PICO HOLDINGS INC /NEW
Form 10-K
March 02, 2009

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2008

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 0-18786

PICO HOLDINGS, INC.
(Exact Name of Registrant as Specified in Its Charter)

California	94-2723335
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

875 Prospect Street, Suite 301
La Jolla, California 92037
(Address of Principal Executive Offices)

Registrant's Telephone Number, Including Area Code
(858) 456-6022

Securities Registered Pursuant to Section 12(b) of the Act:
Common Stock, Par Value $.001, Listed on The NASDAQ Stock Market LLC

Securities Registered Pursuant to Section 12(g) of the Act:
None

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

Yes No x

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

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 x No

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

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

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company
Yes x			

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

Approximate aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates of the registrant (based on the closing sales price of such stock as reported in the NASDAQ Global Market) as of June 30, 2008 the last business day of the registrant's most recently completed second fiscal quarter, was $739,511,961.

On February 27, 2009, the registrant had 18,840,392 shares of common stock, $.001 par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the registrant's 2009 Annual Meeting of Shareholders, to be filed subsequent to the date hereof, are incorporated by reference into Part III of this Annual Report on Form 10-K. Such Definitive Proxy Statement will be filed with the Securities and Exchange Commission not later than 120 days after the conclusion of the registrant's fiscal year ended December 31, 2008.

ANNUAL REPORT ON FORM 10-K
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PART I

Note About "Forward-Looking Statements"

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

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

ITEM 1. BUSINESS

Introduction

PICO Holdings, Inc. is a diversified holding company. In this Annual Report, PICO and its subsidiaries are collectively referred to as "PICO", "the Company", or by words such as "we" and "our". We seek to build and operate businesses where we believe significant value can be created from the development of unique assets, and to acquire businesses which we identify as undervalued and where our management participation in operations can aid in the recognition of the business's fair value, as well as create additional value.

Our objective is to maximize long-term shareholder value. Our goal is to manage our operations to achieve a superior return on net assets over the long term, as opposed to short-term earnings.

Our business is separated into four major operating segments:

- Water Resource and Water Storage Operations;
- Real Estate Operations;
- Insurance Operations in "Run Off"; and
- Corporate (formerly known as "Business Acquisitions & Financing").

As of December 31, 2008, our major consolidated subsidiaries are:

- Vidler Water Company, Inc. (“Vidler”), a business that we started more than 11 years ago, which acquires and develops water resources and water storage operations in the southwestern United States, with assets in Nevada, Arizona, Idaho, California and Colorado;
- Nevada Land & Resource Company, LLC (“Nevada Land”), an operation that we built since we acquired the company more than 11 years ago, which currently owns approximately 440,000 acres of former railroad land in Nevada, and certain mineral rights and water rights related to the property;
- UCP, LLC (“UCP”), a business we started in 2008, which acquires and develops partially-developed and finished residential housing lots in selected markets in California;
- Physicians Insurance Company of Ohio (“Physicians”), which is “running off” its medical professional liability insurance loss reserves; and
- Citation Insurance Company (“Citation”), which is "running off” its property & casualty insurance and workers’ compensation loss reserves.

The address of our main office is 875 Prospect Street, Suite 301, La Jolla, California 92037, and our telephone number is (858) 456-6022.

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

History

PICO was incorporated in 1981 and began operations in 1982. The company was known as Citation Insurance Group until a reverse merger with Physicians Insurance Company of Ohio on November 20, 1996. After the reverse merger, the former shareholders of Physicians owned approximately 80% of Citation Insurance Group, the Board of Directors and management of Physicians replaced their Citation counterparts, and Citation Insurance Group changed its name to PICO Holdings, Inc. You should be aware that some data on Bloomberg and other information services pre-dating the reverse merger relates to the old Citation Insurance Group only, and does not reflect the performance of Physicians prior to the merger.

Operating Segments and Major Subsidiary Companies

The following is a description of our operating segments and major subsidiaries. Unless otherwise indicated, we own 100% of each subsidiary. The following discussion of our segments should be read in conjunction with the Consolidated Financial Statements and Notes thereto included elsewhere in this Annual Report on Form 10-K.

Water Resource and Water Storage Operations

Our Water Resource and Water Storage Operations are conducted through Vidler Water Company, Inc. and its subsidiaries.

Vidler is a private company in the water resource development business in the southwestern United States. We develop new sources of water for municipal and industrial use, either from existing supplies of water, such as water used for agricultural purposes, or from acquiring unappropriated (that is, previously unused) water. We also develop water storage infrastructure to facilitate the efficient allocation of available water supplies. Vidler is not a water utility, and does not intend to enter into regulated utility activities.

The inefficient allocation of available water between agricultural users and municipal or industrial users, or the lack of available known water supply in a particular location, or inadequate infrastructure to fully utilize existing and new water supplies, provide opportunities for Vidler because:

- certain areas of the Southwest experiencing growth have insufficient known supplies of water to support future growth. Vidler identifies and develops new water supplies for communities with limited economic water resources to support future community growth. In certain cases, to supply water from the water resources identified by Vidler, it may require regulatory approval to import the water from its source to where the demand is, or permitting of the infrastructure required to convey the water, or both; and
- infrastructure to recharge water will be required to store supplies during times of surplus to enable transfers from stored supplies in years where augmentation of existing supplies is required (for example, in drought conditions).

We entered the water resource development business with our acquisition of Vidler in 1995. At the time, Vidler owned a limited quantity of water rights and related assets in Colorado. Since then, Vidler has acquired or developed:

- additional water rights and related assets, predominantly in Nevada and Arizona, two of the leading states in population growth and new home construction over the past several years. A water right is the legal right to divert water and put it to beneficial use. Water rights are assets which can be bought and sold. The value of a water right depends on a number of factors, which may include location, the seniority of the right, whether or not the right is transferable, or if the water can be exported. We seek to acquire water rights at prices consistent with their current use, which is typically agricultural, with the expectation of an increase in value if the water right can be converted through the development process to a higher use, such as municipal and industrial use. Typically, our water resources are the most competitive source of water (that is, the most economical source of water supply) to support new growth in municipalities or new commercial developments; and
- a water storage facility in Arizona. At December 31, 2008, Vidler had “net recharge credits” of more than 173,000 acre-feet of water in storage for its own account at the Vidler Arizona Recharge Facility. An acre-foot is a unit commonly used to measure the volume of water, being the volume of water required to cover an area of one acre to a depth of one foot, and is equivalent to approximately 325,850 gallons. As a rule of thumb, one acre-foot of water would sustain two families of four persons each for one year.

We have also entered into “teaming” and joint development arrangements with third parties who have water assets but lack the capital or expertise to commercially develop these assets. The first of these arrangements was a water delivery teaming agreement with Lincoln County Water District (“Lincoln/Vidler”), which is developing water resources in Lincoln County, Nevada. We have also entered into a joint development agreement with Carson City and Lyon County, Nevada to develop and provide water resources in Lyon County. We continue to explore additional teaming and joint development opportunities throughout the Southwest.

Vidler generates revenues by:

- selling its developed water resources to real estate developers or industrial users who must secure an assured supply of water in order to receive permits for their projects; and
- storing water at its water storage facility in Arizona from currently available surplus supplies, and then selling the stored water in future years to developers or municipalities that have either exhausted their existing water supplies, or in instances where our water represents the most economical source of water for their developments or communities.

The following table details the water rights and water storage assets owned by Vidler or its subsidiaries at December 31, 2008. Please note that this is intended as a summary, and that some numbers are rounded. "Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Form 10-K contains more detail about these assets, recent developments affecting them, and the current outlook.

Name of asset & approximate location	Brief Description	Present commercial use
WATER RESOURCES		
Arizona:		
Harquahala Valley ground water basin La Paz County 75 miles northwest of metropolitan Phoenix	3,840 acre-feet of transferable groundwater 3,206 acres of real estate.	Leased to farmers.
Nevada:		
Fish Springs Ranch, LLC (51% interest) Washoe County, 40 miles north of Reno	12,987 acre-feet of permitted water rights, 7,987 acre-feet of which are designated as water credits and are available for sale and use in the north valleys of Reno. 8,600 acres of ranch land.	Vidler has constructed a total of 35 miles of pipeline to deliver an initial 8,000 acre-feet of water annually from Fish Springs Ranch to the north valleys of Reno, Nevada.
Lincoln County water delivery teaming agreement	Applications* for more than 100,000 acre-feet of water rights through an agreement with Lincoln County. It is currently anticipated that up to 40,000 acre-feet of the applications will be permitted, and the water put to use on projects approved in Lincoln County/northern Clark County, Nevada. *The numbers indicated for water rights applications are the maximum amount which we have filed for. In some cases, we anticipate that the actual permits received will be for smaller quantities	Agreement to sell 7,240 acre-feet of water as, and when, supplies are permitted from existing applications in Tule Desert Groundwater Basin, in Lincoln County, Nevada. Agreement to sell water to a developer as, and when, supplies are permitted from applications in Kane Springs Basin in Lincoln County, Nevada.
Sandy Valley Near the Nevada/California state line near the Interstate 15 corridor	Water rights applications for 4,000 acre-feet.	Agreement to sell permitted water for proposed developments in Sandy Valley.

Muddy River water rights In the Moapa Valley, approximately 35 miles east of Las Vegas near the Interstate 15 corridor	267 acre-feet of water rights.	Currently leased to Southern Nevada Water Authority and available for specific development projects in the future.
Dry Lake Lincoln County, Nevada	Approximately 795 acres of real estate with stock water rights.	Development of water resource for use in Dry Lake valley to be utilized from water applications by Lincoln/Vidler.
Carson River Carson City, Lyon County and Douglas County, Nevada	Approximately 1,070 acre-feet of municipal use water rights and 3,500 acre-feet of Carson River agricultural use water rights. Options over 2,800 acre-feet of Carson River agricultural use water rights.	Development and Improvement agreements with Carson City and Lyon County to provide water resources for planned future growth in Lyon County and to connect the water systems of both municipalities.
	43 acres of ranch land.	Parceled into 4 developable lots.
	950 acres of developable real estate.	Available for development.
Other states:		
Colorado water rights	176 acre-feet of water rights.	66 acre-feet leased. 110 acre-feet are available for sale or lease.
Idaho Near Boise, Idaho	7,044 acre-feet of water rights and 1,886 acres of farm land.	Vidler is currently farming the properties.
WATER STORAGE		
Vidler Arizona Recharge Facility Harquahala Valley, Arizona	An underground water storage facility with permitted recharge capacity exceeding 1 million acre-feet and annual recharge capability of at least 35,000 acre-feet.	Vidler is currently buying water and storing it on its own account. At December 31, 2008, Vidler had net recharge credits of approximately 173,667 acre-feet of water in storage at the Arizona Recharge Facility. In addition, Vidler has ordered approximately 48,700 acre-feet of water for recharge in 2009.

Real Estate Operations

Our Real Estate Operations are primarily conducted through Nevada Land and UCP.

Nevada Land

In April 1997, PICO paid $48.6 million to acquire Nevada Land, which at the time owned approximately 1,352,723 acres of deeded real estate in northern Nevada, and the water, mineral, and geothermal rights related to the property. Much of Nevada Land's property is checker-boarded in square mile sections with publicly owned land. The properties generally parallel the Interstate 80 corridor and the Humboldt River, from Fernley, in western Nevada, to Elko County, in northeast Nevada.

Nevada Land is one of the largest private landowners in the state of Nevada. Real estate available for private development in Nevada is relatively scarce, as governmental agencies own or control approximately 87% of the land in Nevada. Before we acquired Nevada Land, the property had been under the ownership of a succession of railway companies, to whom it was a non-core asset. Accordingly, when we acquired Nevada Land, we believed that the commercial potential of the property had not been maximized.

After acquiring Nevada Land, we completed a "highest and best use" study which divided the real estate into categories. We developed strategies to maximize the value of each category, with the objective of monetizing assets once they had reached their highest and best use. These strategies include:

- the sale of real estate and water rights. There is demand for real estate and water for a variety of purposes including residential development, farming, ranching, and from industrial users;
- the development of water rights. Nevada Land has applied for additional water rights and where water rights are permitted, we anticipate that the value, productivity, and marketability of the related real estate will increase;
- the development of real estate in and around growing municipalities; and
- the management of mineral rights.

At December 31, 2008, Nevada Land owns approximately 440,000 acres of former railroad land.

In recent years, Nevada Land has filed additional applications for approximately 47,497 acre-feet of water rights on its properties. Of these applications, approximately 9,297 acre-feet of water rights have been certificated and permitted, and applications are pending for approximately 38,200 acre-feet of water use for agricultural, municipal, and industrial use. Potentially, some of these water rights could be utilized to support the growth of municipalities in northern Nevada, or alternative energy requirements.

UCP

UCP was formed in 2007 with the objective of acquiring attractive and well-located finished and partially-developed residential lots, primarily in California. During 2008, most of UCP's efforts were focused on the Fresno Metropolitan Area, which is located in the San Joaquin Valley area in central California. As is the case in most regions of California, medium-sized regional developers and homebuilders operating in Fresno have experienced liquidity challenges and are rapidly deleveraging as a result of the severe downturn in the real estate market.

We believe UCP's analysis of the Fresno Metropolitan Area, which indicates that, despite the difficult conditions in the current housing market, there are still attractive opportunities for select real estate projects. UCP acquires properties with compelling valuations (that is, our purchase price has to be at a steep discount to our estimated cost to replace like product) in areas where there appear to be sound demand fundamentals constricted by a limited supply of buildable lots (that is, finished lots) and declining resale home inventory. While we are unable to predict when the

housing market will recover, we fully anticipate and are prepared to carry and develop our projects for several years until homebuilders start to replenish their inventory of lots. We believe we will generate our minimum required economic return despite the potential long duration of these projects, as our acquisition basis is low and our carrying and development costs are, typically, relatively insignificant.

As of December 31, 2008, UCP owns or controls a total of 389 finished lots and 1,501 potential lots in various stages of entitlement, all in and around the Fresno Metropolitan Area.

Insurance Operations in "Run Off"

This segment consists of Physicians Insurance Company of Ohio and Citation Insurance Company.

Physicians Insurance Company of Ohio
Until 1995, Physicians wrote medical professional liability insurance, mostly in the state of Ohio. In 1995, we concluded that maximum value would be obtained by selling the prospective book of business (that is, the opportunity to renew existing policies and to write new policies) and placing Physicians in "run off" (that is, handling and resolving claims on expired policies, but not writing any new business). Physicians wrote its last policy in 1995; however, claims can be filed until 2017 related to events that allegedly occurred during the period when Physicians provided coverage.

Insurance companies in "run off" obtain the funds to pay claims from the maturity of fixed-income securities, the sale of investments, and collections from reinsurance companies (that is, specialized insurance companies who share in our claims risk).

Once an insurance company is in "run off" and the last of its policies have expired, typically most revenues come from interest and dividend income, and realized gains and losses, from the securities investments which correspond to the insurance company's reserves and shareholders' equity. Occasionally, earned premiums are recorded, which relate to reinsurance.

During the "run off" process, as claims are paid, both the loss reserve liabilities and the corresponding fixed-income investment assets decrease. Since interest income in this segment will decline over time, we are attempting to minimize segment overhead expenses as much as possible.

Although we regularly evaluate the strategic alternatives, we currently believe that the most advantageous option is for Physicians' own claims personnel to manage the "run off." We believe that this will ensure a high standard of claims handling for our policyholders and, from the Company's perspective, ensure the most careful examination of claims made to minimize loss and loss adjustment expense payments.

Administering our own "run off" also provides us with the following opportunities:

- we retain management of the associated investment portfolios. Since the claims reserves of the "run off" insurance companies effectively recognize the cost of paying and handling claims in future years, the investment return on the corresponding investment assets, less non-insurance expenses, accrues to PICO. We aim to maximize this source of income; and
- to participate in favorable development in our claims reserves if there is any, although this entails the corresponding risk that we could be exposed to unfavorable development.

As the "run off" progresses, at a time in the future which cannot currently be predicted, Physicians' claims reserves may diminish to the point where it is more cost-effective to outsource claims handling to a third party administrator.

At December 31, 2008, Physicians had $3.8 million in medical professional liability loss reserves, net of reinsurance.

Citation Insurance Company
In 1996, Physicians completed a reverse merger with Citation's parent company. In the past, Citation wrote various lines of commercial property and casualty insurance and workers' compensation insurance, primarily in California and Arizona. At the end of 2000, Citation ceased writing business and went into "run off."

Prior to the reverse merger, Citation had been a direct writer of workers' compensation insurance. Since PICO did not wish to be exposed to that line of business, shortly after the merger was completed, Citation reinsured 100% of its workers' compensation business with a subsidiary, Citation National Insurance Company ("CNIC"), and sold CNIC to Fremont Indemnity Company ("Fremont") in 1997. Fremont merged CNIC into Fremont, and administered and paid all of the workers' compensation claims which had been sold to it. From 1997 until the second quarter of 2003, Citation booked the losses reported by Fremont, and recorded an equal and offsetting reinsurance recoverable from Fremont, as an admitted reinsurer, for all losses and loss adjustment expenses. This resulted in no net impact on Citation's reserves and financial statements, and no net impact on our consolidated financial statements.

In June 2003, the California Department of Insurance obtained a conservation order over Fremont, and applied for a court order to liquidate Fremont. In July 2003, the California Superior Court placed Fremont in liquidation. Since Fremont was no longer an admitted reinsurance company under the statutory basis of insurance accounting, Citation reversed the $7.5 million reinsurance recoverable from Fremont in its financial statements for the 2003 financial year , prepared on both the statutory basis of accounting, and generally accepted accounting principles in the U.S., or "GAAP". Citation was unsuccessful in court action to recover deposits reported as held by Fremont for Citation's insureds.

We currently have a third-party administration agreement with Intercare Insurance Services to administer the handling and payment of claims for Citation's workers' compensation insurance "run off" book of business.

At December 31, 2008, Citation had $8.1 million in loss reserves, net of reinsurance. Citation's loss reserves consist of $645,000 for property and casualty insurance, principally in the artisans/contractors line of business, and approximately $7.4 million for workers' compensation insurance.

Corporate

Formerly known as "Business Acquisitions and Financing", this segment consists of cash, majority interests in small businesses, and other parent company assets and liabilities. This segment also contains the deferred compensation assets held in trust for the benefit of several PICO officers, as well as the corresponding and offsetting deferred compensation liabilities. Revenues in this segment vary considerably from period to period, primarily due to fluctuations in net realized gains or losses on the sale or impairment of securities. At December 31, 2008, virtually all of the securities held in this segment are deferred compensation assets.

Until April 2008, the largest asset in this segment was a 22.5% shareholding in Jungfraubahn Holding AG, which was held by our wholly-owned Swiss subsidiary, Global Equity AG. Jungfraubahn is a publicly-traded company which operates railway and related tourism and transport activities in the Swiss Alps. On April 22, 2008, Global Equity AG sold its interest in Jungfraubahn for net proceeds of 75.5 million Swiss Francs ("CHF"), or approximately US$75.3 million. The sale of Jungfraubahn resulted in a gain of $46.1 million before taxes in our consolidated statement of operations in the 2008.

The majority of the sales proceeds were immediately converted into U.S. dollars. In December 2008, Global Equity AG declared a dividend, and repatriated most of the remaining sale proceeds to the U.S. As of December 31, 2008, Global Equity AG's assets principally consist of a CHF6.8 million (US$6.3 million) "at call" bank deposit denominated in Swiss Francs.

We do not sell securities on a regular basis. A security may be sold if the price has significantly exceeded our target, or if there have been changes which we believe limit further appreciation potential on a risk-adjusted basis. Consequently, the amount of net realized gains or losses recognized during any accounting period has no predictive value. In addition, in this segment, various income items relate to specific holdings owned during a particular accounting period. Our holdings have changed over time, so results in this segment are not necessarily comparable from year to year.

PICO seeks to acquire businesses and interests in businesses which we identify as undervalued based on fundamental analysis -- that is, our assessment of what the business is worth, based on the private market value of its assets, earnings, and cash flow. Typically, the business will be generating free cash flow and have a low level of debt, or, alternatively, strong interest coverage ratios or the ability to realize surplus assets. As well as being undervalued, the business must have special qualities such as unique assets, a potential catalyst for change, or be in an industry with attractive economics. We are also interested in acquiring businesses and interests in businesses where there is significant unrecognized value in land and other tangible assets.

We have acquired businesses and interests in businesses through the acquisition of private companies, and the purchase of shares in public companies, both directly through participation in financing transactions and through open market purchases.

When we acquire an interest in a public company, we are prepared to play an active role, for example encouraging companies to use proper financial criteria when making capital expenditure decisions, or by providing financing or strategic input.

At the time we acquire an interest in a public company, we believe that the intrinsic value of the underlying business significantly exceeds the current market capitalization. The gap between market price and intrinsic value may persist for several years, and the stock price may decline while our estimate of intrinsic value is stable or increasing. Sometimes the gap is not eliminated until another party attempts to acquire the company.

When acquisitions become core operations, typically through majority ownership, we become involved in the management and strategic direction of the business. If we acquire majority ownership, the business may become a separate segment in our consolidated financial statements.

Discontinued Operations

HyperFeed Technologies, Inc.
During the fourth quarter of 2006, our majority-owned subsidiary HyperFeed Technologies, Inc. (“HyperFeed”) filed for bankruptcy protection under Chapter 7 of the U.S. Bankruptcy Code. Consequently, HyperFeed is recorded as a Discontinued Operation for 2006 in the Consolidated Financial Statements in this Annual Report on Form 10-K.

HyperFeed was a provider of enterprise-wide ticker plant and transaction technology software and services enabling financial institutions to process and use high performance exchange data with Smart Order Routing and other applications. HyperFeed was a publicly-traded company, which became a subsidiary of PICO Holdings in 2003, when we acquired direct ownership of a majority voting interest.

Despite possessing potentially valuable technology, HyperFeed was unable to generate sufficient cash flow to finance its own operations. During 2006, PICO and HyperFeed negotiated a business combination with Exegy Incorporated (“Exegy”). On August 25, 2006, PICO, HyperFeed, and Exegy entered into an agreement, pursuant to which the common stock of HyperFeed owned by PICO would have been contributed to Exegy in exchange for Exegy's issuing certain Exegy stock to PICO. However, in a letter dated November 7, 2006, Exegy informed PICO and HyperFeed that it was terminating the agreement.

Given the uncertainty of additional funding available to HyperFeed due to the termination of the agreement, and therefore for HyperFeed to continue as a going concern, HyperFeed filed for bankruptcy protection under Chapter 7 of the U.S. Bankruptcy Code on November 29, 2006. See Item 3. “Legal Proceedings” and Note 2 of Notes to Consolidated Financial Statements, "Discontinued Operations”.

Employees

At December 31, 2008, PICO had 64 employees.

Executive Officers

The executive officers of PICO are as follows:

Name	Age	Position
John R. Hart	49	President, Chief Executive Officer and Director
Richard H. Sharpe	53	Executive Vice President and Chief Operating Officer
Damian C. Georgino	48	Executive Vice President of Corporate Development and Chief Legal Officer
James F. Mosier	61	General Counsel and Secretary
Maxim C. W. Webb	47	Executive Vice President and Chief Financial Officer and Treasurer
W. Raymond Webb	47	Vice President, Investments
John T. Perri	39	Vice President, Controller

Mr. Hart has served as our President and Chief Executive Officer and as a member of our board of directors since 1996. Mr. Hart also serves as an officer and/or director of our following subsidiaries: Physicians Insurance Company of Ohio (President, Chief Executive Officer, and director since 1993), Vidler Water Company, Inc. (Chairman since 1997 and Chief Executive Officer since 1998). Mr. Hart was a director of HyperFeed Technologies, Inc., our 80% owned subsidiary. On November 29, 2006, HyperFeed Technologies filed a petition for bankruptcy under Chapter 7 of the U.S. Bankruptcy Code with the U.S. Bankruptcy Court, District of Delaware.

Mr. Sharpe has served as Executive Vice President and Chief Operating Officer of PICO since November 1996 and in various executive capacities since joining Physicians in 1977.

Mr. Georgino has served as Executive Vice President of Corporate Development and Chief Legal Officer since September 2007. Beginning in 2003, he was a partner with the law firm of Pepper Hamilton LLP. From 2000 to 2003 he was a partner with the international law firm of LeBoeuf, Lamb, Greene and MacRae LLP (now Dewey & LeBoeuf LLP). Prior to that, Mr. Georgino served as Executive Vice President, General Counsel and Corporate Secretary of United States Filter Corporation (also known as "US Filter").

Mr. Mosier has served as General Counsel and Secretary of PICO since November 1996 and of Physicians since October 1984 and in various other executive capacities since joining Physicians in 1981.

Mr. Maxim Webb has been Executive Vice President and Chief Financial Officer and Treasurer of PICO since May 14, 2001. Mr. Webb served in various capacities with the Global Equity Corporation group of companies since 1993, including Vice President, Investments of Forbes Ceylon Limited from 1994 through 1996. Mr. Webb became an officer of Global Equity Corporation in November 1997 and Vice President, Investments of PICO on November 20, 1998.

Mr. Raymond Webb has been with the Company since August 1999 as Chief Investment Analyst and became Vice President, Investments in April 2003.

Mr. Perri has been Vice President, Controller of PICO since April 2003 and served in various capacities since joining the Company in 1998, including Financial Reporting Manager and Corporate Controller.

ITEM 1A. RISK FACTORS

The following information sets out factors that could cause our actual results to differ materially from those contained in forward-looking statements we have made in this Annual Report on Form 10-K and those we may make from time to time. You should carefully consider the following risks, together with other matters described in this Form 10-K or incorporated herein by reference in evaluating our business and prospects. If any of the following risks occurs, our business, financial condition or operating results could be harmed. In such case, the trading price of our securities could decline, in some cases significantly. There may be other additional risks, not presently known to us, which may also impair our business operations.

Our future water revenues are uncertain and depend on a number of factors that may make our revenue streams and profitability volatile.

We engage in various water resource acquisitions, management, development, and sale and lease activities. Accordingly, our future profitability will primarily be dependent on our ability to acquire, develop and sell or lease water and water rights. Our long-term profitability will be affected by various factors, including the availability and timing of water resource acquisitions, regulatory approvals and permits associated with such acquisitions, transportation arrangements, and changing technology. We may also encounter unforeseen technical or other difficulties which could result in construction delays and cost increases with respect to our water resource and water storage development projects. Moreover, our profitability is significantly affected by changes in the market price of water. Future prices of water may fluctuate widely as demand is affected by climatic, economic, demographic and technological factors as well as the relative strength of the residential, commercial, financial, and industrial real estate markets. Additionally, to the extent that we possess junior or conditional water rights, during extreme climatic conditions, such as periods of low flow or drought, our water rights could be subordinated to superior water rights holders. The factors described above are not within our control. One or more of these factors could impact the profitability of our water resources, negatively affect our financial condition and cash flows, and cause our results of operations to be volatile.

Our water activities may become concentrated in a limited number of assets, making our growth and profitability vulnerable to fluctuations in local economies and governmental regulations.

In the future, we anticipate that a significant amount of our revenues and asset value will come from a limited number of assets, including our water resources in Nevada and Arizona and our Arizona Recharge Facility. Water resources in this region are scarce and we may not be successful in continuing to acquire and develop additional water assets. If we are unable to develop additional water assets, our revenues will be derived from a limited number of assets, primarily located in Arizona and Nevada. As a result of this concentration, our invested capital and results of operations will be vulnerable to fluctuations in local economies and governmental regulations.

Our Arizona Recharge Facility is one of the few private sector water storage sites in Arizona. To date, we have stored more than 170,000 acre feet at the facility for our own account. We have not stored any water on behalf of any customers, and have not as yet generated any revenue from the recharge facility. We believe that the best economic return on the asset will come from storing water in surplus years for sale in dry years; however, we cannot be certain that we will ultimately be able to sell the stored water at a price sufficient to provide an adequate economic profit.

We have constructed a pipeline approximately 35 miles long to deliver water from Fish Springs Ranch to the northern valleys of Reno, Nevada. The total cost of the pipeline project was approximately $100.9 million. To date, Vidler has only entered into sale agreements for a very small proportion of the total amount of water that will be conveyed through the pipeline to the northern valleys of Reno. Although the current market pricing of water in the area greatly exceeds our total estimated cost of the pipeline, we cannot provide any assurance that the sales prices we may obtain

in the future will provide an adequate economic return. Furthermore, the principal buyers of this water are largely real estate developers who are having to contend with the effects of the current economic downturn and if our negotiations with these buyers do not result in prices that are acceptable to us, we may choose to monetize the water resources at a later time, which would have an adverse effect on our near-term revenues and cash flows.

General economic conditions could have a material adverse effect on our financial results, financial condition and our ability to grow or finance our businesses.

We are sensitive to general economic conditions, both nationally and locally, as well as international economic conditions. General economic conditions and the effects of a recession could have a material adverse effect on the demand for our real estate and water assets, near-term cash flow from operations, results of operations, financial condition and our ability to grow our business. These conditions include higher unemployment, inflation, deflation, increased commodity costs, decreases in consumer demand, changes in buying patterns, a weakened dollar, general transportation and fuel costs, higher consumer debt levels, higher tax rates and other changes in tax laws or other economic factors that may affect commercial and residential development. Specifically, the recent increase in national unemployment may delay a recovery of the residential real estate market, which could adversely affect the demand for our real estate and water assets. Any prolonged lack of demand for our real estate and water assets could have a significant adverse affect on our revenues, profitability, and cash flows.

A prolonged continuation of the significant and sustained downturn that the homebuilding industry is undergoing will materially adversely affect our business and results of operations.

The homebuilding industry is experiencing a significant and sustained downturn having been impacted by lack of consumer confidence, housing affordability and large supplies of resale and new home inventories and alternatives to new homes. These factors have resulted in an industry-wide softening of demand for new homes. These conditions in the homebuilding industry have a material adverse effect on the growth of the local economies in our markets where our real estate and water assets are located, which include Nevada, Arizona, California, Colorado and Idaho. Among other considerations, continuation of the residential and commercial real estate development process is essential for our profitability. Additionally, current economic credit conditions have adversely impacted global credit markets and have restricted liquidity in financial markets. These conditions could adversely affect the availability and cost of capital. Economic conditions, including restricted liquidity in financial markets, could adversely impact various development projects within the markets in which our real estate and water assets are located and this could materially affect our ability to monetize such assets. Declines in the U.S. housing market have reduced revenues and profitability in our real estate and water resource businesses and may continue to do so in the future.

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

The financial markets are experiencing significant volatility, driven by continued fallout from the credit crisis and overall weakening global economy. We expect that the current downturn will have a near term adverse effect on real estate market fundamentals, including tenant demand, overall occupancies, leasing velocity and rental rates, and will lead to increased subletting and tenant defaults. These events have impacted the values of commercial real estate assets, including potentially our real estate and water assets. Values of real estate assets have declined from the values achieved over the last 24 months. It is uncertain how much of the declines are attributable to the current illiquidity and volatility in the markets, the prospects of a deepening recession and its impact on real estate or a longer-term re-pricing of real estate assets. Depending on how the markets perform over the next several months, or years, these events could result in a decline in the value of our existing real estate and water assets, result in our having to retain such assets for longer than we initially expected, cause us to divest such assets for less than our intended return on investment, or cause us to write-down such assets to realizable value. Such events would adversely impact our profitability, cash flows and financial condition.

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

The real estate and water assets we hold have fair values that are significantly affected by the growth in population and the general state of the local economies where our real estate and water assets are located, primarily in the states of Arizona and Nevada, but also in California, Colorado and Idaho. The recent increase in national unemployment and issues related to the credit markets may deepen or prolong a slowdown of these local economies. This could materially and adversely affect the demand for our real estate and water assets and, consequently, our growth, revenues, and the return on our investment in these assets.

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

We have filed certain water rights applications in Nevada, primarily as part of the water teaming agreement with Lincoln County. We deploy the capital required to enable the filed applications to be converted into permitted water rights over time as and when we deem appropriate or as otherwise required. We only expend capital in those areas where our initial investigations lead us to believe that we can obtain a sufficient volume of water to provide an adequate economic return on the capital employed in the project. These capital expenditures largely consist of drilling and engineering costs for water production, costs of monitoring wells, and legal and consulting costs for hearings with the State Engineer, and National Environmental Protection Act, or "NEPA", compliance costs. Until the State Engineer permits the water rights, we can not provide any assurance that we will be awarded all of the water that we expect based on the results of our drilling and our legal position. Any significant reduction in the volume of water awarded to us from our base expectations could adversely affect our revenues, profitability, and cash flows.

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

We value our water assets, in part, based upon the volume (amounts in acre-feet) of water we anticipate from water rights applications and permitted rights. The water and water rights held by us and the transferability of these rights to other uses, persons, and places of use are governed by the laws concerning water rights in the states of Arizona, Colorado, Idaho and Nevada. The volumes of water actually derived from the water rights applications or permitted rights may vary considerably based upon physical availability and may be further limited by applicable legal restrictions. As a result, the volume of water anticipated from the water rights applications or permitted rights do not in every case represent a reliable, firm annual yield of water, but in some cases describe the face amount of the water right claims or management's best estimate of such entitlement. Additionally, we may face legal restrictions on the sale or transfer of some of our water assets, which may affect their commercial value. If we were unable to transfer or sell our water assets, we may lose some or all of our stated or anticipated returns.

If we do not successfully identify, select and manage acquisitions and investments, or if our acquisitions or investments otherwise fail or decline in value, our financial condition could suffer.

We acquire and invest in businesses and assets that we believe are undervalued or that will benefit from additional capital, restructuring of operations, strategic initiatives, or improved competitiveness through operational efficiencies. If an acquired business, investment or asset fails or its fair value declines, we could experience a material adverse effect on our business, financial condition, the results of operations and cash flows. Additionally, we may not be able to find sufficient opportunities to make our business strategy successful. If we fail to successfully identify, select and manage acquisition and investment opportunities, particularly water and water rights, our business, financial condition, the results of operations and cash flows could be materially affected. Such business failures, declines in fair values, and/or failure to successfully identify, select and manage acquisitions or investments, particularly water and water rights, could result in a negative return on equity. We could also lose part or all of our capital in these businesses and experience reductions in our net income, cash flows, assets and equity.

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

Failure to successfully manage newly acquired companies could adversely affect our business.

Our management of the operations of acquired businesses requires significant efforts, including the coordination of information technologies, research and development, sales and marketing, operations, taxation, regulatory matters, and finance. These efforts result in additional expenses and involve significant amounts of our management's time and could distract our management from the day-to-day operations of our business. The diversion of our management's attention from the day-to-day operations, or difficulties encountered in the integration process, could have a material adverse effect on our business, financial condition, and the results of operations and cash flows. If we fail to integrate acquired businesses, resources, or assets into our operations successfully, we may be unable to achieve our strategic goals or an economic return and the value of your investment could suffer.

We operate in a variety of industries and market sectors, all of which are very competitive and susceptible to economic downturns and would be adversely affected by a recession. A worsening of general economic or market conditions may require us to devote more of our management resources to newly acquired companies and may result in lower valuations for our businesses or investments or have a negative impact on the credit quality of our assets.

Our acquisitions may result in dilution to our shareholders and increase our exposure to additional liabilities.

We make selective acquisitions of companies that we believe could benefit from our resources of additional capital, business expertise, management direction and oversight, or existing operations. We endeavor to enhance and realize additional value to these acquired companies through our influence and control. Any acquisition could result in the use of a significant portion of our available cash, significant dilution to you, and significant acquisition-related charges. Acquisitions may also result in the assumption of liabilities, including liabilities that are unknown or not fully known to us at the time of the acquisition, which could have a material adverse financial effect on us. Additionally, our acquisitions and investments may yield low or negative returns for an extended period of time, which could temporarily or permanently depress our return on shareholders' equity, and we may not realize the value of the funds invested.

We generally make acquisitions and investments that tend to be long term in nature, and for the purpose of realizing additional value by means of appropriate levels of influence and control. We acquire businesses that we believe to be undervalued or may benefit from additional capital, restructuring of operations or management or improved competitiveness through operational efficiencies with our existing operations or through appropriate and strategic management input. We may not be able to develop acceptable revenue streams and investment returns through the businesses we acquire, and as a result we may lose part or all of our investment in these assets. Additionally, when any of our acquisitions do not achieve acceptable rates of return or we do not realize the value of the funds invested, we may write down the value of such acquisitions or sell the acquired businesses at a loss. Some of our prior acquisitions have lost either part or all of the capital we invested. Unsuccessful acquisitions could have negative impacts on our cash flows, income, assets and shareholders' equity, which may be temporary or permanent. Moreover, the process we employ to enhance value in our acquisitions and investments can consume considerable amounts of time and resources. Consequently, costs incurred as a result of these acquisitions and investments may exceed their revenues and/or increases in their values, if any, for an extended period of time.

Our ability to achieve an acceptable rate of return on any particular investment is subject to a number of factors which may be beyond our control, including increased competition and loss of market share, the ability of management to implement their strategic and operational directives, cyclical or uneven financial results, technological obsolescence, foreign currency risks and regulatory delays.

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

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

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

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

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

The water resources we hold and the transferability of these assets and rights to other uses, persons, or places of use are governed by the laws concerning the laws concerning water rights in the states of Arizona, California, and Nevada, Colorado and Idaho. Our sale of water resources is subject to the risks of delay associated with receiving all necessary regulatory approvals and permits. Additionally, the transfer of water resources from one use to another may affect the economic base or impact other issues of a community including development, and will, in some instances, be met with local opposition. Moreover, certain of the end users of our water resources, namely municipalities, regulate the use of water in order to manage growth, thereby creating additional requirements that we must satisfy to sell and convey water resources. If we are unable to effectively transfer, sell and convey water resources, our ability to monetize this asset will suffer and our revenues and financial condition would decline.

Our insurance companies hold material positions in equities and fixed-income securities which have significantly declined in value during 2008, causing volatility in our profitability and financial condition.

Our insurance subsidiaries hold significant positions in equities and fixed-income securities as part of their investment portfolios to cover payments for insurance claims and related costs established in our reserves for unpaid loss and loss adjustment expenses. During 2008, our insurance company investment portfolios significantly declined in value as global equity and fixed-income markets in general declined in response to the weakening global economy and the tightening of credit availability. As a result of the decline in value of our securities, our financial condition has suffered and, in the future, any volatility in our insurance investment portfolios could adversely impact our financial condition and cash flows. Furthermore, if the duration and extent of the declines in value of any of our securities are prolonged, we may have to provide other-than-temporary impairments against such securities which will adversely impact our profitability. In addition, our insurance subsidiaries' investment portfolios consist in part of thinly-traded U.S. and non-U.S. equities. These equity securities are illiquid in nature and we cannot provide any assurance that we can timely, effectively, and efficiently liquidate and monetize those positions.

Our acquisitions of and investments in non-U.S. companies subject us to additional market and liquidity risks which could affect the value of our stock.

We have acquired, and may continue to acquire, businesses and securities in non-U.S. public companies and other assets or businesses not located in the U.S. Typically, these non-U.S. securities are not registered with the SEC and

regulation of these companies is under the jurisdiction of the relevant non-U.S country. The respective non-U.S regulatory regime may limit our ability to obtain timely and comprehensive financial information for the non-U.S. companies in which we have invested. In addition, if a non-U.S. company in which we invest were to take actions which could be deleterious to its shareholders, non-U.S. legal systems may make it difficult or time-consuming for us to challenge such actions. These factors may affect our ability to acquire controlling stakes, or to dispose of our non-U.S. investments, or to realize the full fair value of our non-U.S. investments. In addition, investments in non-U.S. countries may give rise to complex cross-border tax issues. We aim to manage our tax affairs efficiently, but given the complexity of dealing with U.S. and non-U.S. tax jurisdictions, we may have to pay tax in both the U.S. and in non-U.S. countries, and we may be unable to offset any U.S. tax liabilities with non-U.S. tax credits. If we are unable to manage our non-U.S. tax issues efficiently, our financial condition and the results of operations and cash flows could be adversely affected. In addition, our base currency is United States dollars. Accordingly, we are subject to foreign exchange risk through our acquisitions of stocks in non-U.S. public companies. We attempt to mitigate this foreign exchange risk by borrowing funds in the same currency to purchase the equities. Significant fluctuations in the non-U.S. currencies in which we hold investments or consummate transactions could negatively impact our financial condition and the results of operations and cash flows. We also may be unable to effectively and efficiently repatriate funds into the U.S. upon monetization of assets, securities, or businesses not located in the U.S., which could have an impact on our liquidity.

Volatile fluctuations in our insurance reserves could cause our financial condition to be materially misstated.

Our insurance subsidiaries have established reserves that we believe are adequate to meet the ultimate cost of losses arising from claims. However, it has been, and will continue to be, necessary for our insurance subsidiaries to review and make appropriate adjustments to reserves for claims and expenses for settling claims. Inadequate reserves could cause our financial condition to fluctuate from period to period and cause our financial condition to appear to be better than it actually is for periods in which insurance claims reserves are understated. In subsequent periods if we discover an underestimation and pay the additional claims, our cash needs will be greater than expected and our financial results of operations for that period will be worse than they would have been had our reserves been adequately estimated.

The inherent uncertainties in estimating loss reserves are greater for some insurance products than for others, and are dependent on various factors including:

- the length of time in reporting claims;
- the diversity of historical losses among claims;
- the amount of historical information available during the estimation process;
- the degree of impact that changing regulations and legal precedents may have on open claims; and
- the consistency of reinsurance programs over time.

Because medical malpractice liability, commercial property and casualty, and workers' compensation claims may not be completely paid off for several years, estimating reserves for these types of claims can be more uncertain than estimating reserves for other types of insurance. As a result, precise reserve estimates cannot be made for several years following the year for which reserves were initially established. During the past several years, the levels of the reserves for our insurance subsidiaries have been very volatile. We have had to significantly increase and decrease these reserves in the past several years. We may need to significantly increase the reserves in the future, and the future level of reserves for our insurance subsidiaries may be volatile. These increases or volatility may have an adverse effect on our business, financial condition, and the results of operations and cash flows.

If we underestimate the amount of reinsurance we need or if the companies with which we have reinsurance agreements default on their obligations, we may be unable to cover claims made and that would have a material adverse effect on our results of operations and cash flows.

We have reinsurance agreements with reinsurance companies on all of our insurance books of business. We purchase reinsurance based upon our assessment of the overall direct underwriting risk. It is possible that we may underestimate the amount of reinsurance required to achieve the desired level of net claims risk, and a claim may exceed the combined value of our reserve and the amount of reinsurance available. Additionally, our reinsurers could default on amounts owed to us for their portion of the direct insurance claim. Our insurance subsidiaries, as direct writers of lines of insurance, have ultimate responsibility for the payment of claims, and any defaults by reinsurers may result in our established reserves not being adequate to meet the ultimate cost of losses arising from claims. If claims made exceed the amount of our direct reserves and the available reinsurance, we may be subject to regulatory action or litigation and our results of operation and cash flows would suffer as a result.

State regulators could require changes to our capitalization and/or to the operations of our insurance subsidiaries, and/or place them into rehabilitation or liquidation.

Beginning in 1994, our subsidiaries, Physicians and Citation, became subject to the provisions of the Risk-Based Capital for Insurers Model Act which has been adopted by the National Association of Insurance Commissioners for the purpose of helping regulators identify insurers that may be in financial difficulty. The Model Act contains a formula which takes into account asset risk, credit risk, underwriting risk and all other relevant risks. Under this formula, each insurer is required to report to regulators using formulas which measure the quality of its capital and the relationship of its modified capital base to the level of risk assumed in specific aspects of its operations. The formula does not address all of the risks associated with the operations of an insurer. The formula is intended to provide a minimum threshold measure of capital adequacy by an individual insurance company and does not purport to compute a target level of capital. Companies which fall below the threshold will be placed into one of four categories: Company Action Level, where the insurer must submit a plan of corrective action; Regulatory Action Level, where the insurer must submit such a plan of corrective action, the regulator is required to perform such examination or analysis the Superintendent of Insurance considers necessary and the regulator must issue a corrective order; Authorized Control Level, which includes the above actions and may include rehabilitation or liquidation; and Mandatory Control Level, where the regulator must rehabilitate or liquidate the insurer. As of December 31, 2008, all of our insurance subsidiaries’ risk-based capital results exceeded the Company Action Level. However, we cannot assure you that insurance subsidiaries’ risk-based capital results will exceed the Company Action Level in the future. If the risk-based capital of any of our insurance subsidiaries fails to exceed the Company Action Level, we will be subject to the regulatory action described above and our results of operations could suffer.

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

To run our day-to-day operations and to successfully manage newly acquired companies we must, among other things, continue to attract and retain key management. We rely on the services of several key executive officers. If they depart, it could have a significant adverse effect upon our business. Mr. Hart, our CEO, is key to the implementation of our strategic focus, and our ability to successfully develop our current strategy is dependent upon our ability to retain his services. Also, increased competition for skilled management and staff employees in our businesses could cause us to experience significant increases in operating costs and reduced profitability.

We use estimates and assumptions in preparing financial statements in accordance with accounting principles generally accepted in the United States of America.

The preparation of our financial statements in conformity with United States GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent liabilities at the date of financial statements and the reported amount of revenues and expenses during the reporting period. We regularly evaluate our estimates, which are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. The results of these evaluations form the basis for our judgments about the carrying values of assets and liabilities and the reported amount of revenues and expenses that are not readily apparent from other sources. The carrying values of assets and liabilities and the reported amount of revenues and expenses may differ by using different assumptions. In addition, in future periods, in order to incorporate all known experience at that time, we may have to revise assumptions previously made which may change the value of previously reported assets and liabilities. This potential subsequent change in value may have a material adverse effect on our business, financial condition, and the results of operations and cash flows.

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

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

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

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

- quarterly variations in financial performance and condition;
- shortfalls in revenue or earnings from estimates forecast by securities analysts or others;
- changes in estimates by such analysts;
- product introductions;
- the availability of economically viable acquisition or investment opportunities, including water resources and real estate, which will return an adequate economic return;
- our competitors' announcements of extraordinary events such as acquisitions;
- litigation; and
- general economic conditions and other matters described herein.

Our results of operations have been subject to significant fluctuations, particularly on a quarterly basis, and our future results of operations could fluctuate significantly from quarter to quarter and from year to year. Causes of such fluctuations may include the inclusion or exclusion of operating earnings from newly acquired or sold operations. Statements or changes in opinions, ratings, or earnings estimates made by brokerage firms or industry analysts relating to the markets in which we do business or relating to us specifically could result in an immediate and adverse effect on the market price of our common stock. Such fluctuations in the market price of our common stock could affect the value of your investment and your ability to sell your shares. In addition, some investors favor companies that pay dividends, particularly in market downturns. We have never declared or paid any cash dividends on our common stock. We currently intend to retain any future earnings for funding growth and, therefore, we do not currently anticipate paying cash dividends on our common stock.

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

We currently anticipate that our available capital resources and operating income will be sufficient to meet our expected working capital and capital expenditure requirements for at least the next 12 months. However, we cannot provide any assurance that such resources will be sufficient to fund the long-term growth of our business and acquisitions. We may raise additional funds through public or private debt, equity or hybrid securities financings, including, without limitation, through the issuance of securities pursuant to our universal shelf registration statement on file with the SEC.

We may experience difficulty in raising necessary capital in view of the recent volatility in the capital markets and increases in the cost of finance. Increasingly stringent rating standards could make it more difficult for use to obtain financing. If we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our shareholders could be significantly diluted, and these newly issued securities may have rights, preferences or privileges senior to those of existing shareholders. The incurrence of indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations. We cannot provide any assurance that any additional financing we may need will be available on terms

favorable to us, or at all. If adequate funds are not available or are not available on acceptable terms, if and when needed, our ability to fund our operations, take advantage of unanticipated opportunities, respond to competitive pressures or otherwise execute our strategic plan would be significantly limited. In any such case, our business, operating results or financial condition could be materially adversely affected.

Litigation may harm our business or otherwise distract our management.

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

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

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

We are impacted by international affairs, which directly exposes us to the adverse effects of any foreign economic or governmental instability.

Because our investments are globally diversified, our business, financial condition, results of operations and cash flows may be adversely affected by:

- exposure to fluctuations in exchange rates;
- the imposition of governmental controls;
- the need to comply with a wide variety of non-U.S. and U.S. tax laws;
- political and economic instability;
- volatile interest rates;
- exchange controls which may limit our ability to withdraw money; and
- general economic conditions outside the United States.

Changes in any or all of these factors could result in reduced market values of our investments, loss of assets, additional expenses, reduced investment income, reductions in shareholders' equity due to foreign currency fluctuations. If we were to experience any of these negative effects, we may be required to reduce our global diversification.

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

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We lease approximately 6,354 square feet in La Jolla, California for our principal executive offices. Physicians leases approximately 1,892 square feet of office space in Columbus, Ohio for its headquarters. Citation leases approximately 1,530 square feet of office space for a claims office in Orange County, California. Vidler and Nevada Land lease approximately 6,859 square feet of office space in Carson City, Nevada. UCP leases a total of approximately 2,240 square feet of office space in San Jose, California and Fresno, California. We continually evaluate our current and future space capacity in relation to our business needs. We believe that our existing facilities are suitable and adequate to meet our current business requirements.

Vidler, Nevada Land and UCP have significant holdings of real estate and water assets in the southwestern United States. For a description of our real estate and water assets, see "Item 1-Operating Segments and Major Subsidiary Companies."

ITEM 3. LEGAL PROCEEDINGS

We are subject to various litigation arising in the ordinary course of our business. Our insurance companies are frequently a party in claims proceedings and actions regarding insurance coverage, all of which we consider routine and incidental to our business. Based upon information presently available, we are of the opinion that such litigation will not have a material adverse effect on our consolidated financial position, results of operations or cash flows.

Neither we nor our subsidiaries are parties to any potentially material pending legal proceedings other than the following.

Exegy Litigation:

HyperFeed Technologies, Inc. ("Hyperfeed"), our majority-owned subsidiary, was a provider of enterprise-wide ticker plant and transaction technology software and services enabling financial institutions to process and use high performance exchange data with Smart Order Routing and other applications. During 2006, PICO and HyperFeed negotiated a business combination with Exegy Incorporated ("Exegy"). On August 25, 2006, PICO, HyperFeed, and Exegy entered into a contribution agreement, pursuant to which the common stock of HyperFeed owned by PICO would have been contributed to Exegy in exchange for Exegy's issuing certain Exegy stock to PICO. However, in a letter dated November 7, 2006, Exegy informed PICO and HyperFeed that it was terminating the agreement.

On November 13, 2006 Exegy filed a lawsuit against PICO and HyperFeed in state court in Missouri seeking a declaratory judgment that Exegy's purported November 7, 2006 termination of the August 25, 2006 contribution agreement was valid. In the event that Exegy's November 7, 2006 letter is not determined to be a valid termination of the contribution agreement, Exegy seeks declaration that PICO and HyperFeed have materially breached the contribution agreement, for which Exegy seeks monetary damages and an injunction against further material breach. Finally, Exegy seeks a declaratory judgment that if its November 7, 2006 notice of termination was not valid, and that if (1) PICO and HyperFeed did materially breach the contribution agreement and (2) a continuing breach cannot be remedied or enjoined, then Exegy seeks a declaration that Exegy should be relieved of further performance under the contribution agreement. On December 15, 2006 the lawsuit was removed from Missouri state court to federal court. On February 2, 2007, this case was transferred to the United States Bankruptcy Court, District of Delaware.

On November 17, 2006 HyperFeed and PICO filed a lawsuit against Exegy in state court in Illinois. PICO and HyperFeed allege that Exegy, after the November 7, 2006 letter purporting to terminate the contribution agreement, used and continues to use HyperFeed's confidential and proprietary information in an unauthorized manner and without HyperFeed's consent. PICO and HyperFeed are also seeking a preliminary injunction enjoining Exegy from disclosing, using, or disseminating HyperFeed's confidential and proprietary information, and from continuing to interfere with HyperFeed's business relations. PICO and HyperFeed also seek monetary damages from Exegy. On January 18, 2007, this case was removed from Illinois state court to federal bankruptcy court in Illinois. On February 6, 2007 this case was transferred to the United States Bankruptcy Court, District of Delaware.

On July 11, 2007, the parties entered into mediation to attempt to resolve these two lawsuits. However, the mediation was unsuccessful and both cases have resumed as adversary proceedings in the United States Bankruptcy Court, District of Delaware.

Fish Springs Ranch, LLC:

In 2006, the Company, through Fish Springs Ranch LLC, a 51% owned subsidiary, began construction of a pipeline from Fish Springs Ranch in northern Nevada to the north valleys of Reno, Nevada. The final regulatory approval required for the pipeline project was a Record of Decision for a right of way, which was granted on May 31, 2006. On October 26, 2006, the Pyramid Lake Paiute Tribe of Indians (the "Tribe") filed suit against the Bureau of Land Management of the United States Department of the Interior ("BLM") and the United States Department of the Interior in the United States in the United States District Court for the District of Nevada claiming that the BLM had failed to fulfill its legal obligations to protect and conserve the trust resources of the Tribe and seeking various equitable remedies. The Tribe asserted that the exportation of 8,000 acre-feet of water per year from the properties owned by Fish Springs Ranch, LLC would negatively impact their water rights located in a basin within the boundaries of the Tribe reservation. Fish Springs Ranch, LLC was allowed to participate in this proceeding and was later allowed to intervene directly in the action.

On May 9, 2007, the Tribe initiated other legal action against the BLM and the Department of the Interior before the United States Court of Appeals for the Ninth Circuit to stop construction of the pipeline and the transportation of water from the properties owned by Fish Springs Ranch, LLC. Again, Fish Springs Ranch, LLC was allowed to participate in this proceeding and was later allowed to intervene directly in the action.

While we believed the claims were without merit, the Tribe's legal actions might have caused significant delays to the completion of the construction of the pipeline. To avoid future delays and additional costs of litigation, the parties reached a complete monetary settlement and signed a settlement agreement on May 30, 2007, that resolved all of the Tribe's claims. The settlement agreement is subject to ratification by the United States Congress, which we anticipate will occur during 2009. The settlement agreement required Fish Springs Ranch to take the following action with respect to the Tribe:

- pay $500,000 upon signing of agreement;
- transfer 6,214 acres of real estate that Fish Spring Ranch, LLC owns, with a fair value of $500,000;
- pay $3.1 million on January 8, 2008; and
- pay $3.6 million on the later of January 8, 2009 or the date the United States Congress ratifies the settlement agreement. Interest accrues at the London Inter-Bank Offered Rate, or LIBOR, from January 8, 2009, if the payment is made after that date.

There are 13,000 acre-feet per-year of permitted water rights at Fish Springs Ranch. The existing permit allows up to 8,000 acre-feet of water per year to be exported to support the development in the Reno area. The settlement agreement also provides that, in exchange for the Tribe agreeing to not oppose all permitting activities for the pumping and export of groundwater in excess of 8,000 acre-feet of water per year, Fish Springs will pay the Tribe

12% of the gross sales price for each acre-foot of additional water that Fish Springs sells in excess of 8,000 acre-feet per year, up to 13,000 acre- feet per year. Currently, we do not have regulatory approval to export any water in excess of 8,000 acre-feet per year from the Fish Springs Ranch, and it is uncertain whether we will obtain such regulatory approval in the future.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted during the fourth quarter of 2008 to a vote of our shareholders, through the solicitation of proxies or otherwise.

PART II

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

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

	2008		2007	
	High	Low	High	Low
First Quarter	$ 34.30	$ 29.47	$ 47.21	$ 34.10
Second Quarter	$ 44.45	$ 31.44	$ 48.29	$ 43.26
Third Quarter	$ 48.22	$ 35.91	$ 47.22	$ 40.21
Fourth Quarter	$ 35.52	$ 17.97	$ 43.44	$ 33.62

On February 26, 2009, the closing sale price of our common stock was $21.48, and there were approximately 562 holders of record.

We have not declared or paid any dividends in the last two years, and we do not expect to pay any dividends in the foreseeable future.

Securities Authorized for Issuance Under Equity Compensation Plans

The information required by Item 201(d) of Regulation S-K is provided under Item 12, Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters, "Securities Authorized for Issuance Under Equity Compensation Plans," which is incorporated herein by reference.

Company Stock Performance Graph

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

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

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total number of shares purchased	(b) Average Price Paid per Share	(c) Total Number of Shares (or Units) Purchased as Part of	(d) Maximum Number (or Approximate Dollar Value) of

			Publicly Announced Plans or Programs (1)	Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (1)
10/1/08 - 10/31/08	-	-		
11/1/08 - 11/30/08	-	-		
12/1/08 - 12/31/08	-	-		

(1) In October 2002, our Board of Directors authorized the repurchase of up to $10 million of PICO common stock. The stock purchases may be made from time to time at prevailing prices through open market or negotiated transactions, depending on market conditions, and will be funded from available cash. As of December 31, 2008, we have not repurchased any stock under this authorization.

ITEM 6. SELECTED FINANCIAL DATA

The following table presents our selected consolidated financial data. The information set forth below is not necessarily indicative of the results of future operations and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of this Form 10-K and the consolidated financial statements and the related notes thereto included elsewhere in this document.

	Year Ended December 31,				
	2008	2007	2006	2005	2004
OPERATING RESULTS	(In thousands, except share data)				
Revenues:					
Total investment income	$ 46,373	$ 19,788	$ 39,609	$ 15,917	$ 9,056
Sale of real estate and water assets (includes gain on sale of water storage of $8.7 million in 2008)	12,054	9,496	41,509	124,984	10,879
Other income	1,925	4,645	1,605	1,210	2,188
Total revenues	$ 60,352	$ 33,929	$ 82,723	$ 142,111	$ 22,123
Income (loss) from continuing operations	$ 28,631	$ (1,270)	$ 31,511	$ 22,267	$ (7,860)
Loss from discontinued operations, net			(2,268)	(6,065)	(2,698)
Net income (loss)	$ 28,631	$ (1,270)	$ 29,243	$ 16,202	$ (10,558)
PER COMMON SHARE BASIC AND DILUTED:					
Net income (loss) from continuing operations	$ 1.52	$ (0.07)	$ 2.10	$ 1.72	$ (0.64)
Loss from discontinued operations			(0.15)	(0.47)	(0.21)
Net income (loss)	$ 1.52	$ (0.07)	$ 1.95	$ 1.25	$ (0.85)
Weighted Average Shares Outstanding – basic	18,835,002	18,321,449	14,994,947	12,959,029	12,368,068
Weighted Average Shares Outstanding - diluted	18,861,853	18,321,449	15,025,341	12,959,029	12,368,068

	As of December 31,				
	2008	2007	2006	2005	2004
FINANCIAL CONDITION	(In thousands, except per share data)				
Total assets	$ 592,634	$ 676,342	$ 549,043	$ 441,830	$ 354,658
Total asset of discontinued operations				$ 4,616	$ 3,974
Unpaid losses and loss adjustment expenses	$ 27,773	$ 32,376	$ 41,083	$ 46,647	$ 55,944
Borrowings	$ 42,382	$ 18,878	$ 12,721	$ 11,835	$ 17,556
				$ 4,282	$ 3,121

Liabilities of discontinued operations										
Total liabilities and minority interest	$	114,888	$	150,492	$	143,816	$	140,955	$	114,729
Shareholders' equity	$	477,746	$	525,851	$	405,227	$	300,875	$	239,929
Book value per share (1)	$	25.36	$	27.92	$	25.52	$	22.67	$	19.40

(1) Book value per share is computed by dividing shareholders' equity by the net of total shares issued less shares held as treasury shares.

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

INTRODUCTION

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the Consolidated Financial Statements and the accompanying Notes presented later in this Annual Report on Form 10-K.

The consolidated financial statements and other portions of this Annual Report on Form 10-K for the fiscal year ended December 31, 2008 , including Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," reflect the effects of presenting HyperFeed Technologies, Inc. as a discontinued operation. See Note 2 of Notes to Consolidated Financial Statements, "Discontinued Operations".

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

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

COMPANY SUMMARY, RECENT DEVELOPMENTS, AND FUTURE OUTLOOK

WATER RESOURCE AND WATER STORAGE OPERATIONS

BACKGROUND

The long-term future demand for our water assets is driven by population growth relative to currently available water supplies in the southwestern United States.

The population growth rate in the southwest has consistently been higher than the national rate for the past several years. According to the U.S. Census Bureau, in the eight-and-one-quarter year period from April 1, 2000 to July 1, 2008, the population of Nevada grew by a total of 30.1% (601,910 people), Arizona grew by 26.7% (1,369,573 people), Colorado grew by 14.8% (637,441 people), Idaho grew by 17.8% (229,861 people), and California grew by 8.5% (2,885,016 people). This compares to a total national growth rate of 8% (22,635,122 people) over the same period.

The current economic recession and housing slow-down in the U.S. has decreased the rate of growth in the Southwest in 2007 and 2008 from earlier years, but the Southwest's population growth is still well in excess of the national growth rate. According to the Census Bureau's annual estimate of state population changes for the years ended July 1, 2008 and 2007, Nevada's annual growth rate was 1.8% (2007: 2.9%), Arizona 2.3% (2007: 2.8%), Colorado 2% (2007: 2%), Idaho 1.8% (2007: 2.4%) and California 1% (2007: 0.8%). These statistics compare to the national total growth rate of 0.9% (2007: 1%).

In 2008, Nevada, the nation's fastest-growing state for approximately the last 20 years, published a study of its estimated population projection from 2008 to 2028. The Nevada State Demographer's Office estimates that Nevada's population will grow by approximately 49% (1,334,231people) in that 20 year period. Of that total, over 1 million people are expected to move to Clark County, which includes metropolitan Las Vegas, and over 200,000 people to western Nevada, which includes Carson City, Washoe County (where Reno is situated), and Lyon County. These population estimates have been revised downwards from previous growth estimates by the Nevada State Demographer, and take into account current economic conditions and factors.

Currently, a significant portion of the Southwest's water supplies come from the Colorado River. The balance is provided by other surface rights, such as rivers and lakes, groundwater (that is, water pumped from underground aquifers), and water previously stored in reservoirs or aquifers. A prolonged drought (possibly in part due to increasing temperatures from climate change which can lead to a decreased snow pack runoff and therefore decreased surface water) and rapid population growth in the past few years have exacerbated the region's general water scarcity. In turn, this leads to an increased likelihood of conflict as additional stress is placed on the arid Southwest's water resources.

In August 2005, the U.S. Department of the Interior published a study titled "Water 2025: Preventing Crises and Conflict in the West". The study included a map of the western and southwestern states and highlighted the potential water supply crises by 2025. Various areas were designated as having moderate, substantial, or highly likely water conflict potential. (that is, areas where existing supplies are not adequate to meet water demands for people, agricultural use, and for the environment). Areas identified as having a highly likely or substantial conflict potential included western Nevada, southern Nevada, and the metropolitan Phoenix to Tucson region. Starting over a decade ago, we have concentrated our acquisition and development efforts on water assets that will serve these markets.

The development of our water assets is a long-term process. It requires significant capital and expertise. A complete project -- from acquisition, development, permitting and sale -- may take as long as ten years. Typically, in the regions in which we operate, new housing, commercial and industrial developments require an assured water supply (that is, access to water supplies for at least one hundred years) before a permit for the development will be issued. The current economic recession with the corresponding slow-down in housing throughout the U.S. -- including the Southwest -- has impacted the timing of sales of our water assets. However, we believe that the long-term demand for our assets, and their economic value, are substantially underpinned by the region's continued population growth and the increasing scarcity of sustainable water supplies to support that growth. The supply and demand factors which characterize water resources in the southwest also present us with a continuing business opportunity to provide sustainable water resource solutions for economic development and communities throughout the region.

The following is a description and summary of our water resource and water storage assets at December 31, 2008.

WATER RESOURCES

Arizona

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

groundwater to be made available as assured water supply to cities and communities in Arizona through agreements with the Central Arizona Groundwater Replenishment District.

At December 31, 2008, Vidler owned approximately 3,840 acre-feet of groundwater and the related land in the Harquahala Valley. The Harquahala Valley is located in La Paz County and Maricopa County, approximately 75 miles northwest of metropolitan Phoenix, Arizona. According to U.S. Census Bureau data, the population of Maricopa County increased 22.6% from 2000 to 2006, with the addition of more than 110,000 people per year. Vidler anticipates that as the boundaries of the greater Phoenix metropolitan area continue to push out, this is likely to lead to demand for our land as well as our water to support growth within the Harquahala Valley itself. The remaining water can also be transferred for municipal use outside of the Harquahala Valley.

In addition, the area in and around the Harquahala Valley appears to be a desirable area to site solar power-generating plants, due to the high solarity in the region and its proximity to energy transmission lines. The water assets owned by Vidler in this region, including our water storage credits - (see "Water Storage: Vidler Arizona Recharge Facility" below) -could potentially provide a water source for any solar plants that might be constructed in this area.

Nevada

Vidler has acquired land and water rights in Nevada through the purchase of ranch properties (appropriating existing supplies of water), filing applications for new water rights (appropriating new supplies of water), and entering into teaming arrangements with parties owning water rights, which they wish to develop.

In 19 of the past 21 years, Nevada was the state which experienced the most rapid population growth and new home construction in the United States. As noted above, the rate of population growth has slowed in the last couple of years, but Nevada's own population estimates forecast that the state will grow by over 1.3 million people in the next 20 years. The population is concentrated in southern Nevada, which includes the Las Vegas metropolitan area.

1. Lincoln County

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

Under the Lincoln County Land Act, more than 13,300 acres of federal land in southern Lincoln County near the City of Mesquite was offered for sale in February 2005. According to press reports, the eight parcels offered were sold to various developers for approximately $47.5 million. The land was sold without environmental approvals, water, and city services, which will be required before development can proceed. Additional water supply will be required in Lincoln County if this land is to be developed.

Tule Desert Groundwater Basin

In 1998, Lincoln/Vidler filed for 14,000 acre-feet of water rights for industrial use from the Tule Desert Groundwater Basin. In November 2002, the Nevada State Engineer granted and permitted an application for 2,100 acre-feet of water rights -- which Lincoln/Vidler subsequently sold to a developer -- and ruled that an additional 7,244 acre-feet could be granted pending additional studies by Lincoln/Vidler.

In 2005 Lincoln/Vidler entered into an agreement with a developer for Lincoln County Land Act property. The developer has up to 10 years to purchase up to 7,240 acre-feet of water, as and when supplies are permitted from the applications. During 2006, 2007 and 2008, Vidler conducted significant data collection and successfully drilled a series of production and monitoring wells to provide evidence to support the applications. We expect the State Engineer to rule on the initial permitting of water rights from these applications in the near future.

By agreement, the initial price of $7,500 per acre-foot increases at 10% each year. At December 31, 2008 the current price is $9,983 per acre-foot. In addition, the developer pays a commitment fee equal to 10% of the outstanding balance of unpurchased water each year, beginning August 9, 2006, which will be applied to the purchase of water.

The Lincoln County teaming arrangement is an example of a transaction where Vidler can partner with an entity, in this case a governmental entity, to provide the necessary capital, entrepreneurial skills, and technical expertise to commercially develop water assets, thereby providing a significant economic benefit to the partner as well as creating future job growth and tax base for the County.

Coyote Springs

Coyote Springs (www.coyotesprings.com) is a planned mixed-use development to be located approximately 40 miles north of Las Vegas, at the junction of U.S. Highway 93 and State Highway 168, approximately two-thirds of which is within Lincoln County, Nevada, and the balance is in Clark County, Nevada. Coyote Springs is the largest privately-held property for development in southern Nevada. The developer, Coyote Springs Investment, LLC (“CSIL”), has received entitlements for approximately 50,000 residential units, 6 golf courses, and 1,200 acres of retail and commercial development on 13,100 acres in Clark County. CSIL expects to receive additional entitlements for its 29,800 acres in Lincoln County. Based on the entitlements obtained so far, it is estimated that the community will require approximately 35,000 acre-feet of permanent water. Additional water will be required as further entitlements are obtained. It is expected that full absorption of the residential units will take 25 years or more.

Pardee Homes has agreed to be the master residential developer on the first phase of the development. The first golf course is now open, and construction of other parts of the project is scheduled to begin in 2009 or 2010.

In 2006, Lincoln/Vidler sold approximately 570 acre-feet of water rights at Meadow Valley, located in Lincoln and Clark counties, to CSIL for approximately $3.4 million, or $6,050 per acre-foot. Vidler's 50% share of the sales price was $1.7 million.

We anticipate that Lincoln County/Vidler could provide the majority of the water required for the Coyote Springs project from the jointly filed applications for water rights in various basins in Lincoln County.

In 2005, Lincoln/Vidler agreed to sell additional water to CSIL, as and when supplies are permitted from existing applications in Kane Springs, Nevada. The initial purchase price for the water was $6,050 per acre-foot for the first year of the agreement. The price of unpurchased water will increase 10% each year on the anniversary of the agreement, and is currently $8,053 per acre-foot.

A hearing was completed in 2006 on a filing for water rights from Kane Springs, and in January 2007 Lincoln/Vidler was awarded 1,000 acre-feet of permitted water rights. The Nevada State Engineer has requested additional data before making a determination on the balance of the applications from this groundwater basin, where Lincoln/Vidler maintains priority applications for approximately 17,375 acre-feet of water. The actual permits received may be for a lesser quantity, which cannot be accurately predicted.

In the fourth quarter of 2008, Lincoln/Vidler obtained the right-of-way over federally managed lands, on behalf of CSIL, relating to a pipeline to convey the water rights from Kane Springs. As a result of obtaining the right-of-way, Lincoln/Vidler expects to close on the sale of the permitted water rights to CSIL in 2009.

Lincoln County Power Plant Project

In 2005, Vidler entered into an option agreement to sell its interest in a project to construct a new electricity-generating plant in southern Lincoln County, for $4.8 million. It is anticipated that the new plant will supply electricity to the new communities to be developed near Mesquite, and surrounding areas. During 2008, we agreed to extend the option period until December 31, 2009 in exchange for further option payments totaling $300,000. The purchaser has made all of the scheduled option payments to date.

This project is 100% owned by Vidler, and does not form part of the Lincoln/Vidler teaming arrangement.

2. Fish Springs Ranch

Vidler has a 51% membership interest in, and is the managing partner of, Fish Springs Ranch, LLC ("Fish Springs") which owns the Fish Springs Ranch and other properties totaling approximately 8,600 acres in Honey Lake Valley in Washoe County, approximately 40 miles north of Reno, Nevada. In addition, Fish Springs owns 12,987 acre-feet of permitted water rights related to the properties of which 7,987 acre-feet are transferable to the Reno/Sparks area and designated as water credits. Currently, there is no regulatory approval to export the additional volume of 5,000 acre-feet per year of water from Fish Springs Ranch to support development in northern Reno, and it is uncertain whether such regulatory approval will be granted in the future.

The Fish Springs Ranch water rights have been identified as the most economical, sustainable, and proven new source of supply to support new growth in the north valley communities of Washoe County. Residential property developers have publicly stated that Reno is constrained for land and that there are no existing water supplies to support further development in the north valleys of Reno. If additional water can be supplied to Reno and the surrounding areas, this will allow the development of additional land in accordance with the community's master plan. According to the

Nevada State Demographer, from 2000 to 2006, the population of Washoe County (including Reno/Sparks) increased by 19.6% to approximately 409,000 people. In addition, despite the current housing downturn, we continue to expect that, in the long term, new home construction in the Reno area will be robust as the Nevada State Demographer forecasts that the population of Washoe County will increase by over 150,000 people in the next 20 years.

During 2006, we began construction of a pipeline and an electrical substation to provide the power which will be required to pump the water to the north valleys. Construction of the pipeline to convey the water from Fish Springs Ranch to a central storage tank in northern Reno was completed during 2008. As of December 31, 2008, $100.9 million of direct pipeline costs and other related expenditure, including interest, plus the cost of our water credits, have been capitalized within the Real Estate and Water Assets section of our balance sheet. As water is sold by Fish Springs and revenues are generated, the asset will be expensed as a cost of sale in our consolidated statement of operations in the period in which the associated revenues are recorded.

In July 2008, the pipeline and associated infrastructure was dedicated to Washoe County, Nevada under the terms of an Infrastructure Dedication Agreement (“IDA”) between Washoe County and Fish Springs. Under the provisions of the IDA, Washoe County is responsible for the operation and maintenance of the pipeline and Fish Springs has the exclusive right to the capacity of the pipeline to allow for the sale of water for future economic development in the north valley area of Reno. Water from Fish Springs that has regulatory approval to be imported to the North Valleys of Reno (approximately 8,000 acre-feet) is also available for sale under a Water Banking Agreement entered into between Fish Springs and Washoe County. Under the Water Banking Agreement, Washoe County holds transferred and dedicated water rights in trust on behalf of Fish Springs, which will then be able to transfer and assign water rights credits. Fish Springs can sell the water credits to developers, who must then dedicate the water to the local water utility for service.

Without changing the potential revenues to Fish Springs, the IDA and Water Banking Agreement allow Washoe County to perform its role as a water utility by delivering and maintaining water service to new developments. The agreements enable Fish Springs to complete its water development project by selling water credits to developers, who can then obtain will-serve commitments from Washoe County.

Since the dedication of the pipeline in July 2008, and, as a result, the Fish Springs water becoming available for sale, we have sold 12.8 water credits during 2008 for sales proceeds of approximately $577,000. (One water credit is equivalent to a water right of one acre-foot volume of water per annum in perpetuity). We originally had sales contracts for 119 water credits once the water was available for sale. However, given the economic climate in general and the slow-down in development activity in the north valleys of Reno in particular, we agreed to restructure the majority of these sales contracts. The restructuring allowed the purchaser to limit their acquisition of water credits, at a minimum price of $45,000 per water credit, from the funds initially deposited with Vidler as a down-payment under the original sales contract.

We believe the Fish Springs water credits represent the only source of new water supplies that will be available to developers in order for them to obtain their requisite permits as and when economic activity in and around the Reno area picks up again.

In accordance with the Fish Springs partnership agreement, our 49% partner’s proportionate share of all costs related to the pipeline project, including a financing cost of the London Inter-Bank Offered Rate (“LIBOR”) plus 450 basis points on Vidler’s funding of the pipeline related expenditures to the Fish Springs partnership, will be recouped from the revenues generated from the sale of Fish Springs water resources.

3. Carson City and Lyon County, Western Nevada

The capital city of Nevada, Carson City, and Lyon County are located in the western part of the state, close to Lake Tahoe and the border with California. There are currently few existing water sources to support future growth and development in the Dayton corridor area, which is located in this region.

In 2007, Vidler entered into development and improvement agreements with both Carson City and Lyon County to provide water resources for planned future growth in Lyon County and to connect the municipal water systems of Carson City and Lyon County.

The agreements allow for Carson River water rights owned or controlled by Vidler to be conveyed for use in Lyon County. The agreements also allow Vidler to bank water with Lyon County and authorize Vidler to build the infrastructure to upgrade and inter-connect the Carson City and Lyon County water systems.

As a result of the Carson-Lyon Intertie project, Carson City is expected to obtain greater stability in its peak day water supply demands. In addition, the ranches from which the water rights are being utilized will, in part, be acquired by Carson City for use as precious riverfront open space for the community. It is anticipated that the Lyon County utility will have at least 4,000 acre-feet of water available for development projects in the Dayton corridor for which there is currently limited supplies of water, as well as new water infrastructure to improve Lyon County's water management program. The connection of the two water systems will also allow Carson City and Lyon County greater stability and flexibility with their water supplies in the event of emergencies such as wildfires or infrastructure failures.

Estimated total capital costs for the proposed new infrastructure are expected to be approximately $23 million over a four to six year period. The infrastructure will be sufficient to deliver an expected volume of water of at least 4,000 acre-feet per year. Expenditures on this infrastructure project commenced during 2008.

As of December 31, 2008, Vidler has acquired and optioned water rights consisting of both Carson River agriculture designated water rights and certain municipal and industrial designated water rights. On completion of our re-designation development process of the water rights to municipal and industrial use, we anticipate at least 4,000 acre-feet to be available for municipal use in Lyon County, principally by means of delivery through the proposed new infrastructure being constructed by Vidler.

4. Sandy Valley, Nevada

In June 2002, the Nevada State Engineer awarded Vidler 415 acre-feet of water rights near Sandy Valley, Nevada. The award of the permit for the 415 acre-feet of water rights was appealed in the Nevada Supreme Court by certain residents of Sandy Valley. The Supreme Court denied Vidler the originally permitted rights due to a procedural error in certifying the record on appeal. Vidler appealed this decision in the Supreme Court but was not successful in keeping the original rights. However, Vidler has water rights applications for 4,000 acre-feet for groundwater appropriation in Sandy Valley and is preparing these applications to go through the permitting process to obtain perfected water rights.

5. Muddy River, Nevada

The Muddy River is a perennial river fed by the Muddy Springs in southern Nevada, originating in Nevada and flowing into Lake Mead. Currently, Muddy River water rights are utilized for agriculture and electricity generation; however, in the future, we anticipate that Muddy River water rights may be utilized to support development in southern Nevada. The Southern Nevada Water Authority 2006 water resource plan identifies Muddy River water rights as a water resource to support future growth in Clark County, Nevada.

At December 31, 2008, Vidler owned approximately 267 acre-feet of Muddy River water rights.

Colorado

Vidler is completing the process of monetizing its water rights in Colorado, through sale or lease:

- in 2006, Vidler closed on the sale of various water rights and related assets to the City of Golden, Colorado for $1.2 million;
- in 2007, Vidler closed on the sale of approximately 0.6 acre-feet of water rights for $45,000; and
- in 2008, Vidler closed on the sale of approximately 3.9 acre-feet of water rights for $302,000.

Idaho

In 2007, Vidler closed on the purchase of two farm properties in Idaho totaling approximately 1,886 acres of land, together with the related 7,044 acre-feet of agricultural water rights. The properties are currently being farmed, and grow apples, silage corn, and alfalfa.

These purchases are Vidler's first acquisition of real estate and water resources in Idaho. The properties are located near the areas of Boise, Nampa, and Caldwell, where future development could be constrained by the lack of developable land with water to support development.

We believe that the properties are well suited to residential planned unit development, although we are also considering other alternatives for both the land and the water resources acquired.

WATER STORAGE

1. Vidler Arizona Recharge Facility

During 2000, Vidler completed the second stage of construction at its facility to "bank", or store, water underground in the Harquahala Valley, and received the necessary permits to operate a full-scale water "recharge" facility. "Recharge" is the process of placing water into storage underground. Vidler has the permitted right to recharge 100,000 acre-feet of water per year at the Vidler Arizona Recharge Facility, and anticipates being able to store in excess of 1 million acre-feet of water in the aquifer underlying much of the valley. When needed, the water will be "recovered," or removed from storage, by ground water wells.

The Vidler Arizona Recharge Facility is a privately owned water storage facility for the Colorado River system, which is a primary source of water for the Lower Basin States of Arizona, California, and Nevada. The water storage facility is strategically located adjacent to the Central Arizona Project ("CAP") aqueduct, a conveyance canal running from Lake Havasu to Phoenix and Tucson. The recharged water comes from surplus flows of CAP water. Proximity to the CAP provides a competitive advantage as it minimizes the cost of water conveyance.

Vidler is able to provide storage for users located both within Arizona and out-of-state. Potential users include industrial companies, power-generating companies, developers, and local governmental political subdivisions in Arizona, and out-of-state users such as municipalities and water agencies in Nevada and California. The Arizona Water Banking Authority ("AWBA") has the responsibility for intrastate and interstate storage of water for governmental entities.

Vidler's recharge facility is one of the few permitted and completed private water storage facilities in Arizona. Given that Arizona is the only southwestern state with surplus flows of Colorado River water available for storage, we believe that the Vidler site is a private water storage facility where it is practical to "bank," or store, water for users in other states, which is known as "interstate water banking". Having a permitted water storage facility also allows Vidler to acquire, and store, surplus water for re-sale in future years.

Vidler has not yet stored water for customers at the recharge facility, and has not as yet generated any revenue from the facility. We believe that the best economic return on the facility will come from storing water in surplus years for sale in dry years. Vidler has been recharging water for its own account since 1998, when the pilot plant was constructed. At the end of 2008, Vidler had "net recharge credits" of approximately 173,667 acre-feet of water in storage at the facility, and has ordered a further 48,700 acre-feet for recharge in 2009. Vidler purchased the water from the CAP, and intends to resell this recharged water at an appropriate time.

Vidler anticipates being able to recharge at least 35,000 acre-feet of water per year at the facility, and to store in excess of 1 million acre-feet of water in the aquifer. Vidler's estimate of the aquifer's storage volume is primarily based on a hydrological report prepared by an independent engineering firm for the Central Arizona Water Conservation District in 1990, which concluded that there is storage capacity of 3.7 million acre-feet.

2. Semitropic, California

Vidler originally purchased an 18.5% right to participate in the Semitropic Water Banking and Exchange Program, which operates a 1 million acre-foot water storage facility at Semitropic, near the California Aqueduct, northwest of Bakersfield, California.

In July 2008, Vidler completed the sale of its remaining interest of 30,000 acre-feet of storage capacity at the Semitropic Water Banking and Exchange Program in a transaction with the San Diego County Water Authority. The sale generated cash proceeds of $11.7 million and we recorded a net gain, as revenue, of $8.7 million in 2008. We still retain approximately 10,000 acre-feet of water stored in the facility and we are actively pursuing the sale of this water.

Other Projects

We continue to investigate and evaluate water and land opportunities in the southwestern United States, which meet our risk/reward and value criteria, and, in particular, assets which have the potential to add value to our existing assets. We routinely evaluate the purchase of further water-righted properties or other water resources in the southwest and western United States, particularly Nevada, Arizona, Colorado, New Mexico and Idaho. We also continue to be approached by parties who are interested in obtaining a water supply, or discussing joint ventures to commercially develop water assets and/or develop water storage facilities in Arizona, Nevada, and other southwestern states.

REAL ESTATE OPERATIONS

The majority of the Real Estate Operations segment's revenues come from the sale of Nevada Land's property in northern Nevada. In addition, various types of recurring revenue are generated from use of the Nevada Land's properties, including leasing, easements, and mineral royalties. Nevada Land also generates interest revenue from real estate sales contracts where Nevada Land has provided partial financing, and from temporary investment of sale proceeds.

Nevada Land recognizes the sale of real estate when a transaction closes. On closing, the entire sales price is recorded as revenue, and the associated cost basis is reported within cost of real estate sold. Since typically the date of closing determines the accounting period in which the revenue and cost of real estate are recorded, Nevada Land's reported results fluctuate from period to period, depending on the dates when transactions close. Consequently, results for any one year are not necessarily indicative of likely results in future years.

In 2005 and 2006, sales of real estate were significantly higher than in preceding years and the market for many types of real estate in Nevada was buoyant. We believe that higher prices for real estate in and around municipalities increased the demand for, and in some locations the price of, property 50 miles or more from municipalities, including some parcels of real estate we own.

The current slow-down in U.S. real estate markets has affected Nevada Land's 2008 and 2007 results of operations, when compared to 2006. In 2008 and 2007, the volume of acreage sold declined by 82% and 52% respectively from 2006, and the revenues generated in 2008 and 2007 declined by approximately 76% and 43% respectively from 2006 levels. However, it can take a year or more to complete a real estate sale transaction, and as such the timing of real estate sales is unpredictable. Historically the level of real estate sales at Nevada Land has fluctuated from year to year.

During 2008, UCP's operations were focused on acquiring finished and entitled residential lots in and around the Fresno Metropolitan Area (in central California) and completion of the entitlements of UCP's partially-entitled projects.

Fresno County is the tenth largest county in California and has a population of over 900,000. The county's population is expected to grow to approximately 1.2 million by 2020. Fresno County is also the leading county in the United States for agriculture production, with a gross crop value exceeding $5.3 billion. The employment base in Fresno is approximately 370,000 spread across a diversified set of industries: the largest of which are government, trade transportation and utilities, agriculture, and education and health services. As of November 2008, the median price of a home in Fresno County was $180,750 and the affordability index (that is, a measure of the financial ability of U.S. families to buy a house based on the median household income) for first time homebuyers was 65%. In terms of current inventories, there is approximately seven months of housing inventory and existing home sales pace has generally been greater than the number of homes coming on the market – a large percentage of which are bank-owned properties.

We believe that the real estate development market for detached single family homes in Fresno is attractive in the long term due to the high affordability ratio, the favorable market demographics (population growth and diverse employment base) and fundamental supply and demand forces arising from the existing balance of inventories of standing homes & lots and the demand for homes. Further, we believe that certain of these same fundamentals are present in other markets in California.

INSURANCE OPERATIONS IN "RUN OFF"

This segment consists of Physicians Insurance Company of Ohio and Citation Insurance Company, whose operations are in "run off", which means that the companies are handling and resolving claims on expired policies, but not writing any new business. Typically, most of the revenues of an insurance company in "run off" come from investment income (that is, interest from fixed-income securities and dividends from stocks) earned on funds held as part of their insurance business. In addition, gains or losses are realized from the sale or impairment of investments.

In broad terms, our insurance companies hold cash and fixed-income securities corresponding to their loss reserves and state capital & deposit requirements, and the remainder of the portfolio is invested in small-capitalization value stocks in the U.S. and selected foreign markets. At December 31, 2008, Physicians and Citation held cash of $3.3 million, fixed-income securities with a market value of $14 million, and stocks with a market value of $111.2 million.

We hold bonds issued by the U.S. Treasury and government-sponsored enterprises (namely Freddie Mac, FNMA, FHLB, and PEFCO) and State of California general obligations municipal bonds only to the extent required for capital under state insurance codes, or as required for deposits or collateral with state regulators. Otherwise, the bond portfolios primarily consist of investment-grade corporate issues, with 10 or less years to maturity.

At December 31, 2008, the insurance company bond portfolios consisted of:

Issuer	Fair Value December 31, 2008	Percentage of Total Fair Value
U.S. Treasury	$ 1,222,000	9%
Government-sponsored enterprises	7,869,000	56%
State of California general obligations	2,128,000	15%
Investment-grade corporate bonds	2,356,000	17%
Non-investment-grade corporate bond	387,000	3%
	$ 13,962,000	100%

At December 31, 2008, the aggregate market value of Physicians' and Citation's bond portfolios ($14 million) was approximately 97% of amortized cost.

To protect the capital value of our bond portfolio from a decline in value that could be brought on by higher interest rates in the medium term, our bond holdings are concentrated in issues maturing in five years or less. At December 31, 2008, the duration of Citation's bond portfolio was 2.6 years, and the duration of Physicians' bond portfolio was 2.9 years. The duration of a bond portfolio measures the amount of time it will take for the cash flows from scheduled interest payments and the maturity of bonds to equal the current value of the portfolio. Duration indicates the sensitivity of the market value of a bond portfolio to changes in interest rates. If interest rates increase, the market value of existing bonds will decline. During periods when market interest rates decline, the market value of existing bonds increases. Typically, the longer the duration, the greater the sensitivity of the value of the bond portfolio to changes in interest rates. Duration of less than five years is generally regarded as medium term, and less than three years is generally regarded as short term.

Our insurance companies hold their liquid funds in a government obligations money market fund. We do not own any preferred stock, mortgage-backed or asset-backed securities, collateralized debt obligations, auction-rate securities, or commercial paper, and we do not have any exposure to credit default swaps.

The equities component of the insurance company portfolios is concentrated in a limited number of asset-rich small-capitalization value stocks. These positions have been accumulated at a significant discount to our estimate of the private market value of each company's underlying "hard" assets (that is, land and other tangible assets). At December 31, 2008, holdings in the U.S. comprised approximately 44% of the stock portfolio; Switzerland, 41%; and New Zealand & Australia, 15%.

During the fourth quarter of 2006, Physicians purchased PICO European Holdings, LLC ("PICO European") from PICO Holdings, Inc. The PICO group began to invest in European companies in 1996. In particular, we have been accumulating shares in a number of undervalued asset-rich companies in Switzerland. PICO European currently has holdings in 20 Swiss companies. Typically, we believe that these companies will benefit from pan-European and domestic consolidation. In some cases, we believe that conversion to international standards of accounting will make the underlying value of the companies more visible. In addition, many Swiss companies are partially-owned by "cantons" (that is, the 26 states comprising Switzerland) and local governments, and in some cases this ownership structure may not survive future business challenges. At December 31, 2008, the market value (and carrying value) of the stocks in the PICO European Holdings portfolio was $45.9 million.

On December 31, 2008, PICO European owned 24,400 shares of Accu Holding AG, which represents a voting ownership interest of approximately 24.4%. We do not have the ability to exercise significant influence over Accu Holding AG's activities, so the investment is carried at market value under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities".

The fixed-income securities and common stocks in the insurance companies' investment portfolios generated total returns of approximately 13% in 2006, 12% in 2007, and -41% in 2008. The decline in 2008 should be viewed in light of the performance of the principal stock markets we invest in. Over 2008, the DJ Wilshire 5,000 Index (U.S.) declined by 38.7% and, expressed in U.S. dollars, the SMI Index (Switzerland) declined 28.7%, the NZSE 50 Gross Index (New Zealand) declined 48.5%, and the S&P/ASX 200 Index (Australia) declined 49.7%.

The equity portfolios of our insurance companies are managed on an absolute value basis, using an approach which investors refer to as "Graham and Dodd". Stocks are selected based on the investment fundamentals of the underlying company, that is our assessment of what the enterprise is worth, based on the private market value of its assets, earnings, and cash flow. Typically we buy stocks at a significant discount to our assessment of the value of the company's "hard assets", such as land, natural resources, or cash. We also own shares in operating companies, which are undervalued on the basis of their earnings and cash flow, and whose businesses have special or unique characteristics. We invest with a patient, long term orientation, with the intention of holding a stock until fair and full value is realized. The gap between market price and intrinsic value may persist for several years, and we typically hold stocks for 3 to 5 years, or longer. In many cases, we only sell a stock when the company is acquired by a third party. During periods of weakness in the broad stock market, such as 2008, the gap between market price and intrinsic value may widen, but we only sell the stock if it has reached our target, its fundamentals have deteriorated, or other changes limit upside potential on a risk-adjusted basis.

Over time, we expect the stocks in our insurance company portfolios to generate significantly higher returns than if we were to solely invest in fixed-income securities and cash and cash equivalents. We assumed direct management of our insurance company portfolios in 2000. The subsequent eight years, which include the substantial market decline of 2008, have not been favorable for investors in the broad U.S. stock market, with the DJ Wilshire 5,000 Index declining by approximately 25%. Over the same eight year period, the insurance companies' investment portfolios generated a positive total return of approximately 44%, with the equities portion generating a total return of approximately 109%. Excluding 2008, the investment portfolios generated a total return of approximately 75%, with

the equities portion generating a total return of approximately 244%

During the “run off” process, the investment assets and investment income of a “run off” insurance company are expected to decline, as fixed-income investments mature or are sold to provide the funds to pay down the company’s claims reserves. However, from 2003 until 2007, the investment assets of the Insurance Operations in “Run Off” segment actually increased, as appreciation in stocks owned more than offset the maturity or sale of fixed-income securities owned by Physicians and Citation to pay claims.

The financial results of insurance companies in “run off” can be volatile if there is favorable or unfavorable development in their loss reserves. Changes in assumptions about future claim trends, and the cost of handling claims, can lead to significant increases and decreases in our loss reserves. When loss reserves are reduced, this is referred to as favorable development. If loss reserves are increased, the development is referred to as adverse or unfavorable.

Physicians Insurance Company of Ohio

Physicians wrote its last policy in 1995; however, claims can be filed until 2017 related to events which allegedly occurred during the period when Physicians provided coverage.

By its nature, medical professional liability insurance involves a relatively small number (frequency) of relatively large (severity) claims. We have purchased excess of loss reinsurance to limit our potential losses. The amount of risk we have retained on each claim varies depending on the accident year but, in general, we are liable for the first $1 million to $2 million per claim.

Due to the long “tail” (that is, the period of time between the occurrence of the alleged event giving rise to the claim, and the claim being reported to us) in the medical professional liability insurance business, it is difficult to accurately quantify future claims liabilities and establish appropriate loss reserves. Our loss reserves are reviewed by management every quarter and are assessed in the fourth quarter of each year, based on independent actuarial analysis of past, current, and projected claims trends in the 12 months ended September 30 of each year.

At December 31, 2008, our medical professional liability reserves totaled $3.8 million, net of reinsurance (that is, claims reserves which have been transferred to the reinsurer), compared to $6.5 million net of reinsurance at December 31, 2007, and $9.4 million net of reinsurance at December 31, 2006.

PHYSICIANS INSURANCE COMPANY OF OHIO -- LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

	December 31,		
	2008	2007	2006
Direct reserves	$ 3,834,000	$ 6,603,000	