InfraREIT, Inc.
Form 10-Q
November 01, 2018

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 September 30, 2018

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ___________ to ___________

Commission file number: 001-36822

InfraREIT, Inc.

(Exact name of Registrant as specified in its charter)

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

1900 North Akard Street

Dallas, Texas 75201	75201
(Address of Principal Executive Offices)	(Zip Code)

(214) 855-6700

(Registrant's Telephone Number, Including Area Code)

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

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

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

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

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

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

As of October 29, 2018, 43,962,167 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 defined terms used herein.

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

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FORWARD-LOOKING STATEMENTS

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

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

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

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

Forward-looking statements speak only as of the date on which they are made. While we may update these statements from time to time, we are not required to do so other than pursuant to applicable laws. For a further discussion of these and other factors that could impact our future results and performance, see Part I, Item 1A., Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2017, filed with the U.S. Securities and Exchange Commission (SEC) on March 5, 2018 (2017 Form 10-K) and Part II, Item 1A., Risk Factors of this Quarterly Report on Form 10-Q.

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements
InfraREIT, Inc.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	September 30, 2018 (Unaudited)	December 31, 2017
Assets		
Current Assets		
Cash and cash equivalents	$3,223	$2,867
Restricted cash	1,687	1,683
Due from affiliates	33,401	35,172
Inventory	7,592	6,759
Prepaids and other current assets	1,041	2,460
Total current assets	46,944	48,941
Electric Plant, net	1,800,517	1,772,229
Goodwill	138,384	138,384
Other Assets	31,771	34,314
Total Assets	$2,017,616	$1,993,868
Liabilities and Equity		
Current Liabilities		
Accounts payable and accrued liabilities	$28,345	$21,230
Short-term borrowings	101,000	41,000
Current portion of long-term debt	8,667	68,305
Dividends and distributions payable	15,176	15,169
Accrued taxes	748	5,633
Total current liabilities	153,936	151,337
Long-Term Debt, Less Deferred Financing Costs	834,693	841,215
Regulatory Liabilities	111,811	100,458
Total liabilities	1,100,440	1,093,010
Commitments and Contingencies		
Equity		
Common stock, $0.01 par value; 450,000,000 shares authorized; 43,962,167 and 43,796,915 issued and outstanding as of September 30, 2018 and December 31, 2017, respectively	440	438
Additional paid-in capital	709,488	706,357
Accumulated deficit	(38,229)	(49,728)
Total InfraREIT, Inc. equity	671,699	657,067
Noncontrolling interest	245,477	243,791
Total equity	917,176	900,858

Total Liabilities and Equity	$2,017,616	$1,993,868

See accompanying notes to the unaudited consolidated financial statements.

InfraREIT, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Lease revenue	$48,926	$51,618	$142,409	$131,664
Operating costs and expenses				
General and administrative expense	6,787	6,718	19,506	19,565
Depreciation	12,063	13,328	35,632	38,997
Total operating costs and expenses	18,850	20,046	55,138	58,562
Income from operations	30,076	31,572	87,271	73,102
Other (expense) income				
Interest expense, net	(10,120)	(10,357)	(31,864)	(30,196)
Other income, net	7	331	1,114	351
Total other expense	(10,113)	(10,026)	(30,750)	(29,845)
Income before income taxes	19,963	21,546	56,521	43,257
Income tax expense (benefit)	257	308	(4,885)	873
Net income	19,706	21,238	61,406	42,384
Less: Net income attributable to noncontrolling interest	5,435	5,908	16,937	11,797
Net income attributable to InfraREIT, Inc.	$14,271	$15,330	$44,469	$30,587
Net income attributable to InfraREIT, Inc. common stockholders per share:				
Basic	$0.32	$0.35	$1.01	$0.70
Diluted	$0.32	$0.35	$1.01	$0.70
Cash dividends declared per common share	$0.25	$0.25	$0.75	$0.75

See accompanying notes to the unaudited consolidated financial statements.

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InfraREIT, Inc.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands, except share data)

(Unaudited)

	Number of Common Shares Outstanding	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Total InfraREIT, Inc Equity	Noncontrolling Interest	Total Equity
Balance December 31, 2017	43,796,915	438	706,357	(49,728)	657,067	243,791	900,858
Dividends and distributions	—	—	—	(10,990)	(10,990)	(4,186)	(15,176)
Redemption of operating partnership units for common stock	163,969	2	3,104	—	3,106	(3,106)	—
Net income	—	—	—	12,864	12,864	4,900	17,764
Equity based compensation	—	—	—		—	140	140
Balance March 31, 2018	43,960,884	440	709,461	(47,854)	662,047	241,539	903,586
Dividends and distributions	—	—	—	(10,990)	(10,990)	(4,186)	(15,176)
Redemption of operating partnership units for common stock	1,283	—	27	—	27	(27)	—
Net income	—	—	—	17,334	17,334	6,602	23,936
Equity based compensation	—	—	—	—	—	180	180
Balance June 30, 2018	43,962,167	440	709,488	(41,510)	668,418	244,108	912,526
Dividends and distributions	—	—	—	(10,990)	(10,990)	(4,186)	(15,176)
Net income	—	—	—	14,271	14,271	5,435	19,706
Equity based compensation	—	—	—	—	—	120	120
Balance September 30, 2018	43,962,167	$ 440	$ 709,488	$ (38,229)	$ 671,699	$ 245,477	$ 917,176
Balance December 31, 2016	43,772,283	$ 438	$ 705,845	$ (18,243)	$ 688,040	$ 255,871	$ 943,911
Dividends and distributions	—	—	—	(10,944)	(10,944)	(4,225)	(15,169)
Redemption of operating partnership units for common stock	3,100	—	55	—	55	(55)	—
Net income	—	—	—	7,949	7,949	3,068	11,017

Equity based compensation	—	—	—	—	—	140	140
Balance March 31, 2017	43,775,383	438	705,900	(21,238)	685,100	254,799	939,899
Dividends and distributions	—	—	—	(10,944)	(10,944)	(4,225)	(15,169)
Redemption of operating partnership units for common stock	3,107	—	55	—	55	(55)	—
Net income	—	—	—	7,308	7,308	2,821	10,129
Equity based compensation	—	—	—	—	—	145	145
Balance June 30, 2017	43,778,490	438	705,955	(24,874)	681,519	253,485	935,004
Dividends and distributions	—	—	—	(10,950)	(10,950)	(4,219)	(15,169)
Redemption of operating partnership units for common stock	17,142	—	382	—	382	(382)	—
Net income	—	—	—	15,330	15,330	5,908	21,238
Equity based compensation	—	—	—	—	—	143	143
Balance September 30, 2017	43,795,632	$ 438	$ 706,337	$ (20,494)	$ 686,281	$ 254,935	$ 941,216

See accompanying notes to the unaudited consolidated financial statements.

InfraREIT, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Cash flows from operating activities		
Net income	$61,406	$42,384
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	35,632	38,997
Amortization of deferred financing costs	2,568	3,101
Allowance for funds used during construction - other funds	(1,094)	(318)
Equity based compensation	440	428
Changes in assets and liabilities:		
Due from affiliates	1,624	4,036
Inventory	(833)	95
Prepaids and other current assets	(66)	(27)
Accounts payable and accrued liabilities	(590)	334
Net cash provided by operating activities	99,087	89,030
Cash flows from investing activities		
Additions to electric plant	(48,653)	(147,803)
Proceeds from asset exchange transaction	1,632	—
Net cash used in investing activities	(47,021)	(147,803)
Cash flows from financing activities		
Proceeds from short-term borrowings	118,000	110,500
Repayments of short-term borrowings	(58,000)	(213,000)
Proceeds from borrowings of long-term debt	—	200,000
Repayments of long-term debt	(66,185)	(5,845)
Deferred financing costs	—	(809)
Dividends and distributions paid	(45,521)	(45,499)
Net cash (used in) provided by financing activities	(51,706)	45,347
Net increase (decrease) in cash, cash equivalents and restricted cash	360	(13,426)
Cash, cash equivalents and restricted cash at beginning of period	4,550	19,294
Cash, cash equivalents and restricted cash at end of period	$4,910	$5,868

See accompanying notes to the unaudited consolidated financial statements.

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InfraREIT, Inc.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

InfraREIT, Inc. is a Maryland corporation, which may be referred to in these financial statements as the “Company,” “InfraREIT,” “we,” “us” and “our.” These unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. For further information, refer to the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the U.S. Securities and Exchange Commission (SEC) on March 5, 2018 (2017 Form 10-K).

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

Use of Estimates

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

Recent Accounting Guidance

Recently Adopted Accounting Guidance

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers. ASU 2014-09 requires revenue to be recognized when promised goods or services are transferred to customers in an amount that reflects the expected consideration for these goods and services. As part of this guidance, lease transactions have been excluded from the requirements of this standard. We adopted this guidance on January 1, 2018, and it had no impact on our financial position, results of operations and cash flows.

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

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 203): Restricted Cash (A Consensus of the FASB Emerging Issues Task Force). ASU 2016-18 adds to or clarifies current guidance on the classification and presentation of restricted cash in the statement of cash flows. The new guidance requires entities to include in their cash and cash equivalent balances in the statement of cash flows those amounts that are deemed to be restricted cash and restricted cash equivalents. We adopted the guidance on January 1, 2018 and have adjusted all periods presented for the change in presentation of restricted cash on our Consolidated Statement of Cash Flows.

Recent Accounting Guidance Not Yet Adopted

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). ASU 2016-02 amended the existing accounting standard for lease accounting, including requiring lessees to recognize all leases on their balance sheets with terms of more than 12 months and making targeted changes to lessor accounting. In January 2018, the FASB issued ASU 2018-01, Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842. ASU 2018-01 permits an entity to elect to not evaluate land easements under ASU 2016-02 that exist or expired before the entity's adoption of ASU 2016-02 and that were not previously considered leases. The guidance under these standards is effective for periods beginning after December 15, 2018, with early adoption permitted. In July 2018, the FASB issued ASU 2018-11, Leases (Topic 842): Targeted Improvements which provides an additional transition method. This transition method allows an entity to initially apply the new lease standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. We will adopt the new guidance using this transition method as of January 1, 2019. We believe the adoption of new guidance will have a minimal impact on our financial position, results of operations and cash flows due to the limited changes related to lessor transactions. However, additional disclosures are required, and full annual disclosures are required for each interim period of 2019.

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

2. 2017 Asset Exchange Transaction

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

3. Cash, Cash Equivalents and Restricted Cash

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

(In thousands)	September 30, 2018	2017
Cash and cash equivalents	$3,223	$4,186
Restricted cash	1,687	1,682
Total cash, cash equivalents and restricted cash shown on the Statement of Cash Flows	$4,910	$5,868

Amounts included in restricted cash represent the principal and interest payable for two consecutive periods associated with the $25.0 million senior secured notes of the Operating Partnership’s wholly-owned subsidiary, Transmission and Distribution Company, L.L.C. (TDC), as described in Note 9, Long-Term Debt.

4. Related Party Transactions
We lease, through SDTS, all our regulated assets to Sharyland through several lease agreements. Under the leases, we have agreed to fund capital expenditures for footprint projects. Our leases define “footprint projects” to be transmission or, if applicable, distribution projects that (1) are primarily situated within our current or previous distribution service territory, as applicable, (2) physically hang from our existing transmission assets, such as the addition of another circuit to our existing transmission lines, or that are physically located within one of our substations or (3) connect or are otherwise added to transmission lines or other properties that comprise a part of the transmission assets acquired in the 2017 Asset Exchange Transaction.

We earned lease revenue from Sharyland under these agreements of $48.9 million and $51.6 million during the three months ended September 30, 2018 and 2017, respectively. We earned lease revenue of $142.4 million and $131.7 million from Sharyland during the nine months ended September 30, 2018 and 2017, respectively. In connection with our leases with Sharyland, we had a deferred rent liability of $14.6 million and $14.7 million as of September 30, 2018 and December 31, 2017, respectively, which is included in accounts payable and accrued liabilities on the Consolidated Balance Sheets.

In addition to rent payments that Sharyland makes to us, we and Sharyland also make payments to each other under the leases that primarily consist of payments to reimburse Sharyland for the costs of gross plant and equipment added to our regulated assets. For the nine months ended September 30, 2018 and 2017, the net amount of payments we made to Sharyland was $48.3 million and $151.2 million, respectively.

In July 2017, SDTS and Sharyland entered into a letter agreement (Side Letter) in which they agreed to certain terms and conditions to address the actual or potential conflicts of interest arising between SDTS and Sharyland in connection with the 2017 Asset Exchange Transaction. Specifically, the Side Letter includes, among other things, certain representations and warranties from Sharyland that correspond to representations and warranties of SDTS under the 2017 Asset Exchange Agreement relating to certain matters for which SDTS relies, in whole or in part, upon Sharyland under the leases and as operator of the assets and an allocation of expenses incurred in connection with the transactions. For information related to the 2017 Asset Exchange Transaction, see Note 2, 2017 Asset Exchange Transaction.

As of September 30, 2018 and December 31, 2017, accounts payable and accrued liabilities on the Consolidated Balance Sheets included $5.0 million and $2.1 million, respectively, related to amounts owed to Sharyland for construction costs incurred and property taxes paid on our behalf. As of September 30, 2018 and December 31, 2017, amounts due from affiliates on the Consolidated Balance Sheets included $33.4 million and $35.2 million, respectively, related to amounts owed by Sharyland primarily associated with our leases.

The management fee paid to Hunt Utility Services, LLC (Hunt Manager) for the nine months ended September 30, 2018 and 2017 was $10.3 million and $14.1 million, respectively. There were no prepaid or accrued amounts associated with the management fees on the Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017. As of December 31, 2016, there was $3.5 million accrued associated with management fees on the Consolidated Balance Sheets. Additionally, during the nine months ended September 30, 2018 and 2017, we paid Hunt Manager $0.1 million and $0.2 million, respectively, for reimbursement of annual software license and maintenance fees and other expenses in accordance with our management agreement.

Our management agreement with Hunt Manager provides for an annual base fee, or management fee. The base fee for each 12 month period beginning each April 1 will equal 1.50% of our total equity as of December 31 of the immediately preceding year, subject to a $30.0 million cap. The term of the management agreement expires December 31, 2019 and will automatically renew for successive five year terms unless a majority of our independent directors decides to terminate the agreement.

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

(In millions)	Base Fee
April 1, 2016 - March 31, 2017	$14.0
April 1, 2017 - March 31, 2018	14.2
April 1, 2018 - March 31, 2019	13.5

For information related to the pending sale of InfraREIT and asset exchange with Sharyland, including the proposed termination of the leases and management agreement, see Note 20, Subsequent Events.

5. Electric Plant and Depreciation
The major classes of electric plant are as follows:

(In thousands)	September 30, 2018	December 31, 2017
Electric plant:		
Transmission plant	$1,784,175	$1,685,466
Distribution plant	151,458	143,865
General plant	3,023	3,023
Total plant in service	1,938,656	1,832,354
Construction work in progress	60,027	113,643
Total electric plant	1,998,683	1,945,997
Accumulated depreciation	(198,166)	(173,768)
Electric plant, net	$1,800,517	$1,772,229

General plant consists primarily of a warehouse, buildings and associated assets. Construction work in progress (CWIP) reflects the regulated asset projects in various stages of construction prior to being placed in service. The capitalized amounts of CWIP consist primarily of route development expenditures, labor and materials expenditures, right of way acquisitions, engineering services and legal fees. Electric plant, net includes plant acquisition adjustments of $28.6 million and $29.4 million as of September 30, 2018 and December 31, 2017, respectively.

6. Goodwill
Goodwill represents the excess of costs of an acquired business over the fair value of the assets acquired, less liabilities assumed. We conduct an impairment test of goodwill at least annually. As of September 30, 2018 and December 31, 2017, $138.4 million was recorded as goodwill on the Consolidated Balance Sheets.

7. Other Assets
Other assets are as follows:

	September 30, 2018			December 31, 2017		
	Gross		Net	Gross		Net
	Carrying	Accumulated	Carrying	Carrying	Accumulated	Carrying
(In thousands)	Amount	Amortization	Amount	Amount	Amortization	Amount

Deferred financing costs on undrawn revolver	$967	$ (736)	$231	$967	$ (591)	$376
Other regulatory assets:						
Deferred financing costs	10,365	(5,137)	5,228	28,570	(20,944)	7,626
Deferred costs recoverable in future years	23,793	—	23,793	23,793	—	23,793
Other regulatory assets	34,158	(5,137)	29,021	52,363	(20,944)	31,419
Investments	2,519	—	2,519	2,519	—	2,519
Other assets	$37,644	$ (5,873)	$31,771	$55,849	$ (21,535)	$34,314

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

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

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

Deferred costs recoverable in future years of $23.8 million as of September 30, 2018 and December 31, 2017 represent operating costs incurred from the inception of Sharyland through 2007. We have determined that these costs are probable of recovery through future rates based on orders of the 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, we received a participation in the National Rural Utilities Cooperative Finance Corporation. We account for this investment under the cost method of accounting. We believe that the investment is not impaired as of September 30, 2018 and December 31, 2017.

8. Borrowings Under Credit Facilities

InfraREIT LP Revolving Credit Facility

In 2014, InfraREIT LP entered into a $75.0 million revolving credit facility, led by Bank of America, N.A., as administrative agent, with up to $15.0 million available for issuance of letters of credit and a maturity date of December 10, 2019. The revolving credit facility is secured by certain assets of InfraREIT LP, including accounts and other personal property, and is guaranteed by us and TDC, with the TDC guarantee secured by the assets of, and InfraREIT LP’s equity interests in, TDC on materially the same basis as TDC’s senior secured notes described below in Note 9, Long-Term Debt.

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

As of September 30, 2018 and December 31, 2017, there were no borrowings or letters of credit outstanding and there was $75.0 million of borrowing capacity available under the revolving credit facility. As of September 30, 2018 and December 31, 2017, InfraREIT LP was in compliance with all debt covenants under the credit agreement.

SDTS Revolving Credit Facility

In 2014, SDTS entered into the third amended and restated credit agreement led by Royal Bank of Canada, as administrative agent, with a maturity date of December 10, 2019. The credit agreement contains a revolving credit facility with a borrowing capacity up to $250.0 million with up to $25.0 million of the revolving credit facility available for issuance of letters of credit and up to $5.0 million of the revolving credit facility available for swingline loans. The revolving credit facility is secured by certain of SDTS’s regulated assets, the leases, certain accounts and TDC’s equity interests in SDTS on the same basis as SDTS’s various senior secured note obligations described below in Note 9, Long-Term Debt.

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

As of September 30, 2018, SDTS had $101.0 million of borrowings outstanding at a weighted average interest rate of 4.21%, no letters of credit outstanding and $149.0 million of borrowing capacity available under this revolving credit facility. As of December 31, 2017, SDTS had $41.0 million of borrowings outstanding at a weighted average interest rate of 3.12% with no letters of credit outstanding and $209.0 million of borrowing capacity available under this revolving credit facility. As of September 30, 2018 and December 31, 2017, SDTS was in compliance with all debt covenants under the credit agreement.

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

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

9. Long-Term Debt

Long-term debt consisted of the following:

(Dollar amounts in thousands)	Maturity Date	September 30, 2018 Amount Outstanding	September 30, 2018 Interest Rate	December 31, 2017 Amount Outstanding	December 31, 2017 Interest Rate
TDC					
Senior secured notes - $25.0 million	December 30, 2020	$15,313	8.50%	$16,250	8.50%
SDTS					
Senior secured notes - $60.0 million	June 20, 2018	—	n/a	60,000	5.04%
Senior secured term loan - $200.0 million	June 5, 2020	200,000	3.42%	200,000	2.71%
Senior secured notes - $400.0 million	December 3, 2025	400,000	3.86%	400,000	3.86%
Senior secured notes - $100.0 million	January 14, 2026	100,000	3.86%	100,000	3.86%
Senior secured notes - $53.5 million	December 30, 2029	38,905	7.25%	40,546	7.25%
Senior secured notes - $110.0 million	September 30, 2030	89,214	6.47%	92,821	6.47%
Total SDTS debt		828,119		893,367	
Total long-term debt		843,432		909,617	
Less unamortized deferred financing costs		(72)		(97)	
Total long-term debt, less deferred financing costs		843,360		909,520	
Less current portion of long-term debt		(8,667)		(68,305)	
Debt classified as long-term debt, less deferred financing costs		$834,693		$841,215	

In 2010, TDC issued $25.0 million aggregate principal amount of 8.50% per annum senior secured notes to The Prudential Insurance Company of America and affiliates (TDC Notes). Principal and interest on the TDC Notes are payable quarterly, and the TDC Notes are secured by the assets of, and InfraREIT LP's equity interest in, TDC on materially the same basis as with lenders under InfraREIT LP's revolving credit facility described above in Note 7, Borrowings Under Credit Facilities. In connection with the issuance of the TDC Notes, TDC incurred deferred financing costs, which are shown as a reduction of the senior secured notes balance. The amount of unamortized deferred financing costs associated with the TDC Notes was $0.1 million as of September 30, 2018 and December 31, 2017.

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

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

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

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

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

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

The agreements governing the senior secured notes and 2017 Term Loan contain customary covenants, such as debt to capitalization ratios, debt service coverage ratios, limitations on liens, dispositions, mergers, entry into other lines of business, investments and the incurrence of additional indebtedness. The debt to capitalization ratios are calculated on a combined basis with Sharyland. SDTS's Series A Notes and Series B Notes are not required to maintain a debt service coverage ratio. As of September 30, 2018 and December 31, 2017, SDTS and TDC were in compliance with all debt covenants under the applicable agreements. See Note 20, Subsequent Events for information related to the pending sale of InfraREIT and asset exchange with Sharyland.

SDTS's Series A Notes, Series B Notes, 2009 Notes, 2010 Notes and 2017 Term Loan are, and the 2011 Notes were, secured by certain of SDTS's regulated assets, the leases, certain accounts and TDC's equity interests in SDTS on the same basis as SDTS's revolving credit facility described above in Note 8, Borrowings Under Credit Facilities.

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

10. Fair Value of Financial Instruments

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

We had fixed interest rate borrowings totaling $643.4 million and $709.6 million under our senior secured notes with a weighted average interest rate of 4.5% and 4.6% per annum as of September 30, 2018 and December 31, 2017, respectively. The fair value of these borrowings was estimated using discounted cash flow analysis based on current market rates.

As of September 30, 2018 and December 31, 2017, we had $200.0 million of borrowings under our 2017 Term Loan that accrues interest under a floating interest rate structure, which is typically repriced every month or three months. Accordingly, the carrying value of such indebtedness approximated its fair value for the amounts outstanding.

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

	Carrying	Fair Value		
(In thousands)	Value	Level 1	Level 2	Level 3
September 30, 2018				
Long-term debt	$843,432	$—	$859,303	$ —
December 31, 2017				

Long-term debt	$909,617	$—	$950,522	$ —

11. Regulatory Matters
Regulatory Liability

Regulatory liabilities are as follows:

(In thousands)	September 30, 2018	December 31, 2017
Cost of removal	$ 56,032	$ 44,679
Excess ADFIT	55,779	55,779
Regulatory liabilities	$ 111,811	$ 100,458

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

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

Rate Case Filing

In January 2014, the PUCT approved a rate case (2013 Rate Case) filed by Sharyland applicable to our regulated assets providing for a capital structure consisting of 55% debt and 45% equity; a cost of debt of 6.73%; a return on equity of 9.70%; and a return on invested capital of 8.06% in calculating rates. The new rates became effective May 1, 2014. Under the order approving the 2013 Rate Case, Sharyland was required to file its next rate case in 2016 (2016 Rate Case). In November 2017, the 2016 Rate Case was dismissed resulting in the 2013 Rate Case regulatory parameters remaining in place. As part of the PUCT order approving the 2017 Asset Exchange Transaction, the PUCT also granted SDTS a CCN to continue to own and lease its assets to Sharyland. Under existing PUCT orders, SDTS and Sharyland are required to file a new rate case by July 1, 2020 using the test year ending December 31, 2019.

12. Commitments and Contingencies

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

13. Equity

We and the Operating Partnership declared cash dividends on common stock and distributions on OP Units of $0.75 per share or unit, as applicable, during each of the nine months ended September 30, 2018 and 2017. We paid a total of $45.5 million in dividends and distributions during each of the nine months ended September 30, 2018 and 2017.

14. Noncontrolling Interest

We present as a noncontrolling interest the portion of any equity in entities that we control and consolidate but do not own. Generally, OP Units of our Operating Partnership participate in net income allocations and distributions and entitle their holder to the right, subject to the terms set forth in the partnership agreement, to require the Operating Partnership to redeem all or a portion of the OP Units held by such limited partner. At our option, we may satisfy this redemption requirement with cash or by exchanging shares of InfraREIT, Inc. common stock on a one-for-one basis. As of September 30, 2018 and December 31, 2017, there were a total of 16.7 million and 16.9 million OP Units, respectively, held by the limited partners of the Operating Partnership.

During the nine months ended September 30, 2018 and 2017, an aggregate of 28,952 and 31,633 long-term incentive units (LTIP Units), respectively, were issued by the Operating Partnership to members of our board of directors. For additional information, refer to Note 17, Share-Based Compensation.

We follow the guidance issued by the FASB regarding the classification and measurement of redeemable securities. Accordingly, we have determined that the OP Units meet the requirements to be classified as permanent equity. During the nine months ended September 30, 2018, we redeemed 165,252 OP Units with the issuance of 165,252 shares of common stock. We redeemed 23,349 OP Units with the issuance of 23,349 shares of common stock during the nine months ended September 30, 2017.

15. Earnings Per Share

Basic earnings per share is calculated by dividing net earnings after noncontrolling interest by the weighted average shares outstanding. Diluted earnings per share is calculated similarly, except that it includes the dilutive effect of the assumed redemption of OP Units for shares of our common stock, if such redemption were dilutive. The redemption of OP Units would have been anti-dilutive during the three and nine months ended September 30, 2018 and 2017.

Earnings per share are calculated as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands, except per share data)	2018	2017	2018	2017
Basic net income per share:				
Net income attributable to InfraREIT, Inc.	$14,271	$15,330	$44,469	$30,587
Weighted average common shares outstanding	43,962	43,784	43,919	43,779
Basic net income per share	$0.32	$0.35	$1.01	$0.70
Diluted net income per share:				
Net income attributable to InfraREIT, Inc.	$14,271	$15,330	$44,469	$30,587
Weighted average common shares outstanding	43,962	43,784	43,919	43,779
Redemption of Operating Partnership units	—	—	—	—
Weighted average dilutive shares outstanding	43,962	43,784	43,919	43,779
Diluted net income per share	$0.32	$0.35	$1.01	$0.70
Due to the anti-dilutive effect, the computation of diluted earnings per share does not reflect the following adjustments:				
Net income attributable to noncontrolling interest	$5,435	$5,908	$16,937	$11,797
Redemption of Operating Partnership units	16,742	16,891	16,785	16,896

16. Leases

The following table shows the composition of our lease revenue:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2018	2017	2018	2017
Base rent (straight-line)	$48,390	$42,336	$141,873	$122,382
Percentage rent	536	9,282	536	9,282
Total lease revenue	$48,926	$51,618	$142,409	$131,664

SDTS has entered into various leases with Sharyland for all our placed in service regulated assets. The master lease agreements, as amended, expire at various dates from December 31, 2019 through December 31, 2022. Our leases primarily consist of base rent, but certain lease supplements contain percentage rent as well. The lease supplements governing the Stanton Transmission Loop, Permian Basin assets and assets acquired in the 2017 Asset Exchange Transaction, which are part of the competitive renewable energy zones (CREZ) assets, only provide for base rent. Rent for the assets in McAllen and the CREZ assets not acquired in the 2017 Asset Exchange Transaction is comprised primarily of base rent but also includes percentage rent. Prior to its termination on December 31, 2017, the lease that previously covered the Permian Basin assets as well as the assets in Brady and Celeste, Texas that were transferred to Oncor in the 2017 Asset Exchange Transaction also included a percentage rent component. Percentage rent under our leases is based on a percentage of Sharyland's annual gross revenue, as defined in the applicable lease, in excess of annual specified breakpoints, which are at least equal to the base rent under each lease.

The rate used for percentage rent for the reported time periods varies by lease and ranges from a high of 31% to a low of 23%. Because an annual specified breakpoint must be met under our leases before we can recognize any percentage rent, we anticipate that little to no percentage rent will be recognized in the first and second quarters of each year, with the largest amounts of percentage rent recognized during the third and fourth quarters of each year.

See Note 20, Subsequent Events for information related to the pending sale of InfraREIT and asset exchange with Sharyland, including the proposed termination of the leases.

17. Share-Based Compensation

We currently utilize the InfraREIT, Inc. 2015 Equity Incentive Plan primarily for the annual compensation of the non-executive directors for their service on our board of directors. The following table shows the aggregate LTIP Units issued to members of our board of directors during the nine months ended September 30, 2018 and 2017:

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

As part of our board of directors' quarterly compensation, each non-executive director can, subject to certain exceptions, elect to receive part of their compensation in our common stock instead of cash with full vesting upon issuance. During 2017 and 2018, all directors elected to receive their quarterly compensation in cash. The compensation expense, which represents the fair value of the stock or LTIP Unit measured at market price at the date of grant, is recognized on a straight-line basis over the vesting period. For each of the three months ended September 30, 2018 and 2017, $0.1 million was recognized as compensation expense related to these grants and is included in general and administrative expense on the Consolidated Statements of Operations. We recognized $0.4 million of compensation expense during each of the nine months ended September 30, 2018 and 2017. The unamortized compensation expense related to these grants was $0.1 million as of September 30, 2018.

18. Income Taxes

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

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

(In thousands)	September 30, 2018	December 31, 2017

Balance at beginning of period	$ 4,864	$ 3,827
Additions based on tax positions related to the current year	—	1,037
Settlements	(4,864)	—
Balance at end of period	$ —	$ 4,864

As a result of the Texas franchise tax settlement, we began accruing and paying Texas franchise tax on our gross lease revenues effective January 1, 2018.

19. Supplemental Cash Flow Information

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

	Nine Months Ended September 30,	
(In thousands)	2018	2017
Supplemental cash flow information		
Cash paid for interest	$28,317	$26,004
Non-cash investing and financing activities		
Change in accrued additions to electric plant	(2,943)	8,901
Allowance for funds used during construction - debt	1,971	2,261
Redemption of operating partnership units for common stock	3,133	492
Dividends and distributions payable	15,176	15,169

20. Subsequent Events
Pending Corporate Transactions

Sale and Asset Exchange

On October 18, 2018, InfraREIT and InfraREIT LP entered into a definitive agreement to be acquired by Oncor for $21.00 per share or OP Unit, as applicable, in cash, valued at approximately $1.275 billion, plus the assumption of our net debt of approximately $940 million as of September 30, 2018. As a condition to Oncor's acquisition of InfraREIT, SDTS and Oncor also signed a definitive agreement with Sharyland to exchange, immediately prior to Oncor's acquisition, SDTS's South Texas assets for Sharyland's Golden Spread Electric Cooperative interconnection located in the Texas Panhandle, along with certain development projects in the Texas Panhandle and South Plains regions, including the Lubbock Power & Light interconnection. The difference between the net book value of the exchanged assets will be paid in cash at closing. SDTS and Sharyland have agreed to terminate their existing leases in connection with the asset exchange.

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

Arrangements with Hunt

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

Closing Conditions

The closing of the transactions is dependent upon and will be subject to several closing conditions, including: PUCT approval of the transactions; other regulatory approvals; stockholder approval; certain lender consents; the substantially concurrent closing of the acquisition by an affiliate of Sempra Energy of a 50% limited partnership interest in Sharyland Holdings, LP, which will own a 100% interest in Sharyland; and other customary closing conditions.

Timeline

Under the definitive agreements, SDTS, Sharyland and Oncor are required to file a Sale-Transfer-Merger application with the PUCT no later than November 30, 2018. A special meeting of our stockholders will be held following the filing of the definitive proxy statement with the SEC and subsequent mailing to our stockholders, which is expected to be filed by December 10, 2018. The transactions are expected to close by mid-2019.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
This item contains a discussion of our business, including a general overview of our properties, results of operations, liquidity and capital resources and quantitative and qualitative disclosures about market risk.

The following discussion should be read in conjunction with Part II, Item 7., Management's Discussion and Analysis of Financial Condition and Results of Operations of our 2017 Form 10-K and the unaudited consolidated financial statements and related notes beginning on page 5. This Item 2 contains "forward-looking" statements that involve risks and uncertainties. See Forward-Looking Statements at the beginning of this Quarterly Report on Form 10-Q.

Overview

We are engaged in owning and leasing rate-regulated assets in Texas. We are structured as a REIT and lease all our regulated assets to Sharyland, a Texas-based regulated electric utility. Currently, our assets are located in the Texas Panhandle; near Wichita Falls, Abilene and Brownwood; in the Permian Basin; and in South Texas. We were formed in 2009 and have grown our rate base from approximately $60 million as of December 31, 2009 to $1.5 billion as of September 30, 2018.

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

For a description of our business model and other significant components of our results of operations, see Part II, Item 7., Management's Discussion and Analysis of Financial Condition and Results of Operations of our 2017 Form 10-K.

Recent Events

Pending Corporate Transactions

Sale and Asset Exchange

On October 18, 2018, InfraREIT and InfraREIT LP entered into a definitive agreement to be acquired by Oncor for $21.00 per share or OP Unit, as applicable, in cash, valued at approximately $1.275 billion, plus the assumption of our net debt of approximately $940 million as of September 30, 2018. Oncor has obtained equity financing commitments from Sempra Energy and the owners of Texas Transmission Investment LLC to provide an aggregate equity contribution of approximately $1.3 billion to finance the acquisition of InfraREIT and pay certain related fees and expenses.

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

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

Arrangements with Hunt

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

Agreements among Hunt, Oncor and Sempra Energy

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

Solicitation of Additional Offers

The merger agreement with Oncor includes a "go-shop" provision that allows our Conflicts Committee and their advisors to actively solicit and negotiate with other potential acquirers to determine whether they are interested in making a proposal to acquire InfraREIT. Accordingly, we will solicit competing acquisition proposals through November 17, 2018. If our Conflicts Committee and board of directors accept a superior proposal prior to December 27, 2018 that was received during the go-shop period, then we would pay a termination fee to Oncor of approximately $19 million. If our Conflicts Committee and board of directors accept an unsolicited superior proposal received after the go-shop period, we would be required to pay a termination fee to Oncor of approximately $45 million. There can be no assurance that the go-shop process set forth in the merger agreement will result in a superior proposal.

Transaction Approvals and Closing Conditions

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

- PUCT approval of the transactions, including:
- exchange of assets with Sharyland;
- acquisition of InfraREIT by Oncor; and
- Sempra Energy's indirect 50% ownership of Sharyland Holdings
- other necessary regulatory approvals, including Federal Energy Regulatory Commission (FERC) approval, Hart-Scott-Rodino clearance and the Committee on Foreign Investment in the United States (CFIUS) clearance;
- stockholder approval;
- certain lender consents; and
- other customary closing conditions.

Under the definitive agreements, SDTS, Sharyland and Oncor are required to file a Sale-Transfer-Merger application with the PUCT no later than November 30, 2018. A special meeting of our stockholders will be held following the filing of the definitive proxy statement with the SEC and subsequent mailing to our stockholders, which is expected to be filed by December 10, 2018. The transactions are expected to close by mid-2019.

Results of Operations

(In thousands)	Three Months Ended September 30, 2018	2017	Nine Months Ended September 30, 2018	2017
Lease revenue				
Base rent	$48,390	$42,336	$141,873	$122,382
Percentage rent	536	9,282	536	9,282
Total lease revenue	48,926	51,618	142,409	131,664
Operating costs and expenses				
General and administrative expense	6,787	6,718	19,506	19,565
Depreciation	12,063	13,328	35,632	38,997
Total operating costs and expenses	18,850	20,046	55,138	58,562
Income from operations	30,076	31,572	87,271	73,102
Other (expense) income				
Interest expense, net	(10,120)	(10,357)	(31,864)	(30,196)
Other income, net	7	331	1,114	351
Total other expense	(10,113)	(10,026)	(30,750)	(29,845)
Income before income taxes	19,963	21,546	56,521	43,257
Income tax expense (benefit)	257	308	(4,885)	873
Net income	19,706	21,238	61,406	42,384