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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended June 30, 2018

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)

**75-2952822**

(I.R.S. Employer  
Identification Number)

**1900 North Akard Street**

**Dallas, Texas 75201**

(Address of Principal Executive Offices)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 type="checkbox"/>   | Accelerated filer         | <input checked="" type="checkbox"/> |
| Non-accelerated filer   | <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company | <input type="checkbox"/>            |
| Emerging growth company | <input checked="" 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

As of July 27, 2018, 43,962,167 shares of common stock were issued and outstanding.

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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.

| <b>Abbreviation</b>            | <b>Term</b>  |
|--------------------------------|--|
| 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   |
| CWIP                           | construction work in progress  |
| 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 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   |
| 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 or Company) 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 and statements regarding a potential De-REIT alternative (as defined below).

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:

- 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;
- the impact of any termination of our real estate investment trust (REIT) status;
- the implications of our relationships with Hunt Consolidated, Inc. (HCI) and its affiliates (collectively, Hunt) on any transaction or arrangement that may be proposed with respect to our business or structure;
- 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;
- our ability to negotiate future rent payments or renew leases with our tenant;
- insufficient cash available to meet distribution requirements;
- cyber breaches and weather conditions or other natural phenomena;
- 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;
- 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, 2017, filed with the U.S. Securities and Exchange Commission (SEC) on March 5, 2018 (2017 Form 10-K).

**PART I. FINANCIAL INFORMATION**

**Item 1. Consolidated Financial Statements**

**InfraREIT, Inc.**

**CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share amounts)

|   | <u>June 30, 2018</u><br>(Unaudited) | <u>December 31, 2017</u> |
|---|-------------------------------------|--------------------------|
| <b>Assets</b>   |                                     |                          |
| <b>Current Assets</b>   |                                     |                          |
| Cash and cash equivalents   | \$ 2,102                            | \$ 2,867                 |
| Restricted cash   | 1,685                               | 1,683                    |
| Due from affiliates   | 32,423                              | 35,172                   |
| Inventory   | 7,302                               | 6,759                    |
| Prepays and other current assets  | 1,039                               | 2,460                    |
| Total current assets  | <u>44,551</u>                       | <u>48,941</u>            |
| <b>Electric Plant, net</b>  | 1,788,991                           | 1,772,229                |
| <b>Goodwill</b>   | 138,384                             | 138,384                  |
| <b>Other Assets</b>   | 32,188                              | 34,314                   |
| <b>Total Assets</b>   | <u>\$ 2,004,114</u>                 | <u>\$ 1,993,868</u>      |
| <b>Liabilities and Equity</b>   |                                     |                          |
| <b>Current Liabilities</b>  |                                     |                          |
| Accounts payable and accrued liabilities  | \$ 22,955                           | \$ 21,230                |
| Short-term borrowings   | 99,500                              | 41,000                   |
| Current portion of long-term debt   | 7,957                               | 68,305                   |
| Dividends and distributions payable   | 15,176                              | 15,169                   |
| Accrued taxes   | 491                                 | 5,633                    |
| Total current liabilities   | <u>146,079</u>                      | <u>151,337</u>           |
| <b>Long-Term Debt, Less Deferred Financing Costs</b>  | 837,486                             | 841,215                  |
| <b>Regulatory Liabilities</b>   | 108,023                             | 100,458                  |
| Total liabilities   | <u>1,091,588</u>                    | <u>1,093,010</u>         |
| <b>Commitments and Contingencies</b>  |                                     |                          |
| <b>Equity</b>   |                                     |                          |
| Common stock, \$0.01 par value; 450,000,000 shares authorized; 43,962,167 and 43,796,915 issued and outstanding as of June 30, 2018 and December 31, 2017, respectively | 440                                 | 438                      |
| Additional paid-in capital  | 709,488                             | 706,357                  |
| Accumulated deficit   | (41,510)                            | (49,728)                 |
| Total InfraREIT, Inc. equity  | <u>668,418</u>                      | <u>657,067</u>           |
| Noncontrolling interest   | 244,108                             | 243,791                  |
| Total equity  | <u>912,526</u>                      | <u>900,858</u>           |
| <b>Total Liabilities and Equity</b>   | <u>\$ 2,004,114</u>                 | <u>\$ 1,993,868</u>      |

*See accompanying notes to the unaudited consolidated financial statements.*

**InfraREIT, Inc.**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share amounts)

(Unaudited)

|  | <u>Three Months Ended June 30,</u> |                 | <u>Six Months Ended June 30,</u> |                  |
|--|------------------------------------|-----------------|----------------------------------|------------------|
|  | <u>2018</u>                        | <u>2017</u>     | <u>2018</u>                      | <u>2017</u>      |
| <b>Lease revenue</b>   | \$ 47,827                          | \$ 40,422       | \$ 93,483                        | \$ 80,046        |
| <b>Operating costs and expenses</b>  |                                    |                 |                                  |                  |
| General and administrative expense   | 6,631                              | 6,866           | 12,719                           | 12,847           |
| Depreciation   | 11,992                             | 12,982          | 23,569                           | 25,669           |
| Total operating costs and expenses   | 18,623                             | 19,848          | 36,288                           | 38,516           |
| <b>Income from operations</b>  | 29,204                             | 20,574          | 57,195                           | 41,530           |
| <b>Other (expense) income</b>  |                                    |                 |                                  |                  |
| Interest expense, net  | (11,070)                           | (10,141)        | (21,744)                         | (19,839)         |
| Other income, net  | 374                                | 17              | 1,107                            | 20               |
| Total other expense  | (10,696)                           | (10,124)        | (20,637)                         | (19,819)         |
| <b>Income before income taxes</b>  | 18,508                             | 10,450          | 36,558                           | 21,711           |
| Income tax (benefit) expense   | (5,428)                            | 321             | (5,142)                          | 565              |
| <b>Net income</b>  | 23,936                             | 10,129          | 41,700                           | 21,146           |
| <b>Less: Net income attributable to noncontrolling interest</b>                  | 6,602                              | 2,821           | 11,502                           | 5,889            |
| <b>Net income attributable to InfraREIT, Inc.</b>                                | <u>\$ 17,334</u>                   | <u>\$ 7,308</u> | <u>\$ 30,198</u>                 | <u>\$ 15,257</u> |
| <b>Net income attributable to InfraREIT, Inc. common stockholders per share:</b> |                                    |                 |                                  |                  |
| <b>Basic</b>   | <u>\$ 0.39</u>                     | <u>\$ 0.17</u>  | <u>\$ 0.69</u>                   | <u>\$ 0.35</u>   |
| <b>Diluted</b>   | <u>\$ 0.39</u>                     | <u>\$ 0.17</u>  | <u>\$ 0.69</u>                   | <u>\$ 0.35</u>   |
| <b>Cash dividends declared per common share</b>                                  | <u>\$ 0.25</u>                     | <u>\$ 0.25</u>  | <u>\$ 0.50</u>                   | <u>\$ 0.50</u>   |

*See accompanying notes to the unaudited consolidated financial statements.*

**InfraREIT, Inc.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

|   | <b>Six Months Ended June 30,</b> |                         |
|---|----------------------------------|-------------------------|
|   | <b>2018</b>                      | <b>2017</b>             |
| <b>Cash flows from operating activities</b>                                       |                                  |                         |
| Net income  | \$ 41,700                        | \$ 21,146               |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                  |                         |
| Depreciation  | 23,569                           | 25,669                  |
| Amortization of deferred financing costs  | 2,142                            | 2,030                   |
| Allowance for funds used during construction - other funds                        | (1,094)                          | —                       |
| Equity based compensation   | 320                              | 285                     |
| Changes in assets and liabilities:  |                                  |                         |
| Due from affiliates   | 2,749                            | 5,227                   |
| Inventory   | (543)                            | 104                     |
| Prepays and other current assets  | (211)                            | (296)                   |
| Accounts payable and accrued liabilities  | (3,390)                          | 1,986                   |
| Net cash provided by operating activities   | <u>65,242</u>                    | <u>56,151</u>           |
| <b>Cash flows from investing activities</b>                                       |                                  |                         |
| Additions to electric plant   | (31,699)                         | (91,601)                |
| Proceeds from asset exchange transaction  | 1,632                            | —                       |
| Net cash used in investing activities   | <u>(30,067)</u>                  | <u>(91,601)</u>         |
| <b>Cash flows from financing activities</b>                                       |                                  |                         |
| Proceeds from short-term borrowings   | 92,500                           | 65,500                  |
| Repayments of short-term borrowings   | (34,000)                         | (203,000)               |
| Proceeds from borrowings of long-term debt  | —                                | 200,000                 |
| Repayments of long-term debt  | (64,093)                         | (3,869)                 |
| Deferred financing costs  | —                                | (801)                   |
| Dividends and distributions paid  | (30,345)                         | (30,330)                |
| Net cash (used in) provided by financing activities                               | <u>(35,938)</u>                  | <u>27,500</u>           |
| Net decrease in cash, cash equivalents and restricted cash                        | (763)                            | (7,950)                 |
| Cash, cash equivalents and restricted cash at beginning of period                 | 4,550                            | 19,294                  |
| <b>Cash, cash equivalents and restricted cash at end of period</b>                | <u><u>\$ 3,787</u></u>           | <u><u>\$ 11,344</u></u> |

*See accompanying notes to the unaudited consolidated financial statements.*

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,” “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 six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. 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, 2017 filed with the U.S. Securities and Exchange Commission (SEC) on March 5, 2018 (2017 Form 10-K).

We held 72.4% of the outstanding partnership units (OP Units) in InfraREIT Partners, LP (Operating Partnership or InfraREIT LP) as of June 30, 2018 and are its general partner. We include the accounts of the Operating Partnership and its subsidiaries in our consolidated financial statements. Hunt Consolidated, Inc. affiliates, current or former employees and members of our board of directors held the other 27.6% of the outstanding OP Units as of June 30, 2018.

***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 May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (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. As part of this guidance, lease transactions have been excluded from the requirements of this standard. We adopted this guidance on January 1, 2018. As this guidance only applies to us if certain lease criteria are present and under limited circumstances, the new guidance currently has a minimal impact on our financial position, results of operations and cash flows.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Clarification of Certain Cash Receipts and Cash Payments*. The objective of ASU 2016-15 is to eliminate the diversity in practice related to the classification of certain cash receipts and payments in the statement of cash flows by adding or clarifying guidance on eight specific cash flow issues. The new standard should be applied retrospectively to all periods presented, unless deemed impracticable, in which case prospective application is permitted. We adopted the new guidance on January 1, 2018 and the new guidance did not impact our Consolidated Statement of Cash Flows.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 203): Restricted Cash (A Consensus of the FASB Emerging Issues Task Force)*. ASU 2016-18 adds to or clarifies current guidance on the classification and presentation of restricted cash in the statement of cash flows. The new guidance requires entities to include in their cash and cash equivalent balances in the statement of cash flows those amounts that are deemed to be restricted cash and restricted cash equivalents. We adopted the guidance on January 1, 2018 and have adjusted all periods presented for the change in presentation of restricted cash on our Consolidated Statement of 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 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 to not 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. The guidance under these standards is effective for periods beginning after December 15, 2018, with early adoption permitted. We expect to adopt the new guidance as of January 1, 2019. 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. We believe the new guidance will have a minimal impact on our financial position, results of operations and cash flows due to the limited changes related to lessor transactions.

## 2. Asset Exchange Transaction

In July 2017, our regulated subsidiary, Sharyland Distribution & Transmission Services, L.L.C. (SDTS), and our sole tenant, Sharyland Utilities, L.P. (Sharyland), signed a definitive agreement (Definitive Agreement) with Oncor Electric Delivery Company LLC (Oncor) to exchange SDTS's retail distribution assets and certain transmission assets for a group of Oncor's transmission assets located in Northwest and Central Texas (Asset Exchange Transaction). The Asset Exchange Transaction closed in November 2017 and, among other things, resulted in SDTS exchanging \$403 million of net assets for \$383 million of transmission assets owned by Oncor, \$18 million of net cash and a \$2 million receivable from Oncor as of December 31, 2017. The transaction resulted in a gain of \$0.3 million for SDTS. The receivable from Oncor was included in prepaids and other current assets in the Consolidated Balance Sheets at December 31, 2017. The receivable from Oncor was collected during the first quarter of 2018. These transactions were structured to qualify, in part, as a simultaneous tax deferred like-kind exchange of assets to the extent that the assets are of "like kind" (within the meaning of Section 1031 of the Internal Revenue Code of 1986, as amended).

## 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>   | June 30, |           |
|---|----------|-----------|
|   | 2018     | 2017      |
| Cash  | \$ 2,102 | \$ 9,662  |
| Restricted cash   | 1,685    | 1,682     |
| Total cash, cash equivalents and restricted cash shown on the Statement of Cash Flows | \$ 3,787 | \$ 11,344 |

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 the Operating Partnership's wholly-owned subsidiary, Transmission and Distribution Company, L.L.C. (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 in the Asset Exchange Transaction.

We earned lease revenue from Sharyland under these agreements of \$47.8 million and \$40.4 million during the three months ended June 30, 2018 and 2017, respectively. We earned lease revenue of \$93.5 million and \$80.0 million from Sharyland during the six months ended June 30, 2018 and 2017, respectively. In connection with our leases with Sharyland, we had a deferred rent liability of \$14.5 million and \$14.7 million as of June 30, 2018 and December 31, 2017, 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 six months ended June 30, 2018 and 2017, the net amount of payments we made to Sharyland was \$ 31.1 million and \$ 93.9 million, respectively.

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 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 Definitive 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. For information related to Asset Exchange Transaction, see Note 2, *Asset Exchange Transaction*.

As part of the Asset Exchange Transaction, we incurred \$0.2 million in legal fees related to us obtaining the lenders' consents to complete the Asset Exchange Transaction. These costs are eligible to be recovered through rates collected from customers during the 24-month period starting January 2018 through December 2019. We sold the recoverable costs to Sharyland in exchange for 24 equal monthly payments beginning January 2018 through December 2019. The equal monthly payments from Sharyland will be received through the CREZ lease. As of June 30, 2018, Sharyland had made six monthly payments related to the recoverable legal fees. As of December 31, 2017, there were no payments due from Sharyland related to the legal fees and no payments had been received. These fees are included in due from affiliates on the Consolidated Balance Sheets.

As of June 30, 2018 and December 31, 2017, accounts payable and accrued liabilities on the Consolidated Balance Sheets included \$2.7 million and \$2.1 million, respectively, related to amounts owed to Sharyland for construction costs incurred and property taxes paid on our behalf. As of June 30, 2018 and December 31, 2017, amounts due from affiliates on the Consolidated Balance Sheets included \$32.4 million and \$35.2 million, respectively, related to amounts owed by Sharyland primarily associated with our leases.

The management fee paid to Hunt Utility Services, LLC (Hunt Manager) for the six months ended June 30, 2018 and 2017 was \$6.9 million and \$10.5 million, respectively. There were no prepaid or accrued amounts associated with the management fees on the Consolidated Balance Sheets as of June 30, 2018 and December 31, 2017. As of December 31, 2016, there was \$3.5 million accrued associated with management fees on the Consolidated Balance Sheets. Additionally, during the six months ended June 30, 2018 and 2017, we paid Hunt Manager \$0.1 million and \$0.2 million, respectively, for reimbursement of annual software license and maintenance fees and other expenses in accordance with our management agreement.

Our 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. The term of the management agreement expires December 31, 2019 and will automatically renew for successive five year terms unless a majority of our independent directors decides to terminate the agreement.

The annual base fees through March 31, 2019 are as follows:

| <i>(In millions)</i>           | <b>Base Fee</b> |
|--------------------------------|-----------------|
| April 1, 2016 - March 31, 2017 | \$ 14.0         |
| April 1, 2017 - March 31, 2018 | 14.2            |
| April 1, 2018 - March 31, 2019 | 13.5            |

## 5. Electric Plant and Depreciation

The major classes of electric plant are as follows:

| <i>(In thousands)</i>         | June 30, 2018       | December 31, 2017   |
|-------------------------------|---------------------|---------------------|
| Electric plant:               |                     |                     |
| Transmission plant            | \$ 1,779,123        | \$ 1,685,466        |
| Distribution plant            | 150,034             | 143,865             |
| General plant                 | 3,023               | 3,023               |
| Total plant in service        | <u>1,932,180</u>    | <u>1,832,354</u>    |
| Construction work in progress | 46,701              | 113,643             |
| Total electric plant          | 1,978,881           | 1,945,997           |
| Accumulated depreciation      | (189,890)           | (173,768)           |
| Electric plant, net           | <u>\$ 1,788,991</u> | <u>\$ 1,772,229</u> |

General plant consists primarily of a warehouse, buildings and associated assets. Construction work in progress (CWIP) relates to various projects underway related to our regulated assets. 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 \$28.8 million and \$29.4 million as of June 30, 2018 and December 31, 2017, 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 June 30, 2018 and December 31, 2017, \$138.4 million was recorded as goodwill on the Consolidated Balance Sheets.

## 7. Other Assets

Other assets are as follows:

| <i>(In thousands)</i>                        | June 30, 2018               |                             |                           | December 31, 2017           |                             |                           |
|--|-----------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|
|  | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount |
| Deferred financing costs on undrawn revolver | \$ 967                      | \$ (688)                    | \$ 279                    | \$ 967                      | \$ (591)                    | \$ 376                    |
| Other regulatory assets:                     |                             |                             |                           |                             |                             |                           |
| Deferred financing costs                     | 10,365                      | (4,768)                     | 5,597                     | 28,570                      | (20,944)                    | 7,626                     |
| Deferred costs recoverable in future years   | 23,793                      | —                           | 23,793                    | 23,793                      | —                           | 23,793                    |
| Other regulatory assets                      | 34,158                      | (4,768)                     | 29,390                    | 52,363                      | (20,944)                    | 31,419                    |
| Investments                                  | 2,519                       | —                           | 2,519                     | 2,519                       | —                           | 2,519                     |
| Other assets                                 | <u>\$ 37,644</u>            | <u>\$ (5,456)</u>           | <u>\$ 32,188</u>          | <u>\$ 55,849</u>            | <u>\$ (21,535)</u>          | <u>\$ 34,314</u>          |

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.

The \$18.2 million gross deferred financing costs associated with our 2011 Notes (defined below) were fully amortized in June 2018 and removed from our Consolidated Balance Sheets when the 2011 Notes were repaid at maturity. See Note 9, *Long-Term Debt*.

Deferred costs recoverable in future years of \$23.8 million as of June 30, 2018 and December 31, 2017 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.

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 June 30, 2018 and December 31, 2017.

## **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. 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 June 30, 2018 and December 31, 2017, 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 June 30, 2018 and December 31, 2017, InfraREIT LP was in compliance with all debt covenants under the credit agreement.

### ***SDTS Revolving Credit Facility***

In 2014, SDTS entered into the third amended and restated credit agreement led by Royal Bank of Canada, as administrative agent, with a maturity date of December 10, 2019. 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 June 30, 2018, SDTS had \$99.5 million of borrowings outstanding at an interest rate of 4.10%, no letters of credit outstanding and \$150.5 million of borrowing capacity available under this revolving credit facility. During June 2018, \$60.0 million in borrowings were used to repay the outstanding balance on the 2011 Notes. See Note 9, *Long-Term Debt* below. As of December 31, 2017, SDTS had \$41.0 million of borrowings outstanding at a weighted average interest rate of 3.12% with no letters of credit outstanding and \$209.0 million of borrowing capacity available under this revolving credit facility. As of June 30, 2018 and December 31, 2017, 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      | June 30, 2018      |               | December 31, 2017  |               |
|--|--------------------|--------------------|---------------|--------------------|---------------|
|  |                    | Amount Outstanding | Interest Rate | Amount Outstanding | Interest Rate |
| <b>TDC</b>   |                    |                    |               |                    |               |
| Senior secured notes - \$25.0 million                            | December 30, 2020  | \$ 15,625          | 8.50%         | \$ 16,250          | 8.50%         |
| <b>SDTS</b>  |                    |                    |               |                    |               |
| Senior secured notes - \$60.0 million                            | June 20, 2018      | —                  | n/a           | 60,000             | 5.04%         |
| Senior secured term loan - \$200.0 million                       | June 5, 2020       | 200,000            | 3.34%         | 200,000            | 2.71%         |
| 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  | 39,462             | 7.25%         | 40,546             | 7.25%         |
| Senior secured notes - \$110.0 million                           | September 30, 2030 | 90,436             | 6.47%         | 92,821             | 6.47%         |
| Total SDTS debt  |                    | 829,898            |               | 893,367            |               |
| Total long-term debt   |                    | 845,523            |               | 909,617            |               |
| Less unamortized deferred financing costs                        |                    | (80)               |               | (97)               |               |
| Total long-term debt, less deferred financing costs              |                    | 845,443            |               | 909,520            |               |
| Less current portion of long-term debt                           |                    | (7,957)            |               | (68,305)           |               |
| Debt classified as long-term debt, less deferred financing costs |                    | <u>\$ 837,486</u>  |               | <u>\$ 841,215</u>  |               |

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 7, *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 June 30, 2018 and December 31, 2017.

SDTS had \$60.0 million aggregate principal amount of 5.04% per annum senior secured notes that were issued to The Prudential Insurance Company of America and affiliates in 2011 (2011 Notes). Interest was payable quarterly while no principal payments were due until maturity. These notes were paid in full at maturity during June 2018 with proceeds from SDTS's revolving credit facility.

In June 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 bear interest at a rate of 3.86% per annum, payable semi-annually. The Series A Notes are due at maturity with outstanding accrued interest payable each June and December. The Series B Notes are due at maturity with outstanding accrued interest payable 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 June 30, 2018 and December 31, 2017, SDTS and TDC were in compliance with all debt covenants under the applicable agreements.

SDTS's Series A Notes, Series B Notes, 2009 Notes, 2010 Notes and 2017 Term Loan are, and the 2011 Notes were, 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 \$645.5 million and \$709.6 million under our senior secured notes with a weighted average interest rate of 4.6% per annum as of June 30, 2018 and December 31, 2017, respectively. The fair value of these borrowings is estimated using discounted cash flow analysis based on current market rates.

As of June 30, 2018 and December 31, 2017, 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<br>Value | Fair Value |            |         |
|--------------------------|-------------------|------------|------------|---------|
|                          |                   | Level 1    | Level 2    | Level 3 |
| <b>June 30, 2018</b>     |                   |            |            |         |
| Long-term debt           | \$ 845,523        | \$ —       | \$ 861,272 | \$ —    |
| <b>December 31, 2017</b> |                   |            |            |         |
| Long-term debt           | \$ 909,617        | \$ —       | \$ 950,522 | \$ —    |

## 11. Regulatory Matters

### *Regulatory Liability*

Regulatory liabilities are as follows:

| <i>(In thousands)</i>  | June 30, 2018     | December 31, 2017 |
|------------------------|-------------------|-------------------|
| Cost of removal        | \$ 52,244         | \$ 44,679         |
| Excess ADFIT           | 55,779            | 55,779            |
| Regulatory liabilities | <u>\$ 108,023</u> | <u>\$ 100,458</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. 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 REIT structure. With the passage of the Tax Cuts and Jobs Act ( 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 ASC 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 been previously 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 Case Filing**

In January 2014, the PUCT approved a rate case (2013 Rate Case) filed by Sharyland applicable to our regulated assets providing 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. The new rates became effective May 1, 2014. Under the order approving the 2013 Rate Case, Sharyland was required to file its next rate case in 2016 (2016 Rate Case). In November 2017, the 2016 Rate Case was dismissed, which resulted in the 2013 Rate Case regulatory parameters remaining in place. As part of the PUCT order approving the Asset Exchange Transaction, the PUCT also granted SDTS a CCN to continue to own and lease its assets to Sharyland. SDTS and Sharyland are required to file a new rate case by July 1, 2020 with a test year ending December 31, 2019.

### **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 and cash flows.

### **13. Equity**

We and the Operating Partnership declared cash dividends on common stock and distributions on OP Units of \$0.50 per share or unit, as applicable, during each of the six months ended June 30, 2018 and 2017. We paid a total of \$30.3 million in dividends and distributions during each of the six months ended June 30, 2018 and 2017.

### **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 our 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 InfraREIT, Inc. common stock on a one-for-one basis. As of June 30, 2018 and December 31, 2017, there were a total of 16.7 million and 16.9 million OP Units, respectively, held by the limited partners of the Operating Partnership.

During the six months ended June 30, 2018 and 2017, an aggregate of 28,952 and 31,633 long-term incentive units (LTIP Units), respectively, were issued by the Operating Partnership to members of our board of directors. 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 six months ended June 30, 2018, we redeemed 165,252 OP Units with the issuance of 165,252 shares of common stock. We redeemed 6,207 OP Units with the issuance of 6,207 shares of common stock during the six months ended June 30, 2017.

## 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 and six months ended June 30, 2018 and 2017.

Earnings per share are calculated as follows:

| <i>(In thousands, except per share data)</i>  | <u>Three Months Ended June 30,</u> |             | <u>Six Months Ended June 30,</u> |             |
|---|------------------------------------|-------------|----------------------------------|-------------|
|   | <u>2018</u>                        | <u>2017</u> | <u>2018</u>                      | <u>2017</u> |
| <b>Basic net income per share:</b>  |                                    |             |                                  |             |
| Net income attributable to InfraREIT, Inc.  | \$ 17,334                          | \$ 7,308    | \$ 30,198                        | \$ 15,257   |
| Weighted average common shares outstanding  | 43,961                             | 43,778      | 43,897                           | 43,776      |
| Basic net income per share  | \$ 0.39                            | \$ 0.17     | \$ 0.69                          | \$ 0.35     |
| <b>Diluted net income per share:</b>  |                                    |             |                                  |             |
| Net income attributable to InfraREIT, Inc.  | \$ 17,334                          | \$ 7,308    | \$ 30,198                        | \$ 15,257   |
| Weighted average common shares outstanding  | 43,961                             | 43,778      | 43,897                           | 43,776      |
| Redemption of Operating Partnership units   | —                                  | —           | —                                | —           |
| Weighted average dilutive shares outstanding  | 43,961                             | 43,778      | 43,897                           | 43,776      |
| Diluted net income per share  | \$ 0.39                            | \$ 0.17     | \$ 0.69                          | \$ 0.35     |
| <b>Due to the anti-dilutive effect, the computation of diluted earnings per share does not reflect the following adjustments:</b> |                                    |             |                                  |             |
| Net income attributable to noncontrolling interest  | \$ 6,602                           | \$ 2,821    | \$ 11,502                        | \$ 5,889    |
| Redemption of Operating Partnership units   | 16,743                             | 16,897      | 16,807                           | 16,899      |

## 16. Leases

The following table shows the composition of our lease revenue:

| <i>(In thousands)</i>     | <u>Three Months Ended June 30,</u> |             | <u>Six Months Ended June 30,</u> |             |
|---------------------------|------------------------------------|-------------|----------------------------------|-------------|
|                           | <u>2018</u>                        | <u>2017</u> | <u>2018</u>                      | <u>2017</u> |
| Base rent (straight-line) | \$ 47,827                          | \$ 40,422   | \$ 93,483                        | \$ 80,046   |
| Percentage rent           | —                                  | —           | —                                | —           |
| Total lease revenue       | \$ 47,827                          | \$ 40,422   | \$ 93,483                        | \$ 80,046   |

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. The lease supplements governing the Stanton Transmission Loop, Permian Basin assets and assets acquired in the Asset Exchange Transaction, which are part of the CREZ assets, only provide for base rent. Rent for the assets in McAllen and the CREZ assets not acquired in the Asset Exchange Transaction is comprised primarily of base rent but also includes percentage rent. Prior to its termination on December 31, 2017, the lease that previously covered the Permian Basin assets as well as the assets in Brady and Celeste, Texas that were transferred to Oncor in the Asset Exchange Transaction also included a percentage rent component. 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 annual specified breakpoints, 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 a high of 31% to a low of 23%. Because an annual specified breakpoint must be met under our leases before we can recognize any percentage rent, we anticipate that little to no percentage rent will be recognized in the first and second quarters of each year, with the largest amounts of percentage rent recognized during the third and fourth quarters of each year.



## 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 LTIP Units issued to members of our board of directors during the six months ended June 30, 2018 and 2017:

| Grant Date   | LTIP Units | Grant Date Fair Value per LTIP Unit | Aggregate Fair Value (in thousands) | Vesting Date |
|--------------|------------|-------------------------------------|-------------------------------------|--------------|
| January 2017 | 31,633     | \$ 18.02                            | \$ 570                              | January 2018 |
| January 2018 | 28,952     | 18.61                               | 539                                 | January 2019 |

As part of our board of directors' quarterly compensation, each non-executive director can, subject to certain exceptions, elect to receive part of their compensation in our common stock instead of cash with full vesting upon issuance. During 2017 and 2018, all directors received their quarterly compensation in cash. The compensation expense, which represents the fair value of the 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 June 30, 2018 and 2017, \$0.2 million was recognized as compensation expense related to these grants and is included in general and administrative expense on the Consolidated Statements of Operations. We recognized \$0.3 million of compensation expense during each of the six months ended June 30, 2018 and 2017. The unamortized compensation expense related to these grants was \$0.2 million as of June 30, 2018.

## 18. Income Taxes

Historically, we have accrued for potential taxes, penalties and interest related to Texas state franchise taxes on our rental income on our Consolidated Balance Sheets. However, during the second quarter of 2018, we reached a settlement with the state of Texas in which no franchise taxes were owed on lease revenue for all tax years through 2017. As a result, the accrued liability for these potential taxes of \$4.9 million and penalties and interest of \$0.7 million were removed from our Consolidated Balance Sheets and recognized as an income tax benefit on our Consolidated Statements of Operations during the second quarter of 2018.

The tax portion of the liability represented unrecognized tax benefits that, if recognized, would have impacted our effective tax rate. A reconciliation of the beginning and ending amount of unrecognized tax benefits follows:

| <i>(In thousands)</i>  | June 30, 2018 | December 31, 2017 |
|--|---------------|-------------------|
| Balance at beginning of period                               | \$ 4,864      | \$ 3,827          |
| Additions based on tax positions related to the current year | —             | 1,037             |
| Settlements  | (4,864)       | —                 |
| Balance at end of period                                     | \$ —          | \$ 4,864          |

Effective January 1, 2018, we will begin accruing and paying Texas franchise tax on our gross lease revenues.

## 19. Supplemental Cash Flow Information

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

| <i>(In thousands)</i>                                      | Six Months Ended June 30, |           |
|--|---------------------------|-----------|
|  | 2018                      | 2017      |
| <b>Supplemental cash flow information</b>                  |                           |           |
| Cash paid for interest                                     | \$ 20,794                 | \$ 19,007 |
| <b>Non-cash investing and financing activities</b>         |                           |           |
| Change in accrued additions to electric plant              | (95)                      | 3,912     |
| Allowance for funds used during construction - debt        | 1,228                     | 1,557     |
| Redemption of operating partnership units for common stock | 3,133                     | 110       |
| Dividends and distributions payable                        | 15,176                    | 15,169    |

## **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 2017 Form 10-K and the unaudited consolidated financial statements and related notes beginning on page 5. 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 Utilities, L.P. (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 have grown rapidly since our formation, with our rate base increasing from approximately \$60 million as of December 31, 2009 to \$1.5 billion as of June 30, 2018.

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 2017 Form 10-K.

### **Recent Events**

#### *Senior Secured Debt Repayment*

On June 20, 2018, our 2011 Notes (as defined below) matured and were repaid with proceeds from SDTS's revolving credit facility. See *Senior Secured Debt* below.

#### *Franchise Tax Settlement*

Historically, we have accrued for potential taxes, penalties and interest related to Texas state franchise taxes on our rental income on our Consolidated Balance Sheets. However, during the second quarter of 2018, we reached a settlement with the state of Texas in which no franchise taxes were owed on lease revenue for all tax years through 2017. As a result, the accrued liabilities for these potential taxes of \$4.9 million and penalties and interest of \$0.7 million were removed from our Consolidated Balance Sheets and recognized as an income tax benefit on our Consolidated Statements of Operations during the second quarter of 2018. The \$5.6 million franchise tax settlement was partially offset by the related \$1.2 million professional services fee associated with the settlement. Effective January 1, 2018, we will begin accruing and paying Texas franchise tax on our gross lease revenues. For the three and six months ended June 30, 2018, \$0.2 million and \$0.5 million, respectively, has been recorded in income tax expense as a result of our estimated Texas franchise tax on our gross rental revenues for the 2018 tax year.

#### *Company Structure and De-REIT Alternatives*

As previously disclosed, our board of directors completed its initial review of our REIT status and directed management to pursue an alternative structure that would involve, among other things, terminating our REIT status and opting for a traditional C-corporation structure (a De-REIT alternative). As further disclosed, in tandem with our evaluation of a De-REIT alternative, the Conflicts Committee continues to monitor HCI's Schedule 13D filings regarding their intentions with respect to us. It is possible that any transaction that might be proposed as a result of the efforts as described in HCI's filings could serve as the De-REIT alternative that we ultimately choose.

On May 24, 2018, HCI filed an amendment to its Schedule 13D (13D Amendment) with the SEC. In the 13D Amendment, HCI stated that it did not believe that a “going private” transaction was likely to be viable, although HCI may elect to consider and pursue such a transaction in the future. However, as described in the 13D Amendment, in the course of HCI’s discussions with various parties about participating in a “going private” transaction, certain parties expressed interest in a possible direct acquisition of us as an alternative to a “going private” transaction. HCI further disclosed that it was engaged in discussions with potential third-party acquirers regarding certain transactions and arrangements involving HCI and its subsidiaries and affiliates, including Sharyland, that would be implemented in connection with an acquisition of us by a third party (Third-Party Acquisition), including the possible termination of certain agreements between HCI and us.

No assurances can be given that we will agree to any transaction proposed as a result of the efforts described in HCI’s 13D Amendment or that any De-REIT alternative will be executed. Our board of directors and the Conflicts Committee intend to explore various De-REIT alternatives and will carefully consider any proposal that may be submitted to us in conjunction with the efforts described in HCI’s 13D Amendment. We expect to continue operating as a REIT until the execution of any De-REIT alternative.

## Results of Operations

| <i>(In thousands)</i>   | Three Months Ended June 30, |           | Six Months Ended June 30, |           |
|---|-----------------------------|-----------|---------------------------|-----------|
|   | 2018                        | 2017      | 2018                      | 2017      |
| <b>Lease revenue</b>  |                             |           |                           |           |
| Base rent   | \$ 47,827                   | \$ 40,422 | \$ 93,483                 | \$ 80,046 |
| Percentage rent   | —                           | —         | —                         | —         |
| Total lease revenue   | 47,827                      | 40,422    | 93,483                    | 80,046    |
| <b>Operating costs and expenses</b>                             |                             |           |                           |           |
| General and administrative expense                              | 6,631                       | 6,866     | 12,719                    | 12,847    |
| Depreciation  | 11,992                      | 12,982    | 23,569                    | 25,669    |
| Total operating costs and expenses                              | 18,623                      | 19,848    | 36,288                    | 38,516    |
| <b>Income from operations</b>                                   | 29,204                      | 20,574    | 57,195                    | 41,530    |
| <b>Other (expense) income</b>                                   |                             |           |                           |           |
| Interest expense, net   | (11,070)                    | (10,141)  | (21,744)                  | (19,839)  |
| Other income, net   | 374                         | 17        | 1,107                     | 20        |
| Total other expense   | (10,696)                    | (10,124)  | (20,637)                  | (19,819)  |
| <b>Income before income taxes</b>                               | 18,508                      | 10,450    | 36,558                    | 21,711    |
| <b>Income tax (benefit) expense</b>                             | (5,428)                     | 321       | (5,142)                   | 565       |
| <b>Net income</b>   | 23,936                      | 10,129    | 41,700                    | 21,146    |
| <b>Less: Net income attributable to noncontrolling interest</b> | 6,602                       | 2,821     | 11,502                    | 5,889     |
| <b>Net income attributable to InfraREIT, Inc.</b>               | \$ 17,334                   | \$ 7,308  | \$ 30,198                 | \$ 15,257 |

### Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

*Lease revenue* — Lease revenue, consisting of only base rent, was \$47.8 million and \$40.4 million for the three months ended June 30, 2018 and 2017, respectively, representing an increase of \$7.4 million, or 18.3%. There was no percentage rent recognized during the three months ended June 30, 2018 and 2017 as Sharyland’s year-to-date adjusted gross revenue did not exceed the annual specified breakpoints under our leases. See Note 16, *Leases* in the Notes to the Unaudited Consolidated Financial Statements for additional information.

The increase in base rent was driven by the change in the allocation of our total rent components between base and percentage rent and additional assets under lease. In 2018, rent for a significant portion of our assets consists only of a base rent component representing a higher portion of our expected total lease revenue compared to prior years. We expect that once we begin to recognize percentage rent for the year, after the annual specified breakpoint has been achieved, our percentage rent revenue will be lower than in prior years, due to percentage rent representing a smaller portion of our expected total lease revenue than it has historically.

*General and administrative expense* — General and administrative expense was \$6.6 million and \$6.9 million for the three months ended June 30, 2018 and 2017, respectively, representing a decrease of \$0.3 million, or 4.3%. During the second quarter of 2018, we incurred a \$1.2 million professional services fee associated with the settlement of our Texas franchise taxes and \$0.4 million net increase in expenses primarily due to our continued review of De-REIT alternatives and decreased management fees. During the second quarter of 2017, we incurred \$1.9 million of professional services fees related to the asset exchange transaction completed during the fourth quarter of 2017 (Asset Exchange Transaction).

*Depreciation* — Depreciation expense was \$ 12.0 million and \$ 13.0 million for the three months ended June 30, 2018 and 2017, respectively, representing a decrease of \$ 1.0 million, or 7.7%. The decrease in depreciation expense was due to our asset mix changing from approximately 70% transmission and 30% distribution to 90% transmission and 10% distribution after the Asset Exchange Transaction.

*Interest expense, net* — Interest expense, net was \$11.1 million and \$10.1 million during the three months ended June 30, 2018 and 2017, respectively, representing an increase of \$1.0 million, or 10.0%. The increase in interest expense, net was due to higher average debt balances and interest rates during 2018 as compared to 2017. Interest expense was partially offset by \$0.4 million and \$0.7 million of AFUDC on debt in 2018 and 2017, respectively. 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 \$0.4 million and less than \$0.1 million during the three months ended June 30, 2018 and 2017, respectively. The increase in other income, net was primarily driven by \$0.4 million of AFUDC on other funds being recognized in 2018 compared to no AFUDC on other funds recognized in 2017. AFUDC on other funds was not recognized during 2017 as the short-term borrowings were in excess of the CWIP balance; therefore, CWIP was financed completely with debt.

*Income tax (benefit) expense* — During the second quarter of 2018, we settled our Texas franchise taxes related to open tax years through 2017. This settlement resulted in no taxes owed for those taxable years resulting in the removal of the potential tax liability and associated interest and penalties totaling \$5.6 million from our Consolidated Balance Sheets with the recognition in income taxes. This removal included franchise taxes of \$0.3 million that had been accrued during the three months ended June 30, 2017. Additionally, franchise taxes of \$0.2 million were incurred during the three months ended June 30, 2018 for our estimated Texas franchise tax on our gross rental revenues for the 2018 tax year.

*Net income* — Net income was \$23.9 million and \$10.1 million during the three months ended June 30, 2018 and 2017, respectively, representing an increase of \$13.8 million. The increase in net income between the two periods was attributable to a \$7.4 million increase in lease revenue, \$5.6 million benefit from the Texas franchise tax settlement, \$1.0 million decrease in depreciation expense and \$0.4 million increase in other income, net partially offset by a \$1.0 million increase in interest expense, net. Additionally, the decrease in general and administrative expense contributed \$0.3 million to net income. The components of general and administrative expense are described above.

#### ***Six Months Ended June 30, 2018 Compared to Six Months Ended June 30, 2017***

*Lease revenue* — Lease revenue, consisting of only base rent, was \$93.5 million and \$80.0 million for the six months ended June 30, 2018 and 2017, respectively, representing an increase of \$13.5 million, or 16.9%. There was no percentage rent recognized during the six months ended June 30, 2018 and 2017 as Sharyland's year-to-date adjusted gross revenue did not exceed the annual specified breakpoints under our leases. See Note 16, *Leases* in the Notes to the Unaudited Consolidated Financial Statements for additional information.

The increase in base rent was driven by the change in the allocation of the total rent components between base and percentage rent and additional assets under lease. In 2018, rent for a significant portion of our assets consists only of a base rent component representing a higher portion of our expected total lease revenue compared to prior years. We expect that once we begin to recognize percentage rent for the year, after the annual specified breakpoint has been achieved, our percentage rent revenue will be lower than in prior years, due to percentage rent representing a smaller portion of our expected total lease revenue than it has historically. We expect to begin to recognize percentage rent during the third quarter of 2018.

*General and administrative expense* — General and administrative expense was \$12.7 million and \$12.8 million for the six months ended June 30, 2018 and 2017, respectively, representing a decrease of \$0.1 million, or 0.8%. During 2018, we incurred a \$1.2 million professional services fee associated with the settlement of our Texas franchise taxes and \$1.0 million net increase in expenses primarily due to our continued review of De-REIT alternatives, evaluation of the impacts of the Tax Cuts and Jobs Act (TCJA), Asset Exchange Transaction expenses and decreased management fees. During 2017, we incurred \$0.4 million of regulatory expenses and \$1.9 million of professional services fees related to the Asset Exchange Transaction.

*Depreciation* — Depreciation expense was \$23.6 million and \$25.7 million for the six months ended June 30, 2018 and 2017, respectively, representing a decrease of \$2.1 million, or 8.2%. The decrease in depreciation expense was due to our asset mix changing from approximately 70% transmission and 30% distribution to 90% transmission and 10% distribution after the Asset Exchange Transaction.

*Interest expense, net* — Interest expense, net was \$ 21.7 million and \$ 19.8 million during the six months ended June 30, 2018 and 2017, respectively, representing an increase of \$ 1.9 million, or 9.6 %. The increase in interest expense, net was due to higher average debt balances and interest rates during 2018 as compared to 2017. Interest expense was partially offset by \$ 1.2 million and \$ 1.6 million of AFUDC on debt in 2018 and 2017, respectively. 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 \$1.1 million and less than \$0.1 million during the six months ended June 30, 2018 and 2017, respectively. The increase in other income, net was primarily driven by \$1.1 million of AFUDC on other funds being recognized in 2018 compared to no AFUDC on other funds recognized in 2017. AFUDC on other funds was not recognized during 2017 as the short-term borrowings were in excess of the CWIP balance; therefore, CWIP was financed completely with debt.

*Income tax (benefit) expense* — During the second quarter of 2018, we settled our Texas franchise taxes related to open tax years through 2017. This settlement resulted in no taxes owed for those taxable years resulting in the removal of the potential tax liability and associated interest and penalties totaling \$5.6 million from our Consolidated Balance Sheets with the recognition in income taxes. This removal included franchise taxes of \$0.6 million that had been accrued during the six months ended June 30, 2017. Additionally, franchise taxes of \$0.5 million were incurred during the six months ended June 30, 2018 for our estimated Texas franchise tax on our gross rental revenues for the 2018 tax year.

*Net income* — Net income was \$41.7 million and \$21.1 million during the six months ended June 30, 2018 and 2017, respectively, representing an increase of \$20.6 million. The increase in net income between the two periods was attributable to a \$13.5 million increase in lease revenue, \$5.6 million benefit from the Texas franchise tax settlement, \$2.1 million decrease in depreciation expense and \$1.1 million increase in other income, net partially offset by a \$1.9 million increase in interest expense, net. Additionally, the decrease in general and administrative expense contributed \$0.1 million to net income. The components of general and administrative expense are described above.

### **Liquidity and Capital Resources**

As of June 30, 2018, we had \$2.1 million of unrestricted cash and cash equivalents, \$1.7 million of restricted cash and \$225.5 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 (1) we acquire additional regulated assets, (2) debt capital is unavailable on favorable terms, or at all, at a time when we would choose to access debt capital markets, (3) the capital expenditure requirements of our business are different than our expectations, (4) our credit metrics are weaker than our targeted levels, (5) the cash flows from operations do not meet our current estimates or (6) any other unexpected factors, such as changes imposed by the PUCT, 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 six months ended June 30, 2018 and 2017 were \$31.7 million and \$91.6 million, respectively.

On an accrual basis, capital expenditures for the six months ended June 30, 2018 and 2017 were \$30.6 million and \$86.1 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 on a rolling three year basis that sets forth anticipated capital expenditures related to our regulated assets. We expect estimated Footprint Projects capital expenditures for the calendar years 2018 through 2020 in the range of \$ 70 million to \$ 160 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, |          |          |
|--|---------------------------|----------|----------|
|  | 2018                      | 2019     | 2020     |
| <b>Total estimated Footprint Projects capital expenditures</b> | \$ 50-80                  | \$ 10-30 | \$ 10-50 |

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 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.

We paid a total of \$15.2 million in dividends and distributions during each of the three months ended June 30, 2018 and 2017. We paid a total of \$30.3 million in dividends and distributions during each of the six months ended June 30, 2018 and 2017.

On June 1, 2018, our board of directors approved a cash distribution by our Operating Partnership to all unit holders of record on June 29, 2018 of \$0.25 per unit, or \$1.00 per unit on an annualized basis, for a total distribution of \$15.2 million (\$11.0 million to InfraREIT, Inc.). On June 1, 2018, our board of directors also declared a cash dividend to stockholders of record of InfraREIT, Inc. on June 29, 2018 of \$0.25 per share of common stock, or \$1.00 per share on an annualized basis, for a total of \$11.0 million. The cash distribution and cash dividend were paid on July 19, 2018.

### ***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***

Our 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 and a maturity date of December 10, 2019.

As of June 30, 2018 and December 31, 2017, 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 June 30, 2018 and December 31, 2017, our Operating Partnership was in compliance with all debt covenants under the credit agreement.

### *SDTS Revolving Credit Facility*

SDTS 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. The revolving credit facility matures on December 10, 2019.

As of June 30, 2018, SDTS had \$99.5 million of borrowings outstanding at an interest rate of 4.10%, no letters of credit outstanding and \$150.5 million of borrowing capacity available under this revolving credit facility. During June 2018, \$60.0 million in borrowings were used to repay the outstanding balance on the 2011 Notes. As of December 31, 2017, SDTS had \$41.0 million of borrowings outstanding at a weighted average interest rate of 3.12% with no letters of credit outstanding and \$209.0 million of borrowing capacity available under this revolving credit facility. As of June 30, 2018 and December 31, 2017, 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 June 30, 2018, \$15.6 million of principal was outstanding under the TDC Notes.

SDTS had 5.04% per annum senior secured notes that were issued to The Prudential Insurance Company of America and affiliates in 2011 (2011 Notes) with a principal balance of \$60.0 million, which matured on June 20, 2018. The outstanding balance on the 2011 Notes was paid in full at maturity with proceeds from the SDTS revolving credit facility.

In June 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 June 30, 2018, \$200.0 million was outstanding at an interest rate of 3.34% under the 2017 Term Loan.

SDTS has \$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 bear interest at a rate of 3.86% per annum, payable semi-annually. The Series A Notes are due at maturity with outstanding accrued interest payable each June and December. The Series B Notes are due at maturity with outstanding accrued interest payable each January and July. As of June 30, 2018, \$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 June 30, 2018, \$39.5 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 June 30, 2018, \$90.4 million of principal was outstanding under the 2010 Notes.

As of June 30, 2018 and December 31, 2017, 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**

#### ***Six Months Ended June 30, 2018 Compared to Six Months Ended June 30, 2017***

*Cash flows from operating activities* — Net cash provided by operating activities was \$65.2 million and \$56.2 million during the six months ended June 30, 2018 and 2017, respectively. The increase in net cash provided by operating activities related primarily to higher lease revenue during the six months ended June 30, 2018 compared to the same period of 2017 partially offset by less cash provided by working capital changes during 2018 compared to 2017.

*Cash flows from investing activities* — Net cash used in investing activities was \$30.1 million and \$91.6 million during the six months ended June 30, 2018 and 2017, respectively. Capital expenditures related to the construction of our regulated assets were \$31.7 million and \$91.6 million during the six months ended June 30, 2018 and 2017, respectively. Additionally, \$1.6 million was received for the repayment of the receivable during 2018 related to the Asset Exchange Transaction.

*Cash flows from financing activities* —Net cash used in financing activities was \$ 35.9 million during the six months ended June 30, 2018 compared to net cash provided by financing activities of \$ 27.5 million during the six months ended June 30, 2017. The higher use of cash related primarily to a \$5.6 million net repayment of short-term and long-term debt in 2018 as compared to \$58.6 million net borrowings of short-term and long-term debt in 2017. The payment of dividends and distributions were consistent between 2018 and 2017.

### Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements as of June 30, 2018 and December 31, 2017.

### 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 Tax Cuts and Jobs Act regulatory adjustment related to the establishment of the regulatory liability related to the excess ADFIT as a result of the enactment of the TCJA reducing the corporate federal income tax rate from 35% to 21% (see the caption *Tax Cuts and Jobs Act Regulatory Adjustment* under *Significant Components of Our Results of Operations* included in Part II, Item 7., *Management's Discussion and Analysis of Financial Condition and Results of Operations* in our 2017 Form 10-K);
  - adding back the transaction costs related to the Asset Exchange Transaction as these costs are exclusive of our routine business operations or typical rate case costs;
  - removing the effect of the gain associated with the inventory that was sold in the Asset Exchange Transaction;
  - adding back the professional services fee related to the franchise tax settlement with the state of Texas; and
  - removing the effect of the 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 Tax Cuts and Jobs Act regulatory adjustment related to the establishment of the regulatory liability related to the excess ADFIT as a result of the enactment of the TCJA reducing the corporate federal income tax rate from 35% to 21% (see the caption *Tax Cuts and Jobs Act Regulatory Adjustment* under *Significant Components of Our Results of Operations* included in Part II, Item 7., *Management's Discussion and Analysis of Financial Condition and Results of Operations* in our 2017 Form 10-K);
  - adding back the transaction costs related to the Asset Exchange Transaction as these costs are exclusive of our routine business operations or typical rate case costs;
  - removing the effect of the gain associated with the inventory that was sold in the Asset Exchange Transaction;



- adding back the professional services fee related to the franchise tax settlement with the state of Texas ;
- removing the effect of the 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, make payments on our indebtedness or make 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 and six months ended June 30, 2018 and 2017. To provide more analysis around these metrics, the following narratives are provided comparing the three and six months ended June 30, 2018 to the three and six months ended June 30, 2017.

Non-GAAP EPS was \$0.29 per share for the three months ended June 30, 2018 compared to \$0.20 per share for the three months ended June 30, 2017, representing an increase of 45%. Non-GAAP EPS during the three months ended June 30, 2018 and 2017 was based on 60.7 million weighted average shares outstanding. Non-GAAP EPS reflected a \$5.1 million increase in Non-GAAP net income from \$12.4 million during the three months ended June 30, 2017 to \$17.5 million for the three months ended June 30, 2018. The growth in Non-GAAP net income resulted from an increase in lease revenue of \$7.4 million, an increase of \$0.4 million in other income, net and a \$1.0 million decrease in depreciation expense offset by a \$2.4 million base rent adjustment reduction, an increase of \$1.0 million in interest expense, net and a \$0.4 million net increase in general and administrative expense. The increase in general and administrative expense excludes a \$1.2 million professional services fee associated with the settlement of our Texas franchise taxes during the second quarter of 2018 and \$1.9 million of professional service fees related to the Asset Exchange Transaction during the second quarter of 2017.

For the three months ended June 30, 2018, FFO increased \$12.8 million to \$35.9 million as compared to \$23.1 million for the three months ended June 30, 2017. For the three months ended June 30, 2018, AFFO was \$29.1 million compared to \$25.4 million in the same period in 2017, representing an increase of \$3.7 million, or 14.6%.

Non-GAAP EPS was \$0.58 per share for the six months ended June 30, 2018 compared to \$0.40 per share for the six months ended June 30, 2017, representing an increase of 45%. Non-GAAP EPS during the six months ended June 30, 2018 and 2017 was based on 60.7 million weighted average shares outstanding. Non-GAAP EPS reflected a \$10.9 million increase in Non-GAAP net income from \$24.4 million during the six months ended June 30, 2017 to \$35.3 million for the six months ended June 30, 2018. The growth in Non-GAAP net income resulted from an increase in lease revenue of \$13.5 million, an increase of \$1.1 million in other income, net and a \$2.1 million decrease in depreciation expense offset by a \$3.4 million base rent adjustment reduction, an increase of \$1.9 million in interest expense, net and a \$0.6 million net increase in general and administrative expense. The increase in general and administrative expense excludes professional services fees of \$1.2 million associated with the settlement of our Texas franchise taxes and \$0.2 million related to the Asset Exchange Transaction during the six months ended June 30, 2018 and excludes \$1.9 million of professional service fees related to the Asset Exchange Transaction during the six months ended June 30, 2017.

For the six months ended June 30, 2018, FFO increased \$18.5 million to \$65.3 million as compared to \$46.8 million for the six months ended June 30, 2017. For the six months ended June 30, 2018, AFFO was \$57.7 million compared to \$50.0 million in the same period in 2017, representing an increase of \$7.7 million, or 15.4%.

### 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> | <b>Three Months Ended June 30, 2018</b> |                      | <b>Three Months Ended June 30, 2017</b> |                      |
|--|---|----------------------|---|----------------------|
|  | <b>Amount</b>                           | <b>Per Share (1)</b> | <b>Amount</b>                           | <b>Per Share (3)</b> |
| Net income attributable to InfraREIT, Inc.                 | \$ 17,334                               | \$ 0.39              | \$ 7,308                                | \$ 0.17              |
| Net income attributable to noncontrolling interest         | 6,602                                   | 0.39                 | 2,821                                   | 0.17                 |
| Net income   | 23,936                                  | 0.39                 | 10,129                                  | 0.17                 |
| Base rent adjustment                                       | (2,021)                                 | (0.03)               | 342                                     | —                    |
| Transaction costs  | —                                       | —                    | 1,937                                   | 0.03                 |
| Texas franchise tax professional services fee              | 1,196                                   | 0.02                 | —                                       | —                    |
| Texas franchise tax settlement                             | (5,633)                                 | (0.09)               | —                                       | —                    |
| <b>Non-GAAP net income</b>                                 | <b>\$ 17,478</b>                        | <b>\$ 0.29</b>       | <b>\$ 12,408</b>                        | <b>\$ 0.20</b>       |

| <i>(In thousands, except per share amounts, unaudited)</i> | <b>Six Months Ended June 30, 2018</b> |                      | <b>Six Months Ended June 30, 2017</b> |                      |
|--|---------------------------------------|----------------------|---------------------------------------|----------------------|
|  | <b>Amount</b>                         | <b>Per Share (2)</b> | <b>Amount</b>                         | <b>Per Share (3)</b> |
| Net income attributable to InfraREIT, Inc.                 | \$ 30,198                             | \$ 0.69              | \$ 15,257                             | \$ 0.35              |
| Net income attributable to noncontrolling interest         | 11,502                                | 0.69                 | 5,889                                 | 0.35                 |
| Net income   | 41,700                                | 0.69                 | 21,146                                | 0.35                 |
| Base rent adjustment                                       | (2,141)                               | (0.04)               | 1,299                                 | 0.02                 |
| Transaction costs  | 151                                   | —                    | 1,937                                 | 0.03                 |
| Texas franchise tax professional services fee              | 1,196                                 | 0.02                 | —                                     | —                    |
| Texas franchise tax settlement                             | (5,633)                               | (0.09)               | —                                     | —                    |
| <b>Non-GAAP net income</b>                                 | <b>\$ 35,273</b>                      | <b>\$ 0.58</b>       | <b>\$ 24,382</b>                      | <b>\$ 0.40</b>       |

- (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 43.9 million was used to calculate net income attributable to InfraREIT, Inc. per diluted share. The weighted average redeemable partnership units outstanding of 16.8 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.
- (3) 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>              | <b>Three Months Ended June 30,</b> |                  | <b>Six Months Ended June 30,</b> |                  |
|---|------------------------------------|------------------|----------------------------------|------------------|
|   | <b>2018</b>                        | <b>2017</b>      | <b>2018</b>                      | <b>2017</b>      |
| Net income                                    | \$ 23,936                          | \$ 10,129        | \$ 41,700                        | \$ 21,146        |
| Depreciation                                  | 11,992                             | 12,982           | 23,569                           | 25,669           |
| <b>FFO</b>                                    | <b>35,928</b>                      | <b>23,111</b>    | <b>65,269</b>                    | <b>46,815</b>    |
| Base rent adjustment                          | (2,021)                            | 342              | (2,141)                          | 1,299            |
| Other income, net (1)                         | (374)                              | (17)             | (1,107)                          | (20)             |
| Transaction costs                             | —                                  | 1,937            | 151                              | 1,937            |
| Texas franchise tax professional services fee | 1,196                              | —                | 1,196                            | —                |
| Texas franchise tax settlement                | (5,633)                            | —                | (5,633)                          | —                |
| <b>AFFO</b>                                   | <b>\$ 29,096</b>                   | <b>\$ 25,373</b> | <b>\$ 57,735</b>                 | <b>\$ 50,031</b> |

- (1) Includes AFUDC on other funds of \$0.4 million and \$1.1 million for the three and six months ended June 30, 2018. There was no AFUDC on other funds recorded during the three and six months ended June 30, 2017.

## Financial Information Related to Our Tenant

We have legal title to our regulated assets; however, Sharyland maintains operational control of those assets through the 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 us are reflected as liabilities, on Sharyland's balance sheet.

In addition to 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, we believe this non-GAAP financial information provides important supplemental evidence regarding Sharyland's ability to meet its rent obligations to us, and we believe it is helpful to our investors in understanding our tenant's financial condition without the additional implications of the failed sale-leaseback accounting.

We present the following 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 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 basis rather than a 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>                             | <u>Three Months Ended June 30,</u> |             | <u>Six Months Ended June 30,</u> |             |
|---|------------------------------------|-------------|----------------------------------|-------------|
|   | <u>2018</u>                        | <u>2017</u> | <u>2018</u>                      | <u>2017</u> |
| Net (loss) income                                 | \$ (497)                           | \$ 6,427    | \$ 1,375                         | \$ 11,034   |
| Failed sale-leaseback adjustments:                |                                    |             |                                  |             |
| Add: Failed sale-leaseback depreciation expense   | 7,889                              | 8,821       | 15,479                           | 17,449      |
| Add: Failed sale-leaseback interest expense       | 40,360                             | 36,788      | 77,895                           | 72,490      |
| Deduct: Rent expense                              | 47,643                             | 47,328      | 94,962                           | 94,037      |
| Sharyland's management reported net income (loss) | 109                                | 4,708       | (213)                            | 6,936       |
| Adjustments:                                      |                                    |             |                                  |             |
| Add: Interest expense, net                        | 1,776                              | 1,602       | 3,424                            | 3,093       |
| Add: Income tax expense                           | 347                                | 430         | 695                              | 856         |
| Add: Depreciation and amortization                | 3,797                              | 2,275       | 7,663                            | 4,879       |
| Add: Rent expense                                 | 47,643                             | 47,328      | 94,962                           | 94,037      |
| EBITDAR   | \$ 53,672                          | \$ 56,343   | \$ 106,531                       | \$ 109,801  |
| Ratio of EBITDAR to rent expense                  | 1.13x                              | 1.19x       | 1.12x                            | 1.17x       |

| <i>(In thousands)</i>   | <b>June 30, 2018</b>                   |   |                                       |
|---|--|---|---------------------------------------|
|   | <b>U.S. GAAP<br/>Balance<br/>Sheet</b> | <b>Failed Sale-<br/>Leaseback<br/>Adjustments</b> | <b>Non-GAAP<br/>Balance<br/>Sheet</b> |
| <b>Assets</b>   |  |   |                                       |
| Current assets  | \$ 76,468                              | \$ —  | \$ 76,468                             |
| Property, plant and equipment, net                                    | 1,957,877                              | (1,687,849)                                       | 270,028                               |
| Goodwill  | 1,100                                  | —   | 1,100                                 |
| Deferred charges - regulatory assets, net                             | 47,045                                 | (23,793)  | 23,252                                |
| <b>Total Assets</b>   | <b>\$ 2,082,490</b>                    | <b>\$ (1,711,642)</b>                             | <b>\$ 370,848</b>                     |
| <b>Partners' Capital and Liabilities</b>                              |  |   |                                       |
| Current liabilities:  |  |   |                                       |
| Accounts payable and accrued liabilities                              | \$ 29,161                              | \$ —  | \$ 29,161                             |
| Current portion of financing obligation                               | 32,917                                 | (32,917)  | —                                     |
| Current portion of long-term debt                                     | 3,493                                  | —   | 3,493                                 |
| Due to affiliates   | 28,879                                 | —   | 28,879                                |
| Revolving line of credit  | 6,000                                  | —   | 6,000                                 |
| Current state margin tax payable                                      | 995                                    | —   | 995                                   |
| <b>Total current liabilities</b>                                      | <b>101,445</b>                         | <b>(32,917)</b>                                   | <b>68,528</b>                         |
| Long-term financing obligations                                       | 1,680,960                              | (1,680,960)                                       | —                                     |
| Long-term debt  | 153,596                                | —   | 153,596                               |
| Regulatory liabilities  | 14,875                                 | —   | 14,875                                |
| Other post-employment benefits (OPEB) and other long-term liabilities | 1,889                                  | —   | 1,889                                 |
| <b>Total liabilities</b>  | <b>1,952,765</b>                       | <b>(1,713,877)</b>                                | <b>238,888</b>                        |
| Commitments and contingencies   |  |   |                                       |
| Partners' capital   | 129,725                                | 2,235   | 131,960                               |
| <b>Total Partners' Capital and Liabilities</b>                        | <b>\$ 2,082,490</b>                    | <b>\$ (1,711,642)</b>                             | <b>\$ 370,848</b>                     |

| <i>(In thousands)</i>                          | <b>December 31, 2017</b>               |   |                                       |
|--|--|---|---------------------------------------|
|  | <b>U.S. GAAP<br/>Balance<br/>Sheet</b> | <b>Failed Sale-<br/>Leaseback<br/>Adjustments</b> | <b>Non-GAAP<br/>Balance<br/>Sheet</b> |
| <b>Assets</b>                                  |  |   |                                       |
| Current assets                                 | \$ 93,649                              | \$ —  | \$ 93,649                             |
| Property, plant and equipment, net             | 1,942,393                              | (1,672,882)                                       | 269,511                               |
| Goodwill                                       | 1,100                                  | —   | 1,100                                 |
| Deferred charges - regulatory assets, net      | 44,055                                 | (23,793)  | 20,262                                |
| <b>Total Assets</b>                            | <b>\$ 2,081,197</b>                    | <b>\$ (1,696,675)</b>                             | <b>\$ 384,522</b>                     |
| <b>Partners' Capital and Liabilities</b>       |  |   |                                       |
| Current liabilities:                           |  |   |                                       |
| Accounts payable and accrued liabilities       | \$ 46,515                              | \$ —  | \$ 46,515                             |
| Current portion of financing obligation        | 29,611                                 | (29,611)  | —                                     |
| Current portion of long-term debt              | 3,493                                  | —   | 3,493                                 |
| Due to affiliates                              | 31,615                                 | —   | 31,615                                |
| Current state margin tax payable               | 1,915                                  | —   | 1,915                                 |
| <b>Total current liabilities</b>               | <b>113,149</b>                         | <b>(29,611)</b>                                   | <b>83,538</b>                         |
| Long-term financing obligations                | 1,668,904                              | (1,668,904)                                       | —                                     |
| Long-term debt                                 | 155,342                                | —   | 155,342                               |
| Regulatory liabilities                         | 13,563                                 | —   | 13,563                                |
| OPEB and other long-term liabilities           | 1,889                                  | —   | 1,889                                 |
| <b>Total liabilities</b>                       | <b>1,952,847</b>                       | <b>(1,698,515)</b>                                | <b>254,332</b>                        |
| Commitments and contingencies                  |  |   |                                       |
| Partners' capital                              | 128,350                                | 1,840   | 130,190                               |
| <b>Total Partners' Capital and Liabilities</b> | <b>\$ 2,081,197</b>                    | <b>\$ (1,696,675)</b>                             | <b>\$ 384,522</b>                     |

**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 June 30, 2018, the outstanding balance under our revolving credit facilities and 2017 Term Loan were \$99.5 million and \$200.0 million, respectively. A hypothetical increase or decrease in interest rates by 1.00% would have changed our interest expense by \$0.7 million and \$1.5 million for the three and six months ended June 30, 2018, respectively.

**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 June 30, 2018 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 and cash flows.

**Item 1A. Risk Factors**

There have been no material changes in our risk factors during the six months ended June 30, 2018 from those previously disclosed in Part I, Item 1A., *Risk Factors* of our 2017 Form 10-K. You should carefully consider the risk factors discussed in our 2017 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**

| <b>Exhibit Number</b> | <b>Description</b>   |
|-----------------------|--|
| 3.1                   | — <a href="#">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).</a>  |
| 3.2                   | — <a href="#">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).</a>   |
| 10.1                  | — <a href="#">First Amendment to Management Agreement, dated May 16, 2018, among the Registrant, InfraREIT Partners, LP and Hunt Utility Services, LLC (filed as exhibit 10.1 to the Company's Current Report on Form 8-K dated May 16, 2018 and filed May 18, 2018 and incorporated herein by reference).</a> |
| 31.1*                 | — <a href="#">Rule 13A-14(a)/15d-14(a) Certification of Chief Executive Officer</a>  |
| 31.2*                 | — <a href="#">Rule 13A-14(a)/15d-14(a) Certification of Chief Financial Officer</a>  |
| 32.1*                 | — <a href="#">Section 1350 Certification of Chief Executive Officer</a>  |
| 32.2*                 | — <a href="#">Section 1350 Certification of Chief Financial Officer</a>  |
| 99.1*                 | — <a href="#">Consolidated Financial Statements of Sharyland Utilities, L.P.</a>   |
| 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

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David A. Campbell  
President, Chief Executive Officer and Director

Date: August 1, 2018

/s/ Brant Meleski

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Brant Meleski  
Senior Vice President and Chief Financial Officer

Date: August 1, 2018

**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: August 1, 2018

/s/ David A. Campbell

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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: August 1, 2018

/s/ Brant Meleski

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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 June 30, 2018 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: August 1, 2018

/s/ David A. Campbell

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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 June 30, 2018 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: August 1, 2018

/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  
June 30, 2018  
(Unaudited)

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**SHARYLAND UTILITIES, L.P.**

Consolidated Balance Sheets

(In thousands)

(Unaudited)

|  | <u>June 30,</u>                          | <u>December 31,</u> |
|--|--|---------------------|
| <u>Assets</u>                                    | <u>2018</u>                              | <u>2017</u>         |
| <b>Current Assets</b>                            |  |                     |
| Cash and cash equivalents                        | \$ 14,733                                | \$ 25,503           |
| Accounts receivable, net                         | 41,722                                   | 55,885              |
| Due from affiliates                              | 15,419                                   | 7,096               |
| Inventory  | 1,844                                    | 1,844               |
| Prepayments and other current assets             | 2,750                                    | 3,321               |
| Total current assets                             | <u>76,468</u>                            | <u>93,649</u>       |
| <b>Property, Plant and Equipment - net</b>       | 1,957,877                                | 1,942,393           |
| <b>Goodwill</b>                                  | 1,100                                    | 1,100               |
| <b>Deferred Charges – Regulatory Assets, net</b> | 47,045                                   | 44,055              |
| <b>Total Assets</b>                              | <u>\$ 2,082,490</u>                      | <u>\$ 2,081,197</u> |
|  |  |                     |
|  | <u>Liabilities and Partners' Capital</u> |                     |
| <b>Current Liabilities</b>                       |  |                     |
| Accounts payable and accrued liabilities         | \$ 29,161                                | \$ 46,515           |
| Short-term borrowing                             | 6,000                                    | —                   |
| Current portion of long-term debt                | 3,493                                    | 3,493               |
| Current portion of financing obligation          | 32,917                                   | 29,611              |
| Due to affiliates                                | 28,879                                   | 31,615              |
| State margin tax payable                         | 995                                      | 1,915               |
| Total current liabilities                        | <u>101,445</u>                           | <u>113,149</u>      |
| <b>Long-Term Financing Obligation</b>            | 1,680,960                                | 1,668,904           |
| <b>Long-Term Debt</b>                            | 153,596                                  | 155,342             |
| <b>Regulatory Liabilities</b>                    | 14,875                                   | 13,563              |
| <b>OPEB and Other Liabilities</b>                | 1,889                                    | 1,889               |
| Total Liabilities                                | <u>1,952,765</u>                         | <u>1,952,847</u>    |
|  |  |                     |
| <b>Commitments and Contingencies</b>             |  |                     |
| <b>Partners' Capital</b>                         |  |                     |
| General partner                                  | 1,246                                    | 1,232               |
| Limited partner                                  | 128,479                                  | 127,118             |
| Total partners' capital                          | <u>129,725</u>                           | <u>128,350</u>      |
| <b>Total Liabilities and Partners' Capital</b>   | <u>\$ 2,082,490</u>                      | <u>\$ 2,081,197</u> |

*See accompanying notes to the consolidated financial statements.*

**SHARYLAND UTILITIES, L.P.**

Consolidated Statements of Operations

(In thousands)

(Unaudited)

|   | Three Months Ended |                 | Six Months Ended |                  |
|---|--------------------|-----------------|------------------|------------------|
|   | June 30,           |                 | June 30,         |                  |
|   | 2018               | 2017            | 2018             | 2017             |
| <b>Revenues - net</b>   | \$ 66,160          | \$ 82,260       | \$ 132,502       | \$ 162,798       |
| <b>Operating Expenses</b>                                     |                    |                 |                  |                  |
| Distribution expense  | 2                  | 6,426           | 83               | 12,846           |
| Transmission expense  | 3,942              | 7,903           | 7,930            | 15,873           |
| Administrative and general expense                            | 8,592              | 11,716          | 18,038           | 24,492           |
| Depreciation and amortization                                 | 11,686             | 11,096          | 23,142           | 22,328           |
| Total operating expenses                                      | <u>24,222</u>      | <u>37,141</u>   | <u>49,193</u>    | <u>75,539</u>    |
| <b>Operating Income</b>                                       | <b>41,938</b>      | <b>45,119</b>   | <b>83,309</b>    | <b>87,259</b>    |
| <b>Other Expense - net</b>                                    |                    |                 |                  |                  |
| Interest expense - net  | (42,136)           | (38,390)        | (81,319)         | (75,583)         |
| Other income - net  | 48                 | 13              | 80               | 26               |
| Tax reimbursements for contribution in aid of<br>construction | —                  | 115             | —                | 188              |
| Total other expense - net                                     | <u>(42,088)</u>    | <u>(38,262)</u> | <u>(81,239)</u>  | <u>(75,369)</u>  |
| <b>Net (Loss) Income Before Income Taxes</b>                  | <b>(150)</b>       | <b>6,857</b>    | <b>2,070</b>     | <b>11,890</b>    |
| Income Tax Expense  | 347                | 430             | 695              | 856              |
| <b>Net (Loss) Income</b>                                      | <u>\$ (497)</u>    | <u>\$ 6,427</u> | <u>\$ 1,375</u>  | <u>\$ 11,034</u> |

*See accompanying notes to the consolidated financial statements.*

**SHARYLAND UTILITIES, L.P.**

Consolidated Statements of Partners' Capital

Six Months Ended June 30, 2018

(In thousands)

(Unaudited)

|                                 | General<br>Partner | Limited<br>Partner | Total<br>Partners'<br>Capital |
|---------------------------------|--------------------|--------------------|-------------------------------|
| Balance at December 31, 2017    | \$ 1,232           | \$ 127,118         | \$ 128,350                    |
| Net income                      | 14                 | 1,361              | 1,375                         |
| <b>Balance at June 30, 2018</b> | <b>\$ 1,246</b>    | <b>\$ 128,479</b>  | <b>\$ 129,725</b>             |

*See accompanying notes to the consolidated financial statements.*

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**SHARYLAND UTILITIES, L.P.**

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

|   | Six Months Ended |           |
|---|------------------|-----------|
|   | June 30,         |           |
|   | 2018             | 2017      |
| <b>Cash flows from Operating Activities</b>                                       |                  |           |
| Net income  | \$ 1,375         | \$ 11,034 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                  |           |
| Depreciation  | 18,807           | 21,261    |
| Amortization of deferred costs  | 4,937            | 1,670     |
| Allowance for funds used during construction - equity                             | (58)             | —         |
| Changes in assets and liabilities:  |                  |           |
| Accounts receivable   | 14,163           | (9,022)   |
| Due from affiliates   | (8,323)          | 634       |
| Inventory   | —                | (464)     |
| Prepayments and other current assets  | 571              | 1,986     |
| Deferred charges - regulatory assets and liabilities                              | (6,296)          | 1,653     |
| Accounts payable, accrued liabilities and other                                   | (16,231)         | 4,142     |
| Due to affiliates   | (2,736)          | (1,314)   |
| State margin tax payable  | (920)            | (684)     |
| Net cash provided by operating activities   | 5,289            | 30,896    |
| <b>Cash flows from Investing Activities</b>                                       |                  |           |
| Additions to property, plant and equipment  | (4,930)          | (3,234)   |
| Net cash used in investing activities   | (4,930)          | (3,234)   |
| <b>Cash flows from Financing Activities</b>                                       |                  |           |
| Proceeds from notes payable   | —                | 997       |
| Proceeds from short-term borrowing  | 16,000           | 5,000     |
| Proceeds from short-term borrowing from affiliates                                | —                | 10,000    |
| Repayments of notes payable   | (299)            | (98)      |
| Repayments of short-term borrowing  | (10,000)         | —         |
| Repayments of short-term borrowing to affiliates                                  | —                | (10,000)  |
| Repayments of long-term debt  | (1,746)          | (1,746)   |
| Repayments of financing obligation  | (15,084)         | (20,078)  |
| Net cash used in financing activities   | (11,129)         | (15,925)  |
| Net (decrease) increase in cash and cash equivalents                              | (10,770)         | 11,737    |
| Cash and cash equivalents at beginning of period                                  | 25,503           | 12,263    |
| Cash and cash equivalents at end of period  | \$ 14,733        | \$ 24,000 |

*See accompanying notes to the consolidated financial statements.*



**SHARYLAND UTILITIES, L.P.**

**Notes to the Consolidated Financial Statements**

**June 30, 2018**

**(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 a 345 kV transmission line from the eastern half of 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 electrical distribution utility located in Hidalgo County, Texas. On March 24, 2016, the Partnership transferred its ownership in SU FERC, L.L.C., a subsidiary of the Partnership, to its General Partner.

On March 18, 2016, Hunt Power, L.P. (HP), an affiliate of the Partnership, contributed GS Project Entity, L.L.C. (GSPE) to the partners of the Partnership (Partners). The Partners contributed their interests in GSPE to the Partnership. GSPE became a wholly owned subsidiary of the Partnership. On May 6, 2016, HP also contributed CV Project Entity, L.L.C. (CVPE) to the Partners. The Partners contributed their interests in CVPE to the Partnership. CVPE became a wholly owned subsidiary of the Partnership.

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

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)*

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## SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements  
(Unaudited)

## (d) Recent Accounting Guidance

*Recently Adopted Accounting Guidance*

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Clarification of Certain Cash Receipts and Cash Payments. The objective of ASU 2016-15 is to eliminate the diversity in practice related to the classification of certain cash receipts and payments in the statement of cash flows by adding or clarifying guidance on eight specific cash flow issues. The new standard should be applied retrospectively to all periods presented, unless deemed impracticable, in which case prospective application is permitted. We adopted the new guidance on January 1, 2018 with no impact on our presentation of our cash flows.

In March 2017, the FASB issued ASU No. 2017-07, Compensation – Retirement Benefits (Topic 715), the amendments of ASU No. 2017-07 require an entity to report the service cost component of net benefit costs in the same line item as other compensation costs arising from services rendered by the related employees during the applicable service period. The other components of net benefit cost are required to be presented separately from the service cost component and outside the subtotal of income from operations. Further, ASU No. 2017-07 prescribes that only the service cost component of net benefit costs is eligible for capitalization. The Partnership adopted the new guidance on January 1, 2018 with minimal impact on its 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 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.

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 is effective 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. The new guidance does not change this pattern of recognition and therefore the adoption will not have an effect on the Partnership's financial position, results of operations or cash flows.

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(Continued)

## SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements  
(Unaudited)(2) Asset Exchange Transaction

On July 21, 2017, the Partnership and SDTS signed a definitive agreement (Definitive Agreement) with Oncor Electric Delivery Company LLC (Oncor) to exchange SDTS's retail distribution assets and the Partnership's general plant used in distribution operations for a group of Oncor's transmission assets located in West and Central Texas and cash (the Asset Exchange Transaction). The Asset Exchange Transaction closed in November 2017 and, among other things, resulted in the Partnership exchanging \$6.1 million of general plant and regulatory assets used for the retail distribution business net of liabilities at its carrying value with Oncor for approximately \$6.1 million in cash. On November 9, 2017 Oncor paid Sharyland \$6.9 million based on an estimate, and on February 24, 2018, Sharyland repaid \$832,000.

SDTS exchanged approximately \$403.0 million of net distribution assets for \$383 million of transmission assets located in West and Central Texas, \$18 million of net cash and a \$2 million receivable from Oncor as of December 31, 2017.

The Partnership leases these transmission assets from SDTS and operates them under an amended certificate of convenience and necessity (CCN). The Partnership no longer leases the distribution assets transferred to Oncor. SDTS will continue to own and lease to the Partnership certain substations related to its distribution assets, but the Partnership exited the retail distribution business. On October 13, 2017, the PUCT issued an order under Docket No. 47469 approving the Partnership, SDTS and Oncor's joint Sale-Transfer-Merger application (STM).

Concurrently with the execution of the Definitive Agreement, the Partnership and SDTS entered into an agreement (Rate Case Dismissal Agreement) with certain parties to their pending rate case under Docket No 45414 (Rate Case), which resulted in the dismissal of the Rate Case upon the completion of the asset exchange transaction with Oncor. On September 29, 2017, the PUCT issued an order dismissing the Rate Case contingent on PUCT approval of the STM and the closing of the Asset Exchange Transaction. For further information related to the Rate Case and the dismissal, see Note 13, Commitments and Contingencies - regulatory proceedings.

(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 13, 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.

(Continued)

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## SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements  
(Unaudited)

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

|                             | Three Months Ended |                  | Six Months Ended |                  |
|-----------------------------|--------------------|------------------|------------------|------------------|
|                             | June 30,           |                  | June 30,         |                  |
| (In thousands)              | 2018               | 2017             | 2018             | 2017             |
| <b>Fixed Lease Payments</b> | <b>\$ 45,807</b>   | <b>\$ 40,764</b> | <b>\$ 91,201</b> | <b>\$ 81,345</b> |

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 payments of approximately \$346,000 and \$334,000 on March 28, 2018 and March 22, 2017, respectively, associated with the years ended December 31, 2017 and 2016, 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 June 30, 2018 and December 31, 2017.

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

| (In thousands)                      | Total             |
|-------------------------------------|-------------------|
| Year Ending December 31:            |                   |
| 2018 - Q3 and Q4                    | 95,259            |
| 2019                                | 193,655           |
| 2020                                | 182,099           |
| 2021                                | 8,576             |
| 2022 and Thereafter                 | 4,460             |
| Total future minimum lease payments | <u>\$ 484,049</u> |

(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 June 30, 2018 and December 31, 2017, respectively. Approximately \$32.9 million and \$29.6 million of the failed sale-leaseback (financing) obligation are included in current liabilities as of June 30, 2018 and December 31, 2017, respectively.

(Continued)

## SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements  
(Unaudited)

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

|  | Three Months Ended<br>June 30, |                  | Six Months Ended<br>June 30, |                  |
|--|--------------------------------|------------------|------------------------------|------------------|
|  | 2018                           | 2017             | 2018                         | 2017             |
| <i>(In thousands)</i>                          |                                |                  |                              |                  |
| <b>Failed sale-lease back interest expense</b> |                                |                  |                              |                  |
| Fixed portion of failed-leaseback interest     | \$ 38,524                      | \$ 30,224        | \$ 74,134                    | \$ 59,798        |
| Variable portion of failed-leaseback interest  | 1,836                          | 6,564            | 3,761                        | 12,692           |
| <b>Failed sale-lease back interest expense</b> | <b>\$ 40,360</b>               | <b>\$ 36,788</b> | <b>\$ 77,895</b>             | <b>\$ 72,490</b> |

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<br>June 30, |                  | Six Months Ended<br>June 30, |                  |
|---|--------------------------------|------------------|------------------------------|------------------|
|   | 2018                           | 2017             | 2018                         | 2017             |
| <i>(In thousands)</i>                             |                                |                  |                              |                  |
| <b>Payments on long-term financing obligation</b> | <b>\$ 7,186</b>                | <b>\$ 10,303</b> | <b>\$ 15,084</b>             | <b>\$ 20,078</b> |

Future payments of the financing obligation as of June 30, 2018 are as follows:

|   | Total               |
|---|---------------------|
| Year Ending December 31:                      |                     |
| 2018 - Q3 and Q4                              | \$ 16,161           |
| 2019  | 33,360              |
| 2020  | 28,540              |
| 2021  | 6,982               |
| 2022  | 1,264               |
| Thereafter                                    | 1,560,137           |
| Total financing obligation                    | 1,646,444           |
| Less: current portion of financing obligation | (32,917)            |
| Leased system under construction obligation   | 43,640              |
| Lease deferral (Note 7)                       | 23,793              |
| Long-term lease obligation                    | <u>\$ 1,680,960</u> |

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

|  | Three Months Ended<br>June 30, |                 | Six Months Ended<br>June 30, |                  |
|--|--------------------------------|-----------------|------------------------------|------------------|
|  | 2018                           | 2017            | 2018                         | 2017             |
| <i>(In thousands)</i>                              |                                |                 |                              |                  |
| <b>Failed sale-lease back depreciation expense</b> | <b>\$ 7,889</b>                | <b>\$ 8,821</b> | <b>\$ 15,479</b>             | <b>\$ 17,449</b> |

(Continued)

## SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements  
(Unaudited)(5) Property, Plant and Equipment - net

The major classes of property, plant and equipment at June 30, 2018 and December 31, 2017 are as follows:

| <i>(In thousands)</i>                         | <u>June 30,</u><br><u>2018</u> | <u>December 31,</u><br><u>2017</u> |
|---|--------------------------------|------------------------------------|
| Property, plant and equipment                 |                                |                                    |
| Leased system                                 | \$ 1,853,830                   | \$ 1,757,327                       |
| Transmission plant                            | 262,399                        | 262,465                            |
| General plant                                 | 8,531                          | 10,977                             |
|   | <u>2,124,760</u>               | <u>2,030,769</u>                   |
| Construction Work in Progress:                |                                |                                    |
| Leased system under construction              | 43,640                         | 109,697                            |
| Transmission plant under construction         | 6,178                          | 2,231                              |
| General plant under construction              | 645                            | 1,162                              |
|   | <u>50,463</u>                  | <u>113,090</u>                     |
| Other   | 293                            | 293                                |
| Total Property, plant and equipment           | <u>2,175,516</u>               | <u>2,144,152</u>                   |
| Accumulated Depreciation - Leased system      | (209,621)                      | (194,142)                          |
| Accumulated Depreciation - Transmission plant | (6,449)                        | (4,903)                            |
| Accumulated Depreciation - General plant      | (1,569)                        | (2,714)                            |
| Property, Plant, and Equipment - net          | <u>\$ 1,957,877</u>            | <u>\$ 1,942,393</u>                |

See Note 2 in regards to the asset exchange transaction.

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 June 30, 2018 and December 31, 2017.

| <i>(In thousands)</i>                      | Amortization<br>Period | June 30, 2018               |                             |                           | December 31, 2017           |                             |                           |
|--|------------------------|-----------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|
|  |                        | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount |
| Deferred costs recoverable in future years |                        |                             |                             |                           |                             |                             |                           |
| Deferred financing costs                   | (a)                    | \$ 5,763                    | \$ (4,106)                  | \$ 1,657                  | \$ 5,763                    | \$ (3,504)                  | \$ 2,259                  |
| Inception operating costs                  | (b)                    | 23,793                      | —                           | 23,793                    | 23,793                      | —                           | 23,793                    |
| Rate case costs                            | (c)                    | 13,417                      | (4,998)                     | 8,419                     | 13,324                      | (4,998)                     | 8,326                     |
| Study costs/Transition to competition      | (d)                    | 5,918                       | (2,707)                     | 3,211                     | 5,918                       | (2,610)                     | 3,308                     |
| Transition cost                            | (e)                    | 14,100                      | (4,238)                     | 9,862                     | 6,369                       | —                           | 6,369                     |
| Deferred Overhead                          |                        | 104                         | —                           | 104                       | —                           | —                           | —                         |
| Net Deferred Charges - Regulatory Assets   |                        | <u>\$ 63,095</u>            | <u>\$ (16,049)</u>          | <u>\$ 47,046</u>          | <u>\$ 55,167</u>            | <u>\$ (11,112)</u>          | <u>\$ 44,055</u>          |

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

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

(Continued)

## SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements  
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- (c) \$5.0 million was recovered through May 2017. The recovery period for the \$8.4 million is anticipated to be established in 2018 in rate case expense Docket No. 45979.  
 (d) \$2.0 million was recovered through December 2017. \$0.9 million will be recovered through 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 June 30, 2018 and December 31, 2017 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.

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

*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.

The carrying amount of the regulatory liabilities as of June 30, 2018 and December 31, 2017 are as follows:

| <i>(In thousands)</i>               | Amortization<br>period<br>Ends | <u>June 30,</u><br><u>2018</u> | <u>December 31,</u><br><u>2017</u> |
|-------------------------------------|--------------------------------|--------------------------------|------------------------------------|
| Postretirement benefits costs       | (a)                            | \$ 2,701                       | \$ 2,701                           |
| Postretirement benefits collections | (b)                            | 5,806                          | 5,765                              |
| Estimated net removal costs         | (c)                            | 5,163                          | 3,892                              |
| Provision in lieu of Excess ADFIT   | (b)                            | 1,205                          | 1,205                              |
| Regulatory liabilities              |                                | <u>\$ 14,875</u>               | <u>\$ 13,563</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.

*(Continued)*

## SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements  
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(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 rates.

(7) Related-Party Transactions

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

|                       | Three Months Ended |                  | Six Months Ended |                  |
|-----------------------|--------------------|------------------|------------------|------------------|
|                       | June 30,           |                  | June 30,         |                  |
| <i>(In thousands)</i> | 2018               | 2017             | 2018             | 2017             |
| <b>Lease payments</b> | <u>\$ 47,346</u>   | <u>\$ 46,709</u> | <u>\$ 96,309</u> | <u>\$ 92,880</u> |

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 |                  | Six Months Ended |                  |
|--|--------------------|------------------|------------------|------------------|
|  | June 30,           |                  | June 30,         |                  |
| <i>(In thousands)</i>                    | 2018               | 2017             | 2018             | 2017             |
| <b>Asset build out payments received</b> | <u>\$ 18,775</u>   | <u>\$ 43,630</u> | <u>\$ 31,560</u> | <u>\$ 93,824</u> |

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 16, 2018. The promissory note matures on December 31, 2019. The revolving promissory note accrues interest at the floating JP Morgan Chase Prime Rate with all interest compounded semiannually. As of June 30, 2018 and December 31, 2017, the Partnership had no amount outstanding on the subordinated note.

No interest expense was incurred on the subordinated note during the three and six month periods ended June 30, 2018. The interest expense and fees on the subordinated note were approximately \$60,000 and \$100,000 during the three and six months ended June 30, 2017, respectively.

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 |              | Six Months Ended |               |
|-----------------------------|--------------------|--------------|------------------|---------------|
|                             | June 30,           |              | June 30,         |               |
| <i>(In thousands)</i>       | 2018               | 2017         | 2018             | 2017          |
| <b>Lease office expense</b> | <u>\$ 41</u>       | <u>\$ 87</u> | <u>\$ 85</u>     | <u>\$ 172</u> |

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 |               | Six Months Ended |                 |
|--|--------------------|---------------|------------------|-----------------|
|  | June 30,           |               | June 30,         |                 |
| <i>(In thousands)</i>                  | 2018               | 2017          | 2018             | 2017            |
| <b>Infrastructure support services</b> | <u>\$ 1,387</u>    | <u>\$ 498</u> | <u>\$ 1,992</u>  | <u>\$ 1,232</u> |

(Continued)



## SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements  
(Unaudited)

Accrued fees related to these charges are included in due to affiliates on the Partnership's Consolidated Balance Sheets and were approximately \$ 1.3 million and \$ 763,000 as of June 30, 2018 and December 31, 2017, 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.

( 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. The credit facility accrues interest on the outstanding balance at the Prime Rate. At June 30, 2018, the Prime Rate was at 5.0%. In addition to the interest on the outstanding balance, commitment fees accrue at 0.35% for the unused portion of the credit facility. The revolving credit facility expires on August 11, 2019.

As of June 30, 2018 the Partnership had \$6.0 million on the revolving credit facility. As of December 31, 2017, the Partnership had no amount outstanding on the revolving credit facility. The interest expense and fees for the revolving credit facility were approximately \$38,000 and \$57,000 during the three and six months ended June 30, 2018, respectively. The interest expense and fees for the revolving credit facility were approximately \$51,000 and \$86,000 during the three and six months ended June 30, 2017, respectively.

The agreement requires maintenance of certain financial ratios and imposes certain restricted covenants. The Partnership was in compliance with all covenants as of June 30, 2018 and December 31, 2017, respectively.

( 10 ) Long-Term Debt

| <i>(In thousands)</i>                   | <u>Maturity Date</u> | <u>June 30, 2018</u> |        | <u>December 31, 2017</u> |        |
|---|----------------------|----------------------|--------|--------------------------|--------|
| <b>CVPE</b>                             |                      |                      |        |                          |        |
| 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     | 78,891               | 3.73%* | 79,922                   | 3.32%* |
| <b>GSPE</b>                             |                      |                      |        |                          |        |
| Term Loan - \$57.2 million              | October 31, 2019     | 54,698               | 3.73%* | 55,413                   | 3.32%* |
| Total long-term debt                    |                      | <u>157,089</u>       |        | <u>158,835</u>           |        |
| Less: current portion of long-term debt |                      | <u>3,493</u>         |        | <u>3,493</u>             |        |
| Long-term debt                          |                      | <u>\$ 153,596</u>    |        | <u>\$ 155,342</u>        |        |

\* Interest based on LIBOR plus an applicable margin

*Senior Secured Credit Facilities* – On January 15, 2015, in conjunction with the acquisition, 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.

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SHARYLAND UTILITIES, L.P.

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

The CV Project was placed in service June 10, 2016 and the new transmission cost of service (TCOS) rate that included the CV PE 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 June 30, 2018 and December 31, 2017 was \$ 78.9 million and \$ 79.9 million, respectively.

As of June 30, 2018 and December 31, 2017, 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. The Fixed Rate Notes and the term loan mature on January 15, 2020 and do not provide for any principal payments.

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 June 30, 2018 and December 31, 2017.

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. The outstanding borrowing under the term loan at June 30, 2018 and December 31, 2017 was \$54.7 million and \$55.4 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, 2018 and December 31, 2017.

Future maturities of the total long-term debt as of June 30, 2018 are as follows:

| <i>(In thousands)</i>    | Total      |
|--------------------------|------------|
| Year Ending December 31: |            |
| 2018                     | \$ 1,747   |
| 2019                     | 56,045     |
| 2020                     | 99,297     |
|                          | \$ 157,089 |

*(Continued)*

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SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements  
(Unaudited)

( 1 1 ) 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.

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.

( 1 2 ) 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 June 30, 2018 and December 31, 2017, the Partnership had approximately \$133.6 million and \$135.3 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 June 30, 2018 and December 31, 2017. 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>        | <b>Carrying<br/>Value</b> | Fair Value |            |         |
|------------------------------|---------------------------|------------|------------|---------|
|                              |                           | Level 1    | Level 2    | Level 3 |
| <b><u>June 30, 2018</u></b>  |                           |            |            |         |
| Long-term debt               | \$ 157,089                | \$ —       | \$ 156,772 | \$ —    |
| <br><u>December 31, 2017</u> |                           |            |            |         |
| Long-term debt               | 158,835                   | —          | 158,673    | —       |

*(Continued)*

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SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements  
(Unaudited)

( 1 3 ) 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 \$200,000 and \$279,000 during the three and six months ended June 30, 2018, respectively.

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 June 30, 2018:

| <i>(In thousands)</i>    | Total    |
|--------------------------|----------|
| Year Ending December 31: |          |
| 2018 - Q3 and Q4         | \$ 264   |
| 2019                     | 305      |
| 2020                     | 283      |
| 2021                     | 277      |
| Thereafter               | —        |
|                          | \$ 1,129 |

*Regulatory proceedings*

On April 29, 2016, the Partnership filed a system-wide rate proceeding with the PUCT to update its rates (April Rate Case Filing). Pursuant to a restructuring order issued by the PUCT in 2008 allowing the Partnership and SDTS to utilize a REIT structure, the April Rate Case Filing was prepared using the audited books and records of both Sharyland and SDTS and proposed rates to be set on a combined basis. However, as a result of a preliminary order issued by the PUCT in October 2016, Sharyland and SDTS filed an amended rate case application and rate filing packages (December Rate Case Filing) on December 30, 2016 with the PUCT, which superseded the April Rate Case Filing. On September 29, 2017, the PUCT issued an order dismissing the December Rate Case filing contingent on PUCT approval of the STM and the closing of the Asset Exchange Transaction. See Note 2, Asset Exchange Transaction for additional information regarding the asset exchange transaction.

In the interim, the Partnership reduced its base distribution rates by approximately 10% for its residential customers in its Stanton, Brady, and Celeste (SBC) service territories in accordance with the regulatory order issued on July 27, 2017 in Docket No. 45414. The recorded regulatory asset was transferred to Oncor in connection with the Asset Exchange Transaction. See Note 2, regarding the Asset Exchange Transaction.

On October 13, 2017, the PUCT issued an order approving the STM for the Asset Exchange Transaction and granting SDTS a CCN to continue to own and lease its assets to the Partnership. Also on October 13, 2017, the PUCT issued an order approving the settlement of Oncor's rate case in Docket No. 46957 contingent on the closing of the asset exchange transaction. The PUCT's approval of the STM and Oncor's rate case settlement were both conditions to the closing of the asset exchange transaction.

Once the December Rate Case filing dismissal became effective, the Partnership and SDTS continued operating under their existing regulatory structure, and the current regulatory parameters remain in place until the next rate case, including an allowed return on equity of 9.7%, a capital structure of 55% debt and 45% equity and a cost of debt of 6.73%. The Partnership and SDTS will be required to file a new rate case in the calendar year 2020 with a test year ending December 31, 2019.

*(Continued)*

**SHARYLAND UTILITIES, L.P.****Notes to the Consolidated Financial Statements  
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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 \$0.47 million incurred by the municipalities within Sharyland's service territory who intervened in Docket No. 45414. This case is scheduled for hearing before the PUCT on August 8, 2018.

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SHARYLAND UTILITIES, L.P.

Notes to the Consolidated Financial Statements  
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( 1 4 ) Supplemental Cash Flow Information

Supplemental cash flow information and non-cash investment and financing activities for the six months ended June 30 are as follows:

*(In thousands)*

|   | 2018      | 2017      |
|---|-----------|-----------|
| <b>Supplemental cash flow information</b>   |           |           |
| Cash paid for interest  | \$ 83,773 | \$ 75,284 |
| Cash paid for margin taxes  | 1,647     | 1,540     |
| <b>Non-cash investing and financing activities</b>                                      |           |           |
| Right of way additions to property, plant and equipment                                 | —         | 407       |
| Financing obligation incurred   | 30,446    | 70,467    |
| Change in accrued additions to property, plant and equipment                            | 824       | 1,657     |
| Property, plant and equipment - net transferred to deferred charges - regulatory assets | 1,590     | —         |
| Allowance for funds used during construction - debt                                     | 58        | —         |

( 1 5 ) Subsequent Events

On July 18, 2018, the Partnership repaid \$6.0 million under its revolving credit facility with Amegy Bank. The credit facility accrues interest on the outstanding balance at the Prime Rate of 5.0%.

The Partnership has evaluated subsequent events from the Balance Sheet date through July 26, 2018, the date at which the Financial Statements were made available to be issued, and determined there are no other items to disclose.

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Sharyland  
Utilities