KBRA Affirms Rating for Heritage Insurance Holdings, Inc. and its Key Operating Subsidiaries

NEW YORK (October 2, 2019) – Kroll Bond Rating Agency (KBRA) affirms the following insurance financial strength ratings (IFSR) to the key operating subsidiaries of Heritage Insurance Holdings, Inc. (HIH) (NYSE: HRTG): BBB+ to Heritage Property & Casualty Insurance Company (HPCIC); A- to Narragansett Bay Insurance Company (NBIC); and BBB+ to Zephyr Insurance Company, Inc. (ZIC) (collectively referred to as Heritage). Additionally, KBRA affirms the issuer rating of BBB- to HIH. The Outlook for all ratings is Stable. Heritage is a leading U.S. domestic residential property insurer with headquarters in Clearwater, Florida.

The ratings for Heritage's operating companies, Heritage Property & Casualty Insurance Company (HPCIC), Narragansett Bay Insurance Company (NBIC), and Zephyr Insurance Company, Inc. (ZIC), reflect the favorable operating results, continued progress in executing the organization's strategy to geographically diversify its business profile, and adequate capitalization with conservatively invested asset portfolios. Since 2016 through the first half of 2019, Heritage has generated $190 million in cumulative operating profits, despite active hurricane seasons in the last three years. Collectively across the organization, Heritage has continued to adhere to its strategic plan to actively grow and diversify the business organically, and through acquisitions when suitable. KBRA notes that approximately 30% of Heritage's total insured values (TIV) is produced by HPCIC (southeast U.S. exposure), 60% by NBIC (northeast U.S. exposure), and 10% by ZIC (Hawaii exposure). The Heritage operating companies also became members of the FHLB over the last twelve months affording HPCIC, NBIC, and ZIC access to additional, low cost borrowing capability. Additionally, KBRA positively views Heritage's diversified product distribution—including agency networks and large strategic partnerships.

As a catastrophe-exposed property writer, Heritage must maintain a prudent catastrophe excess of loss reinsurance structure designed to absorb multiple severe events. Currently, Heritage's programs are designed to provide adequate coverage in excess of statutory requirements for HPCIC, NBIC, and ZIC, along with coverage for additional events through reinstatements. The first event retention, on a pre-tax basis, for each insurance company subsidiary is: HPCIC – $20.0 million (13% of surplus); NBIC – $13.8 million (13% of surplus); and ZIC - $20.0 million (24% of surplus). The first event retentions relative to surplus remained near expiring levels.

Tempering these strengths are the organization's exposure to natural catastrophes. Additionally, any sizeable hurricane activity or significant change in limits/costs for reinsurance may constrain the operating position (profitability/leverage) of any affected insurance subsidiary. In 2018, HPCIC was supported with additional paid-in capital to replace surplus lost as a result of another active hurricane season and elevated attritional losses in Florida. While the new business mix and TIV continues to shift away from Florida, Heritage (specifically, HPCIC) continues to be a significant Florida property writer, susceptible to a higher frequency of catastrophe events; however, an evolving claim environment as a result of AOB reform legislation may prove beneficial. Moreover, KBRA believes that full integration of NBIC into the company as well as organic expansion to additional states (newly licensed in Delaware, Maryland, and Virginia) involves moderate execution risk.

The organization's publicly traded holding company, Heritage Insurance Holdings, Inc. (HIH) [NYSE: HRTG] benefits from the operating results of the insurance entities as well as its service and claims subsidiaries. HIH can access cash resources through substantial intercompany cash-flows from Heritage MGA, LLC, its managing general agent, and

Contractors' Alliance Network, LLC, a vendor network manager for claims. Heritage continues to integrate the agency and claims services across the organization, principally extending these services to ZIC and NBIC subsequent to being acquired. The revenue and earnings from these subsidiaries alone can support holding company obligations, including interest payments, as well as potential contributions to the operating companies. In the fourth quarter of 2018, the company restructured its current debt to reduce interest expense by retiring, through a combination of cash and share issuances, the 2016 Senior Secured Notes and a large portion of the 2017 Convertible Senior Notes coinciding with entering into a new Senior Secured Credit Facility. HIH's debt-to-capital ratio at Q2 2019 is approximately 23%, down from 31% in the prior year period. The company was in compliance with all covenants through the second quarter of 2019.

A surveillance report will be forthcoming.

Related Publications: (available at **www.kbra.com**)

- **Global Insurer & Insurance Holding Company Rating Methodology**
- **Are Two (IFSR) Ratings Better Than One? You Decide**

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