

PICO HOLDINGS INC /NEW

Form 10-Q

November 02, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

✓ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2016

OR

“ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 033-36383

PICO HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

California

94-2723335

(State or other jurisdiction of incorporation) (IRS Employer Identification No.)

7979 Ivanhoe Avenue, Suite 300 La Jolla, California 92037

(Address of principal executive offices, including zip code)

(858) 456-6022

(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

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

On October 28, 2016, the registrant had 23,069,381 shares of common stock, \$0.001 par value per share outstanding.

PICO Holdings, Inc.

Form 10-Q
For the Nine Months Ended September 30, 2016

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Signatures

Part I: Financial Information

Item 1: Condensed Consolidated Financial Statements (Unaudited)

PICO Holdings, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets - Unaudited

(In thousands, except par value)

| | September 30, 2016 | December 31, 2015 |
|---|-----------------------|----------------------|
| Assets | | |
| Cash and cash equivalents | \$ 37,953 | \$ 56,462 |
| Investments (\$24,870 and \$22,590 measured at fair value at September 30, 2016 and December 31, 2015, respectively) | 28,352 | 26,072 |
| Real estate and tangible water assets, net | 439,401 | 424,235 |
| Intangible assets, net | 126,919 | 126,533 |
| Other assets | 16,996 | 19,990 |
| Assets held-for-sale | 10,900 | 8,793 |
| Total assets | \$ 660,521 | \$ 662,085 |
| Liabilities and equity | | |
| Debt | | |
| Accounts payable and accrued expenses | 36,553 | 34,458 |
| Deferred compensation | 26,744 | 25,493 |
| Other liabilities | 13,193 | 11,556 |
| Liabilities held-for-sale | 903 | 608 |
| Total liabilities | 235,178 | 228,081 |
| Commitments and contingencies | | |
| Common stock, \$0.001 par value; authorized 100,000 shares, 23,125 issued and 23,070 outstanding at September 30, 2016, and 23,116 issued and 23,038 outstanding at December 31, 2015 | 23 | 23 |
| Additional paid-in capital | 493,744 | 494,207 |
| Accumulated deficit | (164,466) | (151,366) |
| Accumulated other comprehensive income | 6,502 | 4,961 |
| Treasury stock, at cost (common shares: 55 and 78 at September 30, 2016 and December 31, 2015, respectively) | (927) | (1,413) |
| Total PICO Holdings, Inc. shareholders' equity | 334,876 | 346,412 |
| Noncontrolling interest in subsidiaries | 90,467 | 87,592 |
| Total equity | 425,343 | 434,004 |
| Total liabilities and equity | \$ 660,521 | \$ 662,085 |

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

PICO Holdings, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations and Comprehensive Income or Loss - Unaudited

(In thousands, except per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|--|-------------|------------------------------------|-------------|
| | 2016 | 2015 | 2016 | 2015 |
| Revenues and other income: | | | | |
| Sale of real estate and water assets | \$95,816 | \$77,044 | \$247,009 | \$175,718 |
| Impairment loss on investment in unconsolidated affiliate | | | | (20,696) |
| Other income, net | 892 | 1,047 | 2,445 | 3,501 |
| Total revenues and other income | 96,708 | 78,091 | 249,454 | 158,523 |
| Cost of sales and expenses: | | | | |
| Cost of real estate and water assets sold | 78,977 | 60,626 | 202,157 | 142,566 |
| General, administrative, and other | 10,098 | 10,168 | 34,867 | 33,661 |
| Sales and marketing | 4,963 | 4,818 | 14,061 | 13,373 |
| Impairment loss on intangible and long-lived assets | 4,615 | 727 | 7,012 | 2,090 |
| Depreciation and amortization | 302 | 653 | 1,193 | 1,649 |
| Total cost of sales and expenses | 98,955 | 76,992 | 259,290 | 193,339 |
| Income (loss) from continuing operations before income taxes and equity in loss of unconsolidated affiliates | (2,247) | 1,099 | (9,836) | (34,816) |
| Benefit (provision) for federal and state income taxes | 406 | (22) | 372 | 2,949 |
| Equity in loss of unconsolidated affiliate | | (1,942) | | (3,422) |
| Loss from continuing operations | (1,841) | (865) | (9,464) | (35,289) |
| Loss from discontinued agribusiness operations, net of tax | (18) | (10,225) | (102) | (29,520) |
| Income (loss) on sale of discontinued agribusiness operations, net of tax | 2 | (1,348) | (1,858) | (18,251) |
| Net loss from discontinued agribusiness operations, net of tax | (16) | (11,573) | (1,960) | (47,771) |
| Net loss | (1,857) | (12,438) | (11,424) | (83,060) |
| Net (income) loss attributable to noncontrolling interests | (1,043) | (1,654) | (1,676) | 2,373 |
| Net loss attributable to PICO Holdings, Inc. | \$(2,900) | \$(14,092) | \$(13,100) | \$(80,687) |

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

PICO Holdings, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations and Comprehensive Income or Loss - Unaudited, Continued

(In thousands, except per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|------------|------------------------------------|------------|
| | 2016 | 2015 | 2016 | 2015 |
| Other comprehensive loss: | | | | |
| Net loss | \$(1,857) | \$(12,438) | \$(11,424) | \$(83,060) |
| Other comprehensive income (loss), net of tax: | | | | |
| Unrealized gain on securities, net of deferred income tax and reclassification adjustments | 954 | 12 | 1,484 | 295 |
| Foreign currency translation | 31 | (48) | 57 | (85) |
| Total other comprehensive income (loss), net of tax | 985 | (36) | 1,541 | 210 |
| Comprehensive loss | (872) | (12,474) | (9,883) | (82,850) |
| Comprehensive (income) loss attributable to noncontrolling interests | (1,043) | (1,654) | (1,676) | 2,373 |
| Comprehensive loss attributable to PICO Holdings, Inc. | \$(1,915) | \$(14,128) | \$(11,559) | \$(80,477) |
| Net loss per common share – basic and diluted: | | | | |
| Loss from continuing operations | \$(0.13) | \$(0.11) | \$(0.48) | \$(1.51) |
| Loss from discontinued agribusiness operations | | (0.50) | (0.09) | (2.00) |
| Net loss per common share – basic and diluted | \$(0.13) | \$(0.61) | \$(0.57) | \$(3.51) |
| Weighted average shares outstanding | 23,068 | 23,017 | 23,049 | 23,010 |

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

PICO Holdings, Inc. and Subsidiaries
Condensed Consolidated Statements of Equity - Unaudited
Nine Months Ended September 30, 2016 and 2015
(In thousands)

| | Shares of Common Stock Issued | Common Stock | Additional Paid-in Capital | Accumulated Deficit | Accumulated Other Comprehensive Income | Shares of Treasury Stock | Treasury Stock, at Cost | Noncontrolling Interest | Total |
|--|---|-----------------|----------------------------------|------------------------|---|-----------------------------------|-------------------------------|----------------------------|-----------|
| Beginning balance, January 1, 2016 | 23,116 | \$ 23 | \$494,207 | \$(151,366) | \$ 4,961 | 78 | \$(1,413) | \$ 87,592 | \$434,004 |
| Stock-based compensation expense | | | 1,730 | | | | | 320 | 2,050 |
| Exercise of restricted stock units | 9 | | | | | | | | — |
| Withholding taxes paid on vested restricted stock units at UCP, Inc. | | | (26) | | | | | (20) | (46) |
| Changes in ownership of noncontrolling interest | | | (1,898) | | | | | 1,899 | 1 |
| Acquisition of interests held by noncontrolling owners | | | | | | | | (1,000) | (1,000) |
| Distribution of treasury stock to deferred compensation plan participants | | | (269) | | | (23) | 486 | | 217 |
| Net loss | | | | (13,100) | | | | 1,676 | (11,424) |
| Unrealized gain on investments, net of deferred income tax of \$799 and reclassification adjustments of \$278 | | | | | 1,484 | | | | 1,484 |
| Foreign currency translation | | | | | 57 | | | | 57 |
| Ending balance, September 30, 2016 | 23,125 | \$ 23 | \$493,744 | \$(164,466) | \$ 6,502 | 55 | \$(927) | \$ 90,467 | \$425,343 |
| | Shares of Common Stock Issued | Common Stock | Additional Paid-in Capital | Accumulated Deficit | Accumulated Other Comprehensive Income | Shares of Treasury Stock | Treasury Stock, at Cost | Noncontrolling Interest | Total |
| Beginning balance, January 1, 2015 | 23,083 | \$ 23 | \$491,662 | \$(69,508) | \$ 4,717 | 78 | \$(1,413) | \$ 86,064 | \$511,545 |
| Stock-based compensation expense | | | 2,379 | | | | | 674 | 3,053 |

| | | | | | | | | | |
|---|--------|-------|-----------|--------------|----------|----|-----------|-----------|-----------|
| Exercise of restricted stock units | | | | | | | | | |
| Withholding taxes paid on vested restricted stock units at UCP, Inc. | | | (211) | | | | (159) | (370) | |
| Distribution to noncontrolling interest | | | | | | | (16) | (16) | |
| Net loss | | | (80,687) | | | | (2,373) | (83,060) | |
| Unrealized gain on investments, net of deferred income tax of \$159 and reclassification adjustments of \$581 | | | | | 295 | | | 295 | |
| Foreign currency translation | | | | | (85) | | | (85) | |
| Ending balance, September 30, 2015 | 23,095 | \$ 23 | \$493,830 | \$(150,195) | \$ 4,927 | 78 | \$(1,413) | \$ 84,190 | \$431,362 |

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

PICO Holdings, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows - Unaudited
(In thousands)

| | Nine Months Ended September 30, | |
|---|------------------------------------|------------|
| | 2016 | 2015 |
| Operating activities: | | |
| Cash used in operating activities - continuing operations | \$(17,798) | \$(58,060) |
| Cash used in operating activities - discontinued agribusiness operations | (508) | (17,462) |
| Net cash used in operating activities | (18,306) | (75,522) |
| Investing activities: | | |
| Purchases of investments | (1,136) | (1,782) |
| Proceeds from sale of investments | 623 | 7,055 |
| Proceeds from maturity of investments | 18 | 1,343 |
| Purchases of property, plant and equipment | (249) | (1,999) |
| Increase in restricted cash | (650) | |
| Other investing activities, net | 667 | 79 |
| Cash provided by (used in) investing activities - continuing operations | (727) | 4,696 |
| Cash provided by investing activities - discontinued agribusiness operations | 8 | 100,098 |
| Net cash provided by (used in) investing activities | (719) | 104,794 |
| Financing activities: | | |
| Repayment of debt | (105,488) | (174,533) |
| Proceeds from debt | 106,663 | 125,294 |
| Payment of withholding taxes on exercise of restricted stock units | (46) | (370) |
| Debt issuance costs | (113) | (698) |
| Purchases of stock of consolidated subsidiary | (1,000) | |
| Distribution to noncontrolling interests | | (16) |
| Cash provided by (used in) financing activities | 16 | (50,323) |
| Decrease in cash and cash equivalents | (19,009) | (21,051) |
| Cash and cash equivalents, beginning of the period | 57,400 | 62,978 |
| Cash and cash equivalents, end of the period | 38,391 | 41,927 |
| Less cash and cash equivalents of discontinued agribusiness operations at the end of the period | 438 | 1,773 |
| Cash and cash equivalents of continuing operations, end of the period | \$37,953 | \$40,154 |
| Supplemental cash flow information: | | |
| Payments (refunds) of federal and state income taxes | \$187 | \$(72) |
| Interest paid, net of amounts capitalized (primarily in discontinued agribusiness operations) | | \$3,295 |
| Non-cash investing and financing activities: | | |
| Unpaid liability incurred for development costs | | \$1,332 |
| Distribution of debt and equity securities in satisfaction of deferred compensation liability (including 22,644 shares of treasury stock) | \$856 | |
| Issuance of common stock for vested restricted stock units | \$274 | \$680 |

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

PICO Holdings, Inc. and Subsidiaries
Notes to the Condensed Consolidated Financial Statements
(Unaudited)

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1. Basis of Presentation and Summary of Significant Accounting Policies

The accompanying unaudited condensed consolidated financial statements of PICO Holdings, Inc. and subsidiaries (collectively, the “Company” or “PICO”) have been prepared in accordance with the interim reporting requirements of Form 10-Q, pursuant to the rules and regulations of the United States Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America (“U.S. GAAP”) for complete consolidated financial statements.

In the opinion of management, all adjustments and reclassifications considered necessary for a fair and comparable presentation of the financial statements presented have been included and are of a normal recurring nature. Operating results presented are not necessarily indicative of the results that may be expected for the year ending December 31, 2016.

These condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto contained in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC.

Use of Estimates in Preparation of Financial Statements:

The preparation of condensed consolidated financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses for each reporting period. The significant estimates made in the preparation of the Company’s condensed consolidated financial statements relate to the assessment of other-than-temporary impairments, the application of the equity method of accounting, goodwill and intangibles, real estate and water assets, deferred income taxes, stock-based compensation, and contingent liabilities. It is reasonably possible that actual results could differ from the estimates upon which the carrying values were based.

Noncontrolling Interest Re-allocation

The Company allocates UCP, Inc. (“UCP”) Class A common stock issued in connection with the vesting of UCP restricted stock units (“RSU”) and stock-based compensation expense between additional paid-in-capital and noncontrolling interest within its condensed consolidated statements of equity. The equity allocations for the UCP, LLC operating partnership are based on the economic and voting interest percentages of the Company and its

noncontrolling interest in UCP. Issuances of UCP Class A common stock for UCP RSUs affect the economic and voting interest percentages, which accordingly are adjusted at the end of each issuance period. The economic and voting interest percentages prevailing during the period are used to determine the current period equity allocations for the operating partnership.

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Recently Issued Accounting Pronouncements:

In August 2016, the Financial Accounting Standards Board (“FASB”) issued guidance on classification of certain cash receipts and cash payments in the statement of cash flows. The amendments in this update clarify guidance on the following eight specific cash flow issues: debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments or other instruments with coupon rates that are insignificant in relation to the effective interest rate, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of company-owned life insurance policies, distributions received from equity method investees, beneficial interests in securitization transactions and separately identifiable cash flows and application of the predominance principle. For public business entities, the guidance is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The guidance should be applied using a retrospective transition method to each period presented. The Company is currently evaluating the effect this guidance will have on the consolidated financial statements.

In April 2015, the FASB issued guidance on simplifying the presentation of debt issuance costs, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. For public business entities, the guidance was effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Entities are to apply the new guidance on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. The Company adopted the guidance effective January 1, 2016. Prior to adoption, the Company included debt issuance costs in other assets on its condensed consolidated balance sheets. Beginning with the Form 10-Q for the three months ended March 31, 2016, the Company changed its presentation of debt issuance costs for all periods presented and the Company reclassified \$1.5 million of debt issuance costs at December 31, 2015 as a direct deduction from the carrying amounts of its debt liabilities both on the condensed consolidated balance sheets and in the notes to the condensed consolidated financial statements.

2. Real Estate and Tangible Water Assets

The costs assigned to the various components of real estate and tangible water assets were as follows (in thousands):

| | September 30, 2016 | December 31, 2015 |
|--|--------------------|-------------------|
| Real estate and improvements held and used, net of accumulated depreciation of \$11,996 and \$11,778 at September 30, 2016 and December 31, 2015, respectively | \$ 9,477 | \$ 9,694 |
| Residential real estate and home construction inventories | 382,219 | 362,056 |
| Other real estate inventories completed or under development | 5,207 | 9,971 |
| Tangible water assets | 42,498 | 42,514 |
| Total real estate and tangible water assets | \$ 439,401 | \$ 424,235 |

Impairment Losses for the Nine Months Ended September 30, 2016:

During the nine months ended September 30, 2016, the Company recorded an impairment loss of \$2.4 million on real estate located in Bakersfield, California, reducing the carrying value to \$5.6 million. The Company entered into a contract to sell the remaining lots in the real estate for less than its carrying value at a future date and as a result, the real estate was written down to its fair value, less selling costs. The loss was reported in the condensed consolidated statements of operations and comprehensive income or loss within impairment loss on intangible and long-lived assets and was included in the results of operations of the real estate operations segment.

Impairment Losses for the Year Ended December 31, 2015:

During the year ended December 31, 2015, the Company recorded an impairment loss of \$923,000 on real estate located in Kern County, California, reducing the carrying value to \$6 million. The loss was reported in the consolidated statements of operations and comprehensive income or loss within impairment loss on intangible and long-lived assets and was included in the results of operations of the real estate operations segment.

During the year ended December 31, 2015, the Company accepted an offer for \$3.4 million for real estate owned near Fresno, California. As a result, an impairment loss of \$274,000 was recorded that reduced the carrying value of the real estate to the offer price. The loss was reported in the condensed consolidated statements of operations and comprehensive income or loss within impairment loss on intangible and long-lived assets and was included in the results of operations of the real estate operations segment.

3. Intangible Assets and Goodwill

The Company owns the following intangible assets, which primarily represent indefinite-lived intangible water assets within its water resource and water storage operations segment (in thousands):

| | September 30, December 31, | |
|---|----------------------------|------------|
| | 2016 | 2015 |
| Pipeline rights and water credits at Fish Springs Ranch | \$ 83,897 | \$ 83,897 |
| Pipeline rights and water rights at Carson-Lyon | 25,569 | 24,831 |
| Other, net of accumulated amortization | 17,453 | 17,805 |
| Total intangible assets | \$ 126,919 | \$ 126,533 |

Impairment Losses for the Nine Months Ended September 30, 2016:

There were no impairment losses recognized on intangible assets during the nine months ended September 30, 2016.

Impairment Losses for the Year Ended December 31, 2015:

As a result of the Company's annual review of indefinite-lived intangible assets, using a discounted cash flow model, the Company recorded an impairment loss of \$269,000, reducing the carrying value to \$3 million, which is included in the table above within other, net of accumulated amortization. The loss was recorded in the consolidated statements of operations and comprehensive income or loss within impairment loss on intangible and long-lived assets and was reported in the water resource and water storage operations segment results.

Goodwill:

The Company had a goodwill balance of \$4.2 million at December 31, 2015. During the three and nine months ended September 30, 2016, the Company recorded an impairment loss of \$4.2 million on goodwill related to the Citizens Homes, Inc. ("Citizens") acquisition due to revised financial forecasts for the Southeast operations as a result of items including weather that delayed new community openings, abandonment of certain opportunities to open new communities as the opportunities did not meet UCP's underwriting criteria, and lower margins on older communities still in existence from the land purchased as part of the Citizens acquisition. The loss was reported in the Company's Real Estate operations reducing the balance of the goodwill to zero. The revised forecasts also reduced the contingent consideration liability related to the Citizens acquisition by \$2.4 million leaving a balance of \$307,000 at September 30, 2016. There were no acquisitions, disposals, or impairments of goodwill during the year ended December 31, 2015.

The Company estimates the fair value of goodwill based on applying the income approach by determining the present value of the estimated future cash flows at a discount rate. When estimating future cash flows, the Company makes various assumptions, including, but not limited to: (i) forecast adjusted pre-tax net income over a ten year period; (ii) weighted average cost of capital; (iii) terminal growth; and (iv) revenue growth and operating profit margin. The risk adjusted discount rate of 14.5% and terminal growth rate of 2.0% were applied to forecast adjusted pre-tax net income.

4. Investments

The cost and carrying value of available-for-sale investments were as follows (in thousands):

| September 30, 2016 | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Carrying Value |
|--------------------------------------|----------|------------------------------|-------------------------------|-------------------|
| Debt securities: corporate bonds | \$4,331 | \$ 91 | \$ (22) | \$4,400 |
| Marketable equity securities | 10,463 | 10,052 | (45) | 20,470 |
| Total available-for-sale investments | \$14,794 | \$ 10,143 | \$ (67) | \$24,870 |

| December 31, 2015 | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Carrying Value |
|--------------------------------------|----------|------------------------------|-------------------------------|-------------------|
| Debt securities: corporate bonds | \$4,458 | \$ 46 | \$ (51) | \$4,453 |
| Marketable equity securities | 10,339 | 7,879 | (81) | 18,137 |
| Total available-for-sale investments | \$14,797 | \$ 7,925 | \$ (132) | \$22,590 |

The amortized cost and carrying value of investments in debt securities, by contractual maturity, are shown below. Actual maturity dates may differ from contractual maturity dates because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands):

| | September 30, 2016 | | December 31, 2015 | |
|---------------------------------------|-----------------------|-------------------|----------------------|-------------------|
| | Amortized Cost | Carrying Value | Amortized Cost | Carrying Value |
| Due in one year or less | | | \$38 | \$ 37 |
| Due after one year through five years | \$4,331 | \$ 4,400 | 2,603 | 2,566 |
| Due after five years | | | 1,817 | 1,850 |
| Total | \$4,331 | \$ 4,400 | \$4,458 | \$ 4,453 |

Debt Securities

The Company owns corporate bonds and other debt securities, which are purchased based on the maturity and yield-to-maturity of the bond and an analysis of the fundamental characteristics of the issuer. At September 30, 2016, and December 31, 2015, there were unrealized losses on certain bonds in the portfolio. The Company does not consider those bonds to be other-than-temporarily impaired because the Company expects to hold, and will not be required to sell, these particular bonds, and it expects to recover the entire amortized cost basis at maturity. There were no impairment losses recorded on debt securities during the three and nine months ended September 30, 2016 and 2015.

Marketable Equity Securities

The Company's investment in marketable equity securities at September 30, 2016 principally consisted of common stock of publicly traded small-capitalization companies in the U.S. and select foreign markets. At September 30, 2016, the Company reviewed its equity securities in an unrealized loss position and concluded certain of such securities were not other-than-temporarily impaired as the declines were not of sufficient duration and severity, and publicly-available financial information, collectively, did not indicate impairment. The primary cause of the loss on those securities was normal market volatility. No material impairment losses were recorded during the three and nine months ended September 30, 2016 and 2015.

Other Investments

The Company owned the following investments at September 30, 2016 and December 31, 2015 that were not classified as available-for-sale (in thousands):

| | Carrying Value | Voting Interest |
|--------------------------|----------------|-----------------|
| Investment in Synthonics | \$ 2,170 | 18.2 % |
| Investment in Mindjet | 1,312 | 19.3 % |
| Total | \$ 3,482 | |

Investment in Synthonics:

Synthonics, Inc. (“Synthonics”) is a private company co-founded by a former member of the Company’s board of directors. The Company’s investment consists of preferred shares as discussed in Note 9 “Related-Party Transactions.”

Investment in Mindjet:

During the third quarter of 2015, the Company determined it no longer had significant influence over the operating and financial policies of Mindjet, Inc. (“Mindjet”) and therefore discontinued the equity method of accounting. The remaining carrying value of the investment, including a convertible note receivable and associated interest, at September 30, 2016 and December 31, 2015 was \$2.3 million and \$2.2 million, respectively. The note and interest receivable is expected to be converted into additional preferred stock during 2016.

As a result of previously using the equity method of accounting for the investment in common stock, the Company recorded a loss within equity in loss of unconsolidated affiliate in the condensed consolidated statement of operations and comprehensive income or loss of \$1.9 million and \$3.4 million for the three and nine months ended September 30, 2015, respectively. The Company’s share of the losses reported by Mindjet during 2015 was allocated to the carrying value of the common stock investment until it reached zero, and then to the preferred stock and convertible debt.

During the three and nine months ended September 30, 2015, the Company recorded a \$20.7 million impairment loss on the investment in Mindjet common and preferred shares as the estimated fair value was less than the carrying value due to significantly increased, and continuing operating losses and resulting liquidity issues, actual financial results significantly less than projections, and decreased market conditions that had adversely affected the value of Mindjet. Such loss was recorded in impairment on investments in the condensed consolidated statement of operations and comprehensive income or loss. The fair value of the investment in Mindjet was based on an analysis of the financial and operational aspects of the company, including consideration of business enterprise value-to-revenue ratios for comparable public companies to current revenue metrics for the company. Determination of the business enterprise value based on the foregoing was then considered in an analysis of the distribution of equity value to the various classes of debt and equity issued by Mindjet in order to reflect differences in value due to differing liquidation preferences, dividend and voting rights. The fair value approach relied primarily on Level 3 unobservable inputs, whereby expected future cash flows were determined using revenue multiples that included assumptions regarding an entity’s assumptions about risk and uncertainties. The estimates were based upon assumptions believed to be reasonable, but which by their nature are uncertain and unpredictable.

It is reasonably possible that the Company’s ownership percentage in Mindjet will continue to decline as other shareholders fund the ongoing operations with additional equity capital and upon conversion of outstanding notes. The Company does not anticipate investing any additional capital into Mindjet.

The carrying value of the Company's investment in Mindjet is subject to impairment testing at each reporting period, or more frequently if facts and circumstances indicate the investment may be impaired. It is reasonably possible that circumstances may continue to deteriorate which could require the Company to record additional impairment losses on the remaining investment balances.

5. Disclosures About Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants under current market conditions at the measurement date. The level within the fair value hierarchy in which the fair value measurements are classified include measurements using quoted prices in active markets for identical assets or liabilities (Level 1), quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active (Level 2), and significant valuation assumptions that are not readily observable in the market (Level 3).

Recurring Fair Value Measurements

Assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability. The Company's policy is to recognize transfers between levels at the end of the reporting period. The following tables set forth the Company's assets and liabilities that were measured at fair value, on a recurring basis, by level within the fair value hierarchy. There were no significant transfers between Level 1 and Level 2 during the nine months ended September 30, 2016 or during the year ended December 31, 2015.

At September 30, 2016 (in thousands):

| | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at September 30, 2016 |
|---|---|---|--|-------------------------------------|
| Assets | | | | |
| Available-for-sale equity securities ⁽¹⁾ | \$ 12,611 | \$ 7,859 | | \$ 20,470 |
| Available-for-sale debt securities ⁽¹⁾ | 4,400 | | | 4,400 |
| Total | \$ 17,011 | \$ 7,859 | | \$ 24,870 |
| Liabilities | | | | |
| Contingent consideration ⁽²⁾ | | | \$ 307 | \$ 307 |

At December 31, 2015 (in thousands):

| | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at December 31, 2015 |
|---|---|---|--|------------------------------------|
| Assets | | | | |
| Available-for-sale equity securities ⁽¹⁾ | \$ 10,685 | \$ 7,452 | | \$ 18,137 |
| Available-for-sale debt securities ⁽¹⁾ | 4,453 | | | 4,453 |
| Total | \$ 15,138 | \$ 7,452 | | \$ 22,590 |
| Liabilities | | | | |
| Contingent consideration ⁽²⁾ | | | \$ 2,707 | \$ 2,707 |

⁽¹⁾ Where there are quoted market prices that are readily available in an active market, securities are classified as Level 1 of the valuation hierarchy. Level 1 available-for-sale investments are valued using quoted market prices multiplied by the number of shares owned and debt securities are valued using a market quote in an active market. All Level 2 available-for-sale securities are one class because they all contain similar risks and are valued using market prices and include securities where the markets are not active, that is where there are few transactions, or the prices are not current or the prices vary considerably over time. Inputs include directly or indirectly observable inputs such as quoted prices. Level 3 available-for-sale securities would include securities where valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

⁽²⁾ Included in this caption is the contingent consideration arrangement that the Company entered into as part of the acquisition of Citizens. The contingent consideration arrangement requires the Company to pay up to a maximum of \$6 million of additional consideration based upon achievement of various pre-tax net income performance milestones of the new business (“performance milestones”) over a five year period commencing on April 1, 2014. Payout calculations are made based on calendar year performance, except for the sixth payout calculation, which will be calculated based on the achievement of performance milestones from January 1, 2019 through March 25, 2019. Payouts are to be made on an annual basis. The potential undiscounted amount of all future payments that the Company could be required to make under the contingent consideration arrangement is between zero and \$6 million. The estimated fair value of the contingent consideration was estimated based on applying the weighted probability of achievement of the performance milestones. The measurement is based on significant inputs that are not observable in the market, which are defined as Level 3 inputs. Key assumptions include: (1) forecast adjusted pre-tax net income over the contingent consideration period; (2) revenue appreciation; (3) cost inflation; and (4) sales and marketing and general and administrative costs. The estimated revenue appreciation of 4.5%, cost inflation of 1.5%, and sales and marketing and general and administrative costs were applied to forecast adjusted net income over the contingent consideration period.

Non-Recurring Fair Value Measurements

Assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company’s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset.

The following tables set forth the Company's non-financial assets that were measured at fair value, on a non-recurring basis, by level within the fair value hierarchy.

Nine months ended September 30, 2016 (in thousands):

| Asset Description | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Loss |
|--|--|---|---|------------|
| Goodwill ⁽¹⁾ | | | \$ — | \$4,223 |
| Real estate and development costs ⁽²⁾ | | | \$ 5,645 | \$2,397 |
| Real estate and development costs ⁽³⁾ | | | \$ 1,066 | \$191 |
| Oil and gas wells ⁽⁴⁾ | | | \$ — | \$201 |

⁽¹⁾ The Company had non-recurring fair value measurements of goodwill discussed in Note 3, "Intangible Assets and Goodwill."

⁽²⁾ The Company had non-recurring fair value measurements of real estate assets discussed in Note 2, "Real Estate and Tangible Water Assets."

⁽³⁾ The Company had non-recurring fair value measurements of real estate assets in its Southeast homebuilding division. The loss was reported in the condensed consolidated statements of operations and comprehensive income or loss within impairment loss on intangible and long-lived assets and was included in the results of operations of the real estate segment.

⁽⁴⁾ The Company recorded an impairment loss to write down the value of certain oil and gas wells. The loss was reported in the condensed consolidated statements of operations and comprehensive income or loss within impairment loss on intangible and long-lived assets and was included in the results of operations of the corporate segment.

Year Ended December 31, 2015 (in thousands):

| Asset Description | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Loss |
|---|--|---|---|------------|
| Intangible water assets ⁽¹⁾ | | | \$ 3,023 | \$269 |
| Oil and gas wells ⁽²⁾ | | | \$ 2,542 | \$1,816 |
| Real estate and development costs ⁽³⁾ | | | \$ 3,400 | \$274 |
| Real estate and development costs ⁽³⁾ | | | \$ 5,960 | \$923 |
| Investments in unconsolidated affiliates ⁽⁴⁾ | | | \$ 2,163 | \$20,696 |

⁽¹⁾ The Company had a non-recurring fair value measurement for intangible assets that resulted in an impairment loss discussed in Note 3, "Intangible Assets and Goodwill."

⁽²⁾ The Company recorded an impairment loss to write down the value of capitalized development costs related to its oil and gas wells. The estimated fair value of the wells was determined using a discounted cash flow model. The loss was reported in the condensed consolidated statements of operations and comprehensive income or loss within impairment loss on intangible and long-lived assets and was included in the results of operations of the corporate segment.

(3) The Company had non-recurring fair value measurements of real estate assets discussed in Note 2, “Real Estate and Tangible Water Assets.”

(4) The Company had a non-recurring fair value measurement of an investment in an unconsolidated affiliate’s equity securities held at cost discussed in Note 4, “Investments.”

Estimated Fair Value of Financial Instruments Not Carried at Fair Value

As of September 30, 2016 and December 31, 2015, the fair values of cash and cash equivalents, accounts payable, and accounts receivable approximated their carrying values because of the short-term nature of these assets or liabilities. The estimated fair value of the Company's investments in unconsolidated affiliates approximated their carrying values. The estimated fair value of the Company's debt was based on cash flow models discounted at the then-current interest rates and an estimate of the then-current spread above those rates at which the Company could borrow, which are Level 3 inputs in the fair value hierarchy. The estimated fair value of certain of the Company's other investments, which included investments in preferred stock of private companies, cannot be reasonably estimated on a recurring basis.

The following table presents the carrying value and estimated fair value of the Company's financial instruments which are not carried at fair value (in thousands):

| | September 30, 2016 | | December 31, 2015 | |
|---|--------------------|----------------------|-------------------|----------------------|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial assets: | | | | |
| Investments in unconsolidated affiliates' equity securities | \$3,482 | \$3,482 | \$3,482 | \$3,482 |
| Financial liabilities: | | | | |
| Debt | \$157,785 | \$167,376 | \$155,966 | \$166,769 |

6. Debt

The following table details the Company's outstanding debt (in thousands):

| | September 30, 2016 | December 31, 2015 |
|---|--------------------|-------------------|
| No stated interest, payments through 2017 | | \$ 1,935 |
| 3% to 4.75% payments through 2018 | \$ 68,705 | 67,336 |
| 5% to 5.5% payments through 2017 | 9,372 | 7,636 |
| 8% payments through 2018 | 3,982 | 3,975 |
| Senior Notes: 8.5% payments through 2017 | 74,122 | 73,480 |
| 10% payments through 2017 | 1,604 | 1,604 |
| Total debt | \$ 157,785 | \$ 155,966 |

At September 30, 2016, and December 31, 2015, the Company's real estate debt had a weighted average interest rate of 6.5% and 6.4%, respectively.

As of September 30, 2016, and December 31, 2015, the Company had approximately \$228.2 million and \$232.6 million, respectively, available in loan commitments to draw upon, of which approximately \$69.6 million and \$75.1 million, respectively, was available.

Debt Provisions, Restrictions, and Covenants on Real Estate Debt:

Certain debt agreements of UCP, Inc. (“UCP”) contain various significant financial covenants, each of which UCP was in compliance with at September 30, 2016 and December 31, 2015.

The \$75 million of senior notes issued in 2014 by UCP limit UCP’s ability to, among other things, incur or guarantee additional unsecured and secured indebtedness (provided that UCP may incur indebtedness so long as UCP’s ratio of indebtedness to its consolidated tangible assets (on a pro forma basis) would be equal to or less than 45% and provided that the aggregate amount of secured debt may not exceed the greater of \$75 million or 30% of UCP’s consolidated tangible assets); pay dividends and make certain investments and other restricted payments (including purchasing UCP stock); acquire unimproved real property in excess of \$75 million per fiscal year or in excess of \$150 million over the term of the notes, except to the extent funded with subordinated obligations or the proceeds of equity issuances; create or incur certain liens; transfer or sell certain assets; and merge or consolidate with other companies or transfer or sell all or substantially all of UCP’s consolidated assets.

Other:

The Company incurred and capitalized \$3.2 million and \$9.3 million of interest during the three and nine months ended September 30, 2016, respectively, and \$3.1 million and \$8.5 million of interest during the three and nine months ended September 30, 2015, respectively, related to construction and real estate development costs. Due to debt covenants and other restrictions, the total restricted net assets of the Company’s consolidated subsidiaries were \$128.9 million at September 30, 2016.

7. Commitments and Contingencies

The Company leases some of its offices under non-cancelable operating leases that expire at various dates through 2021. Rent expense for office space was \$469,000 and \$1.5 million for the three and nine months ended September 30, 2016, respectively, and was \$511,000 and \$1.7 million for the three and nine months ended September 30, 2015, respectively.

Future minimum payments under all operating leases are as follows (in thousands):

| | |
|-------------------------|---------|
| Year ended December 31, | |
| 2016 | \$ 372 |
| 2017 | 1,230 |
| 2018 | 936 |
| 2019 | 413 |
| 2020 | 213 |
| Thereafter | 18 |
| Total | \$3,182 |

Neither PICO nor its subsidiaries are parties to any potentially material pending legal proceedings.

The Company is subject to various litigation matters that arise in the ordinary course of its business. Because litigation is inherently unpredictable and unfavorable resolutions could occur, assessing contingencies is highly subjective and requires judgments about future events. When evaluating contingencies, the Company may be unable to provide a meaningful estimate due to a number of factors, including the procedural status of the matter in question, the presence of complex or novel legal theories, and/or the ongoing discovery and development of information important to the matters. In addition, damage amounts claimed in litigation against the Company may be unsupported, exaggerated or unrelated to possible outcomes, and as such, are not meaningful indicators of the potential liability. The Company

regularly reviews contingencies to determine the adequacy of accruals and related disclosures. The amount of ultimate loss may differ from these estimates, and it is possible that the financial statements could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies.

Whether any losses finally determined in any claim, action, investigation, or proceeding could reasonably have a material effect on the Company's business, financial condition, results of operations, or cash flows will depend on a number of variables, including: the timing and amount of such losses; the structure and type of any remedies; the significance of the impact any such losses, damages or remedies may have on the Company's condensed consolidated financial statements; and the unique facts and circumstances of the particular matter that may give rise to additional factors.

8. Accumulated Other Comprehensive Income

The components of accumulated other comprehensive income are as follows (in thousands):

| | September 30, December 31, | |
|---|----------------------------|----------|
| | 2016 | 2015 |
| Net unrealized gain on available-for-sale investments | \$ 6,549 | \$ 5,065 |
| Foreign currency translation | (47) | (104) |
| Accumulated other comprehensive income | \$ 6,502 | \$ 4,961 |

The unrealized gain on available-for-sale investments is net of a deferred income tax liability of \$3.5 million at September 30, 2016 and \$2.8 million at December 31, 2015.

The following table reports amounts that were reclassified from accumulated other comprehensive income or loss and included in earnings (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|---------|-------------------|---------|
| | September 30, | | September 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Beginning balance | \$5,517 | \$4,963 | \$4,961 | \$4,717 |
| Unrealized loss reclassified and recognized in net loss, net of tax ⁽¹⁾ | (95) | (71) | (181) | (377) |
| Foreign exchange reclassified and recognized in net loss, net of tax ⁽¹⁾ | | 2 | | 342 |
| Total reclassified and recognized in net loss, net of tax | (95) | (69) | (181) | (35) |
| Unrealized gain on marketable securities, net of tax | 1,049 | 83 | 1,665 | 672 |
| Accumulated currency, net of tax | 31 | (50) | 57 | (427) |
| Net change in other comprehensive income, net of tax | 985 | (36) | 1,541 | 210 |
| Accumulated other comprehensive income | \$6,502 | \$4,927 | \$6,502 | \$4,927 |

⁽¹⁾ Amounts reclassified from this category are included in other income, net in the condensed consolidated statement of operations and comprehensive income or loss.

9. Related-Party Transactions

Deferred Compensation

The Company has agreements with certain officers and employees to defer compensation into Rabbi Trust accounts held in the name of the Company. The total value of the deferred compensation obligation for all participants at September 30, 2016 and December 31, 2015, was \$26.7 million and \$25.5 million, respectively, and is included in the accompanying consolidated balance sheets. These totals include a fair value of \$653,000 and \$805,000 of the Company's common stock, for each of the respective periods, with the balance in various publicly traded equities and bonds.

Deferred compensation expense included in general, administrative, and other costs in the accompanying condensed consolidated statements of operations and comprehensive income or loss for the three months ended September 30, 2016 and 2015 was \$1.8 million and \$90,000, respectively and for the nine months ended September 30, 2016 and 2015 was \$2.8 million and \$1.1 million, respectively. During the three and nine months ended September 30, 2016, the Company distributed 22,644 shares of the Company's common stock out of its deferred compensation Rabbi Trusts in satisfaction of the related liability. The distribution was reported as a reduction of treasury stock in the condensed consolidated statements of equity for the nine months ended September 30, 2016.

In connection with the termination of the Company's former Chief Executive Officer, John R. Hart, which was effective as of October 12, 2016, the Company will be required to distribute to Mr. Hart his deferred compensation balance in April 2017. At September 30, 2016, Mr. Harts deferred compensation balance was valued at approximately \$22.8 million. See Note 12, "Subsequent Events," for additional information.

Investment in Synthonics

The Company has an investment in preferred stock of Synthonics, a company co-founded by Mr. Slepicka, formerly a non-employee director of the Company, who is currently the Chairman, Chief Executive Officer and acting Chief Financial Officer of Synthonics. As of September 30, 2016, the Company had invested \$2.2 million for 18.2% of the voting interest in Synthonics. Mr. Slepicka resigned as a member of the Board of Directors effective July 27, 2016.

10. Segment Reporting

PICO is a diversified holding company engaged in the following operating and reportable segments: Water Resource and Water Storage Operations, Real Estate Operations, Corporate, and Discontinued Agribusiness Operations. The accounting policies of the reportable segments are the same as those described in the Company's 2015 Annual Report on Form 10-K filed with the SEC.

Management analyzes segments using the following information:

Segment assets (in thousands):

| | September 30, December 31, | |
|---|----------------------------|------------|
| | 2016 | 2015 |
| Assets: | | |
| Water resource and water storage operations | \$ 185,380 | \$ 185,037 |
| Real estate operations | 426,751 | 421,411 |
| Corporate | 41,879 | 46,844 |
| Discontinued agribusiness operations | 6,511 | 8,793 |
| Total assets | \$ 660,521 | \$ 662,085 |

Segment revenues and loss before taxes (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|----------------------------------|----------|---------------------------------|-------------|
| | 2016 | 2015 | 2016 | 2015 |
| Revenue and other income: | | | | |
| Water resource and water storage operations | \$553 | \$3,468 | \$813 | \$4,191 |
| Real estate operations | 95,567 | 73,777 | 246,731 | 172,243 |
| Corporate | 588 | 846 | 1,910 | (17,911) |
| Total revenue and other income | \$96,708 | \$78,091 | \$249,454 | \$158,523 |
| Income (loss) before income taxes: | | | | |
| Water resource and water storage operations | \$(1,029) | \$834 | \$(4,263) | \$(1,907) |
| Real estate operations | 2,876 | 3,839 | 4,713 | (1,661) |
| Corporate | (4,094) | (3,574) | (10,286) | (31,248) |
| Income (loss) from continuing operations before income taxes and equity in loss of unconsolidated affiliates | \$(2,247) | \$1,099 | \$(9,836) | \$(34,816) |

11. Discontinued Agribusiness Operations and Other Assets Held for Sale

During the third quarter of 2015, the Company sold substantially all of the assets used in its agribusiness segment to CHS Inc. (“CHS”) for a net selling price of \$105.3 million. After repayment of \$80.9 million of outstanding debt and \$5.9 million in selling and other related costs of the sale, the Company received net proceeds of \$18.4 million on the date of close.

The Company was required to deposit \$10.2 million of such net proceeds in escrow accounts, \$6 million of which secures general indemnification obligations through January 2017, and \$4.2 million of which was associated with specified operational matters related to air quality and waste water permit issues (“operational escrow”). The Company resolved the air quality issue and received \$2.4 million of the operational escrow amount in October 2015. However, in February 2016, the Company was notified that the relevant regulatory authorities had not approved the waste water permit at the levels required under the sale agreement. Consequently, the remaining \$1.8 million of the operational escrow amount was released to CHS in full satisfaction of the matter, resulting in the Company recording the amount as additional loss on the sale of discontinued operations for the nine months ended September 30, 2016. Remaining amounts in escrow are reported as accounts receivable in the table below.

The Company also guaranteed up to \$8 million for any indemnification claims in excess of the \$6 million general indemnification escrow pursuant to the terms of a guaranty agreement with CHS, which was executed at the closing. This guaranty will remain in force for five years from the date of sale. The guaranty has been recorded at estimated fair value that reflects the Company’s expectation that no significant amounts will be paid out under the guaranty. However, any amounts paid by the Company to CHS in excess of the estimate will result in additional loss on the sale. Any assets in excess of the resolution of the outstanding matters, and after payment of remaining liabilities, are available to the Company for any corporate purposes.

The Company’s agribusiness segment has been classified as discontinued agribusiness operations in the accompanying condensed consolidated financial statements as of the earliest period presented. Consequently, prior periods presented have been recast from amounts previously reported to reflect the agribusiness segment as discontinued agribusiness operations.

The following table presents the details of the Company's results from discontinued agribusiness operations included in the condensed consolidated statement of operations and comprehensive income or loss (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | | |
|--|-------------------------------------|-----------|------------------------------------|-----------|------------|
| | 2016 | 2015 | 2016 | 2015 | |
| Revenue and other income: | | | | | |
| Sales of canola oil and meal | | \$9,600 | | \$82,267 | |
| Other | | 18 | | (50) | |
| Total revenue and other income | | 9,618 | | 82,217 | |
| Cost of goods sold: | | | | | |
| Cost of canola oil and meal sold | | 8,738 | | 79,763 | |
| Depreciation | | 18 | | 4,360 | |
| Other direct costs of production | | 1,155 | | 5,938 | |
| Total cost of goods sold | | 9,911 | | 90,061 | |
| Depreciation | | | | 95 | |
| Impairment loss on intangible and long-lived assets | | | | 1,875 | |
| Interest | | 428 | | 3,259 | |
| Plant costs and overhead | \$18 | 9,504 | \$102 | 16,447 | |
| Segment total expenses | 18 | 19,843 | 102 | 111,737 | |
| Loss from discontinued agribusiness operations, net of tax | (18) | (10,225) | (102) | (29,520) | |
| Income (loss) on sale of discontinued agribusiness operations, net of tax | 2 | (1,348) | (1,858) | (18,251) | |
| Net loss from discontinued agribusiness operations, net of tax | (16) | (11,573) | (1,960) | (47,771) | |
| Net (income) loss from discontinued agribusiness operations attributable to noncontrolling interests | | (16) | | 1,730 | |
| Net loss from discontinued agribusiness operations attributable to PICO Holdings, Inc. | | \$(16) | \$(11,589) | \$(1,960) | \$(46,041) |

The following table presents the details of the Company's assets and liabilities classified as held-for-sale in the condensed consolidated balance sheets (in thousands):

| | September 30, December 31, | |
|--|----------------------------|----------|
| | 2016 | 2015 |
| Assets | | |
| Cash and cash equivalents | \$ 438 | \$ 938 |
| Accounts receivable | 5,991 | 7,800 |
| Other assets | 82 | 55 |
| Total agribusiness assets held-for-sale | 6,511 | 8,793 |
| Real estate ⁽¹⁾ | 3,400 | |
| Oil and gas assets ⁽¹⁾ | 989 | |
| Total assets held-for-sale | \$ 10,900 | \$ 8,793 |
| Liabilities | | |
| Total agribusiness liabilities held-for-sale | 276 | 608 |
| Oil and gas liabilities ⁽¹⁾ | 627 | |
| Total liabilities held-for-sale | \$ 903 | \$ 608 |

⁽¹⁾ See Note 12 "Subsequent Events."

12. Subsequent Events

Termination of PICO's CEO and Other Related Changes in Executive Management:

On October 10, 2016, John R. Hart's employment as President and Chief Executive Officer of the Company was terminated, effective as of October 12, 2016.

Mr. Hart will receive the severance benefits set forth in Section 4(b) of his Amended and Restated Employment Agreement with the Company, dated March 11, 2016 and filed with the SEC on March 14, 2016 (the "Employment Agreement"). Such benefits include certain severance and vacation differential payments totaling approximately \$10.4 million, certain medical benefits, and immediate vesting of the outstanding RSU and Performance Based Options ("PBO") previously granted. Mr. Hart was also entitled to the balance of his accrued vacation and personal days valued at \$339,000 which was paid to him in October 2016.

The Company will accrue the \$10.4 million in severance benefits and vacation differential, remaining stock-based compensation, and related expenses in the fourth quarter of 2016. In accordance with applicable regulations, payment of the severance benefits and vacation differential, stock settlement of the vested RSU, and distribution of Mr. Hart's deferred compensation balance, will be made to Mr. Hart no earlier than six months and a day after the effective date of the termination.

In connection with Mr. Hart's termination, the Company's board of directors appointed Maxim C.W. Webb as President and Chief Executive Officer and to serve as a class III director of the Company, effective as of October 12, 2016, with a term that expires at the Company's 2017 Annual Meeting of Stockholders, and John T. Perri as Chief Financial Officer. Additionally, each of Mr. Webb and Mr. Perri irrevocably and unconditionally waived their right to receive any bonus payment that would otherwise be payable pursuant to the terms of the Company's executive bonus plan.

Mr. Hart currently continues to serve as a member of the board of directors of the Company and UCP. However, in October 2016, the Company filed a consent solicitation statement seeking written consents of the shareholders of the Company to remove Mr. Hart as a director of the Company.

Asset Sales:

In August 2016, the Company entered into a purchase and sale agreement to sell the majority of the assets used in its oil and gas operations effective October 1, 2016 for gross proceeds of \$10.2 million. After consideration of liabilities assumed by the buyer and escrow holdback of approximately \$587,000 for lease title defects that the Company has the right to cure within one year of the date of sale, cash proceeds to the Company were \$9.2 million. The purchase and sale agreement provides for a Company guarantee of \$1 million for any indemnification claims made by the buyer within one year of the sale. As the carrying value of the assets sold was reduced significantly in prior periods due to impairment losses and depletion charges, the Company will record a gain on sale before income taxes of \$8.6 million during the fourth quarter of 2016 that will be reported within the Company's corporate segment results.

In October 2016, the Company completed a sale of 32 acres of real estate in Fresno, California for cash of \$3.4 million. The transaction did not result in any gain or loss as the real estate was previously written down to the estimated sale price during the year ended December 31, 2015, which is further discussed in Note 2 "Real Estate and Tangible Water Assets."

Item 2: Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of financial condition and results of operations should be read together with the Unaudited Condensed Consolidated Financial Statements and accompanying Notes included elsewhere in this report, and the Consolidated Financial Statements and accompanying Notes included in our Annual Report on Form 10-K for the year ended December 31, 2015.

Note About “Forward-Looking Statements”

This Quarterly Report on Form 10-Q (including the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” section) contains “forward-looking statements,” as defined in Section 21E of the United States Securities Exchange Act of 1934, as amended, regarding our business, financial condition, results of operations, and prospects, including, without limitation, statements about our expectations, beliefs, intentions, anticipated developments, and other information concerning future matters. Words such as “may,” “will,” “could,” “expects,” “anticipates,” “intends,” “plans,” “believes,” “seeks,” “estimates,” “should,” “target,” “projects,” “contemplates,” “predicts,” “potential,” “co” 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 Quarterly Report on Form 10-Q. Although forward-looking statements in this Quarterly Report on Form 10-Q reflect the good faith judgment of our management, such statements can only be based on current expectations and assumptions. Consequently, forward-looking statements are inherently subject to risks and uncertainties, and the actual results and outcomes could differ from what is expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences in results and outcomes include, without limitation, those discussed under the headings “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015, in “Item 1A: Risk Factors” of Part II of this Quarterly Report on Form 10-Q, and in other filings made from time to time with the United States Securities and Exchange Commission (“SEC”) after the date of this Quarterly Report on Form 10-Q. Readers are urged not to place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to (and we expressly disclaim any obligation to) revise or update any forward-looking statement, whether as a result of new information, subsequent events, or otherwise (except as may be required by law), in order to reflect any event or circumstance which may arise after the date of this Quarterly Report on Form 10-Q. Readers are urged to carefully review and consider the various disclosures made in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K and other filings with the SEC.

Business Strategy and Goals

PICO Holdings, Inc. is a diversified holding company. In this Quarterly Report, PICO and its subsidiaries are collectively referred to as “PICO,” “the Company,” or by words such as “we” and “our.”

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

As of September 30, 2016, our business was separated into the following segments:

- Water Resource and Water Storage Operations;
- Real Estate Operations;
- Corporate; and
- Discontinued Agribusiness Operations.

As of September 30, 2016, our major consolidated subsidiaries were (wholly–owned unless noted):

- Vidler Water Company, Inc. (“Vidler”) which acquires and develops water resources and water storage operations in the southwestern United States, with assets and operations in Nevada, Arizona, Colorado and New Mexico; and

UCP, Inc. ("UCP"), a 56.9% owned subsidiary which is a homebuilder and land developer in markets located in California, Washington State, North Carolina, South Carolina and Tennessee.

Results of Operations — Three and Nine Months Ended September 30, 2016 and 2015

Overview of Economic Conditions, Other Recent Events, and Impact on Results of Operations

The economic environment and housing slow-down in the U.S. between 2007 and 2011 significantly decreased the rate of growth in the Southwest and the demand for our water and real estate assets in certain markets. Numerous factors can affect the performance of an individual market. However, we believe that trends in employment, housing inventory, affordability, interest rates, and home prices have a particularly significant impact. We expect that these market trends will have an impact on our operating performance. Trends in housing inventory, home affordability, employment, interest rates and home prices are the principal factors that affect our revenue and many of our costs and expenses. For example, when these trends are favorable, we expect our revenue, as well as our related costs and expenses, to generally increase; conversely, when these trends are negative, we expect our revenue and cost of sales to generally decline, although in each case the impact may not be immediate. There has been a recovery and improvement in the housing markets from levels seen during the slow-down (with seasonal fluctuations) which has led to increased levels of real estate development activity in the past two to three years, and we believe that a continuation of the housing recovery will lead to increased demand for our real estate, and intangible and tangible water assets (which are held in our real estate segment and water resource and water storage segment, respectively). Individual markets continue to experience varying results, as local home inventories, affordability, and employment factors strongly influence each local market and any deterioration in the markets in which we operate has the potential to cause additional impairment losses on our real estate and water assets.

The focus of our operations is building long-term shareholder value. Our revenues and results of operations can and do fluctuate widely from period to period. For example, we recognize revenue from the sale of real estate and water assets when specific transactions close, and as a result, sales of real estate and water assets for any individual quarter are not necessarily indicative of revenues for future quarters or the full financial year.

PICO Holdings, Inc. Shareholders' Equity (in thousands):

| | September 30, 2016 | December 31, 2015 | Change |
|--------------------------------|-----------------------|----------------------|------------|
| Shareholders' equity | \$ 334,876 | \$ 346,412 | \$(11,536) |
| Shareholders' equity per share | \$ 14.52 | \$ 15.04 | \$(0.52) |

The decrease in our shareholders' equity was primarily due to the comprehensive loss of \$11.6 million incurred during the nine months ended September 30, 2016.

Total Assets and Liabilities (in thousands):

| | September 30, 2016 | December 31, 2015 | Change |
|-------------------|-----------------------|----------------------|-----------|
| Total assets | \$ 660,521 | \$ 662,085 | \$(1,564) |
| Total liabilities | \$ 235,178 | \$ 228,081 | \$7,097 |

Total assets decreased during the nine months ended September 30, 2016 due to a decrease in cash of \$18.5 million used primarily to purchase real estate and pay overhead expenses, and a decrease in goodwill of \$4.2 million resulting from an impairment loss recorded due to revised financial forecasts for the Southeast operations, related to the Citizens Homes, Inc. ("Citizens") acquisition were revised. These decreases were partially offset by an increase in real estate and water assets of \$15.2 million and other increases in investments due to appreciation of the portfolio and notes and other receivables.

Total liabilities increased during the nine months ended September 30, 2016 primarily due to the following:

- an increase of \$2.1 million in accounts payable and accrued expenses, primarily related to a \$4.2 million increase in real estate liabilities due to higher homebuilding and land development activity, partially offset by \$1.2 million reduction in our oil and gas business related to construction accruals and royalties payable;
- an increase of \$1.8 million in our debt balance that was used for the acquisition and development of real estate;
- an increase of \$1.6 million in other liabilities, primarily related to a \$2.3 million increase for warranty accruals due to the gross up of such reserves, increases of \$746,000 of accrued bonuses and \$677,000 in deposits received on closed homes (both related to our real estate segment), which was partially offset by a \$2.4 million decrease in the contingent consideration liability related to the Citizens acquisition as income projections for those assets were revised; and
- an increase of \$1.3 million in the deferred compensation liability from security appreciation offset by distributions.

Results of Operations

Revenue

The majority of our recurring revenue was generated in our real estate operation, which records revenue from the sale of residential homes and lots. Our revenue from real estate operations increased during the three months ended September 30, 2016 as the result of a significant increase in the average price of homes sold period over period, and increased during the nine months ended September 30, 2016 as the result of an increase in the number of homes sold and a significant increase in the average price of homes sold period-over-period.

Costs and Expenses

The majority of our costs and expenses were related to cost of real estate and water assets sold. The increase in costs and expenses for the three and nine month ended September 30, 2016 was primarily from an increase in cost of real estate sold in our real estate segment due to the increased number of homes sold year-over-year, and a \$4.2 million loss on impairment of goodwill.

Income Taxes

We continued to record a full valuation allowance on our net deferred tax assets and as a result there were minimal income taxes reported during each of the three and nine months ended September 30, 2016 and three months ended September 30, 2015. During the nine months ended September 30, 2015, we recorded a \$2.9 million income tax benefit primarily due to the reversal of a taxable temporary difference related to our investment in Mindjet. Such temporary difference reversed during the period due to the impairment loss recorded on the investment. No such benefit was recorded during the three and nine months ended September 30, 2016.

Discontinued Agribusiness Operations

Our discontinued agribusiness loss decreased significantly for the three and nine months ended September 30, 2016 as compared to the three and nine months ended September 30, 2015. The losses reported in 2015 included loss on discontinued operations of \$10.2 million and \$29.5 million for the three and nine months ended September 30, 2015, respectively, and loss on sale of discontinued operations of \$1.3 million and \$18.3 million for the three and nine months ended September 30, 2015, respectively. The only material loss in 2016 was additional loss on sale of discontinued agribusiness operations of \$1.9 million, primarily related to the resolution of a waste water permit issue in the first quarter of 2016.

Noncontrolling Interests

Noncontrolling interests reported net income of \$1 million and \$1.7 million for the three months ended September 30, 2016 and 2015, respectively, and net income of \$1.7 million and a net loss of \$2.4 million for the nine months ended September 30, 2016 and 2015, respectively. The majority of the income during the three months ended September 30, 2016 and 2015, and nine months ended September 30, 2016 was from income reported by UCP. Of the loss reported during the nine months ended September 30, 2015, \$1.7 million was attributable to our discontinued agribusiness operations and \$555,000 was attributable to the loss reported by UCP.

Comprehensive Income or Loss

We report comprehensive income or loss as well as net income or loss from the condensed consolidated statements of operations and comprehensive income or loss. Comprehensive income measures changes in equity, and includes unrealized items which are not recorded in the condensed consolidated statements of operations.

Water Resource and Water Storage Operations

| Thousands of dollars | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|--|---------|-----------|---------------------------------------|-----------|-----------|
| | 2016 | 2015 | Change | 2016 | 2015 | Change |
| Revenue and other income: | | | | | | |
| Sale of real estate and water assets | \$476 | \$3,373 | \$(2,897) | \$607 | \$3,797 | \$(3,190) |
| Other | 77 | 95 | (18) | 206 | 394 | (188) |
| Total revenue and other income | 553 | 3,468 | (2,915) | 813 | 4,191 | (3,378) |
| Cost of sales and expenses: | | | | | | |
| Cost of real estate and water assets sold | 252 | 946 | (694) | 316 | 1,197 | (881) |
| Depreciation and amortization | 37 | 256 | (219) | 316 | 781 | (465) |
| Overhead expense | 1,040 | 1,079 | (39) | 3,345 | 3,339 | 6 |
| Project expense | 253 | 353 | (100) | 1,099 | 781 | 318 |
| Segment total expenses | 1,582 | 2,634 | (1,052) | 5,076 | 6,098 | (1,022) |
| Loss before income taxes | \$(1,029) | \$834 | \$(1,863) | \$(4,263) | \$(1,907) | \$(2,356) |

Historically, our water resource and water storage segment revenue and results have been volatile and infrequent. Since the date a transaction closes generally determines the accounting period in which any sales revenue and cost of sales are recorded, our reported revenues and income in this segment fluctuate from period to period, depending on the dates when specific transactions close. Consequently, revenue in any one year is not necessarily indicative of likely revenue in future years.

Segment Revenue

We did not consummate any significant sales of real estate and water assets in the three or nine months ended September 30, 2016. Revenue in these periods consisted primarily of lease income and option fees. During the third quarter of 2015, we sold 258 acres of real estate and approximately 774 acre-feet of water rights in the Harquahala Valley area of Arizona for cash proceeds of \$3.4 million, which generated a gross margin of \$2.4 million.

Segment Expenses

Total expenses remained consistent for both the three and nine month periods year-over-year with overhead being the most significant cost reported during the periods. Overhead costs consisted primarily of salaries and benefits, professional fees, office rent and insurance. The cost of real estate and water assets sold decreased year-over-year for both the three and nine month periods due to the aforementioned significant sale of 258 acres of real estate and approximately 774 acre-feet of water rights in the Harquahala Valley area of Arizona.

Project expenses consisted of costs related to the ongoing maintenance of our assets, and professional fees. Project costs are expensed as appropriate and fluctuate from period to period depending on activity in our various projects. Historically, project expenses principally related to:

• certain costs related to intangible water rights in the Tule Desert groundwater basin and the Dry Lake Valley (both part of the Lincoln County, Nevada agreement); and
• certain costs for water resource development in Nevada and New Mexico.

During the nine months ended September 30, 2016 our Arizona Recharge Facility was fully depreciated, reducing our annual operation and maintenance expense related to the site by approximately \$1 million annually, of which \$879,000 was depreciation. In general, we expect project costs to decrease year-over-year as our assets are essentially fully developed. However, one-time unexpected costs could be incurred occasionally. During the nine months ended September 30, 2016 project expenses increased primarily due to one-time maintenance and legal charges related to our Arizona Recharge Facility and associated water credits, which we do not expect to recur in the future.

If we fail to generate revenue, incur additional expenses beyond expectations, continue to report operating losses, or if expected prices for our water assets fall, we could be required to record additional impairment losses on our real estate, tangible and intangible water assets owned in this segment.

Real Estate Operations

| Thousands of dollars | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|----------------------------------|----------|----------|---------------------------------|-----------|----------|
| | 2016 | 2015 | Change | 2016 | 2015 | Change |
| Revenue and other income: | | | | | | |
| Sale of real estate | \$95,340 | \$73,672 | \$21,668 | \$246,403 | \$171,921 | \$74,482 |
| Other | 227 | 105 | 122 | 328 | 322 | 6 |
| Total revenue and other income | 95,567 | 73,777 | 21,790 | 246,731 | 172,243 | 74,488 |
| Cost of sales and expenses: | | | | | | |
| Cost of real estate sold | 78,725 | 59,680 | 19,045 | 201,841 | 141,369 | 60,472 |
| Impairment loss on intangible and long-lived assets | 4,414 | | 4,414 | 6,811 | 274 | 6,537 |
| General, administrative, and other | 4,699 | 5,566 | (867) | 19,418 | 19,016 | 402 |
| Sales and marketing | 4,853 | 4,692 | 161 | 13,948 | 13,245 | 703 |
| Segment total expenses | 92,691 | 69,938 | 22,753 | 242,018 | 173,904 | 68,114 |
| Income (loss) before income taxes | \$2,876 | \$3,839 | \$(963) | \$4,713 | \$(1,661) | \$6,374 |

As of September 30, 2016, our businesses in the real estate operations segment were primarily conducted through our 56.9% owned subsidiaries UCP, Inc. and UCP, LLC, and its homebuilding and land development operations in California, Washington State, North Carolina, South Carolina, and Tennessee.

During the three and nine months ended September 30, 2016, the overall U.S. housing market continued to show signs of improvement, driven by factors such as continued supply and demand imbalance, low mortgage rates and employment growth. Individual markets continue to experience varying results, as local home inventories, affordability and employment factors strongly influence local markets.

Additionally, we believe that seasonal factors affect the broader housing market as well as our markets (see “Seasonality” in the “Liquidity and Capital Resources” section below). Individual markets continue to experience varying results, as local home inventories, home affordability, and employment factors strongly influence each local market.

Homebuilding and land development are local businesses. As a result, we expect local market conditions will affect our community count, revenue and operating performance. Local market trends are the principal factors that impact our revenue and our revenue-related expenses. For example, when these trends are favorable, we expect our revenues from homebuilding and land development, as well as the expenses that vary with revenue, to generally increase; conversely, when these trends are negative, we expect our revenue and expenses that vary with revenue to generally decline, although in each case the impact may not be immediate or directly proportional. When trends are favorable,

we would expect to increase our community count by opening additional communities and expanding existing communities; conversely, when these trends are negative, we would expect to reduce or maintain our community count or decrease the pace at which we open additional communities and expand existing communities.

Owned and Controlled Lots

The following tables present certain information with respect to our owned or controlled lots, which are pursuant to purchase or option contracts:

| | As of September 30, 2016 | |
|-----------|--------------------------|---------------------------------|
| | Owned | Controlled ⁽¹⁾ Total |
| West | 3,879 | 303 4,182 |
| Southeast | 1,041 | 820 1,861 |
| Total | 4,920 | 1,123 6,043 |

| | As of December 31, 2015 | |
|-----------|-------------------------|---------------------------------|
| | Owned | Controlled ⁽¹⁾ Total |
| West | 3,869 | 415 4,284 |
| Southeast | 882 | 712 1,594 |
| Total | 4,751 | 1,127 5,878 |

⁽¹⁾ Controlled lots are those subject to a purchase or option contract.

Summary Results of UCP Revenue and Gross Margin for Homes and Lots

| | Three Months Ended | | | Nine Months Ended | | |
|--|--------------------|----------|-----------|-------------------|---------------------|-----------|
| | September 30, | | | September 30, | | |
| | 2016 | 2015 | Change | 2016 | 2015 | Change |
| Lots sold | 65 | | 65 | 65 | 114 | (49) |
| Homes sold | 199 | 202 | (3) | 563 | 478 | 85 |
| Average active selling communities during the period | 29 | 28 | 1 | 28 | 27 | 1 |
| Revenue (in thousands) | | | | | | |
| Lot revenue - total | \$3,900 | \$1,116 | \$2,784 | \$5,322 | \$3,156 | \$2,166 |
| Lot revenue - per lot (average selling price) | \$60 | | \$60 | \$60 | ⁽¹⁾ \$28 | \$32 |
| Home revenue - total | \$89,840 | \$70,284 | \$19,556 | \$239,480 | \$163,705 | \$75,775 |
| Home revenue - per home (average selling price) | \$451 | \$348 | \$103 | \$425 | \$342 | \$83 |
| General contracting revenue | | \$2,272 | \$(2,272) | | \$5,060 | \$(5,060) |
| Gross Margin (in thousands, except for percentages) | | | | | | |
| Gross margin - lots | \$66 | \$400 | \$(334) | \$803 | \$892 | \$(89) |
| Gross margin percentage - lots | 1.7 | % 35.8 | % (34.1) | % 15.1 | % 28.3 | % (13.2) |
| Gross margin - homes | \$16,306 | \$13,278 | \$3,028 | \$43,516 | \$28,963 | \$14,553 |
| Gross margin percentage - homes | 18.2 | % 18.9 | % (0.7) | % 18.2 | % 17.7 | % 0.5 |
| Gross margin total - lots and homes | \$16,372 | \$13,678 | \$2,694 | \$44,319 | \$29,855 | \$14,464 |
| Gross margin percentage total - lots and homes | 17.5 | % 19.2 | % (1.7) | % 18.1 | % 17.9 | % 0.2 |

⁽¹⁾ This average does not include \$1.4 million of revenue for the sale of land not previously included in our lot count.

In the following discussion, gross margin is defined as sale of real estate less cost of real estate sold, and gross margin percentage is defined as gross margin divided by sale of real estate.

Third Quarter Segment Revenue and Gross Margin

The year-over-year third quarter increase in total segment revenue was primarily attributable to the following combination of factors:

- an increase in the average selling price (“ASP”) of homes sold, which was primarily the result of increased deliveries at communities located in areas with higher home prices;
- an increase in undeveloped lot revenue; and was partially offset by
- a decrease in the number of homes sold.

The gross margin percentage of homes sold decreased in the third quarter of 2016 as compared to the same period in 2015 primarily due to higher costs of home sales, which was attributable to a change in the mix of selling communities period-over-period, as our current portfolio of selling communities had a relatively higher cost basis than the homes sold during the third quarter of 2015.

The lower gross margin in lot sales for the three months ended September 30, 2016, as compared to the same period in 2015, was the result of a land sale in Bakersfield, California of 65 lots that were impaired, and written down to fair value, in the prior quarter. Although there were no finished lot sales during the third quarter of 2015, we did recognize revenue and the associated cost of goods sold as a result of partially satisfying certain performance obligations related to a land sale from a prior period and we were able to recognize a portion of previously deferred revenue.

Nine Months Segment Revenue and Gross Margin

The increase in first nine months year-over year total segment revenue was primarily attributable to the following combination of factors:

- an increase in the number of homes sold which was attributable to several factors, including an increase in the number of selling communities and favorable sales pace at certain of those communities;
- an increase in the ASP of homes sold, which was primarily the result of increased deliveries at communities located in areas with higher home prices; and was partially offset by
- a decrease in the number of lots sold.

The gross margin percentage of homes sold during the nine months ended September 30, 2016 increased from the nine months ended September 30, 2015 primarily due to a change in the mix of selling communities as our current portfolio of selling communities had a higher ASP than the selling communities we sold during the 2015 period.

For the nine months ended September 30, 2016, our lot sales gross margin percentage decreased, as compared to the same period in 2015, primarily due to an impairment charge during the second quarter of 2016. This land sale closed in the third quarter of 2016 and, as a result of the previous impairment, did not result in a significant gross margin.

During the nine months ended September 30, 2016, UCP recorded an impairment loss of \$2.4 million on real estate located in Bakersfield, California, reducing the carrying value to \$5.6 million and recorded an impairment loss of \$191,000 on real estate located in Charlotte, North Carolina.

Backlog

UCP's homebuilding backlog (homes under sales contracts that have not yet closed at the end of the relevant period) at September 30, 2016 was \$157.2 million as compared to a backlog of \$120.8 million at September 30, 2015. Sales contracts relating to homes in backlog may be canceled by the purchaser for a number of reasons. Accordingly, backlog may not be indicative of future segment revenue.

Segment Expenses

Operating expenses increased in total year-over-year during the nine months ended September 30, 2016. This increase is primarily attributable to an increase in the cost of real estate and water assets sold due to an increase in the number of homes delivered and an increase in the average selling price of homes sold. Additionally, there was an increase in impairment losses from the write off of our goodwill. The year-over-year decrease in operating expenses for the three months ended September 30, 2016 was primarily related to the reduction in the contingent consideration liability

related to the Citizens assets, which was partially offset by increases in salaries and bonus expenses recorded during the period.

If we report significant or sustained operating losses in the future, or if market conditions deteriorate, we could be required to record impairment losses on our real estate assets.

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Corporate

| Thousands of dollars | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|--|-----------|----------|------------------------------------|------------|----------|
| | 2016 | 2015 | Change | 2016 | 2015 | Change |
| Revenue: | | | | | | |
| Deferred compensation revenue (charges) | \$211 | \$345 | \$(134) | \$495 | \$890 | \$(395) |
| Impairment loss on investment in unconsolidated affiliate | | | — | | (20,696) | 20,696 |
| Other | 377 | 501 | (124) | 1,415 | 1,895 | (480) |
| Total revenue and other income | 588 | 846 | (258) | 1,910 | (17,911) | 19,821 |
| Costs and expenses: | | | | | | |
| Impairment loss on intangible and long-lived assets | 201 | 727 | (526) | 201 | 1,816 | (1,615) |
| Stock-based compensation expense | 442 | 496 | (54) | 1,308 | 1,481 | (173) |
| Deferred compensation expense | 1,758 | 90 | 1,668 | 2,808 | 1,086 | 1,722 |
| Foreign exchange loss | 27 | 22 | 5 | 25 | 198 | (173) |
| General, administrative, and other | 2,254 | 3,085 | (831) | 7,854 | 8,756 | (902) |
| Segment total expenses | 4,682 | 4,420 | 262 | 12,196 | 13,337 | (1,141) |
| Loss before income taxes | \$(4,094) | \$(3,574) | \$(520) | \$(10,286) | \$(31,248) | \$20,962 |

The corporate segment consists of cash, fixed-income securities and equity securities, our investments in Mindjet and Synthonics, the assets, liabilities and the results of operations of our oil and gas venture, Mendell, and other parent company assets and liabilities which are not contained in other segments, including the assets and liabilities of the deferred compensation trusts held for the benefit of certain officers and non-employee directors. Revenue includes sales from our oil and gas operations, and realized gains or losses on the sale or impairment of securities and can vary considerably from year to year. The segment results above do not include our share of the income or loss from any investments we accounted for using the equity method during the respective years presented.

The expenses recorded in this segment primarily consist of parent company costs which are not allocated to our other segments, for example, salaries and benefits, directors' fees, shareholder costs, rent for our head office, stock-based compensation expense, deferred compensation expense, and expenses related to the operations of our oil and gas venture, which consists primarily of our administrative service agreement for the management and administration of the oil and gas wells.

Corporate segment results can fluctuate due to one or more individually significant revenue or expense items which occur irregularly, for example, realized gains or losses on the sale of investments, or which can change significantly from period to period, such as foreign currency gains or losses. Consequently, the corporate segment results are not typically comparable from year to year.

Deferred Compensation Revenue and Expense

The participants in the deferred compensation plan bear the risk of the investment return on the deferred compensation assets, similar to a defined contribution plan such as a 401(k) plan. The investment income and realized gains or losses from the deferred compensation assets are recorded as revenue in the period that they are earned, and a corresponding and offsetting cost or benefit is recorded as deferred compensation expense or recovery. The change in net unrealized appreciation or depreciation in the deferred compensation assets is charged to compensation expense. Once the deferred compensation has been distributed, over the lifetime of the assets, the revenue and deferred compensation expense equal and there is no net effect on segment results.

Segment Revenue

The year-over-year increase in segment revenue for the nine months ended September 30, 2016 was primarily due to the \$20.7 million impairment loss on our investment in Mindjet recorded during the second quarter of 2015, while there was no corresponding loss in the current year.

Included in other income was revenue from our oil and gas operations that increased to \$320,000 from \$243,000 for the three months ended September 30, 2016 and 2015, respectively, and to \$1.1 million from \$731,000 for the nine months ended September 30, 2016 and 2015, respectively. The increase in revenue year-over-year was primarily due to significantly higher production volumes of oil and gas, which was partially offset by lower market prices.

Segment Expenses

Excluding deferred compensation expense, segment costs and expenses decreased during the three and nine months ended September 30, 2016 as the Company recorded less stock-based compensation, impairment losses and continued to realize the impact of cost savings measures. The decrease in general, administrative and other expense in each period was the result of decreased salary and benefits expense from a reduction in executive compensation and staffing at the corporate office offset by an increase in legal fees and other costs related to shareholder matters. However, during the fourth quarter of 2016, the Company expects to record significant severance expense related to the termination of PICO's former President and Chief Executive Officer. See Note 12, "Subsequent Events," for additional information.

We recorded impairment losses of \$201,000 and \$1.8 million on our oil and gas wells during the first nine months of 2016 and 2015, respectively. An analysis based on current pricing of crude oil and gas, estimated oil and gas reserves, and ongoing expenses for the wells determined that the capitalized costs of the wells would not be recovered from the estimated future cash flows. The impairment loss reduced the assets down to their estimated fair values. In October 2016, we sold the majority of our oil and gas assets. See Note 12, "Subsequent Events," for additional information. We do not expect to allocate any additional capital to our oil and gas venture, and the remaining carrying value of the assets is not significant.

Deferred compensation expense increased to \$2.8 million from \$1.1 million for the nine months ended September 30, 2016 and 2015, respectively. The increase was due to appreciation of the marketable securities in the portfolio during the nine months ended September 30, 2016.

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

Discontinued Agribusiness Operations

| Thousands of dollars | Three Months | | Nine Months | |
|---|---------------|------------|-------------|------------|
| | Ended | | Ended | |
| | September 30, | | September | |
| | 2016 | 2015 | 2016 | 2015 |
| Revenue and other income (loss): | | | | |
| Sales of canola oil and meal | | \$9,600 | | \$82,267 |
| Other | | 18 | | (50) |
| Total revenue and other income | | 9,618 | | 82,217 |
| Cost of goods sold: | | | | |
| Cost of canola oil and meal sold | | 8,738 | | 79,763 |
| Depreciation | | 18 | | 4,360 |
| Other direct costs of production | | 1,155 | | 5,938 |
| Total cost of goods sold | | 9,911 | | 90,061 |
| Depreciation | | | | 95 |
| Impairment loss on intangible and long-lived assets | | | | 1,875 |
| Interest | | 428 | | 3,259 |
| Plant costs and overhead | \$18 | 9,504 | \$102 | 16,447 |
| Segment total expenses | 18 | 19,843 | 102 | 111,737 |
| Loss before income taxes | \$(18) | \$(10,225) | \$(102) | \$(29,520) |

We sold substantially all of the assets used in our agribusiness operations in 2015 and as a result, we no longer operate an agribusiness segment. We have classified our agribusiness operations as a discontinued agribusiness operation in the accompanying condensed consolidated financial statements. Although there are outstanding issues to resolve with respect to this sale, as of September 30, 2016, we do not expect to record any other significant expenses related to the operations or sale of our discontinued agribusiness operations. However, any future adjustments to the sale price, including resolution of possible indemnification obligations above our initial expectations, and any other costs and expenses incurred in connection with the disposition of the business will be reported within our discontinued agribusiness operations.

Liquidity and Capital Resources — Nine Months Ended September 30, 2016 and 2015

Cash Flow

At September 30, 2016, our assets consisted primarily of real estate and tangible and intangible water assets, cash and cash equivalents, and investments in publicly-traded securities. Our liquid funds are generally held in money market funds.

Our cash and cash equivalents and available-for-sale investments held in each segment at September 30, 2016 were as follows:

Water resource and water storage operations segment held cash of \$373,000.

Real estate operations segment held cash of \$27.6 million.

Corporate segment held cash of \$9.9 million and marketable equity and debt securities with a market value of \$20.5 million and \$4.4 million, respectively. The securities are held in deferred compensation rabbi trusts accounts that will be used to pay the related and offsetting deferred compensation liabilities although such assets could be used to pay creditors if needed. We expect to distribute a portion of the deferred compensation balance in April 2017 having a value of approximately \$22.8 million at September 30, 2016. See Note 12, "Subsequent Events" for additional information.

Discontinued agribusiness operations segment held cash of \$438,000.

Our primary sources of funds include existing cash, the sale of tangible and intangible water resource assets, loans and debt or equity offerings, and sales of our businesses. We are not subject to any debt covenants which limit our ability to obtain additional financing through debt or equity offerings. Debt covenants and restrictions in UCP limit us from transferring cash from those operations for use elsewhere in our Company. However, we expect to receive required cash distributions from UCP for minimum tax payments due as the underlying partnership generates taxable income. Regardless, cash flows from the majority of our real estate operations are restricted for use in those operations.

Our cash flows fluctuate depending on the capital requirements of our operating subsidiaries. The sale of and costs incurred to acquire and develop real estate and water assets are generally classified as operating activities in the condensed consolidated statement of cash flows. The cash flow profiles of our principal operating segments are as follows:

Water Resource and Water Storage Operations

A substantial portion of our revenue in this segment has come from sales of real estate and water assets. The assets are typically long-term water resource development projects to support growth for particular communities in the southwestern U.S. The timing and amount of sales and cash flows depend on a number of factors which are difficult to project, and cannot be directly compared from one period to another. Our project expenses are generally discretionary in nature.

Real Estate Operations

We are a homebuilder and developer in California, Washington State, North Carolina, South Carolina, and Tennessee. We finance additional acquisitions, development and construction costs from our existing cash, proceeds of the sale of existing lots and homes, and/or through external financing.

Certain of our debt agreements in our real estate operations contain various significant financial covenants, with each of which we were in compliance with at September 30, 2016, as follows:

1) Certain of our real estate debt include provisions that require minimum loan-to-value ratios. During the term of the loan, the lender may require us to obtain a third-party written appraisal of the underlying real estate collateral. If the appraised fair value of the collateral securing the loan is below the specified minimum, we may be required to make principal payments in order to maintain the required loan-to-value ratios. As of September 30, 2016, the lenders have not requested, and we have not obtained, any such appraisals.

2) UCP's senior notes limit its ability to, among other things, incur or guarantee additional unsecured and secured indebtedness (provided that UCP may incur indebtedness so long as UCP's ratio of indebtedness to its consolidated tangible assets (on a pro forma basis) would be equal to or less than 45% and provided that the aggregate amount of secured debt may not exceed the greater of \$75 million or 30% of UCP's consolidated tangible assets); pay dividends and make certain investments and other restricted payments; acquire unimproved real property in excess of \$75 million per fiscal year or in excess of \$150 million over the term of the notes, except to the extent funded with subordinated obligations or the proceeds of equity issuances; create or incur certain liens; transfer or sell certain assets; and merge or consolidate with other companies or transfer or sell all or substantially all of UCP's consolidated assets. Additionally, the notes require UCP to maintain at least \$50 million of consolidated tangible assets not subject to liens securing indebtedness; maintain a minimum net worth of \$175 million; maintain a minimum of \$15 million of unrestricted cash and/or cash equivalents; and not permit decreases in the amount of consolidated tangible assets by more than \$25 million in any fiscal year or more than \$50 million at any time.

UCP is actively considering three primary alternatives to meet their obligations with respect to the senior notes that mature in October 2017. UCP may seek to extend the maturity of the senior notes or refinance the senior notes with new senior notes, including the option to arrange new senior notes in the public or private capital markets if conditions are favorable. UCP may also seek to refinance the senior notes on a leverage neutral basis, by seeking to increase the amount of borrowings available under their acquisition, development and construction loans, which are secured by their real estate inventories. Finally, UCP's cash position, which they believe we will continue to grow prior to maturity of the senior notes, may be used to meet a portion of their obligations with respect to the senior notes. Alternatively, UCP may choose to combine some or all of these, or other, potential sources of capital to meet their obligations with respect to the senior notes. UCP's determination of how to meet their obligations with respect to the senior notes and their success in so doing, will depend upon various factors, including general market conditions, conditions in the credit markets, UCP's financial position, operating performance, the value of UCP's land inventories and prospects.

Corporate

On October 10, 2016, John R. Hart's employment as President and Chief Executive Officer of the Company was terminated, effective as of October 12, 2016. As a result, we will accrue \$10.4 million in severance benefits and vacation differential, remaining stock-based compensation, and any related expenses in the fourth quarter of 2016. In accordance with applicable regulations, we will be required to pay such severance benefits and vacation differential, stock settle the vested RSU, and distribute Mr. Hart's deferred compensation balance (which was valued at approximately \$22.8 million as of September 30, 2016), no earlier than six months and a day after the effective date of the termination. See Note 12, "Subsequent Events," for additional information.

Our corporate segment generated a modest amount of cash flow from the sale of oil and gas production from our wells in Colorado. During October 2016, we sold a majority of these assets for gross proceeds of \$10.2 million. After certain holdbacks and consideration of liabilities assumed by the buyer, we received \$9.2 million in cash with the potential to receive an additional \$587,000 if and when certain title defects are corrected. See Note 12, "Subsequent Events" for additional information. We do not expect to reinvest the proceeds or fund any additional capital into our oil and gas operations and expect to be completely out of the oil and gas business within six to nine months as we attempt to sell the remaining wells and leases.

Due to the depressed prices of oil and gas, we recorded impairment losses on our oil and gas assets during the nine months ended September 30, 2016 and September 30, 2015. It is reasonably possible that we will continue reporting operating and impairment losses from our oil and gas operations and remaining assets, although the remaining carrying value of such assets is immaterial.

Discontinued Agribusiness Operations

During the third quarter of 2015, we sold our agribusiness operations. After repayment of outstanding debt and selling and other related costs of the transaction, we received net proceeds of \$18.4 million. From these net proceeds we were required to deposit \$6 million in escrow to secure general indemnification obligations, with any balance remaining after payment of indemnification claims released in January 2017, and \$4.2 million in escrow for specified operational matters (the “operational escrow”). To date, no material claims have been made against the general indemnification.

Specified amounts of the operational escrow related to proposed amendments to two environmental permits. We resolved the air quality issue and had the \$2.4 million escrowed amount released to us in October 2015. However, during the nine months ended September 30, 2016, we were notified that the relevant regulatory authorities had not approved the waste water permit at the levels required under the sale agreement. Consequently, the remaining \$1.8 million operational escrow amount was released to CHS Inc. (“CHS”) in full satisfaction of the matter resulting in us recording the amount as additional loss on the sale of our discontinued operations for the nine months ended September 30, 2016.

We have also guaranteed up to \$8 million for any indemnification claims in excess of the \$6 million general indemnification escrow pursuant to the terms of a guaranty agreement by and between us and CHS, which was executed at the closing. This guaranty will remain in force for five years from the date of sale.

Consolidated Cash and Securities

At September 30, 2016, we had unrestricted and available cash and securities of \$9.7 million, which could be used for general corporate purposes. At December 31, 2015, we had unrestricted and available cash and securities of \$13.1 million.

We estimate that we have sufficient cash and available-for-sale investments to cover our cash needs for at least the next 12 months. In the long-term, we estimate that existing cash resources and cash from operations will provide us with adequate funding for future operations. However, if additional funding is needed, we could defer significant expenditures, sell assets, obtain a line of credit, or complete debt or equity offerings. Any additional equity offerings may be dilutive to our stockholders and any additional debt offerings may include operating covenants that could restrict our business.

Cash Flow

The following is a summary of our cash flows (in thousands):

| | Nine Months Ended September 30, | |
|---|------------------------------------|------------|
| | 2016 | 2015 |
| Cash provided by (used in): | | |
| Operating activities - continuing operations | \$(17,798) | \$(58,060) |
| Operating activities - discontinued agribusiness operations | (508) | (17,462) |
| Total operating activities | (18,306) | (75,522) |
| Investing activities - continuing operations | (727) | 4,696 |
| Investing activities - discontinued agribusiness operations | 8 | 100,098 |
| Total investing activities | (719) | 104,794 |
| Financing activities | 16 | (50,323) |
| Decrease in cash and cash equivalents | \$(19,009) | \$(21,051) |

Cash Flows From Operating Activities

The principal operating cash outflows from continuing operations for the first nine months of 2016 were \$225.4 million used to acquire and develop real estate and residential lots and housing and \$36.7 million used for overhead and various project expenses. Our cash inflows from continuing operations were \$243.2 million from sales of residential real estate and lots. Our discontinued agribusiness operations did not have any significant uses of cash during the first nine months of 2016.

The principal operating cash outflows from continuing operations for the first nine months of 2015 were \$200.2 million in cash to acquire and develop real estate and residential lots and housing and \$36.2 million for overhead and various project expenses. Our cash inflows from continuing operations were \$172.5 million from sales of residential real estate and lots, \$3.9 million from sales of water assets, and \$1.6 million from sales of oil and gas and other operational income. Our discontinued agribusiness operations used \$79.3 million for purchases of canola seed and \$19.9 million for overhead and various other plan expenses, offset by \$82 million provided from the sales of canola

oil and meal during the first nine months of 2015.

Cash Flows From Investing Activities

We did not have any significant cash flows from investing activities in our continuing operations or discontinued agribusiness operations for the first nine months of 2016.

Our primary cash inflows from investing activities of continuing operations for the first nine months of 2015 included \$8.4 million from the sale and maturity of debt and equity securities, offset by \$1.8 million used to purchase debt and equity securities and \$2 million used to purchase property, plant, and equipment. During the first nine months of 2015, investing activities from our discontinued agribusiness operations provided \$95.1 million in net proceeds from the sale of our discontinued agribusiness operations, which was comprised of gross proceeds from the sale of \$105.3 million less \$10.2 million held back in the operational escrow, and \$5 million in cash released from a debt service reserve account.

Cash Flows From Financing Activities

Our financing activities provided cash of \$106.7 million during the first nine months of 2016, from draws on our debt arrangements, which was used primarily to fund the acquisition and development of our real estate projects. We used cash of \$105.5 million primarily to repay mortgage debt when certain real estate properties were sold.

Financing activities, including discontinued agribusiness operations, used cash of 50.3 million during the first nine months of 2015, primarily due to repayments of debt of \$174.5 million, including \$96.6 million paid on debt arrangements in our discontinued agribusiness operations and \$77.9 million of mortgage debt repaid when certain real estate properties were sold. These uses of cash were offset by cash proceeds of \$125.3 million provided from our debt arrangements, including \$12.7 million from our working capital line of credit within our discontinued agribusiness operations and \$112.6 million used primarily to fund the acquisition and development of our real estate projects.

Our outstanding debt held by our continuing operations at September 30, 2016 was \$157.8 million all of which is in UCP and included various types of debt financing incurred for the acquisition, development and construction of real estate inventories and construction of homes, and the senior notes were also for general corporate purposes and working capital. Often, these debt obligations are secured by the underlying real estate. Certain loans are funded in full at the initial loan closing and others are revolving facilities. Although we cannot accurately predict the effect of inflation on our operations, we do not believe that inflation has had a material impact on our net revenues or results of operations, or is likely to in the foreseeable future.

Seasonality

Historically, the homebuilding industry experiences seasonal fluctuations in quarterly operating results and capital requirements. We typically experience the highest new home order activity in spring and summer, although this activity is also highly dependent on the number of active selling communities, timing of new community openings and other market factors. As it typically takes four to six months to construct a new home, we generally deliver more homes in the second half of the year as spring and summer home orders convert to home deliveries. Due to this seasonality, home starts, construction costs and related cash outflows have historically been highest in the second and third quarters, and the majority of cash receipts from home deliveries occur during the second half of the year. We expect this seasonal pattern to continue over the long term, although it may be affected by volatility in the homebuilding industry.

Off-Balance Sheet Arrangements

As of September 30, 2016, we had no off-balance sheet arrangements, other than those disclosed in this Form 10-Q, that have, or are reasonably likely to have, a material current or future effect on our consolidated financial condition, revenues or expenses, results of operations, liquidity, capital expenditure, or capital resources.

Item 3. Quantitative and Qualitative Disclosure about Market Risk

Our balance sheet includes a significant amount of assets and liabilities whose fair value is subject to market risk. Market risk is the risk of loss arising from adverse changes in market interest rates or prices. We currently have interest rate risk as it relates to investments in debt securities, and equity price risk as it relates to our marketable equity securities. The estimated fair value of our debt is based on cash flow models discounted at the then-current interest rates and an estimate of the then-current spread above those rates at which we could borrow, which are Level 3 inputs in the fair value hierarchy.

At September 30, 2016, we had \$4.4 million of marketable debt securities and \$20.5 million of marketable equity securities, and at December 31, 2015, we had \$4.5 million of debt securities and \$18.1 million of marketable equity securities, which were subject to market risk.

Our debt securities principally consist of bonds with short and medium terms to maturity. From time to time, we buy investment-grade bonds with short and medium term maturities to earn a higher return on liquid funds than is available from money market funds. We manage the interest risk by matching the maturity of the securities to budgeted cash requirements. The deferred compensation accounts hold both investment-grade and below investment-grade bonds. In the deferred compensation accounts, we manage interest rate risk by matching the maturities of the bonds to the participant's pre-selected payout schedule.

We use two models to report the sensitivity of our assets and liabilities subject to the above risks. For debt securities, we use duration modeling to calculate changes in fair value. The model calculates the price of a fixed maturity assuming a theoretical 100 basis point, or a 1% increase in interest rates and compares that to the current price of the security. At September 30, 2016 and September 30, 2015 the model did not calculate a material loss in fair value. For our marketable equity securities, we use a hypothetical 20% decrease in fair value to analyze the sensitivity. The hypothetical 20% decrease in fair value of our marketable equity securities would produce a loss in fair value of \$4.1 million and \$3.7 million at September 30, 2016 and 2015, respectively, which would reduce the unrealized appreciation in equity.

Actual results may differ from the hypothetical results assumed in this disclosure due to possible actions we may take to mitigate adverse changes in fair value, and because the fair value of securities may be affected by both factors related to the individual securities (e.g. credit concerns about a bond issuer) and general market conditions.

Item 4: Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision of and with the participation of our management, including our principal executive officer and principal financial officer, we evaluated the effectiveness of our disclosure controls and procedures, as such term is defined under Rules 13a-15(e) and 15(d)-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report on Form 10-Q.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the quarter ended September 30, 2016, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II: Other Information

Item 1: Legal Proceedings

None.

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 Quarterly Report on Form 10-Q 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-Q 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.

The risk factors in this report have been revised to incorporate changes to our risk factors from those included in our Annual Report on Form 10-K for the year ended December 31, 2015. The risk factors set forth below with an asterisk (*) next to the title are new risk factors or risk factors containing changes, including any material changes, from the risk factors previously disclosed in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015, as filed with the SEC.

General economic conditions could have a material adverse effect on our financial results, financial condition and the demand for and the fair value of our assets.

All of our businesses are sensitive to general economic conditions, whether internationally, nationally, or locally. General poor economic conditions and the resulting effect of non-existent or slow rates of growth in the markets in which we operate could have a material adverse effect on the demand for both our real estate and water assets. These poor economic conditions include higher unemployment, inflation, deflation, decreases in consumer demand, changes in buying patterns, a weakened dollar, higher consumer debt levels, and higher tax rates and other changes in tax laws or other economic factors that may affect commercial and residential real estate development.

Specifically, high national or regional unemployment may arrest or delay any significant recovery of the residential real estate markets in which we operate, which could adversely affect the demand for our real estate and water assets. Any prolonged lack of demand for our real estate and water assets could have a significant adverse effect on our revenues, results of operations, cash flows, and the return on our investment from these assets.

Our future revenue is uncertain and depends on a number of factors that may make our revenue, profitability, cash flows, and the fair value of our assets volatile.

Our future revenue and profitability related to our water resource and water storage operations will primarily be dependent on our ability to develop and sell or lease water assets. In light of the fact that our water resource and water storage operations represent a large percentage of our overall business at present, our long-term profitability and the fair value of the assets related to our water resource and water storage operations will be affected by various factors, including the drought in the southwest, regulatory approvals and permits associated with such assets, transportation arrangements, and changing technology. We may also encounter unforeseen technical or other difficulties which could result in cost increases with respect to our water resource and water storage development projects. Moreover, our profitability and the fair value of the assets related to our water resource and water storage operations is significantly affected by changes in the market price of water. Future sales and prices of water may fluctuate widely as demand is affected by climatic, economic, demographic and technological factors as well as the relative strength of the residential, commercial, financial, and industrial real estate markets. Additionally, to the extent that we possess junior or conditional water rights, during extreme climatic conditions, such as periods of low flow or drought, our water rights could be subordinated to superior water rights holders. The factors described above are not within our control.

Our future revenue, growth, and the demand for and the fair value of our assets related to our land development and homebuilding activities depends, in part, upon our ability to successfully identify and acquire attractive land parcels for development of single-family homes at reasonable prices. Our ability to acquire land parcels for new single-family homes may be adversely affected by changes in the general availability of land parcels, the willingness of land sellers to sell land prices at reasonable prices, competition for available land parcels, availability of financing to acquire land parcels, zoning and other market conditions. If the supply of land parcels appropriate for development of single-family homes is limited because of these factors, or for any other reason, our ability to grow and increase the fair value of our assets related to our land development and homebuilding business could be significantly limited, and our land development and homebuilding revenue and gross margin could remain static or decline and it could adversely affect the return on our investment from these assets.

One or more of the above factors in one or more of our operating segments could impact our revenue and profitability, negatively affect our financial condition and cash flows, cause our results of operations to be volatile, and could negatively impact our rate of return on our real estate and water assets and cause us to divest such assets for less than our intended return on our investment.

A downturn in the recent improvement that the homebuilding and land development industry has experienced would materially adversely affect our business, results of operations, and the demand for and the fair value of our assets.

The homebuilding industry experienced a significant and sustained downturn in recent years having been impacted by factors that include, but are not limited to, weak general economic and employment growth, a lack of consumer confidence, large supplies of resale and foreclosed homes, a significant number of homeowners whose outstanding principal balance on their mortgage loan exceeds the market value of their home and tight lending standards and practices for mortgage loans that limit consumers' ability to qualify for mortgage financing to purchase a home. These factors resulted in an industry-wide weakness in demand for new homes and caused a material adverse effect on the growth of the local economies and the homebuilding industry in the southwestern United States ("U.S.") markets where a substantial amount of our real estate and water assets are located, including the states of Nevada, Arizona, California, Colorado, and New Mexico. However, in 2012, we noted a significant improvement in the housing market which led to increased levels of real estate development activity. The continuation of the recent improvement in residential and commercial real estate development process and activity is essential for our ability to generate operating income in our water resource and water storage, and land development and homebuilding businesses. We are unable to predict whether and to what extent this recovery will continue or its timing. Any future slow-down in real estate and homebuilding activity could adversely impact various development projects within the markets in which our real estate and water assets are located and this could materially affect the demand for and the fair value of these assets and our ability to monetize these assets. Declines and weak conditions in the U.S. housing market have reduced our revenues and created losses in our water resource and water storage, and land development and homebuilding businesses in prior years and could do so in the future.

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

We expect that the current rate of growth of the economy will continue to have an impact on real estate market fundamentals. Depending on how markets perform both in the short and long-term, the state of the economy, both nationally and locally in the markets where our assets are concentrated, could result in a decline in the value of our existing real estate and water assets, or result in our having to retain such assets for longer than we initially expected, which would negatively impact our rate of return on our real estate and water assets, cause us to divest such assets for less than our intended return on investment, or cause us to incur impairments on the book values of such assets to estimated fair value. Such events would adversely impact our financial condition, results of operations and cash flows.

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

Both the demand and fair value of our real estate and water assets are significantly affected by the growth in population and the general state of the local economies where our real estate and water assets are located. These local economies may be affected by factors such as the local level of employment and the availability of financing and interest rates, where (1) our real estate and water assets are located, primarily in Arizona and northern Nevada, but also in Colorado and New Mexico and (2) our land development and homebuilding assets are located, primarily in California and also Washington, North Carolina, South Carolina and Tennessee. The unemployment rate in these states, as well as issues related to the credit markets, may prolong a slowdown of the local economies where our real estate and water assets are located. This could materially and adversely affect the demand for and the fair value of our real estate and water assets and, consequently, adversely affect our growth and revenues, results of operations, cash flows and the return on our investment from these assets.

The fair values of our real estate and water assets may decrease which could adversely affect our results of operations by impairments and write-downs.

The fair value of our water resource and water storage assets and our land and homebuilding assets depends on market conditions. We acquire water resources and land for expansion into new markets and for replacement of inventory and expansion within our current markets. The valuation of real estate and water assets is inherently subjective and based on the individual characteristics of each asset. Factors such as changes in regulatory requirements and applicable laws, political conditions, the condition of financial markets, local and national economic conditions, the financial condition of customers, potentially adverse tax consequences, and interest and inflation rate fluctuations subject valuations to uncertainties. In addition, our valuations are made on the basis of assumptions that may not prove to reflect economic or demographic reality. If population growth and, as a result, water and/or housing demand in our markets fails to meet our expectations when we acquired our real estate and water assets, our profitability may be adversely affected and we may not be able to recover our costs when we sell our real estate and water assets. We regularly review the value of our real estate and water assets. These reviews have resulted in significant impairments to our water resource assets and /or land development assets. Such impairments have adversely affected our results of operations and our financial condition in those years.

If future market conditions adversely impact the anticipated timing of and amount of sales of our real estate and water assets we may be required to record further significant impairments to the carrying value of our real estate and water assets which would adversely affect our results of operations and our financial condition.

* Our water resource and water storage operations are concentrated in a limited number of assets, making our profitability and the fair value of those assets vulnerable to conditions and fluctuations in a limited number of local economies.

We anticipate that a significant amount of our water resource and water storage segment revenue, results of operations and cash flows will come from a limited number of assets, which primarily consist of our water resources in Nevada and Arizona and our water storage operations in Arizona. Water resources in this region are scarce and we may not be successful in continuing to develop additional water assets. If we are unable to develop additional water assets, our revenues will be derived from a limited number of assets, primarily located in Arizona and Nevada. Our two most significant assets are our water storage operations in Arizona and our water resources to serve the northern valleys of Reno, Nevada. As a result of this concentration, our invested capital and results of operations will be vulnerable to the conditions and fluctuations in these local economies and potentially to changes in local government regulations.

Our Arizona Recharge Facility is one of the few private sector water storage sites in Arizona. We have approximately 251,000 acre-feet of water stored at the facility. In addition, we have approximately 157,000 acre-feet of water stored in the Phoenix Active Management Area. We have not stored any water on behalf of any customers and have not generated any material revenue from the recharge facility or from the water stored in the Phoenix Active Management Area. We believe that the best economic return on the assets arises from storing water when surplus water is available and selling this water in periods when water is in more limited supply. However, we cannot be certain that we will ultimately be able to sell the stored water at a price sufficient to provide an adequate economic profit, if at all.

We constructed a pipeline approximately 35 miles long to deliver water from Fish Springs Ranch to the northern valleys of Reno, Nevada. As of September 30, 2016, the total cost of the pipeline project, including our water credits, (net of impairment losses incurred to date) carried on our balance sheet is approximately \$83.9 million. To date, we have sold only a small amount of the water credits and we cannot provide any assurance that the sales prices we may obtain in the future will provide an adequate economic return, if at all. Furthermore, we believe the principal buyers of this water are likely real estate developers who are contending with the effects of the current weak demand that exists for new homes and residential development in this area. Any prolonged weak demand for new homes and residential development, and, as a result, for our assets in Nevada and Arizona, would have a material adverse effect on our future revenues, results of operations, cash flows, and the return on our investment from those assets.

We are subject to laws and regulations, which may increase our costs, result in liabilities, limit the areas in which we can build homes and delay completion of our projects.

Our real estate operations are subject to a variety of local, state, federal and other laws, statutes, ordinances, rules and regulations concerning the environment, hazardous materials, the discharge of pollutants and human health and safety. The particular environmental requirements which apply to any given project site vary according to multiple factors, including the site's location, its environmental conditions, the current and former uses of the site, the presence or absence of state- or federal-listed endangered or threatened plants or animals or sensitive habitats, and conditions at nearby properties. We may not identify all of these concerns during any pre-acquisition or pre-development review of project sites. Environmental requirements and conditions may result in delays, may cause us to incur substantial compliance and other costs, and can prohibit or severely restrict development and homebuilding activity in environmentally sensitive regions or in areas contaminated by others before we commence development. We are also subject to third-party challenges, such as by environmental groups or neighborhood associations, under environmental

laws and regulations governing the permits and other approvals for our real estate projects and operations. Sometimes regulators from different governmental agencies do not concur on development, remedial standards or property use restrictions for a project, and the resulting delays or additional costs can be material for a given project.

In addition, in cases where a state-listed or federally-listed endangered or threatened species is involved and related agency rule-making and litigation are ongoing, the outcome of such rule-making and litigation can be unpredictable and can result in unplanned or unforeseeable restrictions on, or the prohibition of, development and building activity in identified environmentally sensitive areas.

Our real estate operations are also subject to numerous other laws and regulations that affect the land development and homebuilding process, including laws and regulations related to zoning, permitted land uses, levels of density, building design, water and waste disposal and use of open spaces. We are typically required to obtain permits, entitlements and approvals from local authorities to start and carry out residential development or home construction. Such permits, entitlements and approvals may, from time-to-time, be opposed or challenged by local governments or other interested parties, adding delays, costs and risks of non-approval to the process. Our obligation to comply with the laws and regulations under which we operate, and our need to ensure that our subcontractors and other agents comply with these laws and regulations may result in delays in construction and land development and may also cause us to incur substantial additional and unbudgeted costs.

We will face significant competition in marketing and selling new homes.

We have entered the homebuilding business by constructing, marketing and selling single-family homes on certain of our finished residential lots that we own in California, Washington, North Carolina, South Carolina and Tennessee. We aim to build homes only in those markets where we have identified that a sufficient demand exists for new homes. However, the homebuilding industry is highly competitive and we will be competing with a number of national and local homebuilders in selling homes to satisfy expected demand. These competitors, especially the national homebuilders, have greater resources and experience in this industry than we have. Such competition could result in lower than anticipated sales volumes and/or profit margins that are below our expectations. In addition, we will have to compete with the resale of existing homes, including foreclosed homes, which could also negatively affect the number and price of homes we are able to sell and the time our homes remain on the market.

We use leverage to finance a portion of the cost to acquire our land development assets and to construct homes.

We currently use, and expect to continue to use, debt to finance a portion of the cost of constructing our homes and acquiring and developing our lots. Such indebtedness is primarily comprised of project-level secured acquisition, development and construction loans, with recourse limited to the securing collateral.

Incurring debt could subject us to many risks that, if realized, would adversely affect us, including the risk that:

- our cash flow from our land development and homebuilding operations may be insufficient to make required payments of principal of and interest on the debt which is likely to result in acceleration of the maturity of such debt;
- our debt may increase our vulnerability to adverse economic and industry conditions with no assurance that investment yields will increase with higher financing cost;
- we may be required to dedicate a portion of our cash flow from our land development and homebuilding operations to payments on our debt, thereby reducing funds available for the operations and capital expenditures; and
- the terms of any refinancing may not be as favorable as the terms of the debt being refinanced.

If we do not have sufficient funds to repay our debt at maturity, it may be necessary to refinance the debt through additional debt or additional equity financings which could dilute our interest in our land development and homebuilding business. If, at the time of any refinancing, prevailing interest rates or other factors result in higher interest rates on refinancing, increases in interest expense could adversely affect our cash flows and results of operations. If we are unable to refinance our debt on acceptable terms, we may be forced to dispose of our land development and housing assets on disadvantageous terms, potentially resulting in losses. To the extent we cannot meet any future debt service obligations, we will risk losing some or all of our assets that may be pledged to secure our obligations to foreclosure. Defaults under our debt agreements used to finance a portion of the cost of constructing homes and acquiring and developing lots could have a material adverse effect on our land development and homebuilding business, prospects, liquidity, financial condition, results of operations, and the return on our investment from those assets.

We may be subject to significant warranty, construction defect and liability claims in the ordinary course of our homebuilding business.

As a homebuilder, we may be subject to home warranty and construction defect claims arising in the ordinary course of business. We may also be subject to liability claims for injuries that occur in the course of construction activities. Due to the inherent uncertainties in such claims, we cannot provide assurance that our insurance coverage or our subcontractors' insurance and financial resources will be sufficient to meet any warranty, construction defect and liability claims we may receive in the future. If we are subject to claims beyond our insurance coverage, our profit from our homebuilding activities may be less than we expect and our financial condition and the return on our investment from those assets may be adversely affected.

We will be relying on the performance of our subcontractors to build horizontal infrastructure and homes according to our budget, timetable and quality.

We rely on subcontractors to perform the actual construction of horizontal infrastructure (in the cases where we are completing the development of entitled lots to finished lots) and of the homes we are building on certain of our finished lots. In certain cases, we will also rely on the subcontractor to select and obtain raw materials. Our subcontractors may fail to meet either our quality control or be unable to build and complete the horizontal infrastructure or homes in the expected timetable due to subcontractor related issues such as being unable to obtain sufficient materials or skilled labor, or due to external factors such as delays arising from severe weather conditions.

Any such failure by our subcontractors could lead to increases in construction costs and construction delays. Such increases could negatively impact the price and number of finished lots and homes we are able to sell.

Our homebuilding operations may be adversely impacted by the availability of and the demand for mortgage financing and any changes to the tax benefits associated with owning a home.

To successfully market and sell the homes we construct depends on the ability of home buyers to obtain mortgage financing for the purchase of these new homes. Current credit requirements for mortgage financing are significantly greater than in the past which makes it more difficult for a potential home buyer to obtain mortgage financing. In addition, any significant increase in interest rates from current rates may also lead to increased mortgage finance costs leading to a decline in demand and availability of mortgage financing. Any decline in the availability of mortgage financing may lead to a reduced demand for the homes we have already constructed, or intend to construct. Furthermore, the demand for homes in general, and the homes we intend to construct, may be affected by changes in federal and state income tax laws. Current federal, and many state, tax laws allow the deduction of, among other homeowner expenses, mortgage interest and property taxes against an individual's taxable income. Any changes to the current tax laws which reduce or eliminate these deductions, or reduce or eliminate the exclusion of taxable gain from the sale of a principal residence, would likely lead to a greatly reduced demand for homes. This would lead to a materially adverse impact on the homebuilding business, and the fair value of those assets in general, and our revenues, cash flows, financial condition, and the return on our investment from those assets specifically.

* UCP has substantial indebtedness, which may exacerbate the adverse effect of any declines in UCP's business, industry or the general economy and exposes UCP to the risk of default. UCP may be unable to service their indebtedness.

As of September 30, 2016, UCP had approximately \$157.8 million of outstanding debt. UCP's substantial outstanding indebtedness, and the limitations imposed on UCP by the instruments and agreements governing its outstanding indebtedness, could have significant adverse consequences, including the following:

- UCP's cash flow may be insufficient to meet its required principal and interest payments;
- UCP may use a substantial portion of their cash flows to make principal and interest payments and UCP may be unable to obtain additional financing as needed or on favorable terms, which could, among other things, have a material adverse effect on their ability to complete our development pipeline, capitalize upon emerging acquisition opportunities, fund working capital or capital expenditures, or meet their other business needs;
- UCP may be unable to refinance its indebtedness at maturity or the refinancing terms may be less favorable than the terms of their original indebtedness;
- UCP may be forced to dispose of one or more of their properties, possibly on unfavorable terms or in violation of certain covenants to which UCP may be subject;
- UCP may be required to maintain certain debt and coverage and other financial ratios at specified levels, which may limit their ability to obtain additional financing in the future, thereby reducing their financial flexibility to react to

changes in their business;

• UCP's vulnerability to general adverse economic and industry conditions may be increased;

- approximately \$78.2 million of UCP's indebtedness bears interest at variable rates, which exposes it to increased interest expense in a rising interest rate environment;

• UCP may be at a competitive disadvantage relative to its competitors that have less indebtedness;

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UCP's flexibility in planning for, or reacting to, changes in their business and the markets in which UCP operates may be limited; and

UCP may default on its indebtedness by failure to make required payments or to comply with certain covenants, which could result in an event of default entitling a creditor to declare all amounts owed to it to be due and payable, and possibly entitling other creditors (due to cross-default or cross-acceleration provisions) to accelerate the maturity of amounts owed to such other creditors or, if such indebtedness is secured, to foreclose on UCP's assets that secure such obligation.

The occurrence of any one of these events could have a material adverse effect on our financial condition, liquidity, results of operations and/or business.

We may suffer uninsured losses or suffer material losses in excess of insurance limits.

We could suffer physical damage to any of our assets at one or more of our different businesses and liabilities resulting in losses that may not be fully recoverable by insurance. In addition, certain types of risks, such as personal injury claims, may be, or may become in the future, either uninsurable or not economically insurable, or may not be currently or in the future covered by our insurance policies or otherwise be subject to significant deductibles or limits. Should an uninsured loss or a loss in excess of insured limits occur or be subject to deductibles, we could sustain financial loss or lose capital invested in the affected asset(s) as well as anticipated future income from that asset. In addition, we could be liable to repair damage or meet liabilities caused by risks that are uninsured or subject to deductibles.

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

We have filed certain water rights applications in Nevada and New Mexico. In Nevada this is primarily as part of the water teaming agreement with Lincoln County. We deploy the capital required to enable the filed applications to be converted into permitted water rights over time as and when we deem appropriate or as otherwise required. We only expend capital in those areas where our initial investigations lead us to believe that we can obtain a sufficient volume of water to provide an adequate economic return on the capital employed in the project. These capital expenditures largely consist of drilling and engineering costs for water production, costs of monitoring wells, legal and consulting costs for hearings with the State Engineer, and NEPA compliance costs. Until the State Engineer in the relevant state permits the water rights we are applying for, we cannot provide any assurance that we will be awarded all of the water that we expect based on the results of our drilling and our legal position and it may be a considerable period of time before we are able to ascertain the final volume of water rights, if any, that will be permitted by the State Engineers. Any significant reduction in the volume of water awarded to us from our original base expectation of the amount of water that may be permitted may result in the write down of capitalized costs which could adversely affect the return on our investment from those assets, our revenues, results of operations, and cash flows.

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

We value our water assets, in part, based upon the volume (as measured in acre-feet) of water we anticipate from water rights applications and our permitted water rights. The water and water rights held by us and the transferability of these rights to other uses, persons, and places of use are governed by the laws concerning water rights in the states of Arizona, Colorado, Nevada, and New Mexico. The volumes of water actually derived from the water rights applications or permitted rights may vary considerably based upon physical availability and may be further limited by applicable legal restrictions.

As a result, the volume of water anticipated from the water rights applications or permitted rights may not in every case represent a reliable, firm annual yield of water, but in some cases describe the face amount of the water right claims or management's best estimate of such entitlement. Additionally, we may face legal restrictions on the sale or transfer of some of our water assets, which may affect their commercial value. If the volume of water yielded from our water rights applications is less than our expectations, or we are unable to transfer or sell our water assets, we may lose some or all of our anticipated returns, which may adversely affect our revenues, profitability and cash flows.

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

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

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

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

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

The water assets we hold and the transferability of these assets and rights to other uses, persons, or places of use are governed by the laws concerning water rights in the states of Arizona, Nevada, Colorado and New Mexico. Our sale of water assets is subject to the risks of delay associated with receiving all necessary regulatory approvals and permits. Additionally, the transfer of water resources from one use to another may affect the economic base or impact other issues of a community including development, and will, in some instances, be met with local opposition. Moreover, municipalities who will likely regulate the use of any water we might sell to them in order to manage growth, could create additional requirements that we must satisfy to sell and convey water assets.

If we are unable to effectively transfer, sell and convey water resources, our ability to monetize these assets will suffer and our return on investment, revenues and financial condition would decline.

If our businesses or investments otherwise fail or decline in value, our financial condition and the return on our investment could suffer.

Historically, we have acquired and invested in businesses and assets that we believed were undervalued or that would benefit from additional capital, restructuring of operations, strategic initiatives, or improved competitiveness through operational efficiencies. If any previously acquired business, investment or asset fails or its fair value declines, we could experience a material adverse effect on our business, financial condition, the results of operations and cash flows. If we are not successful managing our previous acquisitions and investments, our business, financial condition, results of operations and cash flows could be materially affected. Such business failures, declines in fair values, and/or failure to manage acquisitions or investments, could result in a negative return on equity. We could also lose part or all of our capital in these businesses and experience reductions in our net income, cash flows, assets and equity.

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

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

We currently anticipate that our available capital resources and operating cash flows will be sufficient to meet our expected working capital and capital expenditure requirements for at least the next 12 months. However, we cannot provide any assurance that such resources will be sufficient to fund our business. We may raise additional funds through public or private debt, equity or hybrid securities financings, including, without limitation, through the issuance of securities. We currently have an effective shelf registration statement which allows us to sell up to \$400 million of a variety of securities in one or more offerings in the public markets.

We may experience difficulty in raising necessary capital in view of the recent volatility in the capital markets and increases in the cost of finance. Increasingly stringent rating standards could make it more difficult for us to obtain financing. If we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our shareholders could be significantly diluted, and these newly issued securities may have rights, preferences or privileges senior to those of existing shareholders. Indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations. The additional financing we may need may not be available to us, or on favorable terms. If adequate funds are not available or are not available on acceptable terms, if and when needed, our ability to fund our operations or otherwise execute our strategic plan would be significantly limited. In any such case, our business, operating results or financial condition could be materially adversely affected.

* Our ability to utilize net operating loss carryforwards and certain other tax attributes may be limited.

Under Section 382 of the Internal Revenue Code of 1986, as amended, if our Company undergoes an “ownership change” (generally defined as a greater than 50% change (by value) in our equity ownership over a three year period), the ability to use our pre-change net operating loss carryforwards and other pre-change tax attributes to offset our post-change income may be limited. We may experience ownership changes in the future as a result of shifts in our stock ownership. As of September 30, 2016, we had federal and state net operating loss carryforwards of approximately \$139.6 million and \$193.4 million, respectively, which, depending on our value at the time of any ownership changes, could be limited.

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

To run our day-to-day operations and to successfully manage our businesses we must, among other things, continue to retain key management. We rely on the services of a small team of key executive officers. If they depart, it could have a significant adverse effect upon our business. Also, increased competition for skilled management and staff employees in our businesses could cause us to experience significant increases in operating costs and reduced profitability.

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

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

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

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

- quarterly variations in financial performance and condition of our various businesses;
- shortfalls in revenue or earnings from estimates forecast by securities analysts or others;
- changes in estimates by such analysts;

the ability to monetize our assets, including assets related to our water resource and real estate businesses, for an adequate economic return;

- our competitors' announcements of extraordinary events such as acquisitions;
- litigation; and
- general economic conditions and other matters described herein.

Our results of operations have been subject to significant fluctuations, particularly on a quarterly basis, and our future results of operations could fluctuate significantly from quarter to quarter and from year to year. Causes of such fluctuations may include the inclusion or exclusion of operating earnings from sold operations, one time transactions, and impairment losses. Statements or changes in opinions, ratings, or earnings estimates made by brokerage firms or industry analysts relating to the markets in which we do business or relating to us specifically could result in an immediate and adverse effect on the market price of our common stock. Such fluctuations in the market price of our common stock could affect the value of your investment and your ability to sell your shares.

Litigation may harm our business or otherwise distract our management.

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

* We have been, and continue to be, the subject of stockholder activism efforts that could cause a material disruption to our business.

Certain investors have taken steps to involve themselves in the governance and strategic direction of our Company due to governance and strategic-related disagreements with us. While we have formally settled with certain of such activists, other investors could take steps to involve themselves in the governance and strategic direction of our Company. For example, we have received communications from River Road Asset Management, LLC regarding various governance and strategic matters. Such stockholder activism efforts could result in substantial costs and diversion of management's attention and resources, harming our business and adversely affecting the market price of our common stock.

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

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

If equity analysts do not publish research or reports about our business or if they issue unfavorable commentary or downgrade our common stock, the price of our common stock could decline.

The trading market for our common stock will rely in part on the research and reports that equity research analysts publish about us and our business. We do not control these analysts. The price of our stock could decline if one or more equity analysts downgrade our stock or if those analysts issue other unfavorable commentary or cease publishing reports about us or our business.

Our business could be negatively impacted by cyber security threats.

In the ordinary course of our business, we use our data centers and our networks to store and access our proprietary business information. We face various cyber security threats, including cyber security attacks to our information technology infrastructure and attempts by others to gain access to our proprietary or sensitive information. The procedures and controls we use to monitor these threats and mitigate our exposure may not be sufficient to prevent cyber security incidents. The result of these incidents could include disrupted operations, lost opportunities, misstated

financial data, liability for stolen assets or information, increased costs arising from the implementation of additional security protective measures, litigation and reputational damage. Any remedial costs or other liabilities related to cyber security incidents may not be fully insured or indemnified by other means.

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

Item 2: Unregistered Sales of Equity Securities and Use of Proceeds

See Note 6 “Debt” in Notes to Condensed Consolidated Financial Statements for a discussion of working capital restrictions and other limitations upon the payment of dividends, which information is incorporated by reference into this Item 2 of Part II.

Item 3: Defaults Upon Senior Securities

None.

Item 4: Mine Safety Disclosures

Not applicable.

Item 5: Other Information

None.

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Item 6. Exhibits

| Exhibit Number | Description |
|----------------|--|
| 2.1 | Asset Purchase Agreement dated July 13, 2015, by and between PICO Northstar Hallock, LLC and CHS Hallock, LLC. ⁽¹⁾ |
| 3.1 | Amended and Restated Articles of Incorporation of PICO Holdings, Inc. ⁽²⁾ |
| 3.2 | Certificate of Amendment of Amended and Restated Articles of Incorporation of PICO Holdings, Inc. ⁽⁵⁾ |
| 3.3 | Amended and Restated By laws of PICO Holdings, Inc. ⁽³⁾ |
| 3.4 | Amendment to Amended and Restated Bylaws of PICO Holdings, Inc. ⁽⁵⁾ |
| 4.1 | Indenture, dated October 21, 2014, among UCP, Inc., the guarantors named therein, and Wilmington Trust, National Association, as trustee. ⁽⁴⁾ |
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 (Section 906 of the Sarbanes-Oxley Act of 2002). |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 (Section 906 of the Sarbanes-Oxley Act of 2002). |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

⁽¹⁾ Incorporated by reference to Form 8-K filed with the SEC on July 17, 2015.

⁽²⁾ Incorporated by reference to the Quarterly Report on Form 10-Q filed with the SEC on November 7, 2007.

⁽³⁾ Incorporated by reference to Form 8-K filed with the SEC on May 19, 2009.

⁽⁴⁾ Incorporated by reference to Form 8-K filed with the SEC on October 24, 2014.

⁽⁵⁾ Incorporated by reference to Form 8-K filed with the SEC on July 13, 2016.

PICO HOLDINGS, INC. AND SUBSIDIARIES

SIGNATURE

Pursuant to the requirements of the United States Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PICO
HOLDINGS,
INC.

Date: November 1, 2016, By: /s/ John
T. Perri
John T. Perri
Chief
Financial
Officer
(Principal
Financial
Officer and
Authorized
Signatory)