

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2019

or

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

For the transition period from _____ to _____

Commission file number: 001-36822

InfraREIT, Inc.

(Exact name of Registrant as specified in its charter)

Maryland
(State or Other Jurisdiction of
Incorporation or Organization)

1900 North Akard Street
Dallas, Texas 75201
(Address of Principal Executive Offices)

75-2952822
(I.R.S. Employer
Identification Number)

75201
(Zip Code)

(214) 855-6700

(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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

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

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

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

<u>Title of Each Class</u>	<u>Trading Symbol</u>	<u>Name of Each Exchange on Which Registered</u>
Common Stock, \$0.01 par value per share	HIFR	New York Stock Exchange

As of April 29, 2019, the registrant had 44,005,370 shares of common stock, \$0.01 par value per share, outstanding.

InfraREIT, Inc.

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GLOSSARY OF TERMS

This glossary highlights some of the industry terms that we use in this Quarterly Report on Form 10-Q and is not a complete list of all defined terms used herein.

Abbreviation	Term
AFUDC	allowance for funds used during construction
CREZ	competitive renewable energy zones, as defined by a 2005 Texas law establishing the Texas renewable energy program
distribution	that portion of a power delivery network consisting of an interconnected group of electric distribution lines, towers, poles, substations, transformers and associated assets over which electric power is distributed from points within the transmission network to end use consumers
distribution service territory	a designated area in which a utility is required or has the right to supply electric service to ultimate customers under a regulated utility structure
Footprint Projects	transmission or, if applicable, distribution projects that (1) are primarily situated within our current or previous distribution service territory, as applicable; (2) physically hang from our existing transmission assets, such as the addition of another circuit to our existing transmission lines, or that are physically located within one of our substations; or (3) connect or are otherwise added to transmission lines or other property that comprise a part of the transmission assets acquired in the 2017 Asset Exchange Transaction (as defined below). Footprint Projects do not include the addition of a new substation on our existing transmission lines or generation interconnects to our existing transmission lines, unless the addition or interconnection occurred within our current or prior distribution service territories
PUCT	Public Utility Commission of Texas
rate base	calculated as our gross electric plant in service under U.S. GAAP (as defined below), which is the aggregate amount of our total cash expenditures used to construct such assets plus AFUDC, less accumulated depreciation and adjusted for accumulated deferred income taxes, regulatory liabilities and regulatory assets
regulated assets	rate-regulated electric transmission and distribution assets, as applicable, such as power lines, substations, transmission towers, distribution poles, transformers and related property and assets
SEC	U.S. Securities and Exchange Commission
Sharyland	Sharyland Utilities, L.P., a Texas-based regulated electric utility and our sole tenant
transmission	that portion of a power delivery network consisting of an interconnected group of electric transmission lines, towers, poles, switchyards, substations, transformers and associated assets over which electric power is transmitted between points of supply or generation and distribution
U.S. GAAP	accounting principles generally accepted in the United States of America

F FORWARD-LOOKING STATEMENTS

Some of the information in this Quarterly Report on Form 10-Q may contain forward-looking statements. Forward-looking statements give InfraREIT, Inc.'s (we, Company or InfraREIT) current expectations and include projections of results of operations or financial condition or forecasts of future events. Words such as "could," "will," "may," "assume," "forecast," "position," "predict," "strategy," "expect," "intend," "plan," "estimate," "anticipate," "believe," "project," "budget," "potential" or "continue" and similar expressions are used to identify forward-looking statements. Without limiting the generality of the foregoing, forward-looking statements contained in this document include our expectations regarding our strategies, objectives, growth and anticipated financial and operational performance, including guidance regarding our capital expenditures, infrastructure programs and estimated distributions to our stockholders.

A forward-looking statement may include a statement of the assumptions or bases underlying the forward-looking statement. We believe that we have chosen these assumptions or bases in good faith and that they are reasonable. However, the assumptions and estimates underlying the forward-looking statements included in this document are inherently uncertain and are subject to a wide variety of significant business, economic and competitive risks and uncertainties that could cause actual results to differ materially from those contained in this document. Accordingly, when considering these forward-looking statements, you should keep in mind the risk factors and other cautionary statements in this document, and you are cautioned not to place undue reliance on any forward-looking statements. You should also understand that it is not possible to predict or identify all such factors, and you should not consider the following list to be a complete statement of all potential risks and uncertainties. Factors that could cause our actual results to differ materially from the results contemplated by such forward-looking statements include:

- delays in achieving, or failure to achieve, the sale of InfraREIT to Oncor Electric Delivery Company LLC (Oncor) or related transactions, including the asset exchange with Sharyland, whether due to the failure to obtain required approvals or to obtain necessary regulatory approvals on favorable terms or due to other unsatisfied closing conditions, including a termination of the sale under circumstances that could require us to pay a termination fee;
- decisions by regulators or changes in governmental policies or regulations with respect to our organizational structure, lease arrangements, capitalization, acquisitions and dispositions of assets, recovery of investments, authorized rate of return and other regulatory parameters;
- our current reliance on our tenant for all our lease revenue and, as a result, our dependency on our tenant's solvency and financial and operating performance;
- the amount of available investment to grow our rate base;
- cyber breaches and weather conditions or other natural phenomena;
- our ability to negotiate future rent payments or renew leases with our tenant;
- insufficient cash available to meet distribution requirements;
- the price and availability of debt and equity financing;
- our level of indebtedness or debt service obligations;
- the effects of existing and future tax and other laws and governmental regulations;
- our failure to qualify or maintain our status as a real estate investment trust (REIT) or changes in the tax laws applicable to REITs;
- the termination of our management agreement or the loss of the services of Hunt Utility Services, LLC (Hunt Manager) or other qualified personnel;
- adverse economic developments in the electric power industry or in business conditions generally; and
- certain other factors discussed elsewhere in this Quarterly Report on Form 10-Q.

For the above reasons, there can be no assurance that any forward-looking statements included herein will prove to be indicative of our future performance or that actual results will not differ materially from those presented. In no event should the inclusion of forward-looking information in this document be regarded as a representation by any person that the results contained in such forward-looking information will be achieved.

Forward-looking statements speak only as of the date on which they are made. While we may update these statements from time to time, we are not required to do so other than pursuant to applicable laws. For a further discussion of these and other factors that could impact our future results and performance, see Part I, Item 1A., *Risk Factors* in our Annual Report on Form 10-K for the year ended December 31, 2018, filed with the SEC on February 27, 2019 (2018 Form 10-K).

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

InfraREIT, Inc.

CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

	<u>March 31, 2019</u>	<u>December 31, 2018</u>
	<u>(Unaudited)</u>	
Assets		
Current Assets		
Cash and cash equivalents	\$ 3,487	\$ 1,808
Restricted cash	1,693	1,689
Due from affiliates	33,126	38,174
Inventory	6,862	6,903
Prepays and other current assets	2,648	1,077
Total current assets	<u>47,816</u>	<u>49,651</u>
Electric Plant, net	1,814,584	1,811,317
Goodwill	138,384	138,384
Other Assets	31,671	31,678
Total Assets	<u>\$ 2,032,455</u>	<u>\$ 2,031,030</u>
Liabilities and Equity		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 20,881	\$ 19,657
Short-term borrowings	106,500	112,500
Current portion of long-term debt	8,919	8,792
Dividends and distributions payable	15,182	15,176
Accrued taxes	1,307	1,052
Total current liabilities	<u>152,789</u>	<u>157,177</u>
Long-Term Debt, Less Deferred Financing Costs	830,185	832,455
Regulatory Liabilities	119,362	115,532
Long-Term Operating Lease Liabilities	345	—
Total liabilities	<u>1,102,681</u>	<u>1,105,164</u>
Commitments and Contingencies		
Equity		
Common stock, \$0.01 par value; 450,000,000 shares authorized; 44,005,370 and 43,974,998 issued and outstanding as of March 31, 2019 and December 31, 2018, respectively	440	440
Additional paid-in capital	708,519	708,283
Accumulated deficit	<u>(29,278)</u>	<u>(32,022)</u>
Total InfraREIT, Inc. equity	679,681	676,701
Noncontrolling interest	<u>250,093</u>	<u>249,165</u>
Total equity	929,774	925,866
Total Liabilities and Equity	<u>\$ 2,032,455</u>	<u>\$ 2,031,030</u>

See accompanying notes to the unaudited consolidated financial statements.

InfraREIT, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended March 31,	
	2019	2018
Lease revenue	\$ 48,574	\$ 45,656
Operating costs and expenses		
General and administrative expense	7,087	6,088
Depreciation	12,204	11,577
Total operating costs and expenses	19,291	17,665
Income from operations	29,283	27,991
Other (expense) income		
Interest expense, net	(10,060)	(10,674)
Other income, net	1	733
Total other expense	(10,059)	(9,941)
Income before income taxes	19,224	18,050
Income tax expense	255	286
Net income	18,969	17,764
Less: Net income attributable to noncontrolling interest	5,224	4,900
Net income attributable to InfraREIT, Inc.	\$ 13,745	\$ 12,864
Net income attributable to InfraREIT, Inc. common stockholders per share:		
Basic	\$ 0.31	\$ 0.29
Diluted	\$ 0.31	\$ 0.29
Cash dividends declared per common share	\$ 0.25	\$ 0.25

See accompanying notes to the unaudited consolidated financial statements.

InfraREIT, Inc.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands, except share data)

(Unaudited)

	Number of Common Shares Outstanding	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Total InfraREIT, Inc. Equity	Noncontrolling Interest	Total Equity
Balance December 31, 2018	43,974,998	\$ 440	\$ 708,283	\$ (32,022)	\$ 676,701	\$ 249,165	\$ 925,866
Dividends and distributions	—	—	—	(11,001)	(11,001)	(4,180)	(15,181)
Redemption of operating partnership units for common stock	7,698	—	116	—	116	(116)	—
Common stock issued	22,674	—	—	—	—	—	—
Net income	—	—	—	13,745	13,745	5,224	18,969
Equity based compensation	—	—	120	—	120	—	120
Balance March 31, 2019	<u>44,005,370</u>	<u>\$ 440</u>	<u>\$ 708,519</u>	<u>\$ (29,278)</u>	<u>\$ 679,681</u>	<u>\$ 250,093</u>	<u>\$ 929,774</u>
Balance December 31, 2017	43,796,915	\$ 438	\$ 706,357	\$ (49,728)	\$ 657,067	\$ 243,791	\$ 900,858
Dividends and distributions	—	—	—	(10,990)	(10,990)	(4,186)	(15,176)
Redemption of operating partnership units for common stock	163,969	2	3,104	—	3,106	(3,106)	—
Net income	—	—	—	12,864	12,864	4,900	17,764
Equity based compensation	—	—	—	—	—	140	140
Balance March 31, 2018	<u>43,960,884</u>	<u>\$ 440</u>	<u>\$ 709,461</u>	<u>\$ (47,854)</u>	<u>\$ 662,047</u>	<u>\$ 241,539</u>	<u>\$ 903,586</u>

See accompanying notes to the unaudited consolidated financial statements.

InfraREIT, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended March 31,	
	2019	2018
Cash flows from operating activities		
Net income	\$ 18,969	\$ 17,764
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	12,204	11,577
Amortization of deferred financing costs	361	1,071
Allowance for funds used during construction - other funds	—	(730)
Equity based compensation	120	140
Changes in assets and liabilities:		
Due from affiliates	5,048	2,567
Inventory	41	(132)
Prepays and other current assets	(1,553)	(573)
Accounts payable and accrued liabilities	1,217	3,153
Net cash provided by operating activities	<u>36,407</u>	<u>34,837</u>
Cash flows from investing activities		
Additions to electric plant	(11,396)	(15,011)
Proceeds from asset exchange transaction	—	1,632
Net cash used in investing activities	<u>(11,396)</u>	<u>(13,379)</u>
Cash flows from financing activities		
Proceeds from short-term borrowings	22,000	12,000
Repayments of short-term borrowings	(28,000)	(17,500)
Repayments of long-term debt	(2,152)	(2,032)
Dividends and distributions paid	(15,176)	(15,169)
Net cash used in financing activities	<u>(23,328)</u>	<u>(22,701)</u>
Net increase (decrease) in cash, cash equivalents and restricted cash	1,683	(1,243)
Cash, cash equivalents and restricted cash at beginning of period	3,497	4,550
Cash, cash equivalents and restricted cash at end of period	<u><u>\$ 5,180</u></u>	<u><u>\$ 3,307</u></u>

See accompanying notes to the unaudited consolidated financial statements.

InfraREIT, Inc.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business and Presentation of Financial Statements

Basis of Presentation

InfraREIT, Inc. is a Maryland corporation, which may be referred to in these financial statements as the “Company,” “InfraREIT,” “we,” “us” and “our.” These unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2019 are not necessarily indicative of the results that may be expected for the year ending December 31, 2019. For further information, refer to the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2018 filed with the U.S. Securities and Exchange Commission (SEC) on February 27, 2019 (2018 Form 10-K).

We hold 72.5% of the outstanding partnership units (OP Units) in InfraREIT Partners, LP (Operating Partnership or InfraREIT LP) as of March 31, 2019 and are its general partner. We include the accounts of the Operating Partnership and its subsidiaries in our consolidated financial statements. Affiliates and current or former employees of Hunt Consolidated, Inc. (Hunt) and members of our board of directors hold the other 27.5% of the outstanding OP Units as of March 31, 2019.

Use of Estimates

The preparation of our consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Recent Accounting Guidance

Recently Adopted Accounting Guidance

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. ASU 2016-02 amended the existing accounting standard for lease accounting, including requiring lessees to recognize all leases on their balance sheets with terms of more than 12 months and making targeted changes to lessor accounting. In January 2018, the FASB issued ASU 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842*. ASU 2018-01 permits an entity to elect not to evaluate land easements under ASU 2016-02 that exist or expired before the entity’s adoption of ASU 2016-02 and that were not previously considered leases. In December 2018, the FASB issued ASU 2018-20, *Leases (Topic 842), Narrow-Scope Improvements for Lessors*, which permits an entity to elect not to evaluate whether certain sales taxes and other similar taxes are lessor or lessee costs, giving the entity the ability to exclude costs paid on behalf of the lessor by the lessee directly to third parties from the lessor’s income statement. In July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842): Targeted Improvements*, which provides an additional transition method. This transition method allows an entity to initially apply the new lease standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. We adopted the new guidance using this transition method and the other guidance discussed herein as of January 1, 2019. The adoption of the new guidance resulted in the recognition of \$0.4 million in right-of-use assets and operating lease liabilities related to land leases in which we are the lessee and additional disclosures related to all of our leases. See Note 16, *Leases* for additional information.

Recent Accounting Guidance Not Yet Adopted

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement*, which eliminates, modifies and adds disclosure requirements for fair value measurements. The amendments are effective for all entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented in the initial year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Early adoption is permitted. An entity is permitted to early adopt any removed or modified disclosures upon issuance of the guidance and delay adoption of the additional disclosures until their effective date. The Company is currently assessing the timing and impact of adopting the new guidance but does not expect it to have a material impact on the Company’s financial position or results of operations.

2. Pending Corporate Transactions

Sale and Asset Exchange

On October 18, 2018, InfraREIT and InfraREIT LP entered into a definitive agreement to be acquired by Oncor Electric Delivery Company LLC (Oncor) for \$21.00 per share or OP Unit, as applicable, in cash, valued at approximately \$1.275 billion, plus the assumption of InfraREIT's net debt of approximately \$940 million as of March 31, 2019. As a condition to Oncor's acquisition of InfraREIT, Sharyland Distribution & Transmission, L.L.C. (SDTS) and Oncor also signed a definitive agreement with Sharyland Utilities, L.P. (Sharyland) to exchange, immediately prior to Oncor's acquisition, SDTS's South Texas assets for Sharyland's Golden Spread Electric Cooperative interconnection located in the Texas Panhandle, along with certain development projects in the Texas Panhandle and South Plains regions, including the Lubbock Power & Light interconnection. The difference between the net book value of the exchanged assets will be paid in cash at closing. SDTS and Sharyland have agreed to terminate their existing leases in connection with the asset exchange.

The asset exchange with Sharyland and merger with Oncor are mutually dependent on one another, and neither will become effective without the closing of the other.

Arrangements with Hunt

Under the management agreement with Hunt Utility Services, LLC (Hunt Manager), which will be terminated upon the closing of the sale and asset exchange transaction described above, Hunt Manager is entitled to the payment of a termination fee upon the termination or non-renewal of the management agreement. The termination of the management agreement automatically triggers the termination of the development agreement between InfraREIT and Hunt. InfraREIT has agreed to pay Hunt approximately \$40.5 million at the closing of the transactions to terminate the management agreement, development agreement, leases with Sharyland, and all other existing agreements between InfraREIT or its subsidiaries and Hunt, Sharyland or their affiliates. This amount is consistent with the termination fee, as calculated at the time the Company entered into the omnibus termination agreement, contractually required under the management agreement.

Closing Conditions and Status

The closing of the transactions is dependent upon and subject to several closing conditions, including:

- Public Utility Commission of Texas (PUCT) approval of the transactions, including:
 - exchange of assets with Sharyland;
 - acquisition of InfraREIT by Oncor; and
 - Sempra Energy's 50% ownership of Sharyland Holdings LP;
- other necessary regulatory approvals, including approval by the Federal Energy Regulatory Commission (FERC), the expiration or termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (HSR Act) and clearance by the Committee on Foreign Investment in the United States (CFIUS);
- stockholder approval;
- certain lender consents; and
- other customary closing conditions.

Early termination of the 30-day waiting period required by the HSR Act was received in December 2018. In December 2018, the Operating Partnership's wholly-owned subsidiary, Transmission and Distribution Company, L.L.C. (TDC) and SDTS entered into amendments that, effective as of the closing, will satisfy the closing condition with respect to the lender consents. Additionally, a special meeting of InfraREIT's stockholders was held on February 7, 2019, at which time the stockholders voted to approve the transaction. Furthermore, in March 2019, CFIUS clearance was received for the transactions and FERC issued an order approving the transactions.

SDTS, Sharyland, Oncor and Sempra Energy filed a Sale-Transfer-Merger (STM) application with the PUCT on November 30, 2018. In April 2019, the parties to the STM proceeding filed a Stipulation (Settlement) with the PUCT, which is subject to review and approval by the PUCT. A hearing on the merits was held on April 10, 2019. The 180-day deadline for the STM is May 29, 2019, although the PUCT is permitted to extend that deadline for an additional 60 days if necessary.

During the three months ended March 31, 2019, we incurred expenses of \$1.7 million for the sale of InfraREIT and related transactions which are included in general and administrative expense on our Consolidated Statements of Operations. We did not have these expenses during the three months ended March 31, 2018 as the definitive agreements with respect to the transactions were not executed until October 2018.

We continue to expect the transactions to close by mid-2019, subject to obtaining the PUCT approval and satisfaction of other customary closing conditions. See Note 20, *Subsequent Events* for additional information.

3. Cash, Cash Equivalents and Restricted Cash

The following table provides a reconciliation of cash, cash equivalents and restricted cash within the Consolidated Balance Sheets that sum to the total of the same such amounts shown on the Consolidated Statements of Cash Flows:

<i>(In thousands)</i>	March 31,	
	2019	2018
Cash and cash equivalents	\$ 3,487	\$ 1,624
Restricted cash	1,693	1,683
Total cash, cash equivalents and restricted cash shown on the Statement of Cash Flows	<u>\$ 5,180</u>	<u>\$ 3,307</u>

Amounts included in restricted cash represent the principal and interest payable for two consecutive periods associated with the \$25.0 million senior secured notes of TDC, as described in Note 9, *Long-Term Debt*.

4. Related Party Transactions

We lease, through SDTS, all our regulated assets to Sharyland through several lease agreements. Under the leases, we have agreed to fund capital expenditures for footprint projects. Our leases define “footprint projects” to be transmission or, if applicable, distribution projects that (1) are primarily situated within our current or previous distribution service territory, as applicable, (2) physically hang from our existing transmission assets, such as the addition of another circuit to our existing transmission lines, or that are physically located within one of our substations or (3) connect or are otherwise added to transmission lines or other properties that comprise a part of the transmission assets acquired from Oncor in 2017 when SDTS exchanged all of its retail distribution assets for a group of Oncor’s transmission assets located near Wichita Falls, Abilene and Brownwood, Texas (2017 Asset Exchange Transaction). Footprint Projects do not include the addition of a new substation on our existing transmission lines or generation interconnections to our existing transmission lines, unless the addition or interconnection occurred within our current or prior distribution service territories.

We earned lease revenue from Sharyland under these agreements of \$48.6 million and \$45.7 million during the three months ended March 31, 2019 and 2018, respectively. In connection with our leases with Sharyland, we had a deferred rent liability of \$9.8 million and \$11.1 million as of March 31, 2019 and December 31, 2018, respectively, which is included in accounts payable and accrued liabilities on the Consolidated Balance Sheets.

In addition to rent payments that Sharyland makes to us, we and Sharyland also make payments to each other under the leases that primarily consist of payments to reimburse Sharyland for the costs of gross plant and equipment added to our regulated assets. For the three months ended March 31, 2019 and 2018, the net amount of payments we made to Sharyland was \$9.9 million and \$15.0 million, respectively.

As of March 31, 2019 and December 31, 2018, accounts payable and accrued liabilities on the Consolidated Balance Sheets included \$3.2 million and \$2.9 million, respectively, related to amounts owed to Sharyland for construction costs incurred and property taxes paid on our behalf. As of March 31, 2019 and December 31, 2018, amounts due from affiliates on the Consolidated Balance Sheets included \$33.1 million and \$38.2 million, respectively, related to amounts owed by Sharyland primarily associated with our leases.

The management fee paid to Hunt Manager for the three months ended March 31, 2019 and 2018 was \$3.4 million and \$3.5 million, respectively. There were no prepaid or accrued amounts associated with the management fees on the Consolidated Balance Sheets as of March 31, 2019 and December 31, 2018. Additionally, during the three months ended March 31, 2019 and 2018, we paid Hunt Manager less than \$0.1 million for reimbursement of annual software license and maintenance fees and other expenses in accordance with our management agreement.

The management agreement with Hunt Manager provides for an annual base fee, or management fee. The base fee for each 12 - month period beginning each April 1 will equal 1.50% of our total equity as of December 31 of the immediately preceding year, subject to a \$30.0 million cap. We must notify Hunt Manager no later than September 30, 2019 if we intend not to renew the management agreement at the end of its current term, which expires December 31, 2019. Otherwise, the management agreement will automatically renew for successive five-year terms unless a majority of our independent directors decides to terminate the agreement.

The base fees through December 31, 2019 are as follows:

<i>(In millions)</i>	Base Fee
April 1, 2017 - March 31, 2018	\$ 14.2
April 1, 2018 - March 31, 2019	13.5
April 1, 2019 - December 31, 2019	10.4

If the management agreement is renewed under its current terms, we would owe \$3.5 million for the first quarter of 2020, and the management fee owed for the subsequent 12-month period would be calculated as described above. If, instead, the management agreement is terminated, we would owe Hunt Manager a termination fee equal to three times the sum of the management fee paid during the four quarters prior to when the termination notice was given with payment due December 31, 2019. Assuming a termination notice of September 30, 2019, the termination fee would be approximately \$41.1 million. For information related to the pending sale of InfraREIT and asset exchange with Sharyland, including the proposed termination of the leases and management agreement, see Note 2, *Pending Corporate Transactions*.

In July 2017, SDTS and Sharyland entered into a letter agreement (Side Letter) in which they agreed to certain terms and conditions to address the actual or potential conflicts of interest arising between SDTS and Sharyland in connection with the 2017 Asset Exchange Transaction. Specifically, the Side Letter includes, among other things, certain representations and warranties from Sharyland that correspond to representations and warranties of SDTS under the 2017 Asset Exchange Agreement relating to certain matters for which SDTS relies, in whole or in part, upon Sharyland under the leases and as operator of the assets and an allocation of expenses incurred in connection with the transactions.

As a condition to Oncor's acquisition of InfraREIT, in October 2018 SDTS entered into a definitive agreement to exchange certain assets with Sharyland. See Note 2, *Pending Corporate Transactions* for additional information. The difference between the net book value of the exchanged assets will be paid in cash at closing.

In connection with the sale of InfraREIT and related transactions, in October 2018 we entered into an omnibus termination agreement pursuant to which the management agreement, development agreement, leases and all other existing agreements between us and Hunt, Sharyland or their affiliates will be terminated upon the closing. Under the omnibus termination agreement, we have agreed to pay Hunt approximately \$40.5 million upon the closing of the sale. This amount is consistent with the termination fee, as calculated at the time we entered into the omnibus termination agreement, contractually required under the management agreement. For additional information, see Note 2, *Pending Corporate Transactions*.

5. Electric Plant and Depreciation

The major classes of electric plant are as follows:

<i>(In thousands)</i>	March 31, 2019	December 31, 2018
Electric plant:		
Transmission plant	\$ 1,794,442	\$ 1,794,438
Distribution plant	151,698	151,698
General plant	3,210	3,023
Total plant in service	<u>1,949,350</u>	<u>1,949,159</u>
Construction work in progress	<u>77,568</u>	<u>66,121</u>
Total electric plant	2,026,918	2,015,280
Accumulated depreciation	(212,334)	(203,963)
Electric plant, net	<u>\$ 1,814,584</u>	<u>\$ 1,811,317</u>

General plant consists primarily of a warehouse, buildings and associated assets. Construction work in progress (CWIP) reflects the regulated asset projects in various stages of construction prior to being placed in service. The capitalized amounts of CWIP consist primarily of route development expenditures, labor and materials expenditures, right of way acquisitions, engineering services and legal fees. Electric plant, net includes plant acquisition adjustments of \$28.2 million and \$28.5 million as of March 31, 2019 and December 31, 2018, respectively.

6. Goodwill

Goodwill represents the excess of costs of an acquired business over the fair value of the assets acquired, less liabilities assumed. We conduct an impairment test of goodwill at least annually. As of March 31, 2019 and December 31, 2018, \$138.4 million was recorded as goodwill on the Consolidated Balance Sheets.

7. Other Assets

Other assets are as follows:

	March 31, 2019			December 31, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
<i>(In thousands)</i>						
Deferred financing costs on undrawn revolver	\$ 1,025	\$ (811)	\$ 214	\$ 1,025	\$ (779)	\$ 246
Other regulatory assets:						
Deferred financing costs	10,610	(5,810)	4,800	10,610	(5,490)	5,120
Deferred costs recoverable in future years	23,793	—	23,793	23,793	—	23,793
Other regulatory assets	34,403	(5,810)	28,593	34,403	(5,490)	28,913
Operating lease right-of-use asset	345	—	345	—	—	—
Investments	2,519	—	2,519	2,519	—	2,519
Other assets	\$ 38,292	\$ (6,621)	\$ 31,671	\$ 37,947	\$ (6,269)	\$ 31,678

Deferred financing costs on undrawn revolver consist of costs incurred in connection with the establishment of the InfraREIT LP revolving credit facility. See Note 8, *Borrowings Under Credit Facilities*.

Other regulatory assets consist of deferred financing costs within our regulated subsidiary, SDTS. The deferred financing costs primarily consist of debt issuance costs incurred in connection with the construction of SDTS's regulated assets or the refinancing of related debt. These assets are classified as regulatory assets and amortized over the length of the related loan. These costs are recovered through rates established in rate cases.

Deferred costs recoverable in future years of \$23.8 million at March 31, 2019 and December 31, 2018 represent operating costs incurred from the inception of Sharyland through 2007. We have determined that these costs are probable of recovery through future rates based on orders of the PUCT in Sharyland's prior rate cases and regulatory precedent.

Operating lease right-of-use asset represents the asset associated with two land leases in which we are the lessee. For additional information see Note 16, *Leases*.

In connection with the acquisition of Cap Rock Holding Corporation, we received a participation in the National Rural Utilities Cooperative Finance Corporation. We account for this investment under the cost method of accounting. We believe that the investment is not impaired as of March 31, 2019 and December 31, 2018.

8. Borrowings Under Credit Facilities

InfraREIT LP Revolving Credit Facility

In 2014, InfraREIT LP entered into a \$75.0 million revolving credit facility, led by Bank of America, N.A., as administrative agent, with up to \$15.0 million available for issuance of letters of credit and a maturity date of December 10, 2019. In December 2018, InfraREIT LP entered into an amendment to its revolving credit facility that extended the maturity date with respect to \$67.0 million of the available revolving credit facility to December 10, 2020. The remaining \$8.0 million of the available revolving credit facility will continue to mature on December 10, 2019.

The revolving credit facility is secured by certain assets of InfraREIT LP, including accounts and other personal property, and is guaranteed by us and TDC, with the TDC guarantee secured by the assets of, and InfraREIT LP's equity interests in, TDC on materially the same basis as TDC's senior secured notes described below in Note 9, *Long-Term Debt*.

Borrowings and other extensions of credit under the revolving credit facility bear interest, at InfraREIT LP's election, at a rate equal to (1) the one, two, three or six month London Interbank Offered Rate (LIBOR) plus 2.5%, or (2) a base rate (equal to the highest of (a) the Federal Funds Rate plus ½ of 1%, (b) the administrative agent's prime rate and (c) LIBOR plus 1%) plus 1.5%. Letters of credit are subject to a letter of credit fee equal to the daily amount available to be drawn times 2.5%. InfraREIT LP is also required to pay a commitment fee and other customary fees under the revolving credit facility. InfraREIT LP may prepay amounts outstanding under the revolving credit facility in whole or in part without premium or penalty.

As of March 31, 2019 and December 31, 2018, there were no borrowings or letters of credit outstanding, and there was \$75.0 million of borrowing capacity available under the revolving credit facility. As of March 31, 2019 and December 31, 2018, InfraREIT LP was in compliance with all debt covenants under the credit agreement.

SDTS Revolving Credit Facility

In 2014, SDTS entered into a third amended and restated credit agreement led by Royal Bank of Canada, as administrative agent. In December 2018, SDTS entered into an amendment to its revolving credit agreement that extended the maturity date from December 10, 2019 to December 10, 2020.

The credit agreement contains a revolving credit facility with a borrowing capacity up to \$250.0 million with up to \$25.0 million of the revolving credit facility available for issuance of letters of credit and up to \$5.0 million of the revolving credit facility available for swingline loans. The revolving credit facility is secured by certain of SDTS's regulated assets, the leases, certain accounts and TDC's equity interests in SDTS on the same basis as SDTS's various senior secured note obligations described below in Note 9, *Long-Term Debt*.

The interest rate for the revolving credit facility is based, at SDTS's option, at a rate equal to either (1) a base rate, determined as the greatest of (a) the administrative agent's prime rate, (b) the federal funds effective rate plus ½ of 1% and (c) LIBOR plus 1.00% per annum, plus a margin of either 0.75% or 1.00% per annum, depending on the total debt to capitalization ratio of SDTS on a consolidated basis or (2) LIBOR plus a margin of either 1.75% or 2.00% per annum, depending on the total debt to capitalization ratio of SDTS on a consolidated basis. SDTS is also required to pay a commitment fee and other customary fees under its revolving credit facility. SDTS is entitled to prepay amounts outstanding under the revolving credit facility with no prepayment penalty.

As of March 31, 2019, SDTS had \$106.5 million of borrowings outstanding at a weighted average interest rate of 4.49%, no letters of credit outstanding and \$143.5 million of borrowing capacity available under this revolving credit facility. As of December 31, 2018, SDTS had \$112.5 million of borrowings outstanding at a weighted average interest rate of 4.59% with no letters of credit outstanding and \$137.5 million of borrowing capacity available under this revolving credit facility. As of March 31, 2019 and December 31, 2018, SDTS was in compliance with all debt covenants under the credit agreement.

The credit agreements require InfraREIT LP and SDTS to comply with customary covenants for facilities of this type, including: debt to capitalization ratios; debt service coverage ratios; limitations on additional debt, liens, investments, mergers, acquisitions, dispositions or entry into any line of business other than the business of the transmission and distribution of electric power and the provision of ancillary services; and certain restrictions on the payment of dividends. The debt to capitalization ratio on the SDTS credit facility is calculated on a combined basis with Sharyland. The credit agreements also contain restrictions on the amount of Sharyland's indebtedness and other restrictions on, and covenants applicable to, Sharyland.

The revolving credit facilities of InfraREIT LP and SDTS are subject to customary events of default. If an event of default occurs under either facility and is continuing, the lenders may accelerate amounts due under such revolving credit facility.

9. Long-Term Debt

Long-term debt consisted of the following:

<i>(Dollar amounts in thousands)</i>	Maturity Date	March 31, 2019		December 31, 2018	
		Amount Outstanding	Interest Rate	Amount Outstanding	Interest Rate
TDC					
Senior secured notes - \$25.0 million	December 30, 2020	\$ 14,687	8.50%	\$ 15,000	8.50%
SDTS					
Senior secured term loan - \$200.0 million	June 5, 2020	200,000	3.74%	200,000	3.73%
Senior secured notes - \$400.0 million	December 3, 2025	400,000	3.86%	400,000	3.86%
Senior secured notes - \$100.0 million	January 14, 2026	100,000	3.86%	100,000	3.86%
Senior secured notes - \$53.5 million	December 30, 2029	37,762	7.25%	38,338	7.25%
Senior secured notes - \$110.0 million	September 30, 2030	86,712	6.47%	87,973	6.47%
Total SDTS debt		824,474		826,311	
Total long-term debt		839,161		841,311	
Less unamortized deferred financing costs		(57)		(64)	
Total long-term debt, less deferred financing costs		839,104		841,247	
Less current portion of long-term debt		(8,919)		(8,792)	
Debt classified as long-term debt, less deferred financing costs		\$ 830,185		\$ 832,455	

In 2010, TDC issued \$25.0 million aggregate principal amount of 8.50% per annum senior secured notes to The Prudential Insurance Company of America and affiliates (TDC Notes). Principal and interest on the TDC Notes are payable quarterly, and the TDC Notes are secured by the assets of, and InfraREIT LP's equity interest in, TDC on materially the same basis as with lenders under InfraREIT LP's revolving credit facility described above in Note 8, *Borrowings Under Credit Facilities*. In connection with the issuance of the TDC Notes, TDC incurred deferred financing costs, which are shown as a reduction of the senior secured notes balance. The amount of unamortized deferred financing costs associated with the TDC Notes was \$0.1 million as of March 31, 2019 and December 31, 2018.

In 2017, SDTS entered into a \$200.0 million senior secured term loan credit facility (2017 Term Loan) with Canadian Imperial Bank of Commerce, New York Branch (CIBC) and Mizuho Bank, Ltd., as lenders, and CIBC as administrative agent. The interest rate for the 2017 Term Loan is based, at SDTS's option, at a rate equal to either (1) a base rate, determined as the greatest of (a) the administrative agent's prime rate, (b) the federal funds effective rate plus 0.5% and (c) LIBOR plus 1.00% per annum, plus a margin of 0.25% per annum or (2) LIBOR plus a margin of 1.25% per annum. The LIBOR interest period may be one, two, three or six months, but interest is payable no less frequently than quarterly.

In 2015, SDTS issued \$400.0 million series A senior secured notes (Series A Notes), and in 2016 issued an additional \$100.0 million series B senior secured notes (Series B Notes). These senior secured notes are due at maturity and bear interest at a rate of 3.86% per annum, payable semi-annually. The outstanding accrued interest payable on the Series A Notes is due each June and December while the accrued interest payable on the Series B Notes is due each January and July.

In 2009, SDTS issued \$53.5 million aggregate principal amount of 7.25% per annum senior secured notes to The Prudential Insurance Company of America and affiliates (2009 Notes). Principal and interest on the 2009 Notes are payable quarterly.

In 2010, SDTS issued \$110.0 million aggregate principal amount of 6.47% per annum senior secured notes to The Prudential Insurance Company of America (2010 Notes). Principal and interest on the 2010 Notes are payable quarterly.

SDTS and TDC are entitled to prepay amounts outstanding under their senior secured notes, subject to a prepayment penalty equal to the excess of the discounted value of the remaining scheduled payments with respect to such notes over the amount of the prepaid notes. SDTS is entitled to prepay amounts outstanding under the 2017 Term Loan with no prepayment penalty. The 2017 Term Loan is also subject to required prepayments upon the occurrence of certain events.

The agreements governing the senior secured notes and 2017 Term Loan contain customary covenants, such as debt to capitalization ratios, debt service coverage ratios, limitations on liens, dispositions, mergers, entry into other lines of business, investments and the incurrence of additional indebtedness. The debt to capitalization ratios are calculated on a combined basis with Sharyland. SDTS's Series A Notes and Series B Notes are not required to maintain a debt service coverage ratio. As of March 31, 2019 and December 31, 2018, SDTS and TDC were in compliance with all debt covenants under the applicable agreements. See Note 2, *Pending Corporate Transactions* for information related to the pending sale of InfraREIT and asset exchange with Sharyland.

SDTS's Series A Notes, Series B Notes, 2009 Notes, 2010 Notes and 2017 Term Loan are secured by certain of SDTS's regulated assets, the leases, certain accounts and TDC's equity interests in SDTS on the same basis as SDTS's revolving credit facility described above in Note 8, *Borrowings Under Credit Facilities*.

The senior secured notes of TDC and SDTS and 2017 Term Loan are subject to customary events of default. If an event of default occurs with respect to the notes and is continuing, the lenders may accelerate the applicable amounts due.

10. Fair Value of Financial Instruments

The carrying amounts of our cash and cash equivalents, restricted cash, due from affiliates and accounts payable approximate fair value due to the short-term nature of these assets and liabilities.

We had fixed interest rate borrowings totaling \$639.2 million and \$641.3 million under our senior secured notes with a weighted average interest rate of 4.5% per annum as of March 31, 2019 and December 31, 2018. The fair value of these borrowings was estimated using discounted cash flow analysis based on current market rates.

As of March 31, 2019 and December 31, 2018, we had \$200.0 million of borrowings under our 2017 Term Loan that accrues interest under a floating interest rate structure, which is typically repriced every month or three months. Accordingly, the carrying value of such indebtedness approximated its fair value for the amounts outstanding.

Financial instruments, measured at fair value, by level within the fair value hierarchy were as follows:

<i>(In thousands)</i>	Carrying Value	Fair Value		
		Level 1	Level 2	Level 3
March 31, 2019				
Long-term debt	\$ 839,161	\$ —	\$ 882,033	\$ —
December 31, 2018				
Long-term debt	\$ 841,311	\$ —	\$ 864,281	\$ —

11. Regulatory Matters

Regulatory Liability

Regulatory liabilities are as follows:

<i>(In thousands)</i>	March 31, 2019	December 31, 2018
Cost of removal	\$ 63,583	\$ 59,753
Excess accumulated deferred federal income tax	55,779	55,779
Regulatory liabilities	<u>\$ 119,362</u>	<u>\$ 115,532</u>

Our regulatory liability related to cost of removal is established through depreciation rates and represents amounts that we expect to incur in the future. The regulatory liability is recorded as a long-term liability net of actual removal costs incurred.

As an owner of regulated utility assets, we established an accumulated deferred federal income tax (ADFIT) balance for regulatory purposes primarily associated with the difference between U.S. GAAP and federal income tax depreciation on our assets. Prior to the enactment of the Tax Cuts and Jobs Act (TCJA) in December 2017, this ADFIT was calculated based on a 35% corporate federal income tax rate but was not recorded on our consolidated balance sheets or income statements due to the expectation that we would not pay corporate federal income taxes as a result of our real estate investment trust (REIT) structure. With the passage of the TCJA, the corporate federal income tax rate was reduced to 21% effective for tax years beginning on or after January 1, 2018. Regulatory accounting rules require utilities to revalue their ADFIT balances based on a change in corporate federal income tax rates, to remove the difference from ADFIT and to create a regulatory liability for the reduction in ADFIT. Therefore, we reduced the ADFIT by \$55.8 million and created a regulatory liability for regulatory purposes. Additionally, in accordance with Accounting Standards Codification Topic 980, *Regulated Operations*, Section 405, *Liabilities*, we recorded the \$55.8 million regulatory liability on our Consolidated Balance Sheet as of December 31, 2017 with a corresponding reduction to our revenue as deferred tax liabilities had not previously been recorded on our Consolidated Balance Sheets. The regulatory liability will be amortized as an increase to revenue over a future period to be determined in a future rate proceeding. The amount and expected amortization of the regulatory liability could be adjusted in the future due to new laws, regulations or regulatory actions.

Rate Setting

We have separated, between Sharyland and SDTS, the functionality that is typically combined under one commonly owned group in an integrated utility. SDTS is generally responsible for financing and funding asset additions, while Sharyland is responsible for construction management, operation and maintenance of our regulated assets. Accordingly, the PUCT's order approving our restructuring into a REIT structure required Sharyland and SDTS to be regulated on a combined basis, and Sharyland, as the holder of the certificate of convenience and necessity (CCN) required to operate our regulated assets, historically has made all regulatory filings related to our assets with the PUCT. As part of the rate case in Docket No. 45414 related to SDTS's assets (2016 Rate Case), the PUCT raised certain questions indicating that this regulatory construct might change in the future, including the potential regulation of the leases between Sharyland and SDTS as tariffs. In November 2017, the 2016 Rate Case was dismissed upon the completion of the 2017 Asset Exchange Transaction (Rate Case Dismissal), but the dismissal preserved the right of the parties to the 2016 Rate Case to address in a future proceeding all issues not mooted by the Rate Case Dismissal. Additionally, as part of the PUCT order approving the 2017 Asset Exchange Transaction, SDTS was granted a separate CCN to continue to own and lease its assets to Sharyland.

The regulatory parameters in Sharyland's rates and applicable to our regulated assets provide for a capital structure consisting of 55% debt and 45% equity, a cost of debt of 6.73%, a return on equity of 9.70% and a return on invested capital of 8.06% in calculating rates. Additionally, Sharyland's rates also reflect the recovery of an income tax allowance, with respect to our transmission assets, at the 21% corporate federal income tax rate and, with respect to our wholesale distribution assets, at the prior 35% corporate federal income tax rate. Under existing PUCT orders, SDTS and Sharyland are required to file a new rate case by July 1, 2020 using the test year ending December 31, 2019. If the sale of InfraREIT is not completed and we are required to move forward with the 2020 rate case, the outcome of that rate case will result in an adjustment to many of the current parameters applicable to our regulated assets.

12. Commitments and Contingencies

From time to time, we are a party to various legal proceedings arising in the ordinary course of business. Although we cannot predict the outcome of any such legal proceedings, we do not believe the resolution of these proceedings, individually or in the aggregate, will have a material impact on our business, financial condition or results of operations, liquidity or cash flows.

13. Equity

We and the Operating Partnership declared cash dividends on common stock and distributions on OP Units of \$0.25 per share or unit, as applicable, during each of the three months ended March 31, 2019 and 2018. We paid a total of \$15.2 million in dividends and distributions during each of the three months ended March 31, 2019 and 2018.

14. Noncontrolling Interest

We present as a noncontrolling interest the portion of any equity in entities that we control and consolidate but do not own. Generally, OP Units of the Operating Partnership participate in net income allocations and distributions and entitle their holder to the right, subject to the terms set forth in the partnership agreement, to require the Operating Partnership to redeem all or a portion of the OP Units held by such limited partner. At our option, we may satisfy this redemption requirement with cash or by exchanging shares of our common stock on a one-for-one basis. As of March 31, 2019 and December 31, 2018, there were a total of 16.7 million OP Units held by the limited partners of the Operating Partnership.

During the three months ended March 31, 2018, an aggregate of 28,952 long-term incentive units (LTIP Units) were issued by the Operating Partnership to members of our board of directors. There were no LTIP Units issued during the three months ended March 31, 2019. For additional information, refer to Note 17, *Share-Based Compensation*.

We follow the guidance issued by the FASB regarding the classification and measurement of redeemable securities. Accordingly, we have determined that the OP Units meet the requirements to be classified as permanent equity. During the three months ended March 31, 2019, we redeemed 7,698 OP Units with the issuance of 7,698 shares of common stock. We redeemed 163,969 OP Units with the issuance of 163,969 shares of common stock during the three months ended March 31, 2018.

15. Earnings Per Share

Basic earnings per share is calculated by dividing net earnings after noncontrolling interest by the weighted average shares outstanding. Diluted earnings per share is calculated similarly, except that it includes the dilutive effect of the assumed redemption of OP Units for shares of our common stock, if such redemption were dilutive. The redemption of OP Units would have been anti-dilutive during the three months ended March 31, 2019 and 2018.

Earnings per share are calculated as follows:

<i>(In thousands, except per share data)</i>	Three Months Ended March 31,	
	2019	2018
Basic net income per share:		
Net income attributable to InfraREIT, Inc.	\$ 13,745	\$ 12,864
Weighted average common shares outstanding	43,998	43,832
Basic net income per share	\$ 0.31	\$ 0.29
Diluted net income per share:		
Net income attributable to InfraREIT, Inc.	\$ 13,745	\$ 12,864
Weighted average common shares outstanding	43,998	43,832
Redemption of Operating Partnership units	—	—
Weighted average dilutive shares outstanding	43,998	43,832
Diluted net income per share	\$ 0.31	\$ 0.29
Due to the anti-dilutive effect, the computation of diluted earnings per share does not reflect the following adjustments:		
Net income attributable to noncontrolling interest	\$ 5,224	\$ 4,900
Redemption of Operating Partnership units	16,729	16,872

16. Leases

Leases with SDTS as Lessor

As part of the adoption of Topic 842, we elected to not reassess the lease classification for any expired or existing leases; therefore, all of the leases for our regulated assets will continue to be classified as operating leases. Additionally, we have elected to exclude lessor costs paid directly by Sharyland to third parties on our behalf from consideration in the contracts and from variable payments.

The following table shows the composition of our lease revenue:

<i>(In thousands)</i>	Three Months Ended March 31,	
	2019	2018
Base rent (straight-line)	\$ 48,574	\$ 45,656
Percentage rent	—	—
Total lease revenue	<u>\$ 48,574</u>	<u>\$ 45,656</u>

SDTS has entered into various leases with Sharyland for all our placed in service regulated assets. The master lease agreements, as amended, expire at various dates from December 31, 2019 through December 31, 2022. Our leases primarily consist of base rent, but certain lease supplements contain percentage rent as well. All of the rent with respect to the capital expenditures to be placed in service in 2019 consist only of base rent.

Percentage rent under our leases is based on a percentage of Sharyland's annual gross revenue, as defined in the applicable lease, in excess of an annual breakpoint specified in each lease, which are at least equal to the base rent under each lease. The rate used for percentage rent for the reported time periods varies by lease and ranges from 26% to 30%. Because an annual specified breakpoint must be met under our leases before we can recognize any percentage rent, we anticipate that revenue will grow over the year with little to no percentage rent recognized in the first and second quarters of each year, with the largest amounts recognized during the third and fourth quarters of each year.

Future minimum rent revenue expected in accordance with these lease agreements is as follows for the years ending December 31:

<i>(In thousands)</i>	Total
2019	\$ 194,068
2020	184,438
2021	9,089
2022	4,954
2023	—
Thereafter	—
Total	\$ 392,549

See Note 2, *Pending Corporate Transactions* for information related to the pending sale of InfraREIT, Inc. and asset exchange with Sharyland, including the proposed termination of the leases.

Leases with SDTS as Lessee

As part of the adoption of Topic 842, we elected not to reassess existing or expired land easements that were not previously treated as leases; therefore, our existing land easements as of January 1, 2019 will continue to be treated as land and not land leases and will be included in electric plant, net on our Consolidated Balance Sheets. Land easements entered into or modified after January 1, 2019 will be evaluated under Topic 842 to determine if they meet the definition of a lease.

We are the lessee under two land leases that are subleased to Sharyland under the master lease agreements described above under the caption *Leases with SDTS as Lessor*. Sharyland does not make any sublease payments specific to these land leases but pays all rent and other expenses under the land leases. Sharyland's use of the applicable land is included as part of our five master lease agreements discussed above.

Both land leases are surface leases where the lessor retains the mineral rights. There were no initial direct costs incurred or residual value guarantees provided. The weighted-average remaining lease term is 43.2 years. The following table describes the main attributes of the land leases:

Name of Lease	Expiration Date	Renewal Periods	Rent Escalations	Initial Annual Rent (In dollars)
Brownsville	November 1, 2067	None	None	\$ 10,435
Scottish Rite-Rocky Road	January 12, 2035	Four 5-year terms	5% increase every 5 years after initial term	8,000

We have recorded the operating lease right-of-use assets in prepaids and other current assets and other assets, and the lease liabilities in accounts payable and accrued liabilities and long-term operating lease liabilities on our Consolidated Balance Sheets as follows:

<i>(In thousands)</i>	March 31, 2019
Prepaid and other current assets	\$ 18
Other assets	345
Total right-of-use asset	\$ 363
Accounts payable and accrued liabilities	\$ 18
Long-term operating lease liabilities	345
Total operating lease liabilities	\$ 363

See Note 7, *Other Assets* for additional information.

In determining the right-of-use assets and operating lease liabilities, we used a discount rate of 4.25%, which is our incremental borrowing rate, and assumed that we would exercise all four five-year term extensions related to the Scottish Rite-Rocky Road lease.

Rent expense for these operating leases is recognized on a straight-line basis over the lease term and is included in general and administrative expense on our Consolidated Statements of Operations.

17. Share-Based Compensation

We currently utilize the InfraREIT, Inc. 2015 Equity Incentive Plan primarily for the annual compensation of the non-executive directors for their service on our board of directors.

The following table shows the aggregate common stock issued to members of our board of directors for the three months ended March 31, 2019:

<u>Grant Date</u>	<u>Shares of Common Stock</u>	<u>Grant Date Value per Share</u>	<u>Aggregate Fair Value (in thousands)</u>	<u>Vesting Date</u>
January 2019	22,674	\$ 21.15	\$ 480	January 2020

There was no common stock issued to our directors during the three months ended March 31, 2018.

The following table shows the aggregate LTIP Units issued to members of our board of directors for the three months ended March 31, 2018:

<u>Grant Date</u>	<u>LTIP Units</u>	<u>Grant Date Fair Value per LTIP Unit</u>	<u>Aggregate Fair Value (in thousands)</u>	<u>Vesting Date</u>
January 2018	28,952	\$ 18.61	\$ 539	January 2019

There were no LTIP Units issued to our directors during the three months ended March 31, 2019.

As part of our board of directors' quarterly compensation, each non-executive director can, subject to certain exceptions, elect to receive part of his or her compensation in our common stock instead of cash with full vesting upon issuance. During 2019 and 2018, all directors received their quarterly compensation in cash. The compensation expense, which represents the fair value of the common stock or LTIP Unit measured at market price at the date of grant, is recognized on a straight-line basis over the vesting period. For each of the three months ended March 31, 2019 and 2018, \$0.1 million was recognized as compensation expense related to these grants and is included in general and administrative expense on the Consolidated Statements of Operations. The unamortized compensation expense related to these grants was \$0.4 million as of March 31, 2019.

18. Income Taxes

Franchise Taxes

Effective January 1, 2018, we began accruing and paying Texas franchise tax on our gross lease revenues. The accrued franchise tax is recorded in accrued taxes on our Consolidated Balance Sheets, while the expense is recognized in income tax expense on our Consolidated Statements of Operations. For each of the three months ended March 31, 2019 and 2018, \$0.3 million was recognized related to Texas franchise tax on our gross lease revenues.

Tax Cuts and Jobs Act

In 2017, the TCJA was signed into law reducing the corporate federal income tax rate from 35% to 21%, effective for taxable years beginning on or after January 1, 2018. As a result of the reduction in the corporate federal income tax rate, we recorded \$55.8 million as a regulatory liability on our Consolidated Balance Sheets as of December 31, 2017 related to the creation of excess ADFIT, related to our assets. See Note 11, *Regulatory Matters* for additional information.

19. Supplemental Cash Flow Information

Supplemental cash flow information and non-cash investing and financing activities are as follows:

<i>(In thousands)</i>	Three Months Ended March 31,	
	2019	2018
<u>Supplemental cash flow information</u>		
Cash paid for interest	\$ 7,832	\$ 7,469
Establishment of operating lease right-of-use assets and liabilities	363	—
<u>Non-cash investing and financing activities</u>		
Change in accrued additions to electric plant	(242)	(2,902)
Allowance for funds used during construction - debt	988	820
Redemption of operating partnership units for common stock	116	3,106
Dividends and distributions payable	15,182	15,176

20. Subsequent Events

Pending Corporate Transactions

In April 2019, the parties to the STM proceeding filed the Settlement with the PUCT reflecting an agreement to settle all outstanding issues in our STM in Docket No. 48929. The Settlement is supported or unopposed by all parties to the STM. The Settlement is subject to review and approval by the PUCT. A hearing on the merits was held on April 10, 2019.

We continue to expect the transactions to close by mid-2019, subject to obtaining the PUCT approval and satisfaction of other customary closing conditions.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This item contains a discussion of our business, including a general overview of our properties, results of operations, liquidity and capital resources and quantitative and qualitative disclosures about market risk.

The following discussion should be read in conjunction with Part II, Item 7., *Management's Discussion and Analysis of Financial Condition and Results of Operations* of our 2018 Form 10-K and the unaudited consolidated financial statements and related notes beginning on page 6. This Item 2 contains "forward-looking" statements that involve risks and uncertainties. See *Forward-Looking Statements* at the beginning of this Quarterly Report on Form 10-Q.

Overview

We are engaged in owning and leasing rate-regulated assets in Texas. We are structured as a REIT and lease all our regulated assets to Sharyland, a Texas-based regulated electric utility. Currently, our assets are located in the Texas Panhandle; near Wichita Falls, Abilene and Brownwood; in the Permian Basin; and in South Texas. We were formed in 2009 and have grown our rate base from approximately \$60 million as of December 31, 2009 to \$1.5 billion as of March 31, 2019.

We are externally managed by Hunt Manager. All our officers are employees of Hunt Manager. We benefit from the experience, skill, resources, relationships and contacts of the executive officers and key personnel of Hunt Manager. Pursuant to our management agreement, Hunt Manager provides for our day-to-day management, subject to the oversight of our board of directors. In exchange for these management services, we pay a management fee to Hunt Manager.

For a description of our business model and other significant components of our results of operations, see Part II, Item 7., *Management's Discussion and Analysis of Financial Condition and Results of Operations* of our 2018 Form 10-K.

Recent Events

In March 2019, the pending sale of InfraREIT and related transactions were approved by the Committee on Foreign Investment in the United States (CFIUS) and Federal Energy Regulatory Commission (FERC). As a result, PUCT approval of the transactions is the final pending regulatory approval that is required to close the transactions.

On April 2019, the parties to the Sale-Transfer-Merger (STM) proceeding filed a Stipulation (Settlement) with the PUCT reflecting an agreement to settle all outstanding issues in our STM in Docket No. 48929. The Settlement is supported or unopposed by all parties to the STM. The Settlement is subject to review and approval by the PUCT. A hearing on the merits was held on April 10, 2019. See *Pending Corporate Transactions* below for additional information.

Results of Operations

<i>(In thousands)</i>	Three Months Ended March 31,	
	2019	2018
Lease revenue		
Base rent	\$ 48,574	\$ 45,656
Percentage rent	—	—
Total lease revenue	48,574	45,656
Operating costs and expenses		
General and administrative expense	7,087	6,088
Depreciation	12,204	11,577
Total operating costs and expenses	19,291	17,665
Income from operations	29,283	27,991
Other (expense) income		
Interest expense, net	(10,060)	(10,674)
Other income, net	1	733
Total other expense	(10,059)	(9,941)
Income before income taxes	19,224	18,050
Income tax expense	255	286
Net income	18,969	17,764
Less: Net income attributable to noncontrolling interest	5,224	4,900
Net income attributable to InfraREIT, Inc.	\$ 13,745	\$ 12,864

Three Months Ended March 31, 2019 Compared to Three Months Ended March 31, 2018

Lease revenue — Lease revenue, consisting of only base rent, was \$48.6 million and \$45.7 million for the three months ended March 31, 2019 and 2018, respectively, representing an increase of \$2.9 million, or 6.3%. The increase in base rent was driven by the addition of assets under lease. See Note 16, *Leases* in the Notes to the Unaudited Consolidated Financial Statements for additional information.

General and administrative expense — General and administrative expense was \$7.1 million and \$6.1 million for the three months ended March 31, 2019 and 2018, respectively, representing an increase of \$1.0 million, or 16.4%. The increase in general and administrative expense was mainly due to a \$1.5 million increase in transaction costs partially offset by a decrease of \$0.2 million in management fees, \$0.2 million for the evaluation of the Tax Cuts and Jobs Act in 2018 and \$0.1 million in professional fees. The increase in transaction costs represents the difference between the \$1.7 million of professional services fees we incurred in 2019 related to the pending sale of InfraREIT and the \$0.2 million of professional services fees we incurred in 2018 related to the asset exchange transaction completed during the fourth quarter of 2017 (2017 Asset Exchange Transaction).

Depreciation — Depreciation expense was \$12.2 million and \$11.6 million for the three months ended March 31, 2019 and 2018, respectively, representing an increase of \$0.6 million, or 5.2%. The increase in depreciation expense was due to additional assets placed in service.

Interest expense, net — Interest expense, net was \$10.1 million and \$10.7 million during the three months ended March 31, 2019 and 2018, respectively, representing a decrease of \$0.6 million, or 5.6%. The decrease in interest expense, net was mainly due to the deferred financing costs related to the \$60.0 million senior secured notes, which were paid in full in June 2018, being fully amortized during the second quarter of 2018. This amortization represented approximately \$0.7 million of interest expense in the first quarter of 2018 that did not exist during 2019. Adding to this decrease was an additional \$0.2 million of AFUDC on debt in 2019 as compared to 2018. Offsetting these decreases was \$0.3 million of increased interest expense due to higher average debt balances and interest rates during 2019 as compared to 2018. See Note 8, *Borrowings Under Credit Facilities* and Note 9, *Long-Term Debt* in the Notes to the Unaudited Consolidated Financial Statements for additional information.

Other income, net — Other income, net was negligible and \$0.7 million during the three months ended March 31, 2019 and 2018, respectively. The decrease in other income, net was primarily driven by no AFUDC on other funds being recognized in 2019 compared to \$0.7 million of AFUDC on other funds being recognized in 2018. AFUDC on other funds was not recognized during the first quarter of 2019 as the average short-term borrowings were in excess of the average construction work in progress (CWIP) balance resulting in CWIP mainly being financed with debt.

Income tax (benefit) expense — Income tax expense was \$0.3 million for the three months ended March 31, 2019 and 2018, respectively. This amount represents the estimated Texas franchise tax on our gross rental revenues.

Net income — Net income was \$19.0 million and \$17.8 million during the three months ended March 31, 2019 and 2018, respectively, representing an increase of \$1.2 million, or 6.7%. The increase in net income between the two periods was attributable to a \$2.9 million increase in lease revenue and \$0.6 million decrease in interest expense, net partially offset by a \$1.0 million increase in general and administrative expense, \$0.6 million increase in depreciation expense and \$0.7 million decrease in other income, net. The components of general and administrative expense are described above.

Liquidity and Capital Resources

As of March 31, 2019, we had \$3.5 million of unrestricted cash and cash equivalents, \$1.7 million of restricted cash and \$218.5 million of unused capacity under our revolving credit facilities.

We use our cash on hand, cash flows from operations and borrowings under our credit facilities to fund current obligations, working capital requirements, operating expenses, maturities of long-term debt, budgeted capital spending and dividend payments. We expect that we will be able to fund estimated capital expenditures associated with Footprint Projects through the end of 2020 without raising proceeds from additional equity offerings. However, if unexpected factors were to impact our liquidity and cash position, we may seek to raise proceeds from the equity markets at an earlier time.

Management expects that future operating cash flows, along with access to financial markets, will be sufficient to meet any future operating requirements and forecasted capital investment opportunities. As part of our financing strategy, we will periodically issue long-term debt or enter into term loan arrangements and use the proceeds to reduce borrowings under our revolving credit facilities or refinance other debt. If our ability to access the capital markets is restricted or if debt or equity capital were unavailable on favorable terms, or at all, at a time when we would like, or need, to access those markets, our ability to fund capital expenditures under our leases or to comply with the REIT distribution rules could be adversely affected.

Capital Expenditures

We fund Footprint Projects related to our regulated assets as we and Sharyland determine such Footprint Projects are required pursuant to the terms of our leases. Our total capital expenditures, cash for additions to electric plant on the Consolidated Statements of Cash Flows, for the three months ended March 31, 2019 and 2018 were \$11.4 million and \$15.0 million, respectively.

On an accrual basis, capital expenditures for the three months ended March 31, 2019 and 2018 were \$10.7 million and \$17.1 million, respectively. Capital expenditures on an accrual basis differ from our total capital expenditures due in part to differences in construction costs incurred during the period versus cash paid during the period.

Under the terms of our leases, Sharyland provides a capital expenditure forecast that sets forth anticipated capital expenditures related to our regulated assets. We expect estimated Footprint Projects capital expenditures for the calendar years 2019 through 2020 in the range of \$30 million to \$70 million as set forth in the table below. We intend to fund these capital expenditures with a mix of debt and cash flows from operations.

<i>(In millions)</i>	Years Ending December 31,	
	2019	2020
Total estimated Footprint Projects capital expenditures	\$ 20-35	\$ 10-35

In recent years, we made significant capital investments in our former Stanton/Brady/Celeste, Texas distribution service territory to reinforce and upgrade our assets and to support load growth. Additionally, we expanded the capacity of our Panhandle assets to transmit additional electricity from wind farms. As a result of the 2017 Asset Exchange Transaction and with many of these projects coming to a conclusion during 2017 and 2018, our capital expenditures forecast for 2019 and 2020 is primarily driven by expectations regarding maintenance capital expenditures requirements and new assets that either relieve congestion or expand our footprint to connect new generation supply in the Texas Panhandle and West Texas.

Although we believe the assumptions and estimates underlying our forecast to be reasonable as of the date of this report, they are inherently uncertain and subject to a wide variety of significant business, economic and competitive risks and uncertainties that could cause the amount and timing of our capital expenditures to differ materially from our current expectations. See *Forward-Looking Statements* at the beginning of this Quarterly Report on Form 10-Q.

Dividends and Distributions

As a REIT, we must make current distributions of at least 90% of our annual taxable income, excluding capital gains and other adjustments, and as such, we expect to distribute at least 100% of our taxable income. Under the terms of the merger agreement with Oncor, we are permitted to pay regular quarterly cash dividends of \$0.25 per share of common stock (plus a pro-rated dividend for any partial quarter prior to closing).

We paid a total of \$15.2 million in dividends and distributions during each of the three months ended March 31, 2019 and 2018.

On February 26, 2019, our board of directors approved a cash distribution by InfraREIT Partners, LP (Operating Partnership) to all unit holders of record on March 29, 2019 of \$0.25 per unit for a total distribution of \$15.2 million (\$11.0 million to InfraREIT). On February 26, 2019, our board of directors also declared a cash dividend to stockholders of record of InfraREIT on March 29, 2019 of \$0.25 per share of common stock for a total of \$11.0 million. The cash distribution and cash dividend were paid on April 18, 2019.

Credit Arrangements

We have two revolving credit facilities, a senior secured term loan and senior secured notes. Our assets are collateral under our various debt arrangements. See Note 8, *Borrowings Under Credit Facilities* and Note 9, *Long-Term Debt* in the Notes to the Unaudited Consolidated Financial Statements for additional information.

Operating Partnership Revolving Credit Facility

The Operating Partnership is party to a \$75.0 million revolving credit facility with up to \$15.0 million available for issuance of letters of credit, which previously had a maturity date of December 10, 2019. In December 2018, the Operating Partnership entered into an amendment to its revolving credit facility that extended the maturity date with respect to \$67.0 million of the available revolving credit facility to December 10, 2020. The remaining \$8.0 million of the available credit facility will continue to mature on December 10, 2019.

As of March 31, 2019 and December 31, 2018, there were no outstanding borrowings or letters of credit and there was \$75.0 million of borrowing capacity available under the revolving credit facility. As of March 31, 2019 and December 31, 2018, the Operating Partnership was in compliance with all debt covenants under the credit agreement.

SDTS Revolving Credit Facility

Sharyland Distribution & Transmission Services, L.L.C. (SDTS), our regulated subsidiary, has a \$250.0 million revolving credit facility with up to \$25.0 million of the revolving credit facility available for issuance of letters of credit and up to \$5.0 million of the revolving credit facility available for swingline loans. In December 2018, SDTS entered into an amendment to its revolving credit agreement that extended the maturity date from December 10, 2019 to December 10, 2020.

As of March 31, 2019, SDTS had \$106.5 million of borrowings outstanding at a weighted average interest rate of 4.49%, no letters of credit outstanding and \$143.5 million of borrowing capacity available under this revolving credit facility. As of December 31, 2018, SDTS had \$112.5 million of borrowings outstanding at a weighted average interest rate of 4.59% with no letters of credit outstanding and \$137.5 million of borrowing capacity available under this revolving credit facility. As of March 31, 2019 and December 31, 2018, SDTS was in compliance with all debt covenants under the credit agreement.

Senior Secured Debt

Our subsidiary, Transmission and Distribution Company, L.L.C. (TDC), issued \$25.0 million aggregate principal amount of 8.50% per annum senior secured notes to The Prudential Insurance Company of America and affiliates (TDC Notes) with a maturity date of December 30, 2020. Principal and interest on the TDC Notes are payable quarterly. As of March 31, 2019, \$14.7 million of principal was outstanding under the TDC Notes.

In 2017, SDTS entered into a \$200.0 million senior secured term loan credit facility (2017 Term Loan) with a maturity date of June 5, 2020. Interest is payable at least quarterly at the option of SDTS with the full principal amount due at maturity. As of March 31, 2019, \$200.0 million was outstanding under the 2017 Term Loan at an interest rate of 3.74%.

SDTS issued \$400.0 million series A senior secured notes (Series A Notes) due December 3, 2025 and \$100.0 million series B senior secured notes (Series B Notes) due January 14, 2026. These senior secured notes are due at maturity and bear interest at a rate of 3.86% per annum, payable semi-annually. The outstanding accrued interest payable on the Series A Notes is due each June and December while the accrued interest payable on the Series B Notes is due each January and July. As of March 31, 2019, \$400.0 million and \$100.0 million were outstanding under the Series A Notes and Series B Notes, respectively.

SDTS issued \$53.5 million aggregate principal amount of 7.25% per annum senior secured notes to The Prudential Insurance Company of America and affiliates (2009 Notes) with a maturity date of December 30, 2029. Principal and interest on the 2009 Notes are payable quarterly. As of March 31, 2019, \$37.8 million of principal was outstanding under the 2009 Notes.

Additionally, SDTS issued \$110.0 million aggregate principal amount of 6.47% per annum senior secured notes to The Prudential Insurance Company of America (2010 Notes) with a maturity date of September 30, 2030. Principal and interest on the 2010 Notes are payable quarterly. As of March 31, 2019, \$86.7 million of principal was outstanding under the 2010 Notes.

As of March 31, 2019 and December 31, 2018, SDTS and TDC were in compliance with all debt covenants under the applicable agreements governing the senior secured notes and 2017 Term Loan.

Cash Flows

Three Months Ended March 31, 2019 Compared to Three Months Ended March 31, 2018

Cash flows from operating activities — Net cash provided by operating activities was \$36.4 million and \$34.8 million during the three months ended March 31, 2019 and 2018, respectively. The increase in net cash provided by operating activities related primarily to higher lease revenue during the three months ended March 31, 2019 compared to the same period of 2018, partially offset by less cash provided by working capital changes during 2019 compared to 2018.

Cash flows from investing activities — Net cash used in investing activities was \$11.4 million and \$13.4 million during the three months ended March 31, 2019 and 2018, respectively. Capital expenditures related to the construction of our regulated assets were \$11.4 million and \$15.0 million during the three months ended March 31, 2019 and 2018, respectively. Additionally, \$1.6 million was received for the repayment of the receivable during 2018 related to the 2017 Asset Exchange Transaction.

Cash flows from financing activities — Net cash used in financing activities was \$23.3 million and \$22.7 million during the three months ended March 31, 2019 and 2018, respectively. The higher use of cash related primarily to an additional \$0.7 million net repayment of short-term and long-term debt in 2019 as compared to 2018. The payment of dividends and distributions were consistent between 2019 and 2018.

Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements as of March 31, 2019 and December 31, 2018.

Pending Corporate Transactions

Sale and Asset Exchange

On October 18, 2018, InfraREIT and the Operating Partnership entered into a definitive agreement to be acquired by Oncor for \$21.00 per share or OP Unit, as applicable, in cash, valued at approximately \$1.275 billion, plus the assumption of our net debt of approximately \$940 million as of March 31, 2019. Oncor has obtained equity financing commitments from Sempra Energy and the owners of Texas Transmission Investment LLC to provide an aggregate equity contribution of approximately \$1.3 billion to finance the acquisition of InfraREIT and pay certain related fees and expenses.

As a condition to Oncor's acquisition of us, SDTS and Oncor also signed a definitive agreement with Sharyland to exchange, immediately prior to Oncor's acquisition, SDTS's South Texas assets for Sharyland's Golden Spread Electric Cooperative interconnection located in the Texas Panhandle, along with certain development projects in the Texas Panhandle and South Plains regions, including the Lubbock Power & Light interconnection. The difference between the net book value of the exchanged assets will be paid in cash at closing. SDTS and Sharyland have agreed to terminate their existing leases in connection with the asset exchange.

The asset exchange with Sharyland and merger with Oncor are mutually dependent on one another, and neither will become effective without the closing of the other.

Arrangements with Hunt

Under our management agreement with Hunt Manager, which will be terminated upon the closing of the transactions, Hunt Manager is entitled to the payment of a termination fee upon the termination or non-renewal of the management agreement. The termination of the management agreement automatically triggers the termination of the development agreement between us and Hunt Consolidated Inc. and its subsidiaries (collectively, Hunt). We have agreed to pay Hunt approximately \$40.5 million at the closing of the transactions to terminate the management agreement, development agreement, leases with Sharyland, and all other existing agreements between InfraREIT or our subsidiaries and Hunt, Sharyland or their affiliates. This amount is consistent with the termination fee, as calculated at the time we entered into the omnibus termination agreement, contractually required under the management agreement.

Agreements among Hunt, Oncor and Sempra Energy

Concurrently with the execution of the merger agreement and the asset exchange agreement, Sharyland and Sempra Energy entered into an agreement in which Sempra Energy will purchase a 50% limited partnership interest in Sharyland Holdings LP (Sharyland Holdings), which will own a 100% interest in Sharyland. The closing of Sempra Energy's purchase is a requirement of the asset exchange agreement between SDTS and Sharyland. Additionally, under a separate agreement with Sharyland, Oncor will operate all of Sharyland's assets following the closing of the transactions.

Closing Conditions and Status

The closing of the transactions is dependent upon and subject to several closing conditions, including:

- PUCT approval of the transactions, including:
 - exchange of assets with Sharyland;
 - acquisition of InfraREIT by Oncor; and
 - Sempra Energy's 50% ownership of Sharyland Holdings;
- other necessary regulatory approvals, including approval by FERC, the expiration or termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (HSR Act) and clearance by CFIUS;
- stockholder approval;
- certain lender consents; and
- other customary closing conditions.

Early termination of the 30-day waiting period required by the HSR Act was received in December 2018. In December 2018, certain of the Operating Partnership's subsidiaries entered into amendments that, effective as of the closing, will satisfy our closing condition with respect to the lender consents. Additionally, a special meeting of InfraREIT's stockholders was held on February 7, 2019, at which time the stockholders voted to approve the transactions. Furthermore, in March 2019, CFIUS clearance was received for the transactions and FERC issued an order approving the transactions.

In accordance with the definitive agreements, SDTS, Sharyland, Oncor and Sempra Energy filed the STM application with the PUCT on November 30, 2018. In April 2019, the parties to the STM proceeding filed the Settlement with the PUCT, which is subject to review and approval by the PUCT. On April 10, 2019, a hearing on the merits was held and the Settlement was discussed. The 180-day deadline for our STM is May 29, 2019, although the PUCT is permitted to extend that deadline for an additional 60 days if necessary.

We continue to expect the transactions to close by mid-2019, subject to obtaining the PUCT approval and satisfaction of other customary closing conditions.

Regulatory Matters

The regulatory parameters in Sharyland's rates and applicable to our regulated assets provide for a capital structure consisting of 55% debt and 45% equity, a cost of debt of 6.73%, a return on equity of 9.70% and a return on invested capital of 8.06% in calculating rates. Additionally, Sharyland's rates also reflect the recovery of an income tax allowance, with respect to our transmission assets, at the 21% corporate federal income tax rate and, with respect to our wholesale distribution assets, at the prior 35% corporate federal income tax rate. Under existing PUCT orders, SDTS and Sharyland are required to file a new rate case by July 1, 2020 using a test year ending December 31, 2019. If the sale of InfraREIT is not completed and we are required to move forward with the 2020 rate case, the outcome of that rate case will result in an adjustment to many of the current regulatory parameters applicable to our regulated assets. These regulatory parameters include an adjustment to our allowed cost of debt to reflect the actual cost of debt as of the end of the test year, which currently is forecasted to be 4.91%, and an adjustment to Sharyland's wholesale distribution rate to reflect the new 21% corporate federal income tax rate, as well as other potential adjustments to the parameters described above.

Reconciliations to Amounts Reported Under Generally Accepted Accounting Principles

We use certain financial measures that are not recognized under U.S. GAAP. The non-GAAP financial measures used in this report include non-GAAP earnings per share (Non-GAAP EPS), funds from operations (FFO) and FFO adjusted in the manner described below (AFFO).

We derive our non-GAAP measures as follows to show our core operational performance:

- We define non-GAAP net income as net income adjusted in a manner we believe is appropriate to show our core operational performance, which includes:
 - an adjustment for the difference between the amount of base rent payments that we receive with respect to the applicable period and the amount of straight-line base rent recognized under U.S. GAAP;
 - adding back the transaction costs related to the pending sale of InfraREIT to Oncor and asset exchange with Sharyland as these are not typical operational costs;
 - adding back the transaction costs related to the 2017 Asset Exchange Transaction as these costs are exclusive of our routine business operations or typical rate case costs;
 - adding back the professional services fee related to the 2018 franchise tax settlement with the state of Texas; and
 - removing the effect of the 2018 Texas franchise tax settlement.
- We define Non-GAAP EPS as non-GAAP net income divided by the weighted average shares outstanding calculated in the manner described in the footnotes in the Non-GAAP EPS reconciliation tables below.
- The National Association of Real Estate Investment Trusts (NAREIT) defines FFO as net income (loss) (computed in accordance with U.S. GAAP), excluding gains and losses from sales of property, net and impairments of depreciated real estate, plus real estate depreciation and amortization (excluding amortization of deferred financing costs) and after adjustments for unconsolidated partnerships and joint ventures. Applying the NAREIT definition to our consolidated financial statements results in FFO representing net income (loss) before depreciation, impairment of assets and gain (loss) on sale of assets. FFO does not represent cash generated from operations as defined by U.S. GAAP and it is not indicative of cash available to fund all cash needs, including distributions.
- AFFO is FFO adjusted in a manner we believe is appropriate to show our core operational performance, including:
 - an adjustment for the difference between the amount of base rent payments that we receive with respect to the applicable period and the amount of straight-line base rent recognized under U.S. GAAP;
 - adding back the transaction costs related to the pending sale of InfraREIT to Oncor and asset exchange with Sharyland as these are not typical operational costs;
 - adding back the transaction costs related to the 2017 Asset Exchange Transaction as these costs are exclusive of our routine business operations or typical rate case costs;
 - adding back the professional services fee related to the 2018 franchise tax settlement with the state of Texas;
 - removing the effect of the 2018 Texas franchise tax settlement; and
 - adjusting for other income (expense), net.

Our management uses Non-GAAP EPS, FFO and AFFO as important supplemental measures of our operating performance. We also present non-GAAP performance measures because we believe they help investors understand our business, performance and ability to earn and distribute cash to our stockholders by providing perspectives not immediately apparent from net income. Including reporting on these measures in our public disclosures also ensures that this information is available to all our investors. The presentation of Non-GAAP EPS, FFO and AFFO are not intended to be considered in isolation or as a substitute for, or superior to, the financial information prepared and presented in accordance with U.S. GAAP.

We offer these measures to assist the users of our financial statements in assessing our operating performance under U.S. GAAP, but these measures are non-GAAP measures and should not be considered measures of liquidity, alternatives to net income or indicators of any other performance measure determined in accordance with U.S. GAAP, nor are they indicative of funds available to fund our cash needs, including: capital expenditures, payments on our debt, dividends or distributions. Our method of calculating these measures may be different from methods used by other companies and, accordingly, may not be comparable to similar measures as calculated by other companies. Investors should not rely on these measures as a substitute for any U.S. GAAP measure, including net income, cash flows from operating activities or revenues.

Below we provide the tabular calculations of Non-GAAP EPS, FFO and AFFO for the three months ended March 31, 2019 and 2018. To provide more analysis around these metrics, the following narratives are provided comparing the three months ended March 31, 2019 to the three months ended March 31, 2018.

Non-GAAP EPS was \$0.32 per share for the three months ended March 31, 2019 compared to \$0.29 per share for the three months ended March 31, 2018, representing an increase of 10.3%. Non-GAAP EPS during the three months ended March 31, 2019 and 2018 was based on 60.7 million weighted average shares outstanding. Non-GAAP EPS reflected a \$1.6 million increase in Non-GAAP net income from \$17.8 million during the three months ended March 31, 2018 to \$19.4 million for the three months ended March 31, 2019. The increase in Non-GAAP net income resulted from an increase in lease revenue of \$2.9 million, a \$0.6 million net decrease in general and administrative expense and a decrease of \$0.6 million in interest expense, net partially offset by a \$0.7 million decrease in other income, net, a \$0.6 million increase in depreciation expense and a \$1.1 million base rent adjustment reduction. The decrease in general and administrative expense excludes \$1.7 million of professional services fees related to the pending sale of InfraREIT in the first quarter of 2019 and \$0.2 million of professional service fees related to the 2017 Asset Exchange Transaction during the first quarter of 2018.

For the three months ended March 31, 2019, FFO increased \$1.9 million to \$31.2 million as compared to \$29.3 million for the three months ended March 31, 2018. For the three months ended March 31, 2019, AFFO was \$31.6 million compared to \$28.6 million in the same period in 2018, representing an increase of \$3.0 million, or 10.5%.

Non-GAAP EPS

The following sets forth a reconciliation of net income attributable to InfraREIT, Inc. per diluted share to Non-GAAP EPS:

<i>(In thousands, except per share amounts, unaudited)</i>	Three Months Ended March 31, 2019		Three Months Ended March 31, 2018	
	Amount	Per Share (1)	Amount	Per Share (2)
Net income attributable to InfraREIT, Inc.	\$ 13,745	\$ 0.31	\$ 12,864	\$ 0.29
Net income attributable to noncontrolling interest	5,224	0.31	4,900	0.29
Net income	18,969	0.31	17,764	0.29
Base rent adjustment	(1,260)	(0.02)	(120)	—
Transaction costs associated with pending sale of InfraREIT, Inc.	1,725	0.03	—	—
2017 Asset Exchange Transaction costs	—	—	151	—
Non-GAAP net income	\$ 19,434	\$ 0.32	\$ 17,795	\$ 0.29

- (1) The weighted average common shares outstanding of 44.0 million was used to calculate net income attributable to InfraREIT, Inc. per diluted share. The weighted average redeemable partnership units outstanding of 16.7 million was used to calculate the net income attributable to noncontrolling interest per share. The combination of the weighted average common shares and redeemable partnership units outstanding of 60.7 million was used for the remainder of the per share calculations.
- (2) The weighted average common shares outstanding of 43.8 million was used to calculate net income attributable to InfraREIT, Inc. per diluted share. The weighted average redeemable partnership units outstanding of 16.9 million was used to calculate the net income attributable to noncontrolling interest per share. The combination of the weighted average common shares and redeemable partnership units outstanding of 60.7 million was used for the remainder of the per share calculations.

FFO and AFFO

The following sets forth a reconciliation of net income to FFO and AFFO:

<i>(In thousands, unaudited)</i>	Three Months Ended March 31,	
	2019	2018
Net income	\$ 18,969	\$ 17,764
Depreciation	12,204	11,577
FFO	31,173	29,341
Base rent adjustment	(1,260)	(120)
Other income, net ⁽¹⁾	(1)	(733)
Transaction costs associated with pending sale of InfraREIT, Inc.	1,725	—
2017 Asset Exchange Transaction costs	—	151
AFFO	\$ 31,637	\$ 28,639

(1) Includes AFUDC on other funds of \$0.7 million for the three months ended March 31, 2018. There were no AFUDC on other funds recorded during the three months ended March 31, 2019.

Financial Information Related to Our Tenant

We have legal title to our regulated assets; however, Sharyland maintains operational control of those assets through leases and through its managing member interest in SDTS and is responsible for construction and maintenance of our regulated assets. These rights and obligations constitute continuing involvement, which results in failed sale-leaseback financing accounting with respect to the lease of our regulated assets in Sharyland's financial statements. Under failed sale-leaseback financing accounting, Sharyland is treated as the owner of the assets under all lease agreements, including regulated assets currently under construction. Consequently, our regulated assets, including any regulated assets currently under construction, are reflected as assets, and an estimate of Sharyland's lease obligations to SDTS are reflected as liabilities on Sharyland's balance sheet.

In addition to presenting Sharyland's financial information in accordance with U.S. GAAP, we are presenting Sharyland's non-GAAP financial information below, which removes the effect of the failed sale-leaseback accounting. This non-GAAP financial information is reviewed by our management and board of directors in evaluating Sharyland's results of operations and financial condition. Although our management considers Sharyland's U.S. GAAP financial information as well, management believes this non-GAAP financial information provides important supplemental evidence regarding Sharyland's ability to meet its rent obligations to SDTS, as management believes it is helpful to our investors in understanding Sharyland's financial condition without the additional implications of the failed sale-leaseback accounting. However, these non-GAAP measures are not intended to be considered in isolation or as a substitute for, or superior to, the financial information prepared and presented in accordance with U.S. GAAP. In addition, Sharyland's method of calculating these measures may be different from methods used by other companies, and, accordingly, may not be comparable to similar measures as calculated by other companies that do not use the same methodology as Sharyland.

The following information is presented below:

- Sharyland's net income (loss), calculated in accordance with U.S. GAAP.
- Sharyland's non-GAAP net income (loss), which is calculated by adding the amount of depreciation and interest expense that Sharyland incurs as a result of failed sale-leaseback financing accounting to Sharyland's U.S. GAAP net income (loss) and subtracting Sharyland's non-GAAP rent expense. Sharyland's non-GAAP rent expense differs from our lease revenue because Sharyland's non-GAAP rent expense is calculated on a cash rather than U.S. GAAP basis.
- Sharyland's non-GAAP net income (loss) before interest, taxes, depreciation, amortization and rent (EBITDAR), which is calculated by adding Sharyland's non-GAAP interest, taxes, depreciation, amortization and rent expense to Sharyland's non-GAAP net income (loss).
- A coverage ratio illustrating how EBITDAR relates to Sharyland's non-GAAP rent expense.
- Sharyland's non-GAAP balance sheet, which is derived by removing the impacts of the required U.S. GAAP failed sale-leaseback financing accounting treatment.

<i>(In thousands)</i>	Three Months Ended March 31,	
	2019	2018
Net income	\$ 1,480	\$ 1,872
Failed sale-leaseback adjustments:		
Add: Failed sale-leaseback depreciation expense	8,037	7,590
Add: Failed sale-leaseback interest expense	41,029	37,535
Deduct: Rent expense	49,947	47,319
Sharyland's management reported net income (loss)	599	(322)
Adjustments:		
Add: Interest expense, net	1,833	1,648
Add: Income tax expense	414	348
Add: Depreciation and amortization	3,830	3,866
Add: Rent expense	49,947	47,319
EBITDAR	\$ 56,623	\$ 52,859
Ratio of EBITDAR to rent expense	1.13x	1.12x

<i>(In thousands)</i>	March 31, 2019		
	U.S. GAAP Balance Sheet	Failed Sale- Leaseback Adjustments	Non-GAAP Balance Sheet
Assets			
Current assets	\$ 70,109	\$ —	\$ 70,109
Property, plant and equipment, net	1,987,212	(1,709,909)	277,303
Goodwill	1,100	—	1,100
Deferred charges - regulatory assets, net	40,069	(23,793)	16,276
Total Assets	\$ 2,098,490	\$ (1,733,702)	\$ 364,788
Partners' Capital and Liabilities			
Current liabilities:			
Accounts payable and accrued liabilities	\$ 18,308	\$ —	\$ 18,308
Current portion of financing obligation	33,055	(33,055)	—
Current portion of long-term debt	154,469	—	154,469
Due to affiliates	30,868	—	30,868
Short-term borrowings from affiliates	5,000	—	5,000
Revolving line of credit	5,000	—	5,000
Current state margin tax payable	2,246	—	2,246
Total current liabilities	248,946	(33,055)	215,891
Long-term financing obligations	1,701,230	(1,701,230)	—
Regulatory liabilities	26,715	—	26,715
Other post-employment benefits (OPEB) and other long-term liabilities	1,148	—	1,148
Total liabilities	1,978,039	(1,734,285)	243,754
Commitments and contingencies			
Partners' capital	120,451	583	121,034
Total Partners' Capital and Liabilities	\$ 2,098,490	\$ (1,733,702)	\$ 364,788

<i>(In thousands)</i>	December 31, 2018		
	U.S. GAAP Balance Sheet	Failed Sale- Leaseback Adjustments	Non-GAAP Balance Sheet
Assets			
Current assets	\$ 86,579	\$ —	\$ 86,579
Property, plant and equipment, net	1,981,685	(1,707,172)	274,513
Goodwill	1,100	—	1,100
Deferred charges - regulatory assets, net	42,520	(23,793)	18,727
Total Assets	\$ 2,111,884	\$ (1,730,965)	\$ 380,919
Partners' Capital and Liabilities			
Current liabilities:			
Accounts payable and accrued liabilities	\$ 43,061	\$ —	\$ 43,061
Current portion of financing obligation	34,513	(34,513)	—
Current portion of long-term debt	56,046	—	56,046
Due to affiliates	31,926	—	31,926
Current state margin tax payable	1,832	—	1,832
Total current liabilities	167,378	(34,513)	132,865
Long-term financing obligations	1,699,114	(1,699,114)	—
Long-term debt	99,296	—	99,296
Regulatory liabilities	25,977	—	25,977
OPEB and other long-term liabilities	1,148	—	1,148
Total liabilities	1,992,913	(1,733,627)	259,286
Commitments and contingencies			
Partners' capital	118,971	2,662	121,633
Total Partners' Capital and Liabilities	\$ 2,111,884	\$ (1,730,965)	\$ 380,919

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We have floating rate debt under our 2017 Term Loan and revolving credit facilities and are exposed to changes in interest rates on these debt instruments. In recent years, the credit markets have experienced historical lows in interest rates. If interest rates rise, the rates on our floating rate debt and future debt offerings could be higher than current levels, causing our financing costs to increase accordingly.

As of March 31, 2019, the outstanding balance under our revolving credit facilities and 2017 Term Loan was \$106.5 million and \$200.0 million, respectively. A hypothetical increase or decrease in interest rates by 1.00% would have changed our interest expense by \$0.8 million for the three months ended March 31, 2019.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our President and Chief Executive Officer and our Senior Vice President and Chief Financial Officer, we performed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Quarterly Report on Form 10-Q. In designing and evaluating these disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating and implementing possible controls and procedures. Based upon that evaluation, our President and Chief Executive Officer and our Senior Vice President and Chief Financial Officer concluded that, as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There have not been any changes in our internal control over financial reporting during the quarter ended March 31, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. We review our disclosure controls and procedures, which may include internal controls over financial reporting, on an ongoing basis. From time to time, management makes changes to enhance the effectiveness of these controls and ensure that they continue to meet the needs of our business activities over time.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are party to various legal proceedings arising in the ordinary course of business. Although we cannot predict the outcomes of any such legal proceedings, we do not believe the resolution of these proceedings, individually or in the aggregate, will have a material impact on our business, financial condition or results of operations, liquidity or cash flows.

Item 1A. Risk Factors

There have been no material changes in our risk factors during the three months ended March 31, 2019 from those previously disclosed in Part I, Item 1A., *Risk Factors* of our 2018 Form 10-K. You should carefully consider the risk factors discussed in our 2018 Form 10-K, which could materially affect our business, financial condition or future results. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially adversely affect our business, financial condition or future results.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosure

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

<u>Exhibit Number</u>	<u>Description</u>
3.1	— Articles of Restatement of the Registrant (filed as exhibit 3.3 to the Company's Current Report on Form 8-K dated March 9, 2015 and filed March 10, 2015 and incorporated herein by reference).
3.2	— Amended and Restated Bylaws of the Registrant (filed as exhibit 3.5 to Amendment No. 1 to the Company's Registration Statement on Form S-11 filed December 31, 2014 and incorporated herein by reference).
10.1	Second Amendment to Management Agreement, dated February 26, 2019, among the Registrant, InfraREIT Partners, LP and Hunt Utility Services, LLC (filed as exhibit 10.8 to the Company's Annual Report on Form 10-K for the year ended December 31, 2018 and filed on February 27, 2019 and incorporated herein by reference).
10.2	Services Agreement, dated February 26, 2019, between Sharyland Distribution & Transmission Services, L.L.C. and Hunt Utility Services, LLC (filed as exhibit 10.9 to the Company's Annual Report on Form 10-K for the year ended December 31, 2018 and filed on February 27, 2019 and incorporated herein by reference).

Exhibit Number	Description
10.3	<u>Seventeenth Amended and Restated Rent Supplement (McAllen Lease), dated February 26, 2019, between Sharyland Distribution & Transmission Services, L.L.C. and Sharyland Utilities, L.P. (filed as exhibit 10.13 to the Company's Annual Report on Form 10-K for the year ended December 31, 2018 and filed on February 27, 2019 and incorporated herein by reference).</u>
10.4	<u>Eleventh Amended and Restated Rent Supplement (ERCOT Transmission Lease), dated February 26, 2019, between Sharyland Distribution & Transmission Services, L.L.C. and Sharyland Utilities, L.P. (filed as exhibit 10.19 to the Company's Annual Report on Form 10-K for the year ended December 31, 2018 and filed on February 27, 2019 and incorporated herein by reference).</u>
10.5	<u>Fifteenth Amended and Restated Rent Supplement (CREZ Lease), dated February 26, 2019, between Sharyland Distribution & Transmission Services, L.L.C. and Sharyland Utilities, L.P. (filed as exhibit 10.21 to the Company's Annual Report on Form 10-K for the year ended December 31, 2018 and filed on February 27, 2019 and incorporated herein by reference).</u>
10.6	<u>Third Amended and Restated Rent Supplement (Permian Lease), dated February 26, 2019, between Sharyland Distribution & Transmission Services, L.L.C. and Sharyland Utilities, L.P. (filed as exhibit 10.23 to the Company's Annual Report on Form 10-K for the year ended December 31, 2018 and filed on February 27, 2019 and incorporated herein by reference).</u>
31.1*	— <u>Rule 13A-14(a)/15d-14(a) Certification of Chief Executive Officer</u>
31.2*	— <u>Rule 13A-14(a)/15d-14(a) Certification of Chief Financial Officer</u>
32.1*	— <u>Section 1350 Certification of Chief Executive Officer</u>
32.2*	— <u>Section 1350 Certification of Chief Financial Officer</u>
99.1*	— <u>Consolidated Financial Statements of Sharyland Utilities, L.P.</u>
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 Labels Linkbase Document
101.PRE*	— XBRL Taxonomy Extension Presentation Linkbase Document

* Filed or furnished herewith.

SIGNATURES

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

InfraREIT, Inc.
(Registrant)

/s/ David A. Campbell

David A. Campbell
President, Chief Executive Officer and Director

Date: May 2, 2019

/s/ Brant Meleski

Brant Meleski
Senior Vice President and Chief Financial Officer

Date: May 2, 2019

**CERTIFICATION OF PRESIDENT AND CHIEF EXECUTIVE OFFICER
PURSUANT TO
EXCHANGE ACT RULES 13a-14(a) AND 15d-14(a),
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, David A. Campbell, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of InfraREIT, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 2, 2019

/s/ David A. Campbell

David A. Campbell
President and Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO
EXCHANGE ACT RULES 13a-14(a) AND 15d-14(a),
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Brant Meleski, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of InfraREIT, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 2, 2019

/s/ Brant Meleski

Brant Meleski
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

**CERTIFICATION OF PRESIDENT AND CHIEF EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, David A. Campbell, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of InfraREIT, Inc. for the fiscal quarter ended March 31, 2019 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of InfraREIT, Inc.

Date: May 2, 2019

/s/ David A. Campbell

David A. Campbell
President and Chief Executive Officer
(Principal Executive Officer)

The foregoing certification is not deemed filed with the Securities and Exchange Commission for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (Exchange Act), and is not to be incorporated by reference into any filing of InfraREIT, Inc. under Securities Act of 1933, as amended, or the Exchange Act, whether made before or after the date hereof, regardless of any general incorporation language of such filing.

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Brant Meleski, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of InfraREIT, Inc. for the fiscal quarter ended March 31, 2019 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of InfraREIT, Inc.

Date: May 2, 2019

/s/ Brant Meleski

Brant Meleski

Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

The foregoing certification is not deemed filed with the Securities and Exchange Commission for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (Exchange Act), and is not to be incorporated by reference into any filing of InfraREIT, Inc. under Securities Act of 1933, as amended, or the Exchange Act, whether made before or after the date hereof, regardless of any general incorporation language of such filing.



SHARYLAND UTILITIES, L.P.

Consolidated Financial Statements

March 31, 2019

(Unaudited)

SHARYLAND UTILITIES, L.P.

Consolidated Balance Sheets

(In thousands)

(Unaudited)

	<u>Assets</u>	<u>March 31,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
Current Assets			
Cash and cash equivalents		\$ 12,386	\$ 27,672
Accounts receivable, net		47,547	44,501
Due from affiliates		4,303	8,161
Inventory		1,844	1,844
Prepayments and other current assets		4,029	4,401
Total current assets		<u>70,109</u>	<u>86,579</u>
Property, Plant and Equipment - net		1,987,212	1,981,685
Goodwill		1,100	1,100
Deferred Charges – Regulatory Assets, net		40,069	42,520
Total Assets		<u>\$ 2,098,490</u>	<u>\$ 2,111,884</u>
	<u>Liabilities and Partners' Capital</u>		
Current Liabilities			
Accounts payable and accrued liabilities		\$ 18,308	\$ 43,061
Short-term borrowing from affiliates		5,000	-
Short-term borrowing		5,000	-
Current portion of long-term debt		154,469	56,046
Current portion of financing obligation		33,055	34,513
Due to affiliates		30,868	31,926
State margin tax payable		2,246	1,832
Total current liabilities		<u>248,946</u>	<u>167,378</u>
Long-Term Financing Obligation		1,701,230	1,699,114
Long-Term Debt		-	99,296
Regulatory Liabilities		26,715	25,977
OPEB and Other Liabilities		1,148	1,148
Total Liabilities		<u>1,978,039</u>	<u>1,992,913</u>
Commitments and Contingencies			
Partners' Capital			
General partner		1,154	1,139
Limited partner		119,297	117,832
Total partners' capital		<u>120,451</u>	<u>118,971</u>
Total Liabilities and Partners' Capital		<u>\$ 2,098,490</u>	<u>\$ 2,111,884</u>

See accompanying notes to the consolidated financial statements.

SHARYLAND UTILITIES, L.P.
Consolidated Statements of Operations
(In thousands)
(Unaudited)

	Three Months Ended	
	March 31,	
	2019	2018
Revenues - net	\$ 71,433	\$ 66,342
Operating Expenses		
Distribution expense	1	81
Transmission expense	5,183	3,988
Administrative and general expense	9,638	9,446
Depreciation and amortization	11,867	11,456
Total operating expenses	26,689	24,971
Operating Income	44,744	41,371
Other Expense - net		
Interest expense - net	(42,862)	(39,183)
Other income - net	12	32
Total other expense - net	(42,850)	(39,151)
Net Income Before Income Taxes	1,894	2,220
Income Tax Expense	414	348
Net Income	\$ 1,480	\$ 1,872

See accompanying notes to the consolidated financial statements.

SHARYLAND UTILITIES, L.P.

Consolidated Statements of Partners' Capital

Three Months Ended March 31, 2019

(In thousands)

(Unaudited)

	General Partner	Limited Partner	Total Partners' Capital
Balance at December 31, 2018	\$ 1,139	\$ 117,832	\$ 118,971
Net Income	15	1,465	1,480
Balance at March 31, 2019	<u>\$ 1,154</u>	<u>\$ 119,297</u>	<u>\$ 120,451</u>

See accompanying notes to the consolidated financial statements.

SHARYLAND UTILITIES, L.P.

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Three Months Ended	
	March 31,	
	<u>2019</u>	<u>2018</u>
Cash flows from Operating Activities		
Net income	\$ 1,480	\$ 1,872
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation	9,692	9,292
Amortization of deferred costs	2,476	2,465
Allowance for funds used during construction - equity	-	(21)
Changes in assets and liabilities:		
Accounts receivable	(3,046)	16,639
Due from affiliates	3,858	(8,838)
Prepayments and other current assets	372	2,226
Deferred charges - regulatory assets and liabilities	67	(4,247)
Accounts payable, accrued liabilities and other	(24,750)	(21,500)
Due to affiliates	(1,058)	(2,661)
State margin tax payable	414	381
Net cash used in operating activities	<u>(10,495)</u>	<u>(4,392)</u>
Cash flows from Investing Activities		
Additions to property, plant and equipment	(3,801)	(2,823)
Net cash used in provided by investing activities	<u>(3,801)</u>	<u>(2,823)</u>
Cash flows from Financing Activities		
Proceeds from short-term borrowing	5,000	-
Proceeds from short-term borrowing from affiliates	5,000	-
Repayments of notes payable	-	(299)
Repayments of long-term debt	(873)	(873)
Repayments of financing obligation	(10,117)	(7,898)
Net cash used in financing activities	<u>(990)</u>	<u>(9,070)</u>
Net decrease in cash and cash equivalents	(15,286)	(16,285)
Cash and cash equivalents at beginning of period	27,672	25,503
Cash and cash equivalents at end of period	<u>\$ 12,386</u>	<u>\$ 9,218</u>

See accompanying notes to the consolidated financial statements.

SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements

March 31, 2019

(Unaudited)

(1) Description of Business and Summary of Significant Accounting Policies

(a) Description of Business

Sharyland Utilities, L.P. (the Partnership or Sulp) is a partnership engaged in providing transmission of electricity throughout Texas. Those transmission activities include the operation and maintenance of: 138 Kilovolt (kV) looped system of transmission lines and connected substations near Stanton; 138 kV direct current transmission interconnection between Texas and Mexico (Railroad DC Tie); 138 kV transmission lines located in South Texas; 345 kV transmission lines and connected substations in the Texas Panhandle; 345 kV transmission lines near Wichita Falls, Abilene and Brownwood, Texas; and the eastern half of a 345 kV transmission line from the North Edinburg substation to the Palmito substation in South Texas.

The Partnership was organized as a Texas limited partnership on November 3, 1998, as an electric distribution utility located in Hidalgo County, Texas. The Partner's wholly owned subsidiaries include GS Project Entity, L.L.C. (GSPE), a Texas limited liability company; and CV Project Entity, L.L.C. (CVPE), a Texas limited liability company.

The Partnership leases most of its transmission and distribution assets from a related party, Sharyland Distribution & Transmission Services, L.L.C. (SDTS) under Master Lease Agreements. See Note 3.

(b) Principles of Consolidation and Presentation

The consolidated financial statements include the Partnership's account and all other wholly owned entities in which the Partnership has a controlling financial interest. All significant intercompany balances and transactions have been eliminated. The Partnership maintains accounting records in accordance with the uniform system of accounts, as prescribed by the Federal Energy Regulatory Commission (FERC). The Partnership's consolidated financial statements reflect the effects of the different rate making principles mandated by FERC and the Public Utility Counsel of Texas (PUCT) regulating its operations.

(c) Use of Estimates

The preparation of the Partnership's consolidated financial statements in accordance with accounting principles generally accepted in the United States (GAAP) requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

(Continued)

SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements
(Unaudited)

(d) Recently Accounting Guidance

Recently Adopted Accounting Guidance

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. ASU 2014-09 requires revenue to be recognized when promised goods or services are transferred to customers in an amount that reflects the expected consideration for these goods and services. The guidance supersedes the revenue recognition requirements in Topic 605, *Revenue Recognition*, and most industry-specific guidance throughout the Industry Topics of the Codification. ASU 2014-09 was effective for the Partnership for periods beginning after December 15, 2018. The Partnership's revenues from customers are tariff-based and are designed to recover the cost of providing electric delivery service to customers including a reasonable rate of return on invested capital. Revenues are generally recognized when the underlying service has been provided in an amount prescribed by the related tariff. We adopted the new guidance on January 1, 2019. The new guidance did not change this pattern of recognition and therefore the adoption did not have an effect on the Partnership's financial position, results of operations or cash flows.

Recent Accounting Guidance Not Yet Adopted

In February 2016, the FASB issued ASU 2016-02, *Leases*. ASU 2016-02 amended the existing accounting standard for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. ASU 2016-02 is effective for the Partnership for periods beginning after December 15, 2019 with early adoption permitted. The new standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. The Partnership is currently evaluating the new guidance and the extent of the impact this standard may have on its financial position, results of operations or cash flows.

(2) Sale and Asset Exchange2018 Securities Purchase Agreement

On October 18, 2018, the Partnership, SU Investment Partners, L.P. (the limited partner of the Partnership), Sempra Texas Utilities Holdings I, LLC (Sempra), and Sempra Energy entered into a definitive agreement (2018 Securities Purchase Agreement) pursuant to which, Sempra will obtain a fifty percent (50%) limited partnership interest in Sharyland Holdings LP (Sharyland Holdings), which will own a 100% interest in the Partnership (the SU Investment). The SU Investment is contingent upon the closing of a definitive agreement (the Asset Exchange Agreement) among the Partnership, SDTS and Oncor, pursuant to which, the Partnership will exchange its equity interest in GSPE its interest in certain development projects in the Texas Panhandle and South Plains regions, including the Lubbock Power & Light interconnection (LP&L Project) for SDTS's south Texas assets (the Asset Exchange). The difference between the net book value of the exchanged assets will be paid in cash at closing. After the closing, the Partnership will own and operate all of the assets in South Texas that it currently operates through a Master Lease Agreement with SDTS in addition to the Cross Valley transmission line and associated substations. Additionally, under a separate agreement, Oncor will provide certain operation services to the Partnership's assets following the closing of the transactions. In connection with the closing of the SU Investment and the Asset Exchange Agreement, all Master Lease Agreements will be terminated. Concurrently with the closing of the 2018 Securities Purchase Agreement, the Partnership will pay off the CV Project and GS Project debt and issue new debt. The Partnership has initiated the refinancing process and has notified certain lenders in connection with the payoff of the CV Project and GS Project debt discussed in Note 10.

(Continued)

SHARYLAND UTILITIES, L.P.**Notes to the Consolidated Financial Statements
(Unaudited)**

Concurrently with the execution of the 2018 Securities Purchase Agreement and the Asset Exchange Agreement, Oncor entered into a definitive agreement to acquire InfraREIT, Inc. (the ultimate parent of SDTS)(the Oncor Merger). The Asset Exchange, the SU Investment and Oncor Merger are mutually dependent on one another and none will become effective without the closing of the others.

The closing of the transactions is dependent upon and subject to several closing conditions, including:

- (i) PUCT approval of the transactions, including:
 - the Asset Exchange;
 - SU Investment, and;
 - Acquisition of InfraREIT by Oncor.
- (ii) Other necessary regulatory approvals, including approval by the FERC, the expiration or termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (HSR Act), and clearance by the Committee on Foreign Investment in the United States (CFIUS),
- (iii) InfraREIT, Inc. stockholder approval,
- (iv) Certain lender consents, and
- (v) Other customary closing conditions.

Early termination of the 30-day waiting period required by the HSR Act was received in December 2018. In December 2018, the InfraREIT's wholly-owned subsidiary, Transmission and Distribution Company, L.L.C. (TDC) and SDTS entered into amendments that, effective as of the closing, will satisfy the closing condition with respect to the lender consents. A special meeting of the InfraREIT's stockholders was held on February 7, 2019, at which time the stockholders voted to approve the transaction. Furthermore, in March 2019, CFIUS clearance was received for the transactions and FERC issued an order approving the transactions.

Under the definitive agreements, Sulp, SDTS, Oncor and Sempra Energy filed a Sale-Transfer-Merger (STM) application Docket No. 48929 with the PUCT on November 30, 2018. In April 2019, Sulp, SDTS, Oncor, and Sempra Energy, together with most of the other parties to the STM proceeding, filed a Stipulation of Settlement (Settlement) with the PUCT which is subject to review and approval by the PUCT. A hearing on the merits was held on April 10, 2019. The 180-day deadline for the STM is May 29, 2019, although the PUCT is permitted to extend that deadline for an additional 60 days if necessary.

We continue to expect the transactions to close by mid-2019, subject to obtaining the PUCT approval and satisfaction of other customary closing conditions. See Note 15, Subsequent Events for additional information.

(Continued)

SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements
(Unaudited)(3) Leases

The Partnership leases most of its Transmission and all of its Distribution Substation (T&D) assets from SDTS, a related party, under five Master Lease Agreements (MLA). See Regulatory Proceedings on Note 15, Commitment and Contingencies, leases. Also under these same MLAs, SDTS is responsible for funding all prudently incurred electric plant capital expenditures deemed necessary to serve customers by the Partnership. In accordance with the MLAs, the Partnership is responsible for the maintenance and the operation of the T&D assets and for compliance with all regulatory requirements of the PUCT, FERC, and any other regulatory entity with jurisdiction over the T&D assets. The MLAs obligate the Partnership to pay all property-related expenses, including maintenance, repairs, taxes on equipment in service, insurance, and to comply with the terms of the secured credit facilities and secured-term loan, if any, affecting the leased assets. The MLAs are subject to failed sale-leaseback accounting. See Note 4.

The MLAs, as amended, expire at various dates from December 31, 2019 through December 31, 2022. Each agreement includes annual base payments while all but two agreements include additional payments, based on an agreed upon percentage of revenue earned by the Partnership, as defined in the MLAs, in excess of annual specified breakpoints. The rate used to calculate additional payments varies by lease and ranges from a high of 37% to a low of 23% over the term of the agreements.

The Partnership made fixed lease payments during the periods presented as follows:

	Three Months Ended March 31,	
	2019	2018
<i>(In thousands)</i>		
Fixed Lease Payments	\$ 47,343	\$ 45,394

The Partnership's MLAs include a rent validation mechanism after year end to true up lease payments for the difference between actual and estimated incremental capital expenditures placed in service. As a result of the rent validation, the Partnership made additional fixed and variable payments of approximately \$2.1 million and \$335,000 on March 19, 2019 and March 28, 2018, respectively, associated with the years ended December 31, 2018 and 2017, respectively.

The Partnership is also subject to certain restrictive covenants, including indebtedness limits, contained in the MLAs. The Partnership was in compliance with all such covenants as of March 31, 2019 and December 31, 2018.

Future minimum lease payments in accordance with these MLAs are as follows:

<i>(In thousands)</i>	Total
Year Ending December 31:	
2019 - Q2, Q3 and Q4	146,725
2020	184,438
2021	9,089
2022 and Thereafter	4,954
Total future minimum lease payments	\$ 345,206

(Continued)

SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements
(Unaudited)(4) Failed Sale- Leaseback – Financing Obligation

The Partnership leases most of its T&D assets from SDTS, a related party. SDTS has legal title to such T&D assets under lease. The Partnership, as a managing member of SDTS, has the exclusive power and authority on behalf of SDTS to manage, control, administer, and operate the T&D assets and business affairs of SDTS in accordance with the limited liability company agreement governing SDTS. These rights and obligations constitute continuing involvement, which results in failed sale-leaseback (financing) accounting. Under failed sale-leaseback accounting, the Partnership is deemed owner of the assets under all MLAs, including assets currently under construction. Consequently, the T&D assets, including assets currently under construction and corresponding financial obligations, are included in the Partnership's Consolidated Balance Sheets. The leases are considered a failed sale-leaseback (financing) due to the Partnership's continuing involvement in SDTS and due to the ongoing involvement in the construction of the T&D assets as defined by ASC Topic 840, *Accounting for Leases*.

Approximately \$1.7 billion is included in long-term financing obligation liabilities related to the failed sale-leaseback (financing), as of March 31, 2019 and December 31, 2018, respectively. Approximately \$33.1 million and \$34.5 million of the failed sale-leaseback (financing) obligation are included in current liabilities as of March 31, 2019 and December 31, 2018, respectively.

The Partnership recorded interest on failed sale-leaseback (financing) in interest expense, net as follows:

	Three Months Ended March 31,	
	2019	2018
<i>(In thousands)</i>		
<u>Failed sale-lease back interest expense</u>		
Fixed portion of failed-leaseback interest	\$ 38,425	\$ 35,610
Variable portion of failed-leaseback interest	2,604	1,925
Failed sale-lease back interest expense	\$ 41,029	\$ 37,535

As a result of the failed sale-leaseback (financing) transaction, the Partnership accounted for lease payments to the lessor as a reduction of its financing obligation. Payments made on the long-term financing obligation were as follows:

	Three Months Ended March 31,	
	2019	2018
<i>(In thousands)</i>		
Payments on long-term financing obligation	\$ 10,117	\$ 7,898

(Continued)

SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements
(Unaudited)

Future payments of the financing obligation as of March 31, 2019 are as follows:

	<u>Total</u>
Year Ending December 31:	
2019 - Q2, Q3 and Q4	\$ 24,837
2020	29,090
2021	7,086
2022	1,180
2023	125
Thereafter	<u>1,575,289</u>
Total financing obligation	1,637,607
Less: current portion of financing obligation	(33,055)
Leased system under construction obligation	72,885
Lease deferral (Note 7)	23,793
Long-term lease obligation	<u>\$ 1,701,230</u>

The Partnership recorded depreciation expense related to the assets accounted for in accordance with failed sale-leaseback as follows:

	Three Months Ended	
	March 31,	
	<u>2019</u>	<u>2018</u>
<i>(In thousands)</i>		
Failed sale-lease back depreciation expense	\$ 8,037	\$ 7,590

(5) Property, Plant and Equipment - net

The major classes of property, plant and equipment at March 31, 2019 and December 31, 2018 are as follows:

	<u>March 31,</u>	<u>December 31,</u>
	<u>2019</u>	<u>2018</u>
<i>(In thousands)</i>		
Property, plant and equipment		
Leased system	\$ 1,870,657	\$ 1,870,466
Transmission plant	270,047	270,047
General plant	8,470	8,470
	<u>2,149,174</u>	<u>2,148,983</u>
Construction Work in Progress:		
Leased system under construction	72,885	62,301
Transmission plant under construction	158	4,880
General plant under construction	9,293	773
	<u>82,336</u>	<u>67,954</u>
Other	293	293
Total Property, plant and equipment	<u>2,231,803</u>	<u>2,217,230</u>
Accumulated Depreciation - Leased system	(233,633)	(225,595)
Accumulated Depreciation - Transmission plant	(8,846)	(8,035)
Accumulated Depreciation - General plant	(2,112)	(1,915)
Property, Plant, and Equipment - net	<u>\$ 1,987,212</u>	<u>\$ 1,981,685</u>

(Continued)

SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements
(Unaudited)

See Note 4 in regards to leased system and leased system under construction.

General plant consists of a warehouse, furniture, fixtures, equipment, computer hardware, software, and vehicles.

(6) Deferred Charges – Regulatory Assets - Liabilities*Deferred Charges – Regulatory Assets, Net*

Regulatory assets represent probable future recovery of costs from customers through the regulatory ratemaking process. The table below provides detail of deferred charges that are included on the Partnership's Consolidated Balance Sheets as of March 31, 2019 and December 31 2018.

	Amortization Period	March 31, 2019			December 31, 2018		
		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
<i>(In thousands)</i>							
Deferred costs recoverable in future years							
Deferred financing costs	(a)	\$ 5,763	\$ (5,011)	\$ 752	\$ 5,763	(4,710)	\$ 1,053
Inception operating costs	(b)	23,793	-	23,793	23,793	-	23,793
Rate case costs	(c)	13,948	(4,998)	8,950	13,949	(4,998)	8,951
Study costs/Transition to competition	(d)	5,918	(2,853)	3,065	5,918	(2,804)	3,114
Transition cost	(e)	14,100	(10,617)	3,483	14,100	(8,491)	5,609
Deferred overhead cost		26	-	26	-	-	-
Net Deferred Charges - Regulatory Assets		<u>\$ 63,548</u>	<u>\$ (23,479)</u>	<u>\$ 40,069</u>	<u>\$ 63,523</u>	<u>\$ (21,003)</u>	<u>\$ 42,520</u>

(a) Amortized over the length of the related loan.

(b) Amortization period is anticipated to be established in a future rate case.

(c) \$5.0 million was recovered through May 2017. The recovery period for the \$8.9 million is anticipated to be established in 2019 in rate case expense Docket No. 45979.

(d) \$2.9 million was recovered through March 2019. \$17,000 will be recovered in April 2019 and the Partnership anticipates establishing the recovery period for the remaining \$3.0 million in a future rate case.

(e) This amount began to be recovered in January 2018 and is expected to be fully recovered in 2019.

Deferred financing costs included in net deferred charges – regulatory assets consist of debt issuance costs incurred in connection with the construction credit agreements associated with GSPE and CVPE. These assets are classified as regulatory assets and amortized over the length of the related loan. These costs will be included in the costs of debt in connection with a future rate case.

The inception operating costs of approximately \$23.8 million at March 31, 2019 and December 31, 2018 represent operating costs incurred from inception through December 31, 2007. The 2013 rate case settlement established that the Partnership may seek recovery in a future rate case, pursuant to the mechanism established in Docket Nos. 21591 and 27556, of the inception operating costs plus related return on rate base. The right to benefit from the inception operating costs was transferred to SDTS. Consequently, due to the failed sale-leaseback accounting treatment, the Partnership has recorded a corresponding liability in financing obligation.

In 2017, the PUCT approved the asset exchange between the Partnership and Oncor in Docket No. 47649. As part of the Order, the Partnership was allowed to recover certain expenses incurred in connection with the transition of the assets between the Partnership and Oncor (Transition Costs) not to exceed \$17.0 million. The actual transition costs to be recovered is \$14.1 million to be recovered as a regulatory asset.

See Note 13, Commitments and Contingencies – *Regulatory proceedings* for information regarding the rate case Docket.

(Continued)

SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements
(Unaudited)*Regulatory Liabilities*

Regulatory liabilities represent probable future reduction in rates due to the over-recovery of costs from customers through the regulatory ratemaking process.

The Partnership's regulatory liability related to cost of removal is established through depreciation rates and represents the amount that the Partnership expects to incur in the future. The regulatory liability is recorded as long-term liability net of actual removal costs incurred.

With the passage of the Tax Cuts and Jobs Act (TCJA), the PUCT ordered electric utilities in Texas to record a regulatory liability for the balance of excess accumulated deferred income taxes (Excess ADFIT) that now exists because of the decrease in the Federal Income Tax rate from 35% to 21%. The Partnership will continue to assess the amount of the regulatory liability and expects that amortization of the regulatory liability will be determined in the Partnership's next base rate proceeding to be filed in 2020. The regulatory liability is expected to lower future customer rates over a future period to be determined by the PUCT.

In prior interim transmission rate filings, the Partnership incorrectly included certain distribution property, plant and equipment as part of the Partnership's transmission rate base resulting in the Partnership over-collecting revenues for certain periods of time. The Partnership has calculated the amount of over collected transmission revenue and an associated carrying charge and has booked an interim TCOS regulatory liability in September 2018. The Partnership expects the regulatory liability to be addressed in its next base rate case to be filed in 2020.

The carrying amount of the regulatory liabilities as of March 31, 2019 and December 31, 2018 are as follows:

<i>(In thousands)</i>	Amortization period Ends	March 31, 2019	December 31, 2018
Postretirement benefits costs	(a)	\$ 3,724	\$ 3,724
Postretirement benefits collections	(b)	5,586	5,565
Estimated net removal costs	(c)	7,090	6,444
Provision in lieu of excess ADFIT	(b)	1,205	1,205
Interim TCOS	(b)	9,110	9,039
Regulatory liabilities		<u>\$ 26,715</u>	<u>\$ 25,977</u>

(a) This item represents liabilities recorded in accordance with postretirement benefits accounting standards.

(b) The amortization of this item is anticipated to be established in a future rate case.

(c) For regulatory purposes, this balance will be part of accumulated depreciation. In future rate cases, this balance will be taken into account when determining the appropriate depreciation rates.

(7) Related-Party Transactions

The Partnership made payments associated with the lease of some of its T&D assets to SDTS as follows:

<i>(In thousands)</i>	Three Months Ended March 31,	
	2019	2018
Lease payments	<u>\$ 50,131</u>	<u>\$ 48,963</u>

(Continued)

SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements
(Unaudited)

The Partnership received payments throughout the period related to the acquisition of gross property plant and equipment, contracted services, direct labor, materials and supervision associated with its existing asset build out on the T&D assets from SDTS as follows:

	Three Months Ended March 31,	
	2019	2018
<i>(In thousands)</i>		
Asset build out payments received	\$ 10,409	\$ 12,785

Asset build out costs are included on the Consolidated Balance Sheets under Property, Plant and Equipment - net.

On February 12, 2015, the Partnership entered into a subordinated and unsecured loan agreement of \$10.0 million with Loyal Trust No. 1 (LT1), a related party, as amended on, February 15, 2019. The promissory note matures on December 31, 2020. The revolving promissory note accrues interest at the floating JP Morgan Chase Prime Rate with all interest compounded semiannually. As of March 31, 2019, the Partnership had \$5 million outstanding on the subordinated note.

Interest expense incurred on the subordinated note during the three months ended March 31, 2019 were approximately \$55,000. No interest expense was incurred on the subordinated note during the three months ended March 31, 2018.

The Partnership leases office space for its Dallas location from an affiliate through a contractually agreed upon lease amount. Charges for the lease are included in general and administrative expense in the accompanying Consolidated Statements of Operations as follows:

	Three Months Ended March 31,	
	2019	2018
<i>(In thousands)</i>		
Lease office expense	\$ 41	\$ 45

An affiliate of the Partnership provides services to the Partnership at contractually agreed upon hourly rates and set amounts for infrastructure support. Charges for such services are included in general and administrative expense in the accompanying Consolidated Statements of Operations as follows:

	Three Months Ended March 31,	
	2019	2018
<i>(In thousands)</i>		
Infrastructure support services	\$ 878	\$ 605

Accrued fees related to these charges are included in due to affiliates on the Partnership's Consolidated Balance Sheets and were approximately \$1.9 million and \$1.8 million as of March 31, 2019 and December 31, 2018, respectively.

(8) Allocation of Partners' Capital

Revenues, income, gains, losses, expenditures, deductions, credits and distributions, as defined in the partnership agreement, are allocated 1 percent to the general partner and 99 percent to the limited partner.

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SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements
(Unaudited)

(9) Credit Facility

On May 15, 2014, the Partnership entered into an unsecured revolving credit facility of \$5.0 million with Amegy Bank, as amended on, December 10, 2014. On August 11, 2017, the credit facility was amended and extended to increase the commitment to \$10.0 million and extend the term. On February 18, 2019, the credit facility was extended to expire on August 11, 2020. The credit facility accrues interest on the outstanding balance at the Prime Rate. At December 31, 2018, the Prime Rate was at 5.50%. In addition to the interest on the outstanding balance, commitment fees accrue at 0.35% for the unused portion of the credit facility.

As of March 31, 2019, the Partnership had \$5.0 million outstanding on the revolving credit facility. The interest expense and fees for the revolving credit facility were approximately \$44,400 and \$19,000 during the three months ended March 31, 2019 and 2018, respectively. The agreement requires maintenance of certain financial ratios and imposes certain restricted covenants. The Partnership was in compliance with all covenants as of March 31, 2019 and December 31, 2018, respectively.

(10) Long-Term Debt

(In thousands)

	Maturity Date	March 31, 2019		December 31, 2018	
CVPE					
Fixed Rate Notes - \$23.5 million	January 15, 2020	\$ 23,500	3.58%	\$ 23,500	3.58%
Term Loan - \$82.5 million	January 15, 2020	77,344	4.25% *	77,859	4.09% *
GSPE					
Term Loan - \$57.2 million	October 31, 2019	<u>53,625</u>	4.25% *	<u>53,983</u>	4.09% *
Total long-term debt		<u>154,469</u>		155,342	
Less: current portion of long-term debt		<u>154,469</u>		<u>56,046</u>	
Long-term debt		<u>\$ -</u>		<u>\$ 99,296</u>	

* Interest based on LIBOR plus an applicable margin

Senior Secured Credit Facilities – On January 15, 2015, CVPE entered into a construction-term loan agreement consisting of a \$106.5 million construction term loan syndicated to five banks and a \$23.5 million senior secured note issued to Prudential Insurance Company of America and affiliates (Fixed Rate Notes). The senior secured credit facilities and Fixed Rate Notes are collateralized by the CVPE assets.

The CV Project was placed in service June 10, 2016 and the new transmission cost of service (TCOS) rate that included the CVPE assets was approved on September 22, 2016 by the PUCT. On November 30, 2016, the amount outstanding on the construction-term loan was converted into a term loan with a balance of \$82.5 million. After this conversion, interest accrues at LIBOR plus 1.75%. Interest is payable the last day of the selected interest period for interest periods of three months or less, and every three months for interest periods greater than three months. Amortized principal amounts of the term loan are payable quarterly after the conversion. The outstanding borrowing under the term loan at March 31, 2019 and December 31, 2018 was \$77.3 million and \$77.9 million, respectively.

As of March 31, 2019 and December 31, 2018, the Fixed Rate Notes had a principal balance of \$23.5 million, respectively. Interest is payable quarterly at a rate of 3.58% per annum and does not provide for any principal payments. The Fixed Rate Notes and the term loan mature on January 15, 2020. As mentioned in Note 2, with the closing of the 2018 Securities Purchase Agreement, the Partnership will pay off the CV Project debt and issue new debt. The Partnership has initiated the refinancing process and has notified certain lenders in connection with the payoff debt and the Partnership believes that it is probable that it will be able to refinance the debt with acceptable terms to the Partnership.

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SHARYLAND UTILITIES, L.P.

**Notes to the Consolidated Financial Statements
(Unaudited)**

The construction-term loan agreement and senior secured notes contain certain default triggers, including without limitation: failure to maintain compliance with financial and other covenants contained in the agreement, limitation on liens, investments and the incurrence of additional indebtedness. CVPE was in compliance with all debt covenants for the construction-term loan agreement at March 31, 2019 and December 31, 2018 .

On March 31, 2015, GSPE entered into a construction-term loan agreement of \$84.0 million syndicated to three banks. The senior secured credit facilities are collateralized by GSPE's assets.

The GS Project was placed in service in March 29, 2016 and the new TCOS rate that included the GSPE assets was approved on June 13, 2016 by the PUCT. On October 31, 2016, the amount outstanding on the construction-term loan was converted into a term loan with a balance of \$57.2 million. After this conversion, interest accrues at LIBOR plus 1.75%. Interest is payable the last day of the selected interest period for interest periods of three months or less, and every three months for interest periods greater than three months. Amortized principal amounts of the term loan are payable quarterly after the conversion. The term loan will mature on October 31, 2019 and the Partnership believes that it is probable that it will be able to refinance the debt with acceptable terms to the Partnership. As mentioned in Note 2, with the closing of the 2018 Securities Purchase Agreement, the Partnership will pay off the GS Project debt and issue new debt. The Partnership has initiated the refinancing process and has notified certain lenders in connection with the payoff debt and the Partnership believes that it is probable that it will be able to refinance the debt with acceptable terms to the Partnership. The outstanding borrowing under the term loan at March 31, 2019 and December 31, 2018 was \$53.6 million and \$54.0 million, respectively.

The construction-term loan agreement contains certain default triggers, including without limitation: failure to maintain compliance with financial and other covenants contained in the agreement, limitation on liens, investments and the incurrence of additional indebtedness. GSPE was in compliance with all debt covenants for the construction-term loan agreement at March 31, 2019 and December 31, 2018.

Future maturities of the total long-term debt as of March 31, 2019 are as follows:

(In thousands)

Year Ending December 31:

2019 - Q2, Q3 and Q4

2020

	Total
	<u>55,173</u>
	<u>99,296</u>
	<u>\$ 154,469</u>

(11) Postretirement Benefits

The Partnership provides continued major medical and dental coverage to retired employees and their dependents meeting certain eligibility requirements. The Partnership's postretirement health care benefit plan provides prescription drug coverage. The Medicare Prescription Drug Improvement and Modernization Act of 2003 includes a federal subsidy for plans that offer prescription drug benefits that are actuarially equivalent to Medicare Part D. The Partnership and the actuarial advisors have determined that the prescription drug coverage provided by the Partnership's postretirement health care benefit plan is actuarially equivalent to Medicare Part D, and accordingly, the subsidy provides some relief for ongoing retiree prescription costs.

(Continued)

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SHARYLAND UTILITIES, L.P.

**Notes to the Consolidated Financial Statements
(Unaudited)**

The Partnership is required to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability on its balance sheet. FASB guidance requires an entity to include items that have not yet been recognized as net periodic postretirement benefit cost as a component of accumulated other comprehensive income. However, for a regulated utility this item is allowed to be recorded as a regulatory asset if: (i) the utility has historically recovered and currently recovers postretirement benefit plan expenses in its electric rates; and (ii) there is no negative evidence that the existing regulatory treatment will change. The Partnership has recorded the unrecognized components of net periodic postretirement benefit cost as a regulatory asset (liability) as these expenses are probable of future recovery.

(12) Fair Value of Financial Instruments

In accordance with ASC Topic 820, *Fair Value Measurements and Disclosures*, the Partnership is required to assess the fair value of its financial instruments and disclose the level of inputs used for that estimate set forth in ASC 820.

The carrying amounts of the Partnership's cash and cash equivalents, due to and from affiliates, and accounts payable approximate fair value due to the short-term nature of these assets and liabilities.

As of March 31, 2019 and December 31, 2018, the Partnership had approximately \$131.0 million and \$131.8 million, respectively, of borrowings under the construction-term loans which accrued interest under a floating rate structure. Accordingly, the carrying value of such indebtedness approximated the fair value for the amounts outstanding.

The Partnership also had borrowings totaling \$23.5 million under senior secured notes with a rate of 3.58% per annum as of March 31, 2019 and December 31, 2018. The fair value of these borrowings is estimated using discounted cash flow analysis based on current market rates.

Financial instruments, measured at fair value as defined by ASC 820, by level within the fair value hierarchy were as follows:

<i>(In thousands)</i>	Carrying Value	Level 1	Fair Value Level 2	Level 3
<u>March 31, 2019</u>				
Long-term debt	\$ 154,469	\$ -	\$ 154,341	\$ -
 <u>December 31, 2018</u>				
Long-term debt	155,342	-	155,114	-

(13) Commitments and Contingencies

Leases

The Partnership has various obligations under operating leases pertaining to equipment, facilities and office space. Charges for the operating leases included in general and administrative expense in the accompanying Consolidated Statements of Operations amounted to approximately \$132,000 and \$78,000 during the three months ended March 31, 2019 and 2018, respectively.

(Continued)

SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements
(Unaudited)

The following is a schedule of future minimum lease payments required under operating leases with a term of greater than 12 months at inception as of March 31, 2019 :

(In thousands)

	<u>Total</u>
Year Ending December 31:	
2019 - Q2, Q3 and Q4	\$ 359
2020	283
2021	277
Thereafter	244
	<u>\$ 1,163</u>

Regulatory proceedings

On February 27, 2018, the Partnership filed an update to its transmission cost of service rates under Docket No. 47649 in order to reflect an income tax allowance at the new 21% corporate federal income tax rate, due to the enactment of the TCJA. The Partnership has historically incorporated an income tax allowance in its MLAs at a 35% corporate federal income tax, and the Partnership's existing lease supplements with SDTS reflect this assumption.

On February 6, 2018, Sharyland filed its request to recover the rate case expenses incurred in Docket's No. 45414, 41723 and 42699. The amount requested included \$7.9 million of expenses incurred by Sharyland and \$474,000 incurred by the municipalities within Sharyland's service territory who intervened in Docket No. 45414. This case was heard by an administrative law judge (ALJ) in August and the company received a proposal for decision from the ALJ in October. On December 7, 2018, the PUCT commissioner's put this case on hold while the 2018 Securities Purchase Agreement is pending.

On October 18, 2018, the Partnership entered into the 2018 Securities Purchase Agreement with SU Investment Partners, L.P., Sempra, and Sempra Energy pursuant to which, Sempra will obtain a 50% limited partnership interest in Sharyland Holdings, which will own a 100% interest in the Partnership. The Partnership also entered into an Asset Exchange agreement with SDTS and Oncor pursuant to which, the Partnership will exchange, its equity interests in GSPE and certain development projects in the Texas Panhandle and South Plains regions, including the LP&L Project for SDTS's South Texas Assets. Concurrently with the execution of definitive agreements associated with the SU Investment and the Asset Exchange, Oncor entered into a definitive agreement to acquire InfraREIT, Inc. (the Oncor Merger). On November 30, 2018, the Partnership and SDTS filed a joint STM application Docket No. 48929 with Oncor and Sempra for approval of the SU Investment, the Asset Exchange and the Oncor Merger. See Note 2, 2018 Securities Purchase Agreement for additional information regarding the SU Investment, the Asset Exchange and the Oncor Merger.

(Continued)

SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements
(Unaudited)

Texas Regional Entity (Texas RE) conducted a compliance audit of the Partnership for its transmission owner, transmission operator, and transmission planner functions. The audit includes recommendations, areas of concern and findings of potential noncompliance. Texas RE's enforcement division will review the facts and circumstances to determine if there have been any violations of reliability standards, and if so, the appropriate mitigating activities and any penalties. The timeframe for concluding the enforcement activities is unknown.

(14) Supplemental Cash Flow Information

Supplemental cash flow information and non-cash investment and financing activities for the three months ended March 31 are as follows:

(In thousands)

Supplemental cash flow information

	2018	2018
Cash paid for interest	\$ 43,127	\$ 42,286
Cash paid for margin taxes	-	-
Non-cash investing and financing activities		
Financing obligation incurred	\$ 10,775	\$ 17,941
Change in accrued additions to property, plant and equipment	3	450
Property, plant and equipment - net transferred to deferred charges - regulatory assets	-	1,590
Allowance for funds used during construction - debt	-	21

(15) Subsequent Events

In April 2019, the parties to the STM proceeding filed the Settlement with the PUCT reflecting the parties agreement to settle all outstanding issues in our STM under Docket No. 48929. The Settlement is supported or unopposed by all parties to the STM and indicates that the transactions are in the public interest. The Settlement is subject to review and approval by the PUCT. A hearing on the merits was held on April 10, 2019.

On April 3, 2019, the Partnership repaid \$5.0 million under its revolving credit facility with Amegy Bank. The credit facility accrues interest on the outstanding balance at the Prime Rate of 5.50%. On April 8, 2019, the Partnership repaid \$2.0 million under its subordinated note with Loyal Trust No. 1. The subordinated note accrues interest on the outstanding balance at the floating JP Morgan Chase Prime Rate with all interest compounded semiannually.

The Partnership has evaluated subsequent events from the Balance Sheet date through April 25, 2019, the date at which the Financial Statements were made available to be issued, and determined there are no other items to disclose.



Sharyland
Utilities