

InfraREIT, Inc.  
Form 10-Q  
August 03, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-36822

InfraREIT, Inc.

(Exact name of Registrant as specified in its charter)

|   |  |
|---|--|
| Maryland<br>(State or Other Jurisdiction of<br>Incorporation or Organization) | 75-2952822<br>(I.R.S. Employer<br>Identification Number) |
|---|--|

1807 Ross Avenue, 4<sup>th</sup> Floor,

|   |                     |
|---|---------------------|
| Dallas, Texas<br>(Address of Principal Executive Offices) | 75201<br>(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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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 29, 2016, 43,764,471 shares of common stock were issued and outstanding.

InfraREIT, Inc.

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GLOSSARY OF TERMS

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

| Abbreviation       | Term   |
|--------------------|--|
| AFUDC              | allowance for funds used during construction   |
| CREZ               | competitive renewable energy zones, as defined by a 2005 Texas law establishing the Texas renewable energy program   |
| 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  |
| Footprint Projects | transmission or distribution projects primarily situated within our distribution service territory, or that 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; 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 distribution service territory |
| PUCT               | Public Utility Commission of Texas   |
| rate base          | calculated as our gross electric plant in service under generally accepted accounting principles in the United States, 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  |
| ROFO Projects      | identified projects that are being developed by Hunt Consolidated, Inc. and its affiliates with respect to which we have a right of first offer  |
| 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   |
| T&D assets         | rate-regulated electric transmission and distribution assets 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  |



## 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, contain 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," "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, expected lease payments, infrastructure programs, estimated cash flow projections and estimated distributions to our stockholders. Forward-looking statements can be affected by assumptions used or by known or unknown risks or uncertainties. Consequently, no forward-looking statements can be guaranteed.

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, when considering these forward-looking statements, you should keep in mind the risk factors and other cautionary statements in this document. Actual results may vary materially. 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 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, our authorized rate of return and other regulatory parameters;
- our current reliance on our tenant for all of our revenues and, as a result, our dependency on our tenant's solvency and financial and operating performance;
  - risks that the capital expenditures we expect will not materialize for a variety of reasons;
- risks related to future lease negotiations or non-renewal of leases with our tenant;
- insufficient cash available to meet distribution requirements;
- our ability to make strategic acquisitions that add to our rate base;
- the price and availability of debt and equity financing;
- our level of indebtedness or debt service obligations;
- cyber breaches, weather conditions or other natural phenomena;
- the effects of existing and future tax and other laws and governmental regulations;
- our failure to qualify or maintain our status as a real estate investment trust (REIT) or changes in the tax laws applicable to REITs;
- the termination of our management agreement or the loss of the services of Hunt Utility Services, LLC or other qualified personnel;
- adverse economic developments in the electric power industry or in business conditions generally, particularly in Texas; and
- certain factors discussed elsewhere in this Quarterly Report on Form 10-Q.

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, 2015, filed with the U.S. Securities and Exchange Commission (SEC) on March 3, 2016; Part II, Item 1A., Risk Factors in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2016, filed with the SEC on May 5, 2016; and Part II, Item 1A., Risk Factors of this

Quarterly Report on Form 10-Q.

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## EXPLANATORY NOTE

The registrant is a Maryland corporation named InfraREIT, Inc. Before our initial public offering (IPO), which closed on February 4, 2015, substantially all of our business and assets were owned, directly or indirectly, by InfraREIT, L.L.C., a Delaware limited liability company. On February 4, 2015, immediately following the consummation of our IPO, InfraREIT, L.L.C. was merged with and into InfraREIT, Inc. (Merger), with InfraREIT, Inc. as the surviving company. InfraREIT, Inc.'s operating results before the Merger primarily reflected costs related to obtaining a private letter ruling from the Internal Revenue Service and accounting services. As a result, this Quarterly Report on Form 10-Q presents the operations of InfraREIT, L.L.C. from January 1, 2015 through the effectiveness of the Merger, and the operations of InfraREIT, Inc. thereafter.

As used in this Quarterly Report on Form 10-Q, unless the context requires otherwise or except as otherwise noted, the words "Company," "InfraREIT," "we," "our" and "us" refer to InfraREIT, L.L.C., before giving effect to the Merger, and InfraREIT, Inc., after giving effect to the Merger, as the context requires, and also refer to the registrant's subsidiaries, including InfraREIT Partners, LP (Operating Partnership or InfraREIT LP), a Delaware limited partnership. Hunt Consolidated, Inc. (HCI) and its subsidiaries (collectively, Hunt) includes Hunt Utility Services, LLC (Hunt Manager) and Hunt Transmission Services, L.L.C. (Hunt Developer). Our tenant is Sharyland Utilities, L.P. (Sharyland). Unless otherwise indicated or the context requires, all information in this Quarterly Report on Form 10-Q gives effect to a 1 for 0.938550 reverse split of the shares of InfraREIT, L.L.C. and a concurrent 1 for 0.938550 reverse split of the units representing limited partnership interests in our Operating Partnership, which we effected on January 29, 2015.



## PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements  
InfraREIT, Inc.

## CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

|   | June 30,<br>2016<br>(Unaudited) | December<br>31, 2015 |
|---|---------------------------------|----------------------|
| <b>Assets</b>   |                                 |                      |
| <b>Current Assets</b>   |                                 |                      |
| Cash and cash equivalents   | \$ 10,806                       | \$ 9,471             |
| Restricted cash   | 1,682                           | 1,682                |
| Due from affiliates   | 24,600                          | 31,172               |
| Inventory   | 6,648                           | 6,731                |
| Prepays and other current assets  | 1,050                           | 560                  |
| Total current assets  | 44,786                          | 49,616               |
| Electric Plant, net   | 1,539,722                       | 1,434,531            |
| Goodwill  | 138,384                         | 138,384              |
| Other Assets  | 39,638                          | 40,979               |
| Total Assets  | \$ 1,762,530                    | \$ 1,663,510         |
| <b>Liabilities and Equity</b>   |                                 |                      |
| <b>Current Liabilities</b>  |                                 |                      |
| Accounts payable and accrued liabilities                                      | \$ 35,537                       | \$ 22,943            |
| Short-term borrowings   | 48,500                          | 54,000               |
| Current portion of long-term debt   | 7,633                           | 7,423                |
| Dividends and distributions payable   | 15,158                          | 13,634               |
| Accrued taxes   | 3,791                           | 3,312                |
| Total current liabilities   | 110,619                         | 101,312              |
| Long-Term Debt, Less Deferred Financing Costs                                 | 713,452                         | 617,305              |
| Regulatory Liability  | 16,024                          | 10,625               |
| Total liabilities   | 840,095                         | 729,242              |
| <b>Commitments and Contingencies</b>  |                                 |                      |
| <b>Equity</b>   |                                 |                      |
| Common stock, \$0.01 par value; 450,000,000 shares authorized; 43,575,727 and |                                 |                      |
| 43,565,495 issued and outstanding as of June 30, 2016 and December 31, 2015,  |                                 |                      |
| respectively  | 436                             | 436                  |
| Additional paid-in capital  | 702,391                         | 702,213              |
| Accumulated deficit   | (33,389 )                       | (24,526 )            |
| Total InfraREIT, Inc. equity  | 669,438                         | 678,123              |
| Noncontrolling interest   | 252,997                         | 256,145              |
| Total equity  | 922,435                         | 934,268              |

|                              |             |             |
|------------------------------|-------------|-------------|
| Total Liabilities and Equity | \$1,762,530 | \$1,663,510 |
|------------------------------|-------------|-------------|

See accompanying notes to the unaudited consolidated financial statements.

InfraREIT, Inc.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

|   | Three Months   |          | Six Months Ended |            |
|---|----------------|----------|------------------|------------|
|   | Ended June 30, |          | June 30,         |            |
|   | 2016           | 2015     | 2016             | 2015       |
| Lease revenue   | \$33,785       | \$29,458 | \$67,450         | \$58,830   |
| Operating costs and expenses                                    |                |          |                  |            |
| General and administrative expense                              | 4,980          | 4,728    | 10,525           | 53,461     |
| Depreciation  | 11,410         | 9,671    | 22,484           | 19,179     |
| Total operating costs and expenses                              | 16,390         | 14,399   | 33,009           | 72,640     |
| Income (loss) from operations                                   | 17,395         | 15,059   | 34,441           | (13,810)   |
| Other (expense) income  |                |          |                  |            |
| Interest expense, net   | (9,055)        | (6,939)  | (17,897)         | (14,361)   |
| Other income, net   | 1,137          | 847      | 1,896            | 1,473      |
| Total other expense   | (7,918)        | (6,092)  | (16,001)         | (12,888)   |
| Income (loss) before income taxes                               | 9,477          | 8,967    | 18,440           | (26,698)   |
| Income tax expense  | 293            | 124      | 479              | 332        |
| Net income (loss)   | 9,184          | 8,843    | 17,961           | (27,030)   |
| Less: Net income (loss) attributable to noncontrolling interest | 2,576          | 2,481    | 5,038            | (6,519)    |
| Net income (loss) attributable to InfraREIT, Inc.               | \$6,608        | \$6,362  | \$12,923         | \$(20,511) |
| Net income (loss) attributable to InfraREIT, Inc. common        |                |          |                  |            |
| stockholders per share:   |                |          |                  |            |
| Basic   | \$0.15         | \$0.15   | \$0.30           | \$(0.48)   |
| Diluted   | \$0.15         | \$0.15   | \$0.30           | \$(0.48)   |
| Cash dividends declared per common share                        | \$0.250        | \$0.225  | \$0.500          | \$0.625    |

See accompanying notes to the unaudited consolidated financial statements.

InfraREIT, Inc.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

|  | Six Months Ended<br>June 30, |             |
|--|------------------------------|-------------|
|  | 2016                         | 2015        |
| Cash flows from operating activities   |                              |             |
| Net income (loss)  | \$ 17,961                    | \$(27,030 ) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                              |             |
| Depreciation   | 22,484                       | 19,179      |
| Amortization of deferred financing costs   | 2,007                        | 1,824       |
| Allowance for funds used during construction — other funds                               | (1,896 )                     | (1,481 )    |
| Reorganization structuring fee   | —                            | 44,897      |
| Realized gain on sale of marketable securities   | —                            | (66 )       |
| Equity based compensation  | 520                          | 308         |
| Changes in assets and liabilities:   |                              |             |
| Due from affiliates  | 6,572                        | 6,046       |
| Inventory  | 83                           | 455         |
| Prepays and other current assets   | (490 )                       | (855 )      |
| Accounts payable and accrued liabilities   | 13,308                       | 7,683       |
| Net cash provided by operating activities  | 60,549                       | 50,960      |
| Cash flows from investing activities   |                              |             |
| Additions to electric plant  | (120,615)                    | (115,627)   |
| Proceeds from sale of assets   | —                            | 41,211      |
| Sale of marketable securities  | —                            | 1,065       |
| Cash paid to InfraREIT, L.L.C. investors in the merger, net of cash assumed              | —                            | (172,400)   |
| Net cash used in investing activities  | (120,615)                    | (245,751)   |
| Cash flows from financing activities   |                              |             |
| Net proceeds from issuance of common stock upon initial public offering                  | —                            | 493,722     |
| Proceeds from short-term borrowings  | 50,500                       | 33,000      |
| Repayments of short-term borrowings  | (56,000 )                    | (253,000)   |
| Proceeds from borrowings of long-term debt   | 100,000                      | —           |
| Repayments of long-term debt   | (3,660 )                     | (9,569 )    |
| Deferred financing costs   | (649 )                       | (153 )      |
| Dividends and distributions paid   | (28,790 )                    | (34,326 )   |
| Net cash provided by financing activities  | 61,401                       | 229,674     |
| Net increase in cash and cash equivalents  | 1,335                        | 34,883      |
| Cash and cash equivalents at beginning of period   | 9,471                        | 15,612      |
| Cash and cash equivalents at end of period   | \$ 10,806                    | \$ 50,495   |

See accompanying notes to the unaudited consolidated financial statements.



InfraREIT, Inc.

## NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

### 1. Description of Business and Presentation of Financial Statements

#### Basis of Presentation

InfraREIT, Inc. is a Maryland corporation and the surviving corporation of a merger (Merger) with InfraREIT, L.L.C., a Delaware limited liability company, completed on February 4, 2015 in connection with the initial public offering (IPO) of InfraREIT, Inc. and related transactions effected during the first quarter of 2015 (collectively, the Reorganization). For additional information related to our IPO and Reorganization, refer to the consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2015 filed with the U.S. Securities and Exchange Commission (SEC) on March 3, 2016.

The Merger was accounted for as a reverse acquisition, which means for accounting purposes we treated the assets and liabilities of InfraREIT, Inc. as assumed and incorporated with the assets and liabilities of InfraREIT, L.L.C. The accompanying unaudited interim financial statements of InfraREIT, Inc. (which may be referred to as the “Company,” “InfraREIT,” “we,” “our” and “us”) include our accounts and the accounts of all other entities in which we have a controlling financial interest with noncontrolling interest of consolidated subsidiaries reported separately. This Quarterly Report on Form 10-Q presents the operations of InfraREIT, L.L.C. prior to the Merger and the operations of InfraREIT, Inc. after the Merger.

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 of 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, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. 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, 2015 filed with the SEC on March 3, 2016.

We held 71.9% of the outstanding partnership units (OP Units) in InfraREIT Partners, LP (Operating Partnership or InfraREIT LP) as of June 30, 2016 and are its general partner. We include the accounts of the Operating Partnership and its subsidiaries in our consolidated financial statements. MC Transmission Holdings, Inc., which is a subsidiary of Marubeni Corporation (Marubeni), seven members of our board of directors and affiliates of Hunt Consolidated, Inc. (HCI) held the other 28.1% of the outstanding OP Units as of June 30, 2016.

#### Recent Accounting Guidance

#### Recently Adopted Accounting Guidance

In February 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2015-02, Consolidation (Topic 810) – Amendments to the Consolidation Analysis. This amendment affects reporting entities that are required to evaluate whether they should consolidate certain legal entities. ASU 2015-02 was effective

for periods beginning after December 15, 2015 with early adoption permitted. We adopted the guidance on January 1, 2016. The adoption of the new guidance did not have an impact on our current consolidation.

In April 2015, the FASB issued ASU 2015-03, Interest – Imputation of Interest (Subtopic 835-30), Simplifying the Presentation of Debt Issuance Costs. ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability, consistent with debt discounts. ASU 2015-03 was effective for periods beginning after December 15, 2015 with early adoption permitted. The adoption of the new guidance was applied on a retrospective basis with each balance sheet presented reflecting the new guidance along with transitional disclosures. The adoption did change the presentation of our financial position. As a result, \$0.2 million of unamortized deferred financing costs were reclassified from other assets to long-term debt, less deferred financing costs on our Consolidated Balance Sheets as of December 31, 2015. The adoption of the new guidance did not have an impact on our results of operations or cash flows.

In September 2015, the FASB issued ASU 2015-16, Business Combinations (Topic 805), Simplifying the Accounting for Measurement-Period Adjustments. ASU 2015-16 requires an acquirer to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The change in provisional amounts will be recorded in the period in which they are determined with changes to the income statement for any effect on earnings for changes in depreciation, amortization or other income effect calculated as if the accounting had been completed at the acquisition date. ASU 2015-16 was effective for periods beginning after December 15, 2015 with early adoption permitted. The new guidance was adopted as of January 1, 2016 and will be applied prospectively to adjustments to provisional amounts that occur for any future business combination. The adoption of the new guidance has not affected our 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, 2018 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. We are currently evaluating the new guidance and have not determined the impact this standard may have on our financial position, results of operations or cash flows.

#### 2. Related Party Transactions

Our subsidiary, Sharyland Distribution & Transmission, L.L.C. (SDTS), is party to several lease agreements with Sharyland Utilities, L.P. (Sharyland) through which we lease all of our electric transmission and distribution assets (T&D assets) to Sharyland. Under the leases we have agreed to fund capital expenditures for footprint projects. Our leases define “footprint projects” to be transmission or distribution projects primarily situated within our distribution service territory, that physically hang from our existing transmission assets or that are physically located within one of our substations.

We earned lease revenues from Sharyland under these agreements of \$33.8 million and \$29.5 million during the three months ended June 30, 2016 and 2015, respectively. We earned \$67.5 million and \$58.8 million from Sharyland during the six months ended June 30, 2016 and 2015, respectively. In connection with our leases with Sharyland, we recorded a deferred rent liability of \$24.0 million and \$11.5 million as of June 30, 2016 and December 31, 2015, 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 T&D assets. For the six months ended June 30, 2016 and 2015, the net amount of the payments we made to Sharyland was \$120.1 million and \$121.3 million, respectively.

As of June 30, 2016 and December 31, 2015, accounts payable and accrued liabilities on the Consolidated Balance Sheets included \$7.7 million and \$9.2 million, respectively, related to amounts owed to Sharyland. As of June 30, 2016 and December 31, 2015, amounts due from affiliates on the Consolidated Balance Sheets included \$24.6 million and \$31.2 million, respectively, related to amounts owed by Sharyland associated with our leases.



Our management fee paid to Hunt Utility Services, LLC (Hunt Manager) for the six months ended June 30, 2016 and 2015 was \$6.8 million and \$5.8 million, respectively. As of June 30, 2016 and December 31, 2015, there were no prepaid or accrued amounts associated with management fees on the Consolidated Balance Sheets. Additionally, during the six months ended June 30, 2016 and 2015, we paid Hunt Manager less than \$0.1 million and \$0.3 million, respectively, for reimbursement of annual software license and maintenance fees and other expenses in accordance with our management agreement.

Our current management agreement with Hunt Manager provided for an annual base fee, or management fee, of \$10.0 million through April 1, 2015. Effective as of April 1, 2015, the annual base fee was automatically adjusted to \$13.1 million annually through March 31, 2016. Effective as of April 1, 2016, the annual base fee was automatically adjusted to \$14.0 million annually through March 31, 2017. The base fee and each base fee going forward for the twelve month period beginning on each April 1 thereafter will equal 1.50% of our total equity (including noncontrolling interest) as of December 31 of the immediately preceding year, subject to a \$30.0 million cap, unless a greater amount is approved by a majority of our independent directors or a committee comprised solely of independent directors. 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.

In connection with the organization of InfraREIT, L.L.C. in November 2010, our Operating Partnership agreed to issue deemed capital credits and Class A OP Units to Hunt-InfraREIT, L.L.C. (Hunt-InfraREIT), a subsidiary of HCI. Our Operating Partnership agreed to issue up to \$82.5 million to Hunt-InfraREIT, pro-rata, as we funded the capital expenditures related to our competitive renewable energy zones (CREZ) project up to \$737.0 million. In addition, our Operating Partnership also agreed to issue to Hunt-InfraREIT deemed capital credits in an amount equal to 5% of our capital expenditures on certain development projects. As of December 31, 2014, our Operating Partnership issued Hunt-InfraREIT an aggregate of 6.8 million Class A OP Units in respect of these obligations. On January 1, 2015, our Operating Partnership issued an additional 70,846 Class A OP Units to Hunt-InfraREIT, and, upon completion of our IPO, our Operating Partnership issued Hunt-InfraREIT an accelerated deemed capital credit equal to 983,418 Class A OP Units, which settled the related obligations to Hunt-InfraREIT. Following this issuance, our Operating Partnership no longer has the obligation to issue deemed capital credits or related equity to Hunt-InfraREIT. We recorded these capital account credits as asset acquisition costs included as part of the capital project in our construction work in progress (CWIP) balance.

In connection with the IPO, Reorganization and related transactions, we incurred an aggregate of \$5.0 million of legal fees, a portion of which was paid to reimburse HCI and its subsidiaries (collectively, Hunt), to reimburse certain of our pre-IPO investors and to reimburse certain of our pre-IPO independent directors, in each case for legal expenses they incurred in connection with such transactions. Of the total legal fees incurred, \$0.1 million of the legal fees were recorded during the first quarter of 2015. There were no such costs incurred after the completion of our IPO. For additional information related to our IPO and Reorganization refer to the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC on March 3, 2016.

In November 2014, InfraREIT, Inc. borrowed \$1.0 million from HCI pursuant to a promissory note. The note accrued interest at 2.5% per year and was due on November 1, 2015. This note and accrued interest were repaid in February 2015 with proceeds from our IPO for a total of \$1.0 million.

Effective January 15, 2015, we sold all the assets related to the Cross Valley transmission line (Cross Valley Project) to a newly formed development company owned by Hunt and certain of its affiliates for cash of \$34.2 million, which equaled the CWIP of the project on the date of sale, plus reimbursement of out of pocket expenses associated with the project financing. Also on January 15, 2015, we sold all the assets related to the Golden Spread Electric Cooperative interconnection (Golden Spread Project) to Hunt for cash of \$7.0 million, which equaled the CWIP of the project on the date of sale.

In November 2015 and February 2016, the Conflicts Committee of our board of directors received an offer for the purchase of the Golden Spread Project and Cross Valley Project, respectively. On March 10, 2016, we announced our decision to postpone the consideration of the purchase of the Golden Spread Project and Cross Valley Project.

### 3. Electric Plant and Depreciation

The major classes of electric plant are as follows:

| (In thousands) | June 30,<br>2016 | December<br>31, 2015 |
|----------------|------------------|----------------------|
|----------------|------------------|----------------------|

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|                          |              |              |
|--------------------------|--------------|--------------|
| Electric plant:          |              |              |
| Transmission plant       | \$ 1,134,030 | \$ 1,080,050 |
| Distribution plant       | 519,953      | 457,988      |
| General plant            | 15,951       | 15,655       |
| Total plant in service   | 1,669,934    | 1,553,693    |
| CWIP                     | 122,612      | 121,602      |
| Total electric plant     | 1,792,546    | 1,675,295    |
| Accumulated depreciation | (252,824 )   | (240,764 )   |
| Electric plant, net      | \$ 1,539,722 | \$ 1,434,531 |

General plant consists primarily of a warehouse, buildings and associated assets. CWIP relates to various transmission and distribution projects underway. 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 \$28.1 million and \$28.6 million at June 30, 2016 and December 31, 2015, respectively.

In 2013, SDTS purchased from Southwestern Public Service Company approximately 66 miles of existing transmission lines and two substations located near Stanton, Texas for \$37.1 million. SDTS holds legal title to the assets and they are subject to a lease with Sharyland. Sharyland has the responsibility for operating these T&D assets and complying with all applicable regulatory requirements. As of December 31, 2014, these transmission lines and substations were classified as electric plant held for future use within electric plant, net. During August 2015, the assets classified as electric plant held for future use were placed in service and reclassified to transmission plant within electric plant, net on the Consolidated Balance Sheets and began depreciating.

#### 4. 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, 2016 and December 31, 2015, \$138.4 million was recorded as goodwill on the Consolidated Balance Sheets.

#### 5. Other Assets

Other assets are as follows:

|  | June 30, 2016 |              | Net       | December 31, 2015 |              | Net       |
|--|---------------|--------------|-----------|-------------------|--------------|-----------|
|  | Gross         |              |           | Gross             |              |           |
|  | Carrying      | Accumulated  | Carrying  | Carrying          | Accumulated  | Carrying  |
| (In thousands)                               | Amount        | Amortization | Amount    | Amount            | Amortization | Amount    |
| Deferred financing costs on undrawn revolver | \$967         | \$ (300 )    | \$ 667    | \$967             | \$ (204 )    | \$ 763    |
| Other regulatory assets:                     |               |              |           |                   |              |           |
| Deferred financing costs                     | 27,761        | (15,102 )    | 12,659    | 27,112            | (13,208 )    | 13,904    |
| Deferred costs recoverable in future years   | 23,793        | —            | 23,793    | 23,793            | —            | 23,793    |
| Other regulatory assets, net                 | 51,554        | (15,102 )    | 36,452    | 50,905            | (13,208 )    | 37,697    |
| Investments                                  | 2,519         | —            | 2,519     | 2,519             | —            | 2,519     |
| Other assets                                 | \$55,040      | \$ (15,402 ) | \$ 39,638 | \$54,391          | \$ (13,412 ) | \$ 40,979 |

Deferred financing costs on undrawn revolver consist of costs incurred in connection with the establishment of the InfraREIT LP revolving credit facility, see Note 6, Borrowings Under Credit Facilities.

Other regulatory assets consist of deferred financing costs within our regulated entities. These assets are classified as regulatory assets and amortized over the length of the related loan. These costs will be included in the costs to be recovered in connection with a future rate case. Deferred financing costs included in other regulatory assets primarily

consist of debt issuance costs incurred in connection with the construction credit agreement entered into in 2011 by Sharyland Projects, LLC (SPLLC), which was at the time one of our subsidiaries; refinancing costs incurred in connection with the amended and restated revolving credit facility entered into by SDTS in 2013; refinancing costs incurred to amend and restate the SDTS credit facility in order to increase the revolving credit facility to a total of \$250.0 million in 2014 and financing costs incurred in connection with SDTS's senior secured notes, series A and series B in December 2015 and January 2016. See Note 6, Borrowings Under Credit Facilities and Note 7, Long-Term Debt.

Deferred costs recoverable in future years of \$23.8 million at June 30, 2016 and December 31, 2015 represent operating costs incurred from inception of Sharyland through 2007. We have determined that these costs are probable of recovery through future rates based on orders of the Public Utility Commission of Texas (PUCT) in Sharyland's prior rate cases and regulatory precedent.

In connection with the acquisition of Cap Rock Holding Corporation (Cap Rock) in 2010, we received a participation in the National Rural Cooperative Corporation (NRUCFC). We account for this investment under the cost method of accounting. We believe that the investment is not impaired at June 30, 2016 and December 31, 2015.

## 6. Borrowings Under Credit Facilities

### InfraREIT LP Revolving Credit Facility

In December 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 substantially all of the assets of InfraREIT LP. In addition, Transmission and Distribution Company, LLC (TDC) guarantees the revolving credit facility and this guarantee is secured by the assets of, and InfraREIT LP's equity interests in, TDC on materially the same basis as with TDC's senior secured notes described below. Upon consummation of the IPO and Merger, InfraREIT, Inc. became a guarantor under this revolving credit facility.

The credit agreement requires InfraREIT LP to comply with coverage ratios on a consolidated basis and contains affirmative and negative covenants, including: 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 credit agreement also contains restrictions on the amount of Sharyland's indebtedness and other restrictions on, and covenants applicable to, Sharyland.

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 Bank of America 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 multiplied by 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.

At June 30, 2016 and December 31, 2015, 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, 2016 and December 31, 2015, InfraREIT LP was in compliance with all covenants under the credit agreement.

### SDTS Revolving Credit Facility

SDTS's revolving credit facility has a borrowing capacity of up to \$250.0 million and a maturity date of December 10, 2019. Up to \$25.0 million of the revolving credit facility is available for issuance of letters of credit, and up to \$5.0 million of the revolving facility is available for swingline loans. The revolving credit facility is secured by SDTS's T&D 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 7, 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.

At June 30, 2016, SDTS had \$48.5 million of borrowings outstanding at a weighted average interest rate of 2.21%, no letters of credit outstanding and \$201.5 million of remaining borrowing capacity available under this revolving credit facility. At December 31, 2015, SDTS had \$54.0 million of borrowings outstanding at a weighted average interest rate

of 2.05% with no letters of credit outstanding and \$196.0 million of remaining borrowing capacity under this revolving credit facility. As of June 30, 2016 and December 31, 2015, SDTS was in compliance with all covenants under its credit agreement.

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 (except in the case of a bankruptcy event of default, in which case such amounts will automatically become due and payable).

## 7. Long-Term Debt

Long-term debt consisted of the following:

| (In thousands)   | Maturity Date      | June 30, 2016 |          | December 31, 2015 |          |
|--|--------------------|---------------|----------|-------------------|----------|
|  |                    | Amount        | Interest | Amount            | Interest |
| TDC  |                    |               |          |                   |          |
| Senior secured notes - \$25.0 million                            | December 30, 2020  | \$18,125      | 8.50%    | \$18,750          | 8.50%    |
| SDTS   |                    |               |          |                   |          |
| Senior secured notes - \$60.0 million                            | June 20, 2018      | 60,000        | 5.04%    | 60,000            | 5.04%    |
| 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%    | —                 | N/A      |
| Senior secured notes - \$53.5 million                            | December 30, 2029  | 43,574        | 7.25%    | 44,512            | 7.25%    |
| Senior secured notes - \$110.0 million                           | September 30, 2030 | 99,531        | 6.47%    | 101,627           | 6.47%    |
| Total SDTS debt  |                    | 703,105       |          | 606,139           |          |
| Total long-term debt   |                    | 721,230       |          | 624,889           |          |
| Less unamortized deferred financing costs                        |                    | (145 )        |          | (161 )            |          |
| Total long-term debt, less deferred financing costs              |                    | 721,085       |          | 624,728           |          |
| Less current portion of long-term debt                           |                    | (7,633 )      |          | (7,423 )          |          |
| Debt classified as long-term debt, less deferred financing costs |                    | \$713,452     |          | \$617,305         |          |

Senior Secured Notes – In 2010, in connection with the acquisition of Cap Rock, 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. Principal and interest on these senior secured notes are payable quarterly and these senior secured notes are collateralized by the equity interest of TDC and substantially all of the assets of TDC on materially the same basis as with lenders under InfraREIT LP's revolving credit facility described above in Note 6, Borrowings Under Credit Facilities. In connection with the issuance of these senior secured 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 these senior secured notes was \$0.1 million and \$0.2 million as of June 30, 2016 and December 31, 2015, respectively. These costs were reclassified from other assets to long-term debt, less deferred financing costs on the Consolidated Balance Sheets in accordance with new accounting guidance adopted January 1, 2016, see Note 1, Description of Business and Presentation of Financial Statements.

In December 2015, SDTS issued \$400.0 million in 10 year senior secured notes, series A (Series A Notes), due December 3, 2025, and on January 14, 2016 issued an additional \$100.0 million in 10 year senior secured notes, series B (Series B Notes), due January 14, 2026. These senior secured notes were issued through a private placement conducted pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended, and 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 these senior secured notes are payable quarterly.

In 2010, in connection with the acquisition of Cap Rock, 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 these senior secured 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.

The agreements governing the senior secured notes contain certain default triggers related to the failure to maintain compliance with financial and other covenants contained in the agreements, such as limitations on liens, investments and the incurrence of additional indebtedness. As of June 30, 2016 and December 31, 2015, SDTS and TDC were in compliance with all covenants under the applicable agreements.

Senior Secured Credit Facilities - In 2011, SPLLC entered into a construction term loan agreement syndicated broadly to a group of international banks, and issued fixed rate notes to The Prudential Insurance Company of America and affiliates (Fixed Rate Notes).

The \$447.0 million construction term loan was converted into a term loan with a balance of \$407.0 million in May 2014. After this conversion, interest accrued at LIBOR plus 2.25%. Interest under the term loan was 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 were payable quarterly after the conversion. The term loan had an interest rate of 2.44% at June 30, 2015.

In December 2015, the outstanding principal and interest on the term loan were paid in full with proceeds from the SDTS Series A Notes. Also in December 2015, the Fixed Rate Notes were assumed by SDTS in connection with the merger of SPLLC into SDTS.

The Fixed Rate Notes have a principal balance of \$60.0 million which is due in full on June 20, 2018. Interest is payable quarterly at an interest rate of 5.04% per annum. The Fixed Rate Notes do not provide for any principal payments.

The credit agreement governing the Fixed Rate Notes contains certain default triggers related to the failure to maintain compliance with financial and other covenants contained in the agreements, such as limitations on liens, investments and the incurrence of additional indebtedness. SDTS was in compliance with all covenants for the Fixed Rate Notes as of June 30, 2016 and December 31, 2015.

SDTS's Series A Notes, Series B Notes, 2009 Notes, 2010 Notes and Fixed Rate Notes are secured by SDTS's T&D 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 6, Borrowings Under Credit Facilities.

#### 8. 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 borrowings totaling \$721.2 million and \$624.9 million under our senior secured notes with a weighted average interest rate of 4.64% and 4.78% per annum as of June 30, 2016 and December 31, 2015, respectively. The fair value of these borrowings is estimated using discounted cash flow analysis based on current market rates.

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

| (In thousands)    | Carrying<br>Value | Fair Value |           |         |
|-------------------|-------------------|------------|-----------|---------|
|                   |                   | Level 1    | Level 2   | Level 3 |
| June 30, 2016     |                   |            |           |         |
| Long-term debt    | \$721,230         | \$—        | \$790,687 | \$ —    |
| December 31, 2015 |                   |            |           |         |

Long-term debt      \$624,889    \$—\$657,270    \$ —

#### 9. Regulatory Liability

Our regulatory liability is established through our depreciation rates related to cost of removal and represents amounts that we expect to incur in the future. As of June 30, 2016 and December 31, 2015, we recorded on the Consolidated Balance Sheets as a long-term liability \$16.0 million and \$10.6 million, respectively, net of actual removal costs incurred.

#### 10. Commitments and Contingencies

The amounts reported as regulatory assets as of June 30, 2016 and December 31, 2015 are subject to the review by the PUCT and as with all utility assets may change at a later date based on that review, see Note 5, Other Assets.

We are not a party to any legal proceedings other than legal proceedings arising in the ordinary course of business. 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.

## 11. Equity

On June 3, 2016, our board of directors approved a cash distribution by the Operating Partnership to all unit holders of record, including InfraREIT, Inc., on June 30, 2016 of \$0.25 per unit for a total distribution of \$15.2 million (\$10.9 million to InfraREIT, Inc.). Also, on June 3, 2016, our board of directors approved a cash dividend to stockholders of record of InfraREIT, Inc. on June 30, 2016 of \$0.25 per share for a total of \$10.9 million. The cash distribution and cash dividend were paid on July 21, 2016.

On March 2, 2016, our board of directors approved a cash distribution by the Operating Partnership to all unit holders of record, including InfraREIT, Inc., on March 31, 2016 of \$0.25 per unit for a total distribution of \$15.2 million (\$10.9 million to InfraREIT, Inc.). Also, on March 2, 2016, our board of directors approved a cash dividend to stockholders of record of InfraREIT, Inc. on March 31, 2016 of \$0.25 per share for a total of \$10.9 million. The cash distribution and cash dividend were paid on April 21, 2016.

On June 5, 2015, our board of directors approved a cash distribution by the Operating Partnership to all unit holders of record, including InfraREIT, Inc., on June 30, 2015 of \$0.225 per unit for a total distribution of \$13.6 million (\$9.8 million to InfraREIT, Inc.). Also, on June 5, 2015, our board of directors approved a cash dividend to stockholders of record of InfraREIT, Inc. on June 30, 2015 of \$0.225 per share for a total of \$9.8 million. The cash distribution and cash dividend were paid on July 23, 2015.

On March 6, 2015, our board of directors approved a cash distribution by the Operating Partnership to all unit holders of record, including InfraREIT, Inc., on March 31, 2015 of \$0.14 per unit for a total distribution of \$8.5 million (\$6.1 million to InfraREIT, Inc.). Also, on March 6, 2015, our board of directors approved a cash dividend to stockholders of record of InfraREIT, Inc. on March 31, 2015 of \$0.14 per share for a total of \$6.1 million. The cash distribution and cash dividend were paid on April 23, 2015.

On January 13, 2015, InfraREIT, L.L.C.'s board of directors approved a cash distribution by the Operating Partnership to all unit holders of record, including InfraREIT, L.L.C., on January 20, 2015 of \$0.26 per unit for a total distribution of \$11.7 million (\$9.0 million to InfraREIT, L.L.C.). Also, on January 13, 2015, InfraREIT, L.L.C.'s board of directors approved a cash dividend to shareholders of record of InfraREIT, L.L.C. on January 20, 2015 of \$0.26 per share for a total of \$9.0 million. The cash distribution and cash dividend were paid on January 29, 2015.

On December 18, 2014, InfraREIT, L.L.C.'s board of directors approved a cash distribution by the Operating Partnership to all unit holders of record, including InfraREIT, L.L.C., on December 18, 2014 of \$0.31 per unit for a total distribution of \$14.1 million (\$10.8 million to InfraREIT, L.L.C.). Also, on December 18, 2014, InfraREIT, L.L.C.'s board of directors approved a cash dividend to shareholders of record of InfraREIT, L.L.C. on December 18, 2014 of \$0.31 per share for a total of \$10.8 million. The cash distribution and cash dividend were paid on January 16, 2015.

## 12. 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 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 with cash or by exchanging shares of InfraREIT, Inc. common stock on a one-for-one basis. As of June 30, 2016 and December 31, 2015, there were a total of 17.1 million and 17.0 million OP Units, respectively, held by the limited partners of the Operating Partnership.

During the six months ended June 30, 2016 and 2015, our Operating Partnership issued an aggregate of 29,722 and 28,000 long-term incentive units (LTIP Units), respectively, to seven members of our board of directors. For additional information, refer to Note 15, 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. The Operating Partnership did not redeem any OP Units during the six months ended June 30, 2016. During the year ended December 31, 2015, we did not redeem any OP Units other than, in connection with the Reorganization: (1) 1,551,878 Class A OP Units held by Hunt-InfraREIT, which were exchanged with InfraREIT, Inc. for 1,551,878 shares of common stock of InfraREIT, Inc. and (2) 6,242,999 Class A OP Units in exchange for the assignment of a promissory note in the principal amount of \$66.5 million.

## 13. 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 common stock of InfraREIT, Inc. or common shares of InfraREIT, L.L.C., as applicable, if such redemption were dilutive. The redemption of OP Units would have been anti-dilutive during the three and six months ended June 30, 2016 and 2015.

Earnings per share are calculated as follows:

| (In thousands, except per share data)  | Three Months Ended June 30, |         | Six Months Ended June 30, |            |
|--|-----------------------------|---------|---------------------------|------------|
|  | 2016                        | 2015    | 2016                      | 2015       |
| Basic net income per share:  |                             |         |                           |            |
| Net income (loss) attributable to InfraREIT, Inc.  | \$6,608                     | \$6,362 | \$12,923                  | \$(20,511) |
| Weighted average common shares outstanding   | 43,576                      | 43,565  | 43,573                    | 42,391     |
| Basic net income (loss) per share  | \$0.15                      | \$0.15  | \$0.30                    | \$(0.48 )  |
| Diluted net income per share:  |                             |         |                           |            |
| Net income (loss) attributable to InfraREIT, Inc.  | \$6,608                     | \$6,362 | \$12,923                  | \$(20,511) |
| Weighted average common shares outstanding   | 43,576                      | 43,565  | 43,573                    | 42,391     |
| Redemption of operating partnership units  | —                           | —       | —                         | —          |
| Weighted average dilutive shares outstanding   | 43,576                      | 43,565  | 43,573                    | 42,391     |
| Diluted net income (loss) per share  | \$0.15                      | \$0.15  | \$0.30                    | \$(0.48 )  |
| Due to the anti-dilutive effect, the computation of diluted earnings per share does not reflect the following adjustments: |                             |         |                           |            |
| Net income (loss) attributable to noncontrolling interest  | \$2,576                     | \$2,481 | \$5,038                   | \$(6,519 ) |
| Redemption of operating partnership units  | 17,058                      | 17,028  | 17,057                    | 15,424     |

## 14. Leases

The following table shows the composition of our lease revenue:

| (In thousands)            | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
|---------------------------|-----------------------------|----------|---------------------------|----------|
|                           | 2016                        | 2015     | 2016                      | 2015     |
| Base rent (straight-line) | \$33,785                    | \$29,458 | \$67,450                  | \$58,830 |
| Percentage rent           | —                           | —        | —                         | —        |
| Total lease revenue       | \$33,785                    | \$29,458 | \$67,450                  | \$58,830 |

SDTS has entered into various leases with Sharyland for all of our placed in service T&D assets. The master lease agreements, as amended, expire at various dates from December 31, 2017 through December 31, 2022. Each agreement includes annual base rent while all but one agreement includes additional percentage rent (based on an agreed upon percentage of the gross revenue of Sharyland, as defined in the lease agreements, in excess of annual specified breakpoints). The rate used for percentage rent for the reported time periods varies by lease and ranges from a high of 37% 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 our revenue will grow over the year with little to no percentage rent recognized in the first and second quarters of each year and with the largest amounts recognized during the third and fourth quarters of each year.

### 15. Share-Based Compensation

We currently utilize the InfraREIT, Inc. 2015 Equity Incentive Plan (2015 Equity Incentive Plan) to compensate the non-employee directors for their service on our board of directors. In January 2016, we issued an aggregate of 4,735 shares of common stock and 29,722 LTIP Units to members of our board of directors with a grant date fair value of \$18.58 per common share or LTIP Unit and an aggregate fair value of \$0.6 million. The 29,722 LTIP Units will vest in January 2017, subject to continued service, and the 4,735 shares of common stock fully vested upon issuance. In April 2016, we issued 5,497 shares of common stock to members of our board of directors with a grant date fair value of \$16.81 per common share and an aggregate fair value of \$0.1 million. These shares of common stock fully vested upon issuance. In February 2015, an aggregate of 28,000 LTIP Units were issued by the Operating Partnership with a grant date fair value of \$26.41 per share to members of our board of directors which vested in full in February 2016. We recognized \$0.2 million of compensation expense in general and administrative expense on the Consolidated Statements of Operations during the three months ended June 30, 2016 and 2015. We recognized \$0.5 million and \$0.3 million of compensation expense in general and administrative expense on the Consolidated Statements of Operations during the six months June 30, 2016 and 2015, respectively, related to these equity awards.

### 16. Supplemental Cash Flow Information

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

| (In thousands)  | Six Months Ended |          |
|---|------------------|----------|
|   | June 30,<br>2016 | 2015     |
| Supplemental cash flow information  |                  |          |
| Cash paid during the period for interest  | \$15,745         | \$13,569 |
| Non-cash investing and financing activities   |                  |          |
| Change in accrued additions to electric plant   | 1,544            | 5,475    |
| Allowance for funds used during construction - debt                                   | 1,779            | 919      |
| Net non-cash equity issuances related to the Merger and Reorganization                | —                | 97,193   |
| Net non-cash noncontrolling equity issuances related to the Merger and Reorganization | —                | 119,607  |
| Non-cash noncontrolling interests equity issuance                                     | —                | 755      |
| Dividends and distributions payable   | 15,158           | 13,634   |



## 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 the "Explanatory Note" on page 5 and the Unaudited Consolidated Financial Statements and related notes beginning on page 6. This Item 2 contains "forward-looking" statements that involve risks and uncertainties. See Forward-Looking Statements at the beginning of this Quarterly Report on Form 10-Q.

### Overview

We own rate-regulated electric T&D assets in Texas as part of a dividend growth oriented real estate investment trust (REIT). Our assets are located in the Texas Panhandle near Amarillo, the Permian Basin in and around Stanton, Central Texas around Brady, Northeast Texas in and around Celeste and South Texas near McAllen. We have grown rapidly over the last several years, with our rate base increasing from approximately \$60 million as of December 31, 2009 to \$1.3 billion as of June 30, 2016. We expect that organic growth as well as potential acquisitions of T&D assets from Hunt, Sharyland or third parties will allow us to achieve continued growth in our rate base, which is calculated as our gross electric plant in service under accounting principles generally accepted in the United States of America (U.S. GAAP) less accumulated depreciation and adjusted for accumulated deferred income taxes.

We are externally managed by Hunt Manager. All of our officers are employees of Hunt Manager. We expect to benefit from the experience, skill, resources, relationships and contacts of the executive officers and key personnel of Hunt Manager. Pursuant to our management agreement with Hunt Manager, 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 Annual Report on Form 10-K for the fiscal year ended December 31, 2015, filed with the U.S. Securities and Exchange Commission (SEC) on March 3, 2016.

### Recent Events

On April 29, 2016, Sharyland filed a system-wide rate proceeding with the PUCT to update its rates. The timing and outcome of Sharyland's rate case and its effect on InfraREIT is uncertain. As part of the Sharyland rate case, the PUCT indicated that it intends to issue a preliminary order (Preliminary Order) on certain legal and policy issues related to our structure in advance of the final resolution of the rate case. The PUCT has not yet issued the Preliminary Order. In anticipation of the Preliminary Order, we have been, and continue to be, engaged in discussions with key constituencies, including the PUCT staff and intervenors, to develop and implement an approach to regulate Sharyland, SDTS and the leases in a manner that is consistent with applicable laws and regulations and is acceptable to us and these constituencies. However, it is possible that there could be changes to the manner in which we and Sharyland are regulated that could affect our business and operating results. For further information, see Part II, Item 1A., Risk Factors of this Quarterly Report on Form 10-Q.

## InfraREIT, Inc. Results of Operations

| (In thousands)  | Three Months<br>Ended June 30, |          | Six Months Ended<br>June 30, |            |
|---|--------------------------------|----------|------------------------------|------------|
|   | 2016                           | 2015     | 2016                         | 2015       |
| Lease revenue   |                                |          |                              |            |
| Base rent   | \$33,785                       | \$29,458 | \$67,450                     | \$58,830   |
| Percentage rent   | —                              | —        | —                            | —          |
| Total lease revenue   | 33,785                         | 29,458   | 67,450                       | 58,830     |
| Operating costs and expenses                                    |                                |          |                              |            |
| General and administrative expense                              | 4,980                          | 4,728    | 10,525                       | 53,461     |
| Depreciation  | 11,410                         | 9,671    | 22,484                       | 19,179     |
| Total operating costs and expenses                              | 16,390                         | 14,399   | 33,009                       | 72,640     |
| Income (loss) from operations                                   | 17,395                         | 15,059   | 34,441                       | (13,810)   |
| Other (expense) income  |                                |          |                              |            |
| Interest expense, net   | (9,055 )                       | (6,939 ) | (17,897 )                    | (14,361 )  |
| Other income, net   | 1,137                          | 847      | 1,896                        | 1,473      |
| Total other expense   | (7,918 )                       | (6,092 ) | (16,001 )                    | (12,888 )  |
| Income (loss) before income taxes                               | 9,477                          | 8,967    | 18,440                       | (26,698)   |
| Income tax expense  | 293                            | 124      | 479                          | 332        |
| Net income (loss)   | 9,184                          | 8,843    | 17,961                       | (27,030)   |
| Less: Net income (loss) attributable to noncontrolling interest | 2,576                          | 2,481    | 5,038                        | (6,519 )   |
| Net income (loss) attributable to InfraREIT, Inc.               | \$6,608                        | \$6,362  | \$12,923                     | \$(20,511) |

## Three Months Ended June 30, 2016 Compared to Three Months Ended June 30, 2015

Lease revenue — Lease revenue, consisting of only base rent, was \$33.8 million and \$29.5 million for the three months ended June 30, 2016 and 2015, respectively, representing an increase of \$4.3 million, or 14.6%. The increase in base rent was driven by the addition of assets under lease. There was no percentage rent recognized during the three months ended June 30, 2016 or 2015. See Note 14, Leases in the Notes to the Unaudited Consolidated Financial Statements for additional information. Because an annual specified breakpoint must be met under our leases before we can recognize any percentage rent, we anticipate our revenue will grow over the year with little to no percentage rent recognized in the first and second quarters of each year and with the largest amounts recognized during the third and fourth quarters of each year.

General and administrative expense — General and administrative expense was \$5.0 million and \$4.7 million for the three months ended June 30, 2016 and 2015, respectively, representing an increase of \$0.3 million, or 6.4%. The increase in general and administrative expense was primarily driven by an increase in management fees owed to Hunt Manager under our management agreement.

Depreciation — Depreciation expense was \$11.4 million and \$9.7 million for the three months ended June 30, 2016 and 2015, respectively, representing an increase of \$1.7 million, or 17.5%. The increase in depreciation expense was due to additional assets placed in service during 2016 and 2015.

Interest expense, net — Interest expense, net was \$9.1 million and \$6.9 million during the three months ended June 30, 2016 and 2015, respectively, representing an increase of \$2.2 million. The increase in interest expense, net was due to

the refinancing of our variable rate debt in December 2015 with fixed rate debt bearing a higher interest rate, plus higher average debt balances during the second quarter of 2016. The increase in interest expense, net was partially offset by an additional \$0.3 million of AFUDC on debt during 2016 compared to 2015 due to higher CWIP balances and applicable rates during 2016 compared to 2015. See Note 6, Borrowings Under Credit Facilities and Note 7, 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 \$0.8 million during the three months ended June 30, 2016 and 2015, respectively, representing an increase of \$0.3 million. The increase in other income, net was driven by an increase in AFUDC on other funds of \$0.2 million resulting from higher CWIP balances and applicable rates during 2016 compared to 2015.

Six Months Ended June 30, 2016 Compared to Six Months Ended June 30, 2015

Lease revenue — Lease revenue, consisting of only base rent, was \$67.5 million and \$58.8 million for the six months ended June 30, 2016 and 2015, respectively, representing an increase of \$8.7 million, or 14.8%. The increase in base rent was driven by the addition of assets under lease. There was no percentage rent recognized during the six months ended June 30, 2016 or 2015. See Note 14, Leases in the Notes to the Unaudited Consolidated Financial Statements for additional information. Because an annual specified breakpoint must be met under our leases before we can recognize any percentage rent, we anticipate our revenue will grow over the year with little to no percentage rent recognized in the first and second quarters of each year and with the largest amounts recognized during the third and fourth quarters of each year.

General and administrative expense — General and administrative expense was \$10.5 million and \$53.5 million for the six months ended June 30, 2016 and 2015, respectively, representing a decrease of \$43.0 million. During the first quarter of 2015, we incurred a \$44.9 million expense in connection with the issuance by InfraREIT, Inc. of common stock to Hunt-InfraREIT, L.L.C. (Hunt-InfraREIT), a subsidiary of HCI, as a non-cash reorganization advisory fee. We did not have a similar expense in 2016. The elimination of this \$44.9 million expense is partially offset by an increase of \$1.0 million in management fees owed to Hunt Manager under our management agreement, \$0.2 million of stock compensation expense and \$0.8 million of professional service fees. The increase in professional service fees was primarily due to the evaluation of two ROFO Projects by the Conflicts Committee of our board of directors and other public company expenses during the first quarter of 2016.

Depreciation — Depreciation expense was \$22.5 million and \$19.2 million for the six months ended June 30, 2016 and 2015, respectively, representing an increase of \$3.3 million, or 17.2%. The increase in depreciation expense was due to additional assets placed in service during 2016 and 2015.

Interest expense, net — Interest expense, net was \$17.9 million and \$14.4 million during the six months ended June 30, 2016 and 2015, respectively, representing an increase of \$3.5 million, or 24.3%. The increase in interest expense, net was due to the refinancing of our variable rate debt in December 2015 with fixed rate debt bearing a higher interest rate, plus higher average debt balances during 2016. The increase in interest expense, net was partially offset by an additional \$0.9 million of AFUDC on debt during 2016 compared to 2015 due to higher CWIP balances and applicable rates during 2016 compared to 2015. See Note 6, Borrowings Under Credit Facilities and Note 7, Long-Term Debt in the Notes to the Unaudited Consolidated Financial Statements for additional information.

Other income, net — Other income, net was \$1.9 million and \$1.5 million during the six months ended June 30, 2016 and 2015, respectively, representing an increase of \$0.4 million, or 26.7%. The increase in other income, net was driven by an increase in AFUDC on other funds of \$0.4 million resulting from higher CWIP balances and applicable rates during 2016 compared to 2015.

#### Liquidity and Capital Resources

As of June 30, 2016, we had \$10.8 million of unrestricted cash and cash equivalents. We use our cash on hand primarily for the payment of capital expenditures, operating expenses, debt service payments and dividend payments. As of June 30, 2016, we also had \$1.7 million of restricted cash and \$276.5 million of unused capacity under our revolving credit facilities.

We use our cash flows from operations and borrowings under our credit facilities to fund current obligations, projected working capital requirements, maturities of long-term debt, budgeted capital spending and the payment of dividends. We expect that we will be able to fund estimated capital expenditures associated with Footprint Projects through the end of 2018 without raising proceeds from additional equity offerings. However, if (1) we acquire T&D

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 capitalization or other requirements 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.

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 T&D assets. We fund Footprint Projects related to our T&D assets as we and Sharyland determine such Footprint Projects are required pursuant to the terms of our leases. To the extent we fund such Footprint Projects, Sharyland is required to lease the assets related to such Footprint Projects.

Management expects the future operating cash flows, along with access to financial markets, will be sufficient to meet any future operating requirements and forecasted capital investment opportunities. 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

Our total capital expenditures for the six months ended June 30, 2016 and 2015 were \$120.6 million and \$115.6 million, respectively. On an accrual basis, capital expenditures for the six months ended June 30, 2016 and 2015 were \$117.3 million and \$109.2 million, respectively. Capital expenditures on an accrual basis differ from our total capital expenditures and cash for additions to electric plant on the Consolidated Statements of Cash Flows due in part to differences in construction costs incurred during the period versus cash paid during the period.

We expect to have significant future capital expenditures as a result of the growth in Sharyland's service territory. During the fall of each year, Sharyland provides us a rolling three year budget that sets forth anticipated capital expenditures related to Footprint Projects. Additionally, Sharyland provides us a quarterly update to determine if any material changes to the budget have been identified. During this quarter's review, we widened our 2017 and 2018 forecasted capital expenditures range due to increased uncertainty in expected customer and load growth associated with current oil prices. As a result, we expect estimated Footprint Projects capital expenditures for the calendar years 2016 through 2018 in the range of \$590 million to \$740 million as more fully set forth in the table below. We intend to fund these capital expenditures with a mix of debt and cash flows from operations. Our three year capital expenditures forecast reflects estimates of the requirements to improve the reliability of our existing system and meet the identified and expected requirements of customers, reflecting the historical and estimated future growth in our service territories.

| (In millions)   | Years Ended December 31, |           |           |
|---|--------------------------|-----------|-----------|
|   | 2016                     | 2017      | 2018      |
| Total estimated Footprint Projects capital expenditures | \$220-240                | \$235-280 | \$135-220 |

Our expectation is based upon a variety of assumptions, including load growth, Sharyland's and our past experience, reliability needs and historical precedent. Although we believe these assumptions and estimates underlying the 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

We intend to target a payout ratio of 80-90% of our annual cash available for distribution through regular quarterly cash dividends. On June 3, 2016, our board of directors approved a cash distribution by our Operating Partnership to all unit holders of record on June 30, 2016 of \$0.25 per unit, or \$1.00 per unit on an annualized basis, for a total distribution of \$15.2 million (\$10.9 million to InfraREIT, Inc.). Also on June 3, 2016, our board of directors declared a cash dividend to stockholders of record of InfraREIT, Inc. on June 30, 2016 of \$0.25 per share of common stock, or \$1.00 per share on an annualized basis, for a total of \$10.9 million. The cash distribution and cash dividend were paid on July 21, 2016.

We paid a total of \$15.2 million and \$8.5 million in dividends and distributions during the three months ended June 30, 2016 and 2015, respectively. We paid a total of \$28.8 million and \$34.3 million in dividends and distributions during the six months ended June 30, 2016 and 2015, respectively. Of the \$34.3 million of dividends and distributions paid in the first half of 2015, \$25.8 million was paid prior to our IPO.

#### Credit Arrangements

We have two revolving credit facilities and senior secured notes. See Note 6, Borrowings Under Credit Facilities and Note 7, Long-Term Debt in the Notes to the Unaudited Consolidated Financial Statements for additional information.

### Operating Partnership Revolving Credit Facility

In 2014, our Operating Partnership 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 substantially all of the assets of the Operating Partnership. In addition, InfraREIT, Inc. and Transmission and Distribution Company, LLC (TDC), a subsidiary of our Operating Partnership, guarantee the revolving credit facility, and the TDC guarantee is secured by the assets of, and the Operating Partnership's equity interest in, TDC on materially the same basis as with TDC's senior secured notes described below.

The credit agreement requires our Operating Partnership to comply with coverage ratios on a consolidated basis and contains affirmative and negative covenants, including: 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 credit agreement also contains restrictions on the amount of Sharyland's indebtedness and other restrictions on, and covenants applicable to, Sharyland. The revolving credit facility is subject to customary events of default. If an event of default occurs or is continuing, the lenders may accelerate amounts due under the revolving credit facility (except in the case of a bankruptcy event of default, in which case such amounts will automatically become due and payable).

At June 30, 2016 and December 31, 2015, 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, 2016 and December 31, 2015, our Operating Partnership was in compliance with all covenants under the credit agreement.

### SDTS Revolving Credit Facility

SDTS is party to a revolving credit facility, led by Royal Bank of Canada, as administrative agent. Originally established in 2013, the credit facility permits SDTS to borrow up to \$250.0 million on a revolving basis. Up to \$25.0 million of the revolving credit facility is available for issuance of letters of credit, and up to \$5.0 million of the revolving credit facility is available for swingline loans. The revolving credit facility matures on December 10, 2019 and is secured by SDTS's T&D assets, our leases, certain accounts and TDC's equity interests in SDTS on the same basis as SDTS's various senior secured note obligations described below.

The SDTS revolving credit facility is subject to customary events of default. If an event of default occurs and is continuing, the lenders may accelerate amounts due under the SDTS revolving credit facility (except in the case of a bankruptcy event of default, in which case such amounts will automatically become due and payable).

At June 30, 2016, SDTS had \$48.5 million of borrowings outstanding at a weighted average interest rate of 2.21%, no letters of credit outstanding and \$201.5 million of remaining borrowing capacity available under this revolving credit facility. At December 31, 2015, SDTS had \$54.0 million of borrowings outstanding at a weighted average interest rate of 2.05% with no letters of credit outstanding and \$196.0 million of remaining borrowing capacity available under this revolving credit facility. As of June 30, 2016 and December 31, 2015, SDTS was in compliance with all covenants under its credit agreement.

### Senior Secured Notes

In connection with the acquisition of Cap Rock Holding Corporation (Cap Rock) 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, which mature on December 30, 2020. Principal and interest on these senior secured notes are payable quarterly and these senior secured notes are collateralized by the equity interests of TDC and certain accounts



of TDC. As of June 30, 2016, \$18.1 million of principal was outstanding under these senior secured notes.

In December 2015, SDTS issued \$400.0 million in 10 year senior secured notes, series A (Series A Notes), due December 3, 2025, and in January 2016 issued an additional \$100.0 million in 10 year senior secured notes, series B (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, 2016, \$400.0 million and \$100.0 million were outstanding under the Series A Notes and Series B Notes, respectively. The proceeds received in December 2015 from the issuance of the Series A Notes were used to repay the outstanding principal and interest on the Sharyland Projects, LLC (SPLLC) term loan described below, and the proceeds received from the January 2016 issuance of the Series B Notes were used to repay our outstanding balances on the SDTS revolving credit facility and for general operating purposes.

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), which mature on December 30, 2029. Principal and interest on these senior secured notes are payable quarterly. As of June 30, 2016, \$43.6 million of principal was outstanding under these senior secured notes. In connection with the acquisition of Cap Rock in 2010, our subsidiaries entered into several different debt arrangements, including \$110.0 million aggregate principal amount of 6.47% per annum senior secured notes SDTS issued to The Prudential Insurance Company of America (2010 Notes), which mature on September 30, 2030. Principal and interest on these senior secured notes are payable quarterly. As of June 30, 2016, \$99.5 million of principal was outstanding under these senior secured notes.

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.

The agreements governing the senior secured notes contain certain default triggers related to the failure to maintain compliance with financial and other covenants contained in the agreements, such as limitations on liens, investments and the incurrence of additional indebtedness. As of June 30, 2016 and December 31, 2015, SDTS and TDC were in compliance with all covenants under the applicable agreements.

#### CREZ Construction Loan

In 2011, SPLLC, at the time one of our subsidiaries, entered into a construction term loan agreement syndicated to a group of international banks, and issued fixed rate notes to The Prudential Insurance Company of America and affiliates (Fixed Rate Notes). In 2014, the construction term loan was converted into a term loan. In December 2015, the outstanding principal and interest on the term loan were paid in full with proceeds from SDTS's Series A Notes.

The Fixed Rate Notes have a principal balance of \$60.0 million which is due in full on June 20, 2018. Interest is payable quarterly at an interest rate of 5.04% per annum. The Fixed Rate Notes do not provide for any principal payments. In December 2015, the Fixed Rate Notes were assumed by SDTS in connection with the merger of SPLLC into SDTS. The carrying amount of the Fixed Rate Notes was \$60.0 million at June 30, 2016.

The credit agreement governing the Fixed Rate Notes contains certain default triggers related to the failure to maintain compliance with financial and other covenants contained in the agreements, such as limitations on liens, investments and the incurrence of additional indebtedness. SDTS was in compliance with all covenants for the Fixed Rate Notes as of June 30, 2016 and December 31, 2015.

The Series A Notes, Series B notes, 2009 Notes, 2010 Notes and Fixed Rate Notes are secured by SDTS's T&D assets, the leases, certain accounts and TDC's equity interests in SDTS on the same basis as SDTS's revolving credit facility described above.

#### Cash Flows

##### Six Months Ended June 30, 2016 Compared to Six Months Ended June 30, 2015

Cash flows from operating activities — Net cash provided by operating activities was \$60.5 million and \$51.0 million during the six months ended June 30, 2016 and 2015, respectively. The increase in net cash provided by operating activities related primarily to higher lease revenue during the six months ended June 30, 2016 compared to the same period of 2015, combined with more cash provided by working capital changes during the 2016 period compared to the 2015 period.

Cash flows from investing activities — Net cash used in investing activities was \$120.6 million and \$245.8 million during the six months ended June 30, 2016 and 2015, respectively. During the first six months of 2016, we used \$120.6 million for the capital expenditures related to the construction of our T&D assets compared to \$115.6 million during the same period of 2015. During the same period of 2015, we used \$172.4 million of our IPO proceeds as cash consideration in the Merger which was partially offset by our receipt of cash proceeds of \$41.2 million from the sale of the Cross Valley transmission line (Cross Valley Project) and Golden Spread Electric Cooperative interconnection (Golden Spread Project) to Hunt or one of its affiliates and our sale of marketable securities for cash of \$1.1 million. We did not have similar transactions during 2016.

Cash flows from financing activities — Net cash provided by financing activities was \$61.4 million and \$229.7 million during the six months ended June 30, 2016 and 2015, respectively. The decrease related primarily to our receipt of net cash proceeds of \$493.7 million from our IPO during the first quarter of 2015. We did not receive any cash proceeds from the issuance of equity during the first six months of 2016. Additionally, we had repayments of borrowings of \$262.6 million and dividends and distributions of \$34.3 million, partially offset by borrowings of \$33.0 million, during the six months ended June 30, 2015, compared to repayments of borrowings of \$60.0 million and payment of dividends and distributions of \$28.8 million, offset by borrowings of \$150.5 million, during the same period of 2016.

#### Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements as of June 30, 2016 and December 31, 2015.

#### Summary of Critical Accounting Policies and Estimates

The selection and application of accounting policies is an important process that has developed as our business activities have evolved and as the accounting rules have developed. Accounting rules generally do not involve a selection among alternatives, but involve an implementation and interpretation of existing rules, and the use of judgment regarding the specific set of circumstances existing in our business. Compliance with the rules necessarily involves reducing a number of very subjective judgments to a quantifiable accounting entry or valuation. We endeavor to properly comply with all applicable rules on or before their adoption, and we believe the proper implementation and consistent application of the accounting rules are critical.

For a description of our critical accounting policies and estimates, see Part II, Item 7., Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 1, Description of Business and Summary of Significant Accounting Policies in the Notes to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015, filed with the SEC on March 3, 2016. There have been no material changes to these policies during the six months ended June 30, 2016.

#### Reconciliations to Amounts Reported Under Generally Accepted Accounting Principals

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); cash available for distribution (CAD); earnings before interest, taxes, depreciation and amortization (EBITDA); EBITDA as adjusted in the manner described below (Adjusted EBITDA); funds from operations (FFO) and FFO adjusted in the manner described below (AFFO). We derive these measures as follows to appropriately show our core operational performance:

- We define non-GAAP net income as net income (loss) adjusted in a manner we believe is appropriate to show our core operational performance, including:
  - adding back the non-cash reorganization structuring fee;
  - adding back the reorganization expense related to our IPO and related reorganization transactions;
  - adding back the expense related to the contingent consideration issued as deemed capital credits;
  - a quarterly, not annual, adjustment for the difference between the amount of percentage rent payments we expect to receive with respect to the applicable period and the amount of percentage rent we recognize under U.S. GAAP during the period; and
  - 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.
- We define Non-GAAP EPS as non-GAAP net income (loss) divided by the weighted average shares outstanding calculated in the manner described in the footnotes in the Non-GAAP EPS reconciliation tables below.

We define CAD in a manner we believe is appropriate to show our core operational performance, which includes a deduction of the portion of capital expenditures needed to maintain our net assets. This deduction equals depreciation expense within the applicable period. The portion of capital expenditures in excess of depreciation, which we refer to as growth capital expenditures, will increase net assets. The CAD calculation also includes adjustments for the amortization of deferred financing costs and stock compensation expense along with various other adjustments from net income that are consistent with the adjustments made to Non-GAAP EPS, FFO or EBITDA, which are more fully explained above and below.

· We define EBITDA as net income (loss) before interest expense, net; income tax expense; depreciation and amortization.

- Adjusted EBITDA is defined as EBITDA adjusted in a manner we believe is appropriate to show our core operational performance, including:
- adding back the non-cash reorganization structuring fee;
- a quarterly, not annual, adjustment for the difference between the amount of percentage rent payments we expect to receive with respect to the applicable period and the amount of percentage rent we recognize under U.S. GAAP during the period;
- an adjustment for the difference between the amount of base rent payments we receive with respect to the applicable period and the amount of straight-line base rent recognized under U.S. GAAP;
- adding back the reorganization expense related to our IPO and related reorganization transactions; and
- adjusting for other income (expense), net.
- The National Association of Real Estate Investment Trusts (NAREIT) defines FFO as net income (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 for the same items that are used to adjust net income for Adjusted EBITDA.

Our management uses Non-GAAP EPS, CAD, EBITDA, Adjusted EBITDA, FFO and AFFO as important supplemental measures of our operating performance. For example, management uses the CAD measurement when recommending dividends to our board of directors. We also present our 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. We have a diverse set of investors, including investors that primarily focus on utilities, yieldcos, master limited partnerships (MLPs) or REITs. Our management believes that each of these different classes of investors focus on different types of metrics in the evaluation of us. For instance, many utility investors focus on earnings per share (EPS) and we believe our presentation of Non-GAAP EPS enables a better comparison to other utilities. Our management believes it is appropriate to calculate and provide these measures in order to be responsive to these investors. Including reporting on these measures in our public disclosures also enables that this information is available to all our investors. The presentation of Non-GAAP EPS, CAD, EBITDA, Adjusted EBITDA, 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 that do not use our same methodology. 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.

Non-GAAP EPS was \$0.30 per share for the three months ended June 30, 2016 and 2015. Non-GAAP EPS during the three months ended June 30, 2016 and 2015 was based on 60.6 million weighted average shares outstanding. For the three months ended June 30, 2016 and 2015, CAD was \$18.3 million, or \$0.30 per share.

Adjusted EBITDA was \$37.8 million for the three months ended June 30, 2016 compared to \$33.9 million for the three months ended June 30, 2015, representing an increase of \$3.9 million, or 11.5%. For the three months ended June 30, 2016, AFFO was \$28.5 million compared to \$26.8 million in the same period in 2015, representing an

increase of \$1.7 million, or 6.3%.

Non-GAAP EPS was \$0.61 per share for the six months ended June 30, 2016 compared to \$0.62 per share for the six months ended June 30, 2015, representing a decrease of 1.6%. Non-GAAP EPS during the six months ended June 30, 2016 and 2015 was based on 60.6 million and 57.8 million weighted average shares outstanding, respectively. For the six months ended June 30, 2016, CAD was \$37.6 million, or \$0.62 per share, compared to \$36.5 million, or \$0.60 per share, for the six months ended June 30, 2015.





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|   |          |        |          |        |
|---|----------|--------|----------|--------|
| Net income (loss)                         | 17,961   | 0.30   | (27,030) | (0.47) |
| Non-cash reorganization structuring fee   | —        | —      | 44,897   | 0.78   |
| Reorganization expenses                   | —        | —      | 333      | —      |
| Percentage rent adjustment <sup>(1)</sup> | 13,036   | 0.21   | 12,559   | 0.22   |
| Base rent adjustment <sup>(2)</sup>       | 5,998    | 0.10   | 5,131    | 0.09   |
| Non-GAAP net income                       | \$36,995 | \$0.61 | \$35,890 | \$0.62 |

- (1) Represents the difference between the amount of percentage rent payments and the amounts recognized during the applicable period, if, any. Although we receive percentage rent payments related to each quarter, we do not recognize lease revenue related to percentage rent payments until our tenant's annual gross revenues exceed minimum specified annual breakpoints under the leases.
- (2) This adjustment relates to the difference between the timing of cash base rent payments made under our leases and when we recognize base rent revenue under U.S. GAAP. We recognize base rent on a straight-line basis over the applicable term of the lease commencing when the related assets are placed in service, which is frequently different than the period in which the cash base rent becomes due.
- (3) The weighted average common shares outstanding during the applicable periods of 43.6 million was used to calculate net income attributable to InfraREIT, Inc. per diluted share. The weighted average redeemable partnership units outstanding during the applicable periods of 17.0 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 during the applicable periods of 60.6 million was used for the remainder of the per share calculations.

- (4) The weighted average common shares outstanding 42.4 million was used to calculate net loss attributable to InfraREIT, Inc. per diluted share. The weighted average redeemable partnership units outstanding of 15.4 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 57.8 million was used for the remainder of the per share calculations.

## CAD

The following sets forth a reconciliation of net income (loss) to CAD:

| (In thousands, except share amounts, unaudited) | Three Months Ended  |                     | Six Months Ended    |                     |
|---|---------------------|---------------------|---------------------|---------------------|
|   | June 30,            | 2015                | June 30,            | 2015                |
| Net income (loss)                               | \$9,184             | \$8,843             | \$17,961            | \$(27,030)          |
| Depreciation                                    | 11,410              | 9,671               | 22,484              | 19,179              |
| Non-cash reorganization structuring fee         | —                   | —                   | —                   | 44,897              |
| Percentage rent adjustment <sup>(1)</sup>       | 6,046               | 6,095               | 13,036              | 12,559              |
| Base rent adjustment <sup>(2)</sup>             | 2,963               | 3,068               | 5,998               | 5,131               |
| Amortization of deferred financing costs        | 1,004               | 912                 | 2,007               | 1,824               |
| Reorganization expenses                         | —                   | —                   | —                   | 333                 |
| Non-cash equity compensation                    | 228                 | 185                 | 520                 | 308                 |
| Other income, net <sup>(3)</sup>                | (1,137 )            | (847 )              | (1,896 )            | (1,473 )            |
| Capital expenditures to maintain net assets     | (11,410)            | (9,671 )            | (22,484)            | (19,179)            |
| CAD   | \$18,288            | \$18,256            | \$37,626            | \$36,549            |
| Shares (mm of shares) <sup>(4)</sup>            | 60.6 <sup>(5)</sup> | 60.6 <sup>(6)</sup> | 60.6 <sup>(7)</sup> | 60.6 <sup>(6)</sup> |
| CAD per share                                   | \$0.30              | \$0.30              | \$0.62              | \$0.60              |

(1) See footnote (1) to the reconciliation of Non-GAAP EPS above.

(2) See footnote (2) to the reconciliation of Non-GAAP EPS above.

(3) Includes AFUDC on other funds of \$1.1 million and \$0.9 million for the three months ended June 30, 2016 and 2015, respectively, and \$1.9 million and \$1.5 million for the six months ended June 30, 2016 and 2015, respectively.

(4) Beginning with the quarter ended March 31, 2016, we changed our methodology for calculating the share amount from an outstanding share amount at the end of the respective time period to the weighted average shares outstanding during the respective time period to be consistent with our other per share calculations. Calculations for periods ended prior to March 31, 2016 will continue using the shares outstanding at the end of the respective time period.

(5) Consists of 43.6 million weighted average common shares outstanding and 17.0 million weighted average redeemable partnership units outstanding during the three months ended June 30, 2016.

(6) Consists of 43.6 million outstanding shares and 17.0 million redeemable partnership units outstanding as of June 30, 2015.

(7) Consists of 43.6 million weighted average common shares outstanding and 17.0 million weighted average redeemable partnership units outstanding during the six months ended June 30, 2016.

## EBITDA and Adjusted EBITDA

The following sets forth a reconciliation of net income (loss) to EBITDA and Adjusted EBITDA:

| (In thousands, unaudited)                 | Three Months<br>Ended June 30, |          | Six Months Ended<br>June 30, |            |
|---|--------------------------------|----------|------------------------------|------------|
|   | 2016                           | 2015     | 2016                         | 2015       |
| Net income (loss)                         | \$9,184                        | \$8,843  | \$17,961                     | \$(27,030) |
| Interest expense, net                     | 9,055                          | 6,939    | 17,897                       | 14,361     |
| Income tax expense                        | 293                            | 124      | 479                          | 332        |
| Depreciation                              | 11,410                         | 9,671    | 22,484                       | 19,179     |
| EBITDA                                    | 29,942                         | 25,577   | 58,821                       | 6,842      |
| Non-cash reorganization structuring fee   | —                              | —        | —                            | 44,897     |
| Percentage rent adjustment <sup>(1)</sup> | 6,046                          | 6,095    | 13,036                       | 12,559     |
| Base rent adjustment <sup>(2)</sup>       | 2,963                          | 3,068    | 5,998                        | 5,131      |
| Reorganization expenses                   | —                              | —        | —                            | 333        |
| Other income, net <sup>(3)</sup>          | (1,137 )                       | (847 )   | (1,896 )                     | (1,473 )   |
| Adjusted EBITDA                           | \$37,814                       | \$33,893 | \$75,959                     | \$68,289   |

(1) See footnote (1) to the reconciliation of Non-GAAP EPS above.

(2) See footnote (2) to the reconciliation of Non-GAAP EPS above.

(3) See footnote (3) to the reconciliation of CAD above.

## FFO

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

| (In thousands, unaudited)                 | Three Months<br>Ended June 30, |          | Six Months Ended<br>June 30, |            |
|---|--------------------------------|----------|------------------------------|------------|
|   | 2016                           | 2015     | 2016                         | 2015       |
| Net income (loss)                         | \$9,184                        | \$8,843  | \$17,961                     | \$(27,030) |
| Depreciation                              | 11,410                         | 9,671    | 22,484                       | 19,179     |
| FFO                                       | 20,594                         | 18,514   | 40,445                       | (7,851 )   |
| Non-cash reorganization structuring fee   | —                              | —        | —                            | 44,897     |
| Percentage rent adjustment <sup>(1)</sup> | 6,046                          | 6,095    | 13,036                       | 12,559     |
| Base rent adjustment <sup>(2)</sup>       | 2,963                          | 3,068    | 5,998                        | 5,131      |
| Reorganization expenses                   | —                              | —        | —                            | 333        |
| Other income, net <sup>(3)</sup>          | (1,137 )                       | (847 )   | (1,896 )                     | (1,473 )   |
| AFFO                                      | \$28,466                       | \$26,830 | \$57,583                     | \$53,596   |

(1) See footnote (1) to the reconciliation of Non-GAAP EPS above.

(2) See footnote (2) to the reconciliation of Non-GAAP EPS above.

(3) See footnote (3) to the reconciliation of CAD above.

## Financial Information Related to Our Tenant

We have legal title to our T&D 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 T&D assets. These rights and obligations constitute continuing involvement, which results in failed sale-leaseback financing accounting with respect to the lease of our T&D 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 T&D assets currently under construction. Consequently, our T&D assets, including any T&D 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 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, calculated in accordance with U.S. GAAP.
- Sharyland's non-GAAP net income, which is calculated by adding the amount of depreciation expense 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 rather than U.S. GAAP basis.
- Sharyland's non-GAAP net income 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.
- 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.

Sharyland acquired the Golden Spread Project in March 2016 and the Cross Valley Project in May 2016. These acquisitions were accounted for as a combination of entities under common control whereby the net assets acquired were combined with Sharyland at their carrying value. Balance sheet information as of December 31, 2015 and income statement information for the periods ended June 30, 2015 have been adjusted to reflect the acquisitions of the Golden Spread Project and Cross Valley Project. Accordingly, the non-GAAP reconciliations presented below give effect to the Golden Spread Project and Cross Valley Project acquisitions.

| (In thousands)                                    | Three Months Ended June 30, |           | Six Months Ended June 30, |          |
|---|-----------------------------|-----------|---------------------------|----------|
|   | 2016                        | 2015      | 2016                      | 2015     |
| Net income (loss)                                 | \$264                       | \$(3,109) | \$4,026                   | \$967    |
| Failed sale-leaseback adjustments:                |                             |           |                           |          |
| Add: Failed sale-leaseback depreciation expense   | 7,700                       | 6,400     | 15,200                    | 12,800   |
| Add: Failed sale-leaseback interest expense       | 34,500                      | 30,400    | 67,400                    | 59,400   |
| Deduct: Rent expense                              | 43,000                      | 38,300    | 86,200                    | 76,300   |
| Sharyland's management reported net (loss) income | (536)                       | (4,609)   | 426                       | (3,133)  |
| Adjustments:                                      |                             |           |                           |          |
| Add: Interest expense, net                        | 736                         | 664       | 83                        | 1,041    |
| Add: Income tax expense                           | 360                         | 438       | 717                       | 915      |
| Add: Depreciation and amortization                | 2,188                       | 1,225     | 4,356                     | 2,443    |
| Add: Rent expense                                 | 43,000                      | 38,300    | 86,200                    | 76,300   |
| EBITDAR   | \$45,748                    | \$36,018  | \$91,782                  | \$77,566 |
| Ratio of EBITDAR to rent expense                  | 1.06x                       | 0.94x     | 1.06x                     | 1.02x    |

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|   | June 30, 2016      |                       |                   |
|---|--------------------|-----------------------|-------------------|
|   | U.S.               |                       |                   |
|   | GAAP               | Failed Sale-          | Non-GAAP          |
|   | Balance            | Leaseback             | Balance           |
| (In thousands)  | Sheet              | Adjustments           | Sheet             |
| <b>Assets</b>   |                    |                       |                   |
| Current assets  | \$71,376           | \$—                   | \$ 71,376         |
| Property, plant and equipment, net                                    | 1,750,320          | (1,475,564 )          | 274,756           |
| Goodwill  | 1,100              | —                     | 1,100             |
| Deferred charges - regulatory assets, net                             | 39,478             | (23,419 )             | 16,059            |
| <b>Total Assets</b>   | <b>\$1,862,274</b> | <b>\$(1,498,983 )</b> | <b>\$ 363,291</b> |
| <b>Partners' Capital and Liabilities</b>                              |                    |                       |                   |
| <b>Current liabilities:</b>   |                    |                       |                   |
| Accounts payable and accrued liabilities                              | \$49,355           | \$—                   | \$ 49,355         |
| Current portion of financing obligation                               | 34,505             | (34,505 )             | —                 |
| Due to affiliates   | 26,761             | —                     | 26,761            |
| Revolving line of credit  | 5,000              | —                     | 5,000             |
| Fair value of derivatives   | 105                | —                     | 105               |
| Current state margin tax payable                                      | 947                | —                     | 947               |
| <b>Total current liabilities</b>                                      | <b>116,673</b>     | <b>(34,505 )</b>      | <b>82,168</b>     |
| Long-term financing obligations                                       | 1,465,533          | (1,465,533 )          | —                 |
| Long-term debt  | 149,700            | —                     | 149,700           |
| Regulatory liabilities  | 6,110              | —                     | 6,110             |
| Other post-employment benefits (OPEB) and other long-term liabilities | 8,570              | —                     | 8,570             |
| <b>Total liabilities</b>  | <b>1,746,586</b>   | <b>(1,500,038 )</b>   | <b>246,548</b>    |
| Commitments and contingencies   | 1,163              | —                     | 1,163             |
| Partners' capital   | 114,525            | 1,055                 | 115,580           |
| <b>Total Partners' Capital and Liabilities</b>                        | <b>\$1,862,274</b> | <b>\$(1,498,983 )</b> | <b>\$ 363,291</b> |

|   | December 31, 2015  |                       |                   |
|---|--------------------|-----------------------|-------------------|
|   | U.S.               |                       |                   |
|   | GAAP               | Failed Sale-          | Non-GAAP          |
|   | Balance            | Leaseback             | Balance           |
| (In thousands)                            | Sheet              | Adjustments           | Sheet             |
| <b>Assets</b>                             |                    |                       |                   |
| Current assets                            | \$108,970          | \$—                   | \$ 108,970        |
| Property, plant and equipment, net        | 1,615,831          | (1,375,976 )          | 239,855           |
| Goodwill                                  | 1,100              | —                     | 1,100             |
| Deferred charges - regulatory assets, net | 37,758             | (23,045 )             | 14,713            |
| <b>Total Assets</b>                       | <b>\$1,763,659</b> | <b>\$(1,399,021 )</b> | <b>\$ 364,638</b> |

## Partners' Capital and Liabilities

|  |             |                |            |
|--|-------------|----------------|------------|
| Current liabilities:                     |             |                |            |
| Accounts payable and accrued liabilities | \$68,106    | \$—            | \$ 68,106  |
| Current portion of financing obligation  | 32,006      | (32,006 )      | —          |
| Due to affiliates                        | 27,085      | —              | 27,085     |
| Fair value of derivatives                | 32          | —              | 32         |
| Current state margin tax payable         | 1,545       | —              | 1,545      |
| Total current liabilities                | 128,774     | (32,006 )      | 96,768     |
| Long-term financing obligations          | 1,371,502   | (1,371,502 )   | —          |
| Long-term debt                           | 166,700     | —              | 166,700    |
| Regulatory liabilities                   | 5,940       | —              | 5,940      |
| OPEB and other long-term liabilities     | 8,787       | —              | 8,787      |
| Total liabilities                        | 1,681,703   | (1,403,508 )   | 278,195    |
| Commitments and contingencies            | 1,163       | —              | 1,163      |
| Partners' capital                        | 80,793      | 4,487          | 85,280     |
| Total Partners' Capital and Liabilities  | \$1,763,659 | \$(1,399,021 ) | \$ 364,638 |

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

We have floating rate debt under our revolving credit facilities and are exposed to changes in interest rates on this indebtedness. The credit markets have recently experienced historical lows in interest rates. As the overall economy strengthens, it is possible that monetary policy will continue to tighten further, resulting in higher interest rates to counter possible inflation. Interest 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, 2016, the outstanding balance on our revolving credit facilities was \$48.5 million. A hypothetical increase or decrease in interest rates by 1.00% would have changed our interest expense by \$0.1 million and \$0.2 million for the three and six months ended June 30, 2016, 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, 2016 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

We are not a party to any legal proceedings other than legal proceedings arising in the ordinary course of our business. 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

The risk factor below amends and restates the corresponding risk factor previously disclosed in Part I, Item 1A., Risk Factors of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015 and our Quarterly Report on Form 10-Q for the three months ended March 31, 2016.

Our T&D assets and our tenant's operations are subject to governmental regulation and oversight that could adversely impact our expected returns and operating results.

Both Sharyland and SDTS, our subsidiary, are regulated by the PUCT, and decisions by the PUCT, including in some circumstances in which we are not involved directly as a party, can directly impact our business. Although rate regulation is premised on the timely recovery of prudently incurred costs and the opportunity to earn a reasonable rate of return on invested capital, there is no assurance that the PUCT will determine that all of our rate base can be recovered through Sharyland's rates, or that the PUCT will not otherwise make regulatory determinations that adversely affect our T&D assets or Sharyland's operations. The PUCT could, among other things, determine that certain capital expenditures should not be included in our tenant's rates, or the PUCT could challenge other regulatory judgments, such as those related to affiliate charges, operations and maintenance expenses, tax elections, rate case expenses, regulatory assets and other matters. Sharyland filed a rate case with the PUCT on April 29, 2016, and the PUCT's consideration of this rate case is ongoing. The timing and outcome of Sharyland's rate case is uncertain. Recent events, including

complaints from ratepayers in Sharyland's service territory regarding Sharyland's delivery rates, have placed Sharyland under heightened scrutiny and may affect the outcome of the rate case. Any adverse determinations by the PUCT could adversely affect the amount of percentage rent we receive as well as Sharyland's ability to meet its obligations to pay us rent pursuant to the leases. Such determinations are likely to affect the rental rates to which Sharyland will agree upon any extension or renewal of a lease or the negotiation of an amended lease supplement. Furthermore, if the PUCT made a determination that adversely affected our rate base, and as a result, Sharyland was unable to meet its rent obligations and we terminated the related lease, it is unlikely that the replacement tenant would be willing to pay us rent for anything other than the PUCT approved rate base amount. Also, if the PUCT makes a determination that adversely affects the amount of our rate base, we may need to take accounting charges that impair our assets, which could further adversely affect our results of operations and financial condition.

As part of the Sharyland rate case, the PUCT indicated it intends to rule on the following legal and policy issues, among others, in a Preliminary Order in advance of the final resolution of the rate case: (1) whether our leases with Sharyland are tariffs under the Texas Public Utility Regulatory Act (PURA) that are explicitly subject to regulation by the PUCT; (2) whether the PUCT has the authority to treat SDTS and Sharyland as one combined entity for ratemaking and regulatory purposes; and (3) whether the restructuring order we received from the PUCT in 2008 (2008 Restructuring Order) is binding if the PUCT now determines it to be contrary to PURA. The PUCT has not yet issued a Preliminary Order. Under the 2008 Restructuring Order, our leases with Sharyland are not considered tariffs and the rate case filing that Sharyland made on April 29, 2016 presented the combined books and records of SDTS and Sharyland, consistent with the requirements of the 2008 Restructuring Order applicable to us. However, in anticipation of the Preliminary Order, we have been, and continue to be, engaged in discussions with key constituencies, including the PUCT staff and intervenors, to develop and implement an approach to regulate Sharyland, SDTS and the leases in a manner that is consistent with applicable laws and regulations and is acceptable to us and these constituencies. There can be no assurance, however, that our discussions will be successful, and it is possible that, if the Preliminary Order changes the manner in which we and Sharyland are regulated, the process implemented for regulating the leases as tariffs and establishing rates for SDTS and Sharyland on a standalone rather than combined basis could result in regulatory requirements that materially and adversely affect our business. For instance, the PUCT could require us to reset the lease payments under our leases with Sharyland or make other changes to our leasing relationship with Sharyland. These or other changes mandated by the PUCT in the Preliminary Order could materially and adversely affect our operating results and financial condition, impair Sharyland's profitability and financial condition, challenge our ability to continue to operate as a REIT under applicable tax laws or otherwise materially and adversely affect our business.

In addition, compliance with U.S federal, state and local laws and regulations, including laws and regulations related to regulatory, environmental and human health and safety matters may cause us or our tenant to incur significant additional costs, and failure to comply with these requirements could result in the shutdown of the non-complying assets and the imposition of liens, fines and/or civil or criminal liability. Utility operations may also be affected by legislative and regulatory changes, as well as changes to market design, market rules, tariffs and cost allocation by ERCOT, the PUCT or FERC. We cannot predict what effect any such changes in the regulatory environment will have on us or Sharyland's operations.

There have been no other material changes in our risk factors during the three months ended June 30, 2016 from those previously disclosed in Part I, Item 1A., Risk Factors of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015 and in Part II, Item 1A., Risk Factors of our Quarterly Report on Form 10-Q for the quarter ended March 31, 2016 (March 2016 10-Q). You should carefully consider the risk factors discussed in our 2015 Form 10-K, March 2016 10-Q and above, 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

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Item 6. Exhibits

| Exhibit Number | Description   |
|----------------|---|
| 3.1            | —Articles of Restatement of the Registrant (filed as exhibit 3.3 to the Company’s Current Report on Form 8-K dated March 9, 2015 and filed March 10, 2015 and incorporated herein by reference).                |
| 3.2            | —Amended and Restated Bylaws of the Registrant (filed as exhibit 3.5 to Amendment No. 1 to the Company’s Registration Statement on Form S-11 filed December 31, 2014 and incorporated herein by reference).     |
| 10.1*          | —First Amendment to Tenth Amended and Restated Rent Supplement (McAllen Lease), dated June 20, 2016, between Sharyland Distribution & Transmission Services, L.L.C. and Sharyland Utilities, L.P.               |
| 10.2*          | —First Amendment to Tenth Amended and Restated Rent Supplement (Stanton/Brady/Celeste Lease), dated June 20, 2016, between Sharyland Distribution & Transmission Services, L.L.C. and Sharyland Utilities, L.P. |
| 10.3*          | —First Amendment to Eighth Amended and Restated Rent Supplement (CREZ Lease), dated June 20, 2016, between Sharyland Distribution & Transmission Services, L.L.C. and Sharyland Utilities, L.P.                 |
| 10.4*          | —First Amendment to Fifth Amended and Restated Rent Supplement (ERCOT Transmission Lease), dated June 20, 2016, between Sharyland Distribution & Transmission Services, L.L.C. and Sharyland Utilities, L.P.    |
| 31.1*          | —Rule 13A-14(a)/15d-14(a) Certification of Chief Executive Officer  |
| 31.2*          | —Rule 13A-14(a)/15d-14(a) Certification of Chief Financial Officer  |
| 32.1*          | —Section 1350 Certification of Chief Executive Officer  |
| 32.2*          | —Section 1350 Certification of Chief Financial Officer  |
| 99.1*          | —Consolidated Financial Statements of Sharyland Utilities, L.P. as of June 30, 2016   |
| 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 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/ Brant Meleski

Date: August 3, 2016 Brant Meleski  
Senior Vice President and Chief Financial Officer  
(Principal Financial Officer)

/s/ Lance J. Phillips

Date: August 3, 2016 Lance J. Phillips  
Vice President, Principal Accounting Officer and Controller  
(Principal Accounting Officer)