, the term "the Company" as used herein, shall mean such other corporation and this Agreement shall continue in full force and effect, subject to the provisions of Paragraph 6 hereof.

5. Binding Effect. Except as herein otherwise provided, this Agreement shall inure to the benefit of and shall be binding upon the parties hereto, their personal representatives, successors, heirs and assigns. The obligations of Company and the Subsidiaries to Executive are joint and several. All provisions of this Agreement are specifically enforceable by the Subsidiaries in addition to Company. Each of the Subsidiaries shall be considered a third party beneficiary under the provisions of this Agreement.

6. Terminology. All personal pronouns used in this Agreement, whether used in the masculine, feminine or neuter gender, shall include all other genders; the singular shall include the plural and vice versa. Titles of Paragraphs are for convenience only, and neither limit nor amplify the provisions of the Agreement itself.

7. Further Assurances. At any time, and from time to time, each party will take such action as may be reasonably requested by the other party to carry out the intent and purposes of this Agreement.

8. Entire Agreement. This Agreement constitutes the entire agreement between the parties hereto with respect to the subject matter hereof. It supersedes all prior negotiations, letters and understandingsrelating to the subject matter hereof.

9. Amendment. This Agreement may not be amended, supplemented or modified in whole or in part except by an instrument in writing signed by the party or parties against whom enforcement of any such amendment, supplement or modification is sought.

10. Assignment. This Agreement may not be assigned by the Executive and may not be assigned by the Company except as described in above.

11. Choice of Law. This Agreement will be interpreted, construed and enforced in accordance with the laws of the State of Delaware, without giving effect to the application of the principles pertaining to conflicts of laws. The Company shall have the right to seek both equitable and monetary damages from the Executive for any violation of this agreement.

12. Effect of Waiver. The failure of any party at any time or times to require performance of any provision of this Agreement will in no manner affect the right to enforce the same. The waiver by any party of any breach of any provision of this Agreement will not be construed to be a waiver by any such party of any succeeding breach of that provision or a waiver by such party of any breach of any other provision.

13. Construction. The parties hereto and their respective legal counsel participated in the preparation of this Agreement; therefore, this Agreement shall be construed neither against nor in favor of any of the parties hereto, but rather in accordance with the fair meaning thereof.

14. Arbitration. The parties agree that all disputes related to this Agreement, other than disputes seeking equitable remedies. shall be submitted to arbitration in Pinellas County, Florida pursuant to the rules of the American Arbitration Association.

15. Equitable Remedy. The parties hereto acknowledge and agree that any party's remedy at law for a breach or threatened breach of any of the provisions of this Agreement would be inadequate and such breach or threatened breach shall be per se deemed as causing i1Teparable harm to such party. Therefore, in the event of such breach or threatened breach, the parties hereto agree that, in addition to any available remedy at law, including but not limited to monetary damages, an aggrieved party, without posting any bond, shall be entitled to obtain, and the offending party agrees to oppose the aggrieved party's request for, equitable relief in the form of specific enforcement, temporary restraining order, temporary or permanent injunction, or any other equitable remedy that may then be available to the aggrieved party.

16. Binding Nature. This Agreement will be binding upon and will inure to the benefit of any successor or successors of the parties hereto.

17. Counterparts. This Agreement may be executed in one or more counterparts, each of which will be deemed an original.

18. Notice. Any notice required or pe1mitted to be delivered hereunder shall be deemed to be delivered when sent by facsimile with receipt confirmed or when deposited in the United States mail, postage prepaid, registered or certified mail, return receipt requested, or by overnight courier, addressed to the parties at the address first stated herein, or to such other address as either party hereto shall from time to time designate.

Agreed to by:

Heritage Insurance Holdings, Inc.

By: /s/ BRUCE LUCAS ________ By: /s/ ERNIE GARATEIX __________
Bruce Lucas, CEO Ernie Garateix, Chief Operating Officer

HERITAGE INSURANCE HOLDINGS, INC.
Subsidiaries

Exhibit 21

Wholly-owned subsidiaries of Heritage Insurance Holdings, Inc.	*State of Incorporation*
Heritage Property & Casualty Insurance Company, Inc	Florida
NBIC Holdings, Inc.	Delaware
Zephyr Acquisition Company	Delaware
Heritage MGA, LLC	Florida
Osprey Re Ltd	Bermuda
Contractors' Alliance Network	Florida
Skye Lane Properties, LLC	Florida
First Access Insurance Group, LLC	Florida
Wholly-owned subsidiaries of NBIC Holdings, Inc.	
Naragansett Bay Insurance Company	Rhode Island
NBIC Financial Holdings, Inc	Rhode Island
NBIC Service Company, Inc	Rhode Island
Pawtucket Insurance Company	Delaware
Wholly-owned subsidiaries of Zephyr Acquisition Company	
HI Holdings, Inc	Hawaii
Zephyr Insurance Company, Inc.	Hawaii

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statements of Heritage Insurance Holdings, Inc. on Forms S-3 (File No. 333-206117 and File No. 333-221864) and on Form S-8 (333-197906) of our report dated March 10, 2020 with respect to the consolidated financial statements, which appear in Heritage Insurance Holdings, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2019, as filed with the U.S. Securities and Exchange Commission.

/s/ Plante & Moran, PLLC
East Lansing, Michigan
March 10, 2020

Exhibit 23.2

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We have issued our report dated March 15, 2018, with respect to the consolidated financial statements for the year ended December 31, 2017 included in the Annual Report of Heritage Insurance Holdings, Inc. on Form 10-K for the year ended December 31, 2019. We consent to the incorporation by reference of said report in the Registration Statements of Heritage Insurance Holdings, Inc. on Forms S-3 (File No. 333-206117 and File No. 333-221864) and on Form S-8 (File No. 333-197906).

/s/ GRANT THORNTON LLP

Tampa, Florida
March 10, 2020

Exhibit 31.1

CERTIFICATION

I, Bruce Lucas, certify that:

1. I have reviewed this Annual Report on Form 10-K of Heritage Insurance Holdings, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made in light of the circumstances under which such statements were made, not misleading, with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly represent in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 10, 2020

/s/ BRUCE LUCAS
Bruce Lucas
Chief Executive Officer (Principal Executive Officer)

Exhibit 31.2

CERTIFICATION

I, Kirk Lusk, certify that:

1. I have reviewed this Annual Report on Form 10-K of Heritage Insurance Holdings, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made in light of the circumstances under which such statements were made, not misleading, with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly represent in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 10, 2020

/s/ KIRK LUSK

Kirk Lusk

Chief Financial Officer (Principal Financial Officer)

Exhibit 32.1

CERTIFICATIONS PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES–OXLEY ACT OF 2002

In connection with the Annual Report of Heritage Insurance Holdings, Inc. (the “Company”) on Form 10-K for the period ending December 31, 2019, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), we, Bruce Lucas, Chief Executive Officer of the Company and Kirk Lusk, Chief Financial officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to our knowledge, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ BRUCE LUCAS
Bruce Lucas
Chief Executive Officer (Principal Executive Officer)

By: /s/ KIRK LUSK
Kirk Lusk
Co-Chief Financial Officer (Principal Financial Officer)

Date: March 10, 2020