

EPR PROPERTIES

Form 10-Q

April 30, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2019

or

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

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

Commission file number: 001-13561

EPR PROPERTIES

(Exact name of registrant as specified in its charter)

Maryland 43-1790877

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

909 Walnut Street, Suite 200  
Kansas City, Missouri 64106

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (816) 472-1700

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 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

At April 29, 2019, there were 75,495,804 common shares outstanding.

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## CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

With the exception of historical information, certain statements contained or incorporated by reference herein may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), such as those pertaining to our acquisition or disposition of properties, our capital resources, future expenditures for development projects, and our results of operations and financial condition. Forward-looking statements involve numerous risks and uncertainties and you should not rely on them as predictions of actual events. There is no assurance the events or circumstances reflected in the forward-looking statements will occur. You can identify forward-looking statements by use of words such as “will be,” “intend,” “continue,” “believe,” “may,” “expect,” “hope,” “anticipate,” “goal,” “forecast,” “pipeline,” “estimates,” “offers,” “plans,” “would,” or other similar expressions or other comparable terms or phrases in our discussions of strategy, plans or intentions in this Quarterly Report on Form 10-Q. In addition, references to our budgeted amounts and guidance are forward-looking statements.

Factors that could materially and adversely affect us include, but are not limited to, the factors listed below:

• Global economic uncertainty and disruptions in financial markets;

• Reduction in discretionary spending by consumers;

• Adverse changes in our credit ratings;

• Fluctuations in interest rates;

• Defaults in the performance of lease terms by our tenants;

• Defaults by our customers and counterparties on their obligations owed to us;

• A borrower's bankruptcy or default;

• Our ability to renew maturing leases on terms comparable to prior leases and/or our ability to locate substitute lessees for these properties on economically favorable terms;

• Risks of operating in the entertainment industry;

• Our ability to compete effectively;

• Risks associated with a single tenant representing a substantial portion of our lease revenues;

• The ability of our public charter school tenants to comply with their charters and continue to receive funding from local, state and federal governments, the approval by applicable governing authorities of substitute operators to assume control of any failed public charter schools and our ability to negotiate the terms of new leases with such substitute tenants on acceptable terms;

• The ability of our build-to-suit tenants to achieve sufficient operating results within expected timeframes and therefore have capacity to pay their agreed upon rent;

• The ability of our early childhood education tenant, Children's Learning Adventure, to successfully transition our properties to one or more third party operators;

• Risks associated with potential criminal proceedings against one of our waterpark mortgagors and certain related parties, which could negatively impact the likelihood of repayment of the related mortgage loans secured by the waterpark and other collateral;

• Risks relating to our tenants' exercise of purchase options or borrowers' exercise of prepayment options related to our education properties;

• Risks associated with our dependence on third-party managers to operate certain of our recreation anchored lodging properties;

• Risks associated with our level of indebtedness;

• Risks associated with use of leverage to acquire properties;

• Financing arrangements that require lump-sum payments;

• Our ability to raise capital;

• Covenants in our debt instruments that limit our ability to take certain actions;

• The concentration and lack of diversification of our investment portfolio;

• Our continued qualification as a real estate investment trust for U.S. federal income tax purposes and related tax matters;

• The ability of our subsidiaries to satisfy their obligations;

Financing arrangements that expose us to funding or purchase risks;

Our reliance on a limited number of employees, the loss of which could harm operations;

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Risks associated with the employment of personnel by managers of our recreation anchored lodging properties;  
Risks associated with security breaches and other disruptions;  
Changes in accounting standards that may adversely affect our financial statements;  
Fluctuations in the value of real estate income and investments;  
Risks relating to real estate ownership, leasing and development, including local conditions such as an oversupply of space or a reduction in demand for real estate in the area, competition from other available space, whether tenants and users such as customers of our tenants consider a property attractive, changes in real estate taxes and other expenses, changes in market rental rates, the timing and costs associated with property improvements and rentals, changes in taxation or zoning laws or other governmental regulation, whether we are able to pass some or all of any increased operating costs through to tenants or other customers, and how well we manage our properties;  
Our ability to secure adequate insurance and risk of potential uninsured losses, including from natural disasters;  
Risks involved in joint ventures;  
Risks in leasing multi-tenant properties;  
A failure to comply with the Americans with Disabilities Act or other laws;  
Risks of environmental liability;  
Risks associated with the relatively illiquid nature of our real estate investments;  
Risks with owning assets in foreign countries;  
Risks associated with owning, operating or financing properties for which the tenants', mortgagors' or our operations may be impacted by weather conditions and climate change;  
Risks associated with the development, redevelopment and expansion of properties and the acquisition of other real estate related companies;  
Our ability to pay dividends in cash or at current rates;  
Fluctuations in the market prices for our shares;  
Certain limits on changes in control imposed under law and by our Declaration of Trust and Bylaws;  
Policy changes obtained without the approval of our shareholders;  
Equity issuances that could dilute the value of our shares;  
Future offerings of debt or equity securities, which may rank senior to our common shares;  
Risks associated with changes in foreign exchange rates; and  
Changes in laws and regulations, including tax laws and regulations.

Our forward-looking statements represent our intentions, plans, expectations and beliefs and are subject to numerous assumptions, risks and uncertainties. Many of the factors that will determine these items are beyond our ability to control or predict. For further discussion of these factors see Item 1A - "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2018 filed with the Securities and Exchange Commission ("SEC") on February 28, 2019.

For these statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. You are cautioned not to place undue reliance on our forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q or the date of any document incorporated by reference herein. All subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. Except as required by law, we do not undertake any obligation to release publicly any revisions to our forward-looking statements to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q.

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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

## EPR PROPERTIES

## Consolidated Balance Sheets

(Dollars in thousands except share data)

	March 31, 2019 (unaudited)	December 31, 2018
Assets		
Rental properties, net of accumulated depreciation of \$920,409 and \$883,174 at March 31, 2019 and December 31, 2018, respectively	\$5,072,298	\$ 5,024,057
Land held for development	28,080	34,177
Property under development	315,237	287,546
Operating lease right-of-use assets	211,299	—
Mortgage notes and related accrued interest receivable	527,627	517,467
Investment in direct financing leases, net	20,616	20,558
Investment in joint ventures	35,188	34,486
Cash and cash equivalents	11,116	5,872
Restricted cash	11,166	12,635
Accounts receivable	111,146	98,369
Other assets	87,458	96,223
Total assets	\$6,431,231	\$ 6,131,390
Liabilities and Equity		
Liabilities:		
Accounts payable and accrued liabilities	\$ 117,746	\$ 168,463
Operating lease liabilities	235,612	—
Common dividends payable	28,306	26,765
Preferred dividends payable	6,034	6,034
Unearned rents and interest	85,012	79,051
Debt	3,045,742	2,986,054
Total liabilities	3,518,452	3,266,367
Equity:		
Common Shares, \$.01 par value; 100,000,000 shares authorized; and 78,601,769 and 77,226,443 shares issued at March 31, 2019 and December 31, 2018, respectively	786	772
Preferred Shares, \$.01 par value; 25,000,000 shares authorized:		
5,394,050 Series C convertible shares issued at March 31, 2019 and December 31, 2018; liquidation preference of \$134,851,250	54	54
3,447,381 Series E convertible shares issued at March 31, 2019 and December 31, 2018; liquidation preference of \$86,184,525	34	34
6,000,000 Series G shares issued at March 31, 2019 and December 31, 2018; liquidation preference of \$150,000,000	60	60
Additional paid-in-capital	3,597,130	3,504,494
Treasury shares at cost: 3,118,490 and 2,878,587 common shares at March 31, 2019 and December 31, 2018, respectively	(146,906 )	(130,728 )
Accumulated other comprehensive income	8,397	12,085
Distributions in excess of net income	(546,776 )	(521,748 )
Total equity	\$2,912,779	\$ 2,865,023
Total liabilities and equity	\$6,431,231	\$ 6,131,390

See accompanying notes to consolidated financial statements.





## EPR PROPERTIES

## Consolidated Statements of Income

(Unaudited)

(Dollars in thousands except per share data)

	Three Months Ended March 31,	
	2019	2018
Rental revenue	\$ 150,723	\$ 132,924
Other income	344	630
Mortgage and other financing income	13,475	21,414
Total revenue	164,542	154,968
Property operating expense	15,793	7,564
General and administrative expense	12,130	12,324
Costs associated with loan refinancing or payoff	—	31,943
Interest expense, net	33,826	34,337
Transaction costs	5,123	609
Depreciation and amortization	39,743	37,684
Income before equity in income from joint ventures and other items	57,927	30,507
Equity in income from joint ventures	489	51
Gain on sale of real estate	6,328	—
Income before income taxes	64,744	30,558
Income tax benefit (expense)	605	(1,020 )
Net income	65,349	29,538
Preferred dividend requirements	(6,034 )	(6,036 )
Net income available to common shareholders of EPR Properties	\$ 59,315	\$ 23,502
Per share data attributable to EPR Properties common shareholders:		
Basic earnings per share data:		
Net income available to common shareholders	\$ 0.79	\$ 0.32
Diluted earnings per share data:		
Net income available to common shareholders	\$ 0.79	\$ 0.32
Shares used for computation (in thousands):		
Basic	74,679	74,146
Diluted	74,725	74,180

See accompanying notes to consolidated financial statements.

EPR PROPERTIES

Consolidated Statements of Comprehensive Income

(Unaudited)

(Dollars in thousands)

	Three Months Ended March 31,	
	2019	2018
Net income	\$65,349	\$29,538
Other comprehensive income (loss):		
Foreign currency translation adjustment	3,810	(5,400 )
Change in net unrealized (loss) gain on derivatives	(7,498 )	9,398
Comprehensive income	\$61,661	\$33,536

See accompanying notes to consolidated financial statements.

## EPR PROPERTIES

## Consolidated Statements of Changes in Equity

Three Months Ended March 31, 2019 and 2018

(Unaudited)

(Dollars in thousands)

	EPR Properties Shareholders' Equity				Additional paid-in capital	Treasury shares	Accumulated other comprehensive income (loss)	Distributions in excess of net income	Total
	Common Stock Shares	Par	Preferred Stock Shares	Par					
Balance at December 31, 2017	76,858,632	\$769	14,848,165	\$148	\$3,478,986	\$(121,591)	\$12,483	\$(443,470)	\$2,927,325
Issuance of nonvested shares, net	295,202	3	—	—	3,971	—	—	—	3,974
Purchase of common shares for vesting	—	—	—	—	—	(7,116)	—	—	(7,116)
Share-based compensation expense	—	—	—	—	3,791	—	—	—	3,791
Foreign currency translation adjustment	—	—	—	—	—	—	(5,400)	—	(5,400)
Change in unrealized gain on derivatives	—	—	—	—	—	—	9,398	—	9,398
Net income	—	—	—	—	—	—	—	29,538	29,538
Issuances of common shares	6,601	—	—	—	382	—	—	—	382
Conversion of Series E Convertible Preferred shares to common shares	800	—	(1,734)	—	—	—	—	—	—
Dividends to common shareholders (\$1.08 per share)	—	—	—	—	—	—	—	(80,263)	(80,263)
Dividends to Series C preferred shareholders (\$0.359375 per	—	—	—	—	—	—	—	(1,940)	(1,940)

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share)									
Dividends to Series E preferred shareholders (\$0.5625 per share)	—	—	—	—	—	—	—	(1,939 )	(1,939 )
Dividends to Series G preferred shareholders (\$0.359375 per share)	—	—	—	—	—	—	—	(2,156 )	(2,156 )
Balance at March 31, 2018	77,161,235	\$772	14,846,431	\$148	\$3,487,130	\$(128,707)	\$16,481	\$(500,230 )	\$2,875,594
Balance at December 31, 2018	77,226,443	\$772	14,841,431	\$148	\$3,504,494	\$(130,728)	\$12,085	\$(521,748 )	\$2,865,023
Restricted share units issued to Trustees	1,156	—	—	—	—	—	—	—	—
Issuance of nonvested shares, net	197,755	2	—	—	4,831	(403 )	—	—	4,430
Purchase of common shares for vesting	—	—	—	—	—	(9,499 )	—	—	(9,499 )
Share-based compensation expense	—	—	—	—	3,280	—	—	—	3,280
Foreign currency translation adjustment	—	—	—	—	—	—	3,810	—	3,810
Change in unrealized loss on derivatives	—	—	—	—	—	—	(7,498 )	—	(7,498 )
Net income	—	—	—	—	—	—	—	65,349	65,349
Issuances of common shares	1,064,600	11	—	—	78,982	—	—	—	78,993
Stock option exercises, net	111,815	1	—	—	5,543	(6,276 )	—	—	(732 )
Dividends to common shareholders (\$1.125 per share)	—	—	—	—	—	—	—	(84,343 )	(84,343 )
Dividends to Series C preferred	—	—	—	—	—	—	—	(1,939 )	(1,939 )

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shareholders (\$0.359375 per share)									
Dividends to Series E preferred shareholders (\$0.5625 per share)	—	—	—	—	—	—	—	(1,939	) (1,939
Dividends to Series G preferred shareholders (\$0.359375 per share)	—	—	—	—	—	—	—	(2,156	) (2,156
Balance at March 31, 2019	78,601,769	\$786	14,841,431	\$148	\$3,597,130	\$(146,906)	\$8,397	\$(546,776)	\$2,912,779

See accompanying notes to consolidated financial statements.

## EPR PROPERTIES

## Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)

	Three Months Ended March 31,	
	2019	2018
Operating activities:		
Net income	\$65,349	\$29,538
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of real estate	(6,328 )	—
Deferred income tax (benefit) expense	(609 )	428
Costs associated with loan refinancing or payoff	—	31,943
Equity in income from joint ventures	(489 )	(51 )
Distributions from joint ventures	112	116
Depreciation and amortization	39,743	37,684
Amortization of deferred financing costs	1,502	1,398
Amortization of above/below market leases and tenant allowances, net	(59 )	(417 )
Share-based compensation expense to management and Trustees	3,280	3,791
Decrease in operating lease assets and liabilities	445	—
(Increase) decrease in mortgage notes accrued interest receivable	(135 )	845
Decrease in accounts receivable	14,669	3,597
Increase in direct financing leases receivable	(58 )	(198 )
Increase in other assets	(5,673 )	(3,826 )
Increase (decrease) in accounts payable and accrued liabilities	4,684	(9,118 )
Increase in unearned rents and interest	5,951	13,234
Net cash provided by operating activities	122,384	108,964
Investing activities:		
Acquisition of and investments in rental properties and other assets	(93,322 )	(38,869 )
Proceeds from sale of real estate	37,810	—
Investment in unconsolidated joint ventures	(325 )	—
Investment in mortgage notes receivable	(10,998 )	(16,223 )
Proceeds from mortgage notes receivable paydowns	973	11,555
Investment in promissory notes receivable	(61 )	(7,677 )
Additions to properties under development	(61,910 )	(55,702 )
Net cash used by investing activities	(127,833)	(106,916)
Financing activities:		
Proceeds from debt facilities and senior unsecured notes	100,000	380,000
Principal payments on debt	(66,150 )	(281,684)
Deferred financing fees paid	(40 )	(38 )
Costs associated with loan refinancing or payoff (cash portion)	—	(28,650 )
Net proceeds from issuance of common shares	74,323	303
Impact of stock option exercises, net	(732 )	—
Purchase of common shares for treasury for vesting	(9,499 )	(7,116 )
Dividends paid to shareholders	(88,748 )	(83,613 )
Net cash provided (used) by financing activities	9,154	(20,798 )
Effect of exchange rate changes on cash	70	(82 )
Net increase (decrease) in cash and cash equivalents and restricted cash	3,775	(18,832 )
Cash and cash equivalents and restricted cash at beginning of the period	18,507	58,986
Cash and cash equivalents and restricted cash at end of the period	\$22,282	\$40,154

Supplemental information continued on next page.

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## EPR PROPERTIES

## Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)

Continued from previous page.

	Three Months Ended March 31,	
	2019	2018
Reconciliation of cash and cash equivalents and restricted cash:		
Cash and cash equivalents at beginning of the period	\$5,872	\$41,917
Restricted cash at beginning of the period	12,635	17,069
Cash and cash equivalents and restricted cash at beginning of the period	\$18,507	\$58,986
Cash and cash equivalents at end of the period	\$11,116	\$24,514
Restricted cash at end of the period	11,166	15,640
Cash and cash equivalents and restricted cash at end of the period	\$22,282	\$40,154
Supplemental schedule of non-cash activity:		
Transfer of property under development to rental properties	\$7,330	\$55,377
Issuance of nonvested shares and restricted share units at fair value, including nonvested shares issued for payment of bonuses	\$14,682	\$16,809
Conversion or reclassification of mortgage notes receivable to rental properties	\$—	\$155,185
Operating lease right-of-use assets	\$214,576	\$—
Operating lease liabilities	\$238,614	\$—
Sub-lessor straight-line rent receivable	\$24,454	\$—
Acquisition of real estate in exchange for assumption of debt at fair value	\$14,000	\$—
Assumption of debt	\$18,585	\$—
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	\$28,676	\$41,948
Cash paid during the period for income taxes	\$695	\$290
Interest cost capitalized	\$3,137	\$2,244
Decrease in accrued capital expenditures	\$(6,406 )	\$(4,278 )
See accompanying notes to consolidated financial statements.		



## EPR PROPERTIES

### Notes to Consolidated Financial Statements (Unaudited)

#### 1. Organization

##### Description of Business

EPR Properties (the Company) is a specialty real estate investment trust (REIT) organized on August 29, 1997 in Maryland. The Company develops, owns, leases and finances properties in select market segments primarily related to Entertainment, Recreation and Education. The Company's properties are located in the United States and Canada.

#### 2. Summary of Significant Accounting Policies and Recently Issued Accounting Standards

##### Basis of Presentation

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles (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. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates. In addition, operating results for the three month period ended March 31, 2019 are not necessarily indicative of the results that may be expected for the year ending December 31, 2019.

The Company consolidates certain entities when it is deemed to be the primary beneficiary in a variable interest entity (VIE) in which it has a controlling financial interest in accordance with the consolidation guidance of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). The equity method of accounting is applied to entities in which the Company is not the primary beneficiary as defined in the FASB ASC Topic on Consolidation (Topic 810), or does not have effective control, but can exercise influence over the entity with respect to its operations and major decisions.

The consolidated balance sheet as of December 31, 2018 has been derived from the audited consolidated balance sheet at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2018 filed with the Securities and Exchange Commission (SEC) on February 28, 2019.

##### Recently Adopted Accounting Pronouncements

On January 1, 2019, Accounting Standards Update (ASU) No. 2016-02 Leases (Topic 842) became effective for the Company. The Company adopted the standard on the effective date and used the effective date as the date of initial application. Accordingly, comparative periods have not been recast, and disclosures required under the new standard will not be provided for dates and periods before January 1, 2019.

The standard offered several practical expedients for transition and certain expedients specific to lessees or lessors. Both lessees and lessors are permitted to make an election to apply a package of practical expedients available for implementation under the standard. The Company elected to apply the package of practical expedients, which permitted the Company to not reassess its prior conclusions about lease identification, lease classification and initial direct costs. In addition, the Company elected the expedient to not evaluate existing or expired land easements and

elected the practical expedient to not separate lease and non-lease components for all its leases where it is the lessor. In addition, the Company elected the short-term lease exception, which allows the Company to account for leases with a lease term of 12 months or less similar to existing operating leases. The Company did not elect the use-of-hindsight expedient. See Note 16 for information related to the Company's leases.

#### Operating Segments

The Company has four reportable operating segments: Entertainment, Recreation, Education and Other. See Note 15 for financial information related to these operating segments.

### Rental Properties

Rental properties are carried at cost less accumulated depreciation. Costs incurred for the acquisition and development of the properties are capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which generally are estimated to be 30 to 40 years for buildings and three to 25 years for furniture, fixtures and equipment and 10 to 20 years for site improvements. Tenant improvements, including allowances, are depreciated over the shorter of the base term of the lease or the estimated useful life and leasehold interests are depreciated over the useful life of the underlying ground lease. Expenditures for ordinary maintenance and repairs are charged to operations in the period incurred. Significant renovations and improvements that improve or extend the useful life of the asset are capitalized and depreciated over their estimated useful life.

Management reviews a property for impairment whenever events or changes in circumstances indicate that the carrying value of a property may not be recoverable. The review of recoverability is based on an estimate of undiscounted future cash flows expected to result from its use and eventual disposition. If impairment exists due to the inability to recover the carrying value of the property, an impairment loss is recorded to the extent that the carrying value of the property exceeds its estimated fair value.

The Company evaluates the held-for-sale classification of its real estate as of the end of each quarter. Assets that are classified as held for sale are recorded at the lower of their carrying amount or fair value less costs to sell. Assets are generally classified as held for sale once management has initiated an active program to market them for sale and it is probable the assets will be sold within one year. On occasion, the Company will receive unsolicited offers from third parties to buy individual Company properties. Under these circumstances, the Company will classify the properties as held for sale when a sales contract is executed with no contingencies and the prospective buyer has funds at risk to ensure performance.

### Real Estate Acquisitions

Upon acquisition of real estate properties, the Company evaluates the acquisition to determine if it is a business combination or an asset acquisition.

If the acquisition is determined to be an asset acquisition, the Company records the purchase price and other related costs incurred to the acquired tangible assets (consisting of land, building, site improvements, tenant improvements, leasehold interests and furniture, fixtures and equipment) and identified intangible assets and liabilities (consisting of in-place leases, above and below-market leases, tradenames, contract value and assumed financing that is determined to be above or below-market terms) on a relative fair value basis. In addition, costs incurred for asset acquisitions including transaction costs, are capitalized.

If the acquisition is determined to be a business combination, the Company records the fair value of acquired tangible assets (consisting of land, building, site improvements, tenant improvements, leasehold interests and furniture, fixtures and equipment) and identified intangible assets and liabilities (consisting of in-place leases, above and below-market leases, tradenames, contract value and assumed financing that is determined to be above or below-market terms) as well as any noncontrolling interest. In addition, acquisition-related costs in connection with business combinations are expensed as incurred. Costs related to such transactions, as well as costs associated with terminated transactions and pre-opening costs, are included in the accompanying consolidated statements of income as transaction costs.

### Deferred Financing Costs

Deferred financing costs are amortized over the terms of the related debt obligations or mortgage note receivable as applicable. Deferred financing costs of \$32.8 million and \$33.9 million as of March 31, 2019 and December 31, 2018, respectively, are shown as a reduction of debt. The deferred financing costs of \$4.7 million and \$5.0 million as of March 31, 2019 and December 31, 2018, respectively, related to the unsecured revolving credit facility are included in other assets.

Rental Revenue

The Company leases real estate to its tenants primarily under leases that are predominately classified as operating leases. The Company's leases generally provide for rent escalations throughout the lease terms. Rents that are fixed

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and determinable are recognized on a straight-line basis over the lease term. Many of the Company's leasing arrangements include options to extend the lease, which are not included in the minimum lease terms unless it is reasonably certain to be exercised. Straight-line rental revenue is subject to an evaluation for collectibility, and the Company records a direct write-off against rental revenues if collectibility of these future rents is not probable. For the three months ended March 31, 2019 and 2018, the Company recognized \$2.4 million and \$1.9 million, respectively, of straight-line rental revenue, net of write-offs of \$0.9 million for the three months ended March 31, 2019. There were no straight-line write-offs recognized during the three months ended March 31, 2018. Base rent escalations that include a variable component are recognized upon the occurrence of the specified event as defined in the Company's lease agreements.

A substantial portion of the Company's lease contracts are triple-net leases, which require the tenants to make payments to third parties for lessor costs (such as property taxes and insurance) associated with the properties. In accordance with Topic 842, the Company does not include these payments made by the lessees to third parties in rental revenue or property operating expenses. In certain situations, the Company pays these lessor costs directly to third-parties and the tenants reimburse the Company. In accordance with Topic 842, these payments are presented on a gross basis in rental revenue and property operating expense. During the three months ended March 31, 2019, the Company recognized \$2.2 million in tenant reimbursements related to the gross up of these reimbursed expenses which are included in rental revenue.

Certain of the Company's leases, particularly at its entertainment retail centers, require the tenants to make payments to the Company for property related expenses such as common area maintenance. The Company has elected to combine these non-lease components with the lease components in rental revenue. As such, certain reclassifications have been made to the 2018 presentation to conform to the 2019 presentation to combine tenant reimbursements with rental revenue. For the three months ended March 31, 2019 and 2018, the Company recognized \$3.9 million and \$4.0 million, respectively, of tenant reimbursements that related to the operations of its entertainment retail centers.

In addition, most of the Company's tenants are subject to additional rents if gross revenues of the properties exceed certain thresholds defined in the lease agreements (percentage rents). Percentage rents are recognized at the time when specific triggering events occur as provided by the lease agreement. Rental revenue included percentage rents of \$1.4 million and \$1.3 million for the three months ended March 31, 2019 and 2018, respectively.

The Company regularly evaluates the collectibility of its receivables on a lease by lease basis. The evaluation primarily consists of reviewing past due account balances and considering such factors as the credit quality of the Company's tenants, historical trends of the tenant and/or other debtor, current economic conditions and changes in customer payment terms. The Company suspends revenue recognition when the collectibility of lease receivables or future lease payments are no longer probable and records a direct write-off of the receivable to rental revenue. For the three months ended March 31, 2019, the Company recognized \$0.2 million in reductions to rental income related to the write-off of tenant receivables. Certain reclassifications have been made to the 2018 presentation to conform to the 2019 presentation related to the Company's former presentation of the allowance for doubtful accounts.

#### Property Sales

Sales of real estate properties are recognized when a contract exists and the purchaser has obtained control of the property. Gains on sales of properties are recognized in full in a partial sale of nonfinancial assets, to the extent control is not retained. Any noncontrolling interest retained by the seller would, accordingly, be measured at fair value.

The Company evaluates each sale or disposal transaction to determine if it meets the criteria to qualify as discontinued operations. A discontinued operation is a component of an entity or group of components that have been disposed of or are classified as held for sale and represent a strategic shift that has or will have a major effect on the Company's operations and financial results. If the sale or disposal transaction does not meet the criteria, the operations and related

gain or loss on sale is included in income from continuing operations.

**Mortgage Notes and Other Notes Receivable**

Mortgage notes and other notes receivable, including related accrued interest receivable, consist of loans originated by the Company and the related accrued and unpaid interest income as of the balance sheet date. Mortgage notes and other

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notes receivable are initially recorded at the amount advanced to the borrower. Interest income is recognized using the effective interest method based on the stated interest rate over the estimated life of the note. Premiums and discounts are amortized or accreted into income over the estimated life of the note using the effective interest method. The Company evaluates the collectibility of both interest and principal of each of its loans to determine whether it is impaired. A loan is considered to be impaired when, based on current information and events, the Company determines that it is probable that it will be unable to collect all amounts due according to the existing contractual terms. An insignificant delay or shortfall in amounts of payments does not necessarily result in the loan being identified as impaired. When a loan is considered to be impaired, the amount of loss, if any, is calculated by comparing the recorded investment to the value determined by discounting the expected future cash flows at the loan's effective interest rate or to the fair value of the Company's interest in the underlying collateral, less costs to sell, if the loan is collateral dependent. For impaired loans, interest income is recognized on a cash basis, unless the Company determines based on the loan to estimated fair value ratio the loan should be on the cost recovery method, and any cash payments received would then be reflected as a reduction of principal. Interest income recognition is recommenced if and when the impaired loan becomes contractually current and performance is demonstrated to be resumed.

#### Mortgage and Other Financing Income

Certain of the Company's borrowers are subject to additional interest based on certain thresholds defined in the mortgage agreements (participating interest). Participating interest income is recognized at the time when specific triggering events occur as provided by the mortgage agreement. There was no participating interest income for the three months ended March 31, 2019 and 2018. In addition, for the three months ended March 31, 2019, mortgage and other financing income included \$0.9 million in prepayment fees related to a mortgage note that was paid fully in advance of its maturity date. There were no prepayment fees recognized during the three months ended March 31, 2018.

As described above, the Company adopted Topic 842 on January 1, 2019 and elected to not reassess its prior conclusions about lease classification. Accordingly, the Company's leases that were classified as investment in direct financing leases retained this classification. Direct financing lease income is included in mortgage and other financing income and is recognized on the effective interest method to produce a level yield on funds not yet recovered. Estimated unguaranteed residual values at the date of lease inception represent management's initial estimates of fair value of the leased assets at the expiration of the lease, not to exceed original cost. Significant assumptions used in estimating residual values include estimated net cash flows over the remaining lease term and expected future real estate values. The Company evaluates on an annual basis (or more frequently, if necessary) the collectibility of its direct financing lease receivable and unguaranteed residual value to determine whether they are impaired. A direct financing lease receivable is considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the existing contractual terms. When a direct financing lease receivable is considered to be impaired, the amount of loss is calculated by comparing the recorded investment to the value determined by discounting the expected future cash flows at the direct financing lease receivable's effective interest rate or to the fair value of the underlying collateral, less costs to sell, if such receivable is collateralized.

#### Concentrations of Risk

American Multi-Cinema, Inc. (AMC) was the lessee of a substantial portion (33%) of the megaplex theatre rental properties held by the Company at March 31, 2019. For the three months ended March 31, 2019 and 2018, approximately \$30.6 million or 18.6% and \$28.6 million or 18.4%, respectively, of the Company's total revenues were derived from rental payments by AMC.

Topgolf USA (Topgolf) was the lessee of a substantial portion (43%) of the recreation properties held by the Company at March 31, 2019. For the three months ended March 31, 2019 and 2018, approximately \$18.7 million or 11.3% and \$15.1 million or 9.8%, respectively, of the Company's total revenues were derived from rental payments by

Topgolf.

#### Share-Based Compensation

Share-based compensation to employees of the Company is granted pursuant to the Company's Annual Incentive Program and Long-Term Incentive Plan and share-based compensation to non-employee Trustees of the Company is granted pursuant to the Company's Trustee compensation program. Prior to May 12, 2016, share-based compensation granted to employees and non-employee Trustees was issued under the 2007 Equity Incentive Plan. The 2016 Equity Incentive Plan was approved by shareholders at the May 11, 2016 annual shareholder meeting and this plan replaced

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the 2007 Equity Incentive Plan. Accordingly, all share-based compensation granted on or after May 12, 2016 has been issued under the 2016 Equity Incentive Plan.

Share-based compensation expense consists of share option expense and amortization of nonvested share grants issued to employees, and amortization of share units issued to non-employee Trustees for payment of their annual retainers. Share-based compensation included in general and administrative expense in the accompanying consolidated statements of income totaled \$3.3 million and \$3.8 million for the three months ended March 31, 2019 and 2018, respectively.

#### Share Options

Share options are granted to employees pursuant to the Long-Term Incentive Plan. The fair value of share options granted is estimated at the date of grant using the Black-Scholes option pricing model. Share options granted to employees vest over a period of four years and share option expense for these options is recognized on a straight-line basis over the vesting period. Expense recognized related to share options and included in general and administrative expense in the accompanying consolidated statements of income was \$2 thousand and \$73 thousand for the three months ended March 31, 2019 and 2018, respectively.

#### Nonvested Shares Issued to Employees

The Company grants nonvested shares to employees pursuant to both the Annual Incentive Program and the Long-Term Incentive Plan. The Company amortizes the expense related to the nonvested shares awarded to employees under the Long-Term Incentive Plan and the premium awarded under the nonvested share alternative of the Annual Incentive Program on a straight-line basis over the future vesting period (three or four years). Expense recognized related to nonvested shares and included in general and administrative expense in the accompanying consolidated statements of income was \$2.9 million and \$3.4 million for the three months ended March 31, 2019 and 2018, respectively.

#### Restricted Share Units Issued to Non-Employee Trustees

The Company issues restricted share units to non-employee Trustees for payment of their annual retainers under the Company's Trustee compensation program. The fair value of the share units granted was based on the share price at the date of grant. The share units vest upon the earlier of the day preceding the next annual meeting of shareholders or a change of control. The settlement date for the shares is selected by the non-employee Trustee, and ranges from one year from the grant date to upon termination of service. This expense is amortized by the Company on a straight-line basis over the year of service by the non-employee Trustees. Total expense recognized related to shares issued to non-employee Trustees was \$409 thousand and \$337 thousand for the three months ended March 31, 2019 and 2018, respectively.

#### Derivative Instruments

The Company has entered into certain derivative instruments to reduce exposure to fluctuations in foreign currency exchange rates and variable interest rates. The Company has established policies and procedures for risk assessment and the approval, reporting and monitoring of derivative financial instrument activities. These derivatives consist of foreign currency forward contracts, cross-currency swaps and interest rate swaps.

The Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument

with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. For its net investment hedges, the Company has elected to assess hedge effectiveness using a method based on changes in spot exchange rates and record the changes in the fair value amounts excluded from the assessment of effectiveness into earnings on a systematic

and rational basis. The Company may enter into derivative contracts that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting.

The Company's policy is to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio.

#### Impact of Recently Issued Accounting Standards

In June 2016, the FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments, which amends ASC Topic 326, Financial Instruments - Credit Losses. The ASU changes the methodology for measuring credit losses on financial instruments and timing of when such losses are recorded. The amendments in ASU No. 2016-13 require the Company to measure all expected credit losses based upon historical experience, current conditions and reasonable and supportable forecasts that affect the collectibility of financial assets and eliminates the incurred losses methodology under current U.S. GAAP. In addition, in November 2018, the FASB issued ASU No. 2018-19, Codification Improvements to Topic 326, Financial Instruments - Credit Losses, which also amends ASC Topic 326, Financial Instruments - Credit Losses. The ASU states that operating lease receivables are not in the scope of Subtopic 326-20. ASU No. 2016-13 and ASU No. 2018-19 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2019. The Company is currently evaluating the impact that these ASUs will have on its consolidated financial statements and related disclosures.

### 3. Rental Properties

The following table summarizes the carrying amounts of rental properties as of March 31, 2019 and December 31, 2018 (in thousands):

	March 31, 2019	December 31, 2018
Buildings and improvements	\$4,667,681	\$4,593,159
Furniture, fixtures & equipment	99,613	97,463
Land	1,199,372	1,190,568
Leasehold interests	26,041	26,041
	5,992,707	5,907,231
Accumulated depreciation	(920,409 )	(883,174 )
Total	\$5,072,298	\$5,024,057

Depreciation expense on rental properties was \$38.3 million and \$36.5 million for the three months ended March 31, 2019 and 2018, respectively.

### 4. Investments and Dispositions

The Company's investment spending during the three months ended March 31, 2019 totaled \$174.6 million and included investments in each of its operating segments.

Entertainment investment spending during the three months ended March 31, 2019 totaled \$117.9 million, including spending on the acquisition of five megaplex theatres totaling \$93.3 million, build-to-suit development and redevelopment of megaplex theatres, entertainment retail centers and family entertainment centers.

Recreation investment spending during the three months ended March 31, 2019 totaled \$44.2 million, including spending on build-to-suit development of golf entertainment complexes and attractions.

Education investment spending during the three months ended March 31, 2019 totaled \$12.3 million, including spending on build-to-suit development and redevelopment of public charter schools, early education centers and private schools.

Other investment spending during the three months ended March 31, 2019 totaled \$0.2 million and was related to the Resorts World Catskills project in Sullivan County, New York.

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### Property Dispositions

During the three months ended March 31, 2019, pursuant to tenant purchase options, the Company completed the sale of two public charter schools located in Florida and North Carolina for net proceeds totaling \$23.3 million. In connection with these sales, the Company recognized a gain on sale of \$5.4 million.

During the three months ended March 31, 2019, the Company completed the sale of one recreation property and four education properties for net proceeds totaling \$14.4 million and recognized a net gain on sale of \$0.9 million.

### 5. Accounts Receivable

The following table summarizes the carrying amounts of accounts receivable as of March 31, 2019 and December 31, 2018 (in thousands):

	March 31, December 31,	
	2019	2018
Receivable from tenants	\$6,779	\$ 12,158
Receivable from non-tenants	5,995	1,379
Receivable from Sullivan County Infrastructure Revenue Bonds	—	11,500
Straight-line rent receivable <sup>(1)</sup>	98,372	73,332
Total	\$ 111,146	\$ 98,369

<sup>(1)</sup> Includes \$24.6 million in sub-lessor straight-line rent receivables. Sub-lessor straight-line receivables relate to the Company's operating ground leases. The Company's tenants, who are generally sub-tenants under these ground leases, are responsible for paying the rent under these leases. See Note 16 for information related to the Company's leases.

### 6. Investment in Direct Financing Leases

The Company's investment in direct financing leases relates to the Company's leases of two public charter school properties as of March 31, 2019 and December 31, 2018, with affiliates of Imagine Schools, Inc. (Imagine). As described in Note 2, the Company adopted Topic 842 on January 1, 2019 and elected to not reassess its prior conclusions about lease classification, therefore these lease arrangements continue to be classified as direct financing leases. Investment in direct financing leases, net represents estimated unguaranteed residual values of leased assets and net unpaid rentals, less related deferred income. The following table summarizes the carrying amounts of investment in direct financing leases, net as of March 31, 2019 and December 31, 2018 (in thousands):

	March 31, December 31,	
	2019	2018
Total minimum lease payments receivable	\$35,791	\$ 36,352
Estimated unguaranteed residual value of leased assets	16,509	16,509
Less deferred income <sup>(1)</sup>	(31,684 )	(32,303 )
Investment in direct financing leases, net	\$20,616	\$ 20,558

<sup>(1)</sup> Deferred income is net of \$0.3 million of initial direct costs at March 31, 2019 and December 31, 2018.

During the year ended December 31, 2018, the Company completed the sale of four public charter school properties leased to Imagine, located in Arizona, Ohio and Washington D.C. for net proceeds of \$43.4 million. Accordingly, the Company reduced its investment in direct financing leases, net, by \$37.9 million, which included \$31.6 million in original acquisition costs. A gain of \$5.5 million was recognized during the year ended December 31, 2018.

The Company's direct financing leases have expiration dates ranging from approximately 12 to 13 years. Future minimum rentals receivable on these direct financing leases at March 31, 2019 are as follows (in thousands):



	Amount
Year:	
2019	\$1,704
2020	2,333
2021	2,403
2022	2,475
2023	2,550
Thereafter	24,326
Total	\$35,791

## 7. Issuance of Common Shares

During the three months ended March 31, 2019, the Company issued an aggregate of 1,059,656 common shares under the direct share purchase component of its Dividend Reinvestment and Direct Share Purchase Plan (DSPP) for net proceeds of \$78.6 million.

## 8. Unconsolidated Real Estate Joint Ventures

As of March 31, 2019, the Company had a 65% investment interest in two unconsolidated real estate joint ventures related to two recreation anchored lodging properties located in St. Petersburg Beach, Florida. The Company's partner, Gencom and its affiliates, own the remaining 35% interest in the joint venture. There are two separate joint ventures, one that holds the investment in the real estate of the recreation anchored lodging properties and the other that holds lodging operations, which are facilitated by a management agreement with an eligible independent contractor. The Company's investment in the operating entity is held in a taxable REIT subsidiary (TRS). The Company accounts for its investment in these joint ventures under the equity method of accounting. As of March 31, 2019 and December 31, 2018, the Company had invested \$30.3 million and \$29.5 million, respectively, in these joint ventures.

As of March 31, 2019, the Company's investments in these joint ventures were considered to be variable interests and the underlying entities are VIEs. The Company is not the primary beneficiary of the VIEs as the Company does not individually have the power to direct the activities that are most important to the joint ventures and accordingly these investments are not consolidated. See Note 9 for further discussion on these VIEs.

The joint venture that holds the real property partially financed the purchase of the lodging properties with a short-term secured mortgage loan of \$60.0 million with a maturity date of June 21, 2019. On March 28, 2019, the joint venture prepaid in full this mortgage loan and entered into a new secured mortgage loan due April 1, 2022 with an initial balance of \$61.2 million and a maximum availability of \$85.0 million. The note can be extended for two additional one year periods upon the satisfaction of certain conditions. As of March 31, 2019, the joint venture had \$61.2 million outstanding and total availability of \$23.8 million to fund upcoming property renovations. Additionally, the Company has guaranteed the completion of the renovations in the amount of its pro-rata share of approximately \$14.6 million. The mortgage loan bears interest at an annual rate equal to the greater of 6.00% or LIBOR plus 3.75%. Interest is payable monthly beginning on May 1, 2019 until the stated maturity date of April 1, 2022. Additionally, on March 28, 2019, the joint venture entered into an interest rate cap agreement to limit the variable portion of the interest rate (LIBOR) on this note to 3.0% from March 28, 2019 to April 1, 2023.

The Company recognized income of \$494 thousand and received no distributions during the three months ended March 31, 2019 related to the equity investments in these joint ventures. No income or loss was recognized during the three months ended March 31, 2018 related to the equity investment in these joint ventures.

In addition, as of March 31, 2019 and December 31, 2018, the Company had invested \$4.8 million and \$4.9 million, respectively, in unconsolidated joint ventures for three theatre projects located in China. The Company recognized a

loss of \$5 thousand and income of \$51 thousand and received distributions of \$112 thousand and \$116 thousand from its investment in these joint ventures for the three months ended March 31, 2019 and 2018, respectively.



## 9. Variable Interest Entities

The Company's variable interest in VIEs currently are in the form of equity ownership and loans provided by the Company to a VIE or other partner. The Company examines specific criteria and uses its judgment when determining if the Company is the primary beneficiary of a VIE. The primary beneficiary generally is defined as the party with the controlling financial interest. Consideration of various factors include, but are not limited to, the Company's ability to direct the activities that most significantly impact the entity's economic performance and its obligation to absorb losses from or right to receive benefits of the VIE that could potentially be significant to the VIE.

### Consolidated VIEs

As of March 31, 2019, the Company does not have any investments in consolidated VIEs.

### Unconsolidated VIE

At March 31, 2019, the Company's recorded investment in two mortgage notes which are unconsolidated VIEs totaled \$190.7 million. The Company's maximum exposure to loss associated with these VIEs is limited to the Company's outstanding mortgage notes and related accrued interest receivable of \$190.7 million. These mortgage notes are secured by three recreation properties and one public charter school.

In addition, at March 31, 2019, the Company had \$30.3 million of recorded investments in unconsolidated VIEs through joint ventures that own two recreation anchored lodging properties. The Company accounts for these investments in joint ventures under the equity method of accounting. The Company's maximum exposure to loss at March 31, 2019, is its investment in the joint ventures of \$30.3 million as well as the Company's guarantee of its pro-rata share of the estimated costs to complete renovations of approximately \$14.6 million. See Note 8 for further discussion related to the Company's unconsolidated real estate joint ventures.

While these entities are VIEs, the Company has determined that the power to direct the activities of these VIEs that most significantly impact the VIEs' economic performance is not held by the Company.

## 10. Derivative Instruments

All derivatives are recognized at fair value in the consolidated balance sheets within the line items "Other assets" and "Accounts payable and accrued liabilities" as applicable. The Company's derivatives are subject to master netting arrangements and the Company has elected not to offset its derivative position for purposes of balance sheet presentation and disclosure. The Company had no derivative liabilities in the consolidated balance sheet at March 31, 2019 and December 31, 2018. The Company had derivative assets of \$3.1 million and \$10.6 million recorded in "Other assets" in the consolidated balance sheet at March 31, 2019 and December 31, 2018, respectively. The Company has not posted or received collateral with its derivative counterparties as of March 31, 2019 or December 31, 2018. See Note 11 for disclosures relating to the fair value of the derivative instruments as of March 31, 2019 and December 31, 2018.

### Risk Management Objective of Using Derivatives

The Company is exposed to certain risk arising from both its business operations and economic conditions including the effect of changes in foreign currency exchange rates on foreign currency transactions and interest rates on its LIBOR based borrowings. The Company manages this risk by following established risk management policies and procedures including the use of derivatives. The Company's objective in using derivatives is to add stability to reported earnings and to manage its exposure to foreign exchange and interest rate movements or other identified risks. To accomplish this objective, the Company primarily uses interest rate swaps, cross-currency swaps and foreign currency forwards.



#### Cash Flow Hedges of Interest Rate Risk

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements on its LIBOR based borrowings. To accomplish these objectives, the Company currently uses interest rate swaps as its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt or payment of variable-rate amounts from a counterparty which results in the Company recording net interest expense that is fixed over the life of the agreements without exchange of the underlying notional amount.

As of March 31, 2019, the Company had two interest rate swap agreements to fix the interest rate at 2.64% on \$300.0 million of borrowings under its unsecured term loan facility from July 6, 2017 to April 5, 2019. Additionally, as of March 31, 2019, the Company had three interest rate swap agreements to fix the interest rate at 3.15% on an additional \$50.0 million of borrowings under its unsecured term loan facility from November 6, 2017 to April 5, 2019 and on \$350.0 million of borrowings under its unsecured term loan facility from April 6, 2019 to February 7, 2022. Subsequent to March 31, 2019, the Company entered into an interest rate swap agreement to fix the interest rate at 3.35% on the remaining \$50.0 million of borrowings under its unsecured term loan facility from April 5, 2019 to February 7, 2022.

The change in the fair value of interest rate derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income (AOCI) and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings within the same income statement line item as the earnings effect of the hedged transaction. During the three months ended March 31, 2019 and 2018, such derivatives were used to hedge the variable cash flows associated with existing variable-rate debt.

Amounts reported in AOCI related to derivatives will be reclassified to interest expense as interest payments are made on the Company's variable-rate debt. As of March 31, 2019, the Company estimates that during the twelve months ending March 31, 2020, \$1.2 million will be reclassified from AOCI to a reduction of interest expense.

#### Cash Flow Hedges of Foreign Exchange Risk

The Company is exposed to foreign currency exchange risk against its functional currency, USD, on CAD denominated cash flow from its four Canadian properties. The Company uses cross-currency swaps to mitigate its exposure to fluctuations in the USD-CAD exchange rate on cash inflows associated with these properties. These foreign currency derivatives should hedge a significant portion of the Company's expected CAD denominated cash flow of the Canadian properties as their impact on the Company's cash flow when settled should move in the opposite direction of the exchange rates utilized to translate revenues and expenses of these properties.

As of March 31, 2019, the Company had a USD-CAD cross-currency swap with a fixed original notional value of \$100.0 million CAD and \$79.5 million USD. The net effect of this swap is to lock in an exchange rate of \$1.26 CAD per USD on approximately \$13.5 million of annual CAD denominated cash flows through June 2020.

The change in the fair value of foreign currency derivatives designated and that qualify as cash flow hedges of foreign exchange risk is recorded in AOCI and subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings within the same income statement line item as the earnings effect of the hedged transaction. As of March 31, 2019, the Company estimates that during the twelve months ending March 31, 2020, \$0.6 million of gains will be reclassified from AOCI to other income.

#### Net Investment Hedges

The Company is exposed to fluctuations in the USD-CAD exchange rate on its net investments in Canada. As such, the Company uses either currency forward agreements or cross-currency swaps to manage its exposure to changes in foreign exchange rates on certain of its foreign net investments.



As of March 31, 2019, the Company had two fixed-to-fixed cross-currency swaps with a total notional value of \$200.0 million CAD. These instruments became effective on July 1, 2018, mature on July 1, 2023 and are designated as net investment hedges on its Canadian net investments. The net effect of this hedge is to lock in an exchange rate of \$1.32 CAD per USD on \$200.0 million CAD of the Company's foreign net investments. The cross-currency swaps also have a monthly settlement feature locked in at an exchange rate of \$1.32 CAD per USD on \$4.5 million of CAD annual cash flows, the net effect of which is an excluded component from the effectiveness testing of this hedge.

For qualifying foreign currency derivatives designated as net investment hedges, the change in the fair value of the derivatives are reported in AOCI as part of the cumulative translation adjustment. Amounts are reclassified out of AOCI into earnings when the hedged net investment is either sold or substantially liquidated. Gains and losses on the derivative representing hedge components excluded from the assessment of effectiveness are recognized over the life of the hedge on a systematic and rational basis, as documented at hedge inception in accordance with the Company's accounting policy election. The earnings recognition of excluded components are presented in other income.

Below is a summary of the effect of derivative instruments on the consolidated statements of changes in equity and income for the three months ended March 31, 2019 and 2018.

Effect of Derivative Instruments on the Consolidated Statements of Changes in Equity and Income for the Three Months Ended March 31, 2019 and 2018  
(Dollars in thousands)

Description	Three Months Ended March 31,	
	2019	2018
Cash Flow Hedges		
Interest Rate Swaps		
Amount of (Loss) Gain Recognized in AOCI on Derivative	\$(2,439)	\$4,778
Amount of Income (Expense) Reclassified from AOCI into Earnings (1)	775	(13)
Cross-Currency Swaps		
Amount of (Loss) Gain Recognized in AOCI on Derivative	(311)	615
Amount of Income Reclassified from AOCI into Earnings (2)	134	554
Net Investment Hedges		
Cross-Currency Swaps		
Amount of Loss Recognized in AOCI on Derivative	(3,839)	—
Amount of Income Recognized in Earnings (2) (3)	138	—
Currency Forward Agreements		
Amount of Gain Recognized in AOCI on Derivative	—	4,546
Amount of Expense Reclassified from AOCI into Earnings (2)	—	—
Total		
Amount of (Loss) Gain Recognized in AOCI on Derivatives	\$(6,589)	\$9,939
Amount of Income Reclassified from AOCI into Earnings	909	541
Amount of Income Recognized in Earnings	138	—
Interest expense, net in accompanying consolidated statements of income	33,826	34,337
Other income in accompanying consolidated statements of income	344	630
(1) Included in "Interest expense, net" in the accompanying consolidated statements of income for the three months ended March 31, 2019 and 2018.		
(2) Included in "Other income" in the accompanying consolidated statements of income for the three months ended March 31, 2019 and 2018.		

(3) Amounts represent derivative gains excluded from the effectiveness testing.

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#### Credit-risk-related Contingent Features

The Company has agreements with each of its interest rate derivative counterparties that contain a provision where if the Company defaults on any of its obligations for borrowed money or credit in an amount exceeding \$25.0 million for two of the agreements and \$50.0 million for three of the agreements and such default is not waived or cured within a specified period of time, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its interest rate derivative obligations.

As of March 31, 2019, the Company had no derivatives with a fair value in a liability position related to these agreements. If the Company breached any of the contractual provisions of these derivative contracts, it would be required to settle its obligations under the agreements at their termination value, after considering the right of offset. As of March 31, 2019, the Company had not posted any collateral related to these agreements and was not in breach of any provisions in these agreements.

#### 11. Fair Value Disclosures

The Company has certain financial instruments that are required to be measured under the FASB's Fair Value Measurement guidance. The Company currently does not have any non-financial assets and non-financial liabilities that are required to be measured at fair value on a recurring basis.

As a basis for considering market participant assumptions in fair value measurements, the FASB's Fair Value Measurement guidance establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy). Level 1 inputs use quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

#### Derivative Financial Instruments

The Company uses interest rate swaps, foreign currency forwards and cross-currency swaps to manage its interest rate and foreign currency risk. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves, foreign exchange rates, and implied volatilities. The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash receipts and the discounted expected variable cash payments. The variable cash payments are based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves. The Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees. In conjunction with the FASB's Fair Value Measurement guidance, the Company made an accounting policy election to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio.

Although the Company determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives also use Level 3 inputs, such as estimates of current credit spreads, to evaluate the likelihood of default by itself and its counterparties. As of March 31, 2019, the Company assessed the significance of the impact of the credit valuation adjustments on the overall valuation



of its derivative positions and determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives and therefore, classified its derivatives as Level 2 within the fair value reporting hierarchy.

The table below presents the Company's financial assets and liabilities measured at fair value on a recurring basis as of March 31, 2019 and December 31, 2018 aggregated by the level in the fair value hierarchy within which those measurements are classified and by derivative type.

Assets and Liabilities Measured at Fair Value on a Recurring Basis at

March 31, 2019 and December 31, 2018

(Dollars in thousands)

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Assets Balance at end of period
March 31, 2019				
Cross-Currency Swaps*	\$	— \$ 1,993	\$	— \$ 1,993
Interest Rate Swap Agreements*	\$	— \$ 1,130	\$	— \$ 1,130
December 31, 2018				
Cross-Currency Swaps*	\$	— \$ 6,278	\$	— \$ 6,278
Interest Rate Swap Agreements*	\$	— \$ 4,344	\$	— \$ 4,344

\*Included in "Other assets" in the accompanying consolidated balance sheets.

#### Fair Value of Financial Instruments

The following methods and assumptions were used by the Company to estimate the fair value of each class of financial instruments at March 31, 2019 and December 31, 2018:

#### Mortgage notes receivable and related accrued interest receivable:

The fair value of the Company's mortgage notes and related accrued interest receivable is estimated by discounting the future cash flows of each instrument using current market rates. At March 31, 2019, the Company had a carrying value of \$527.6 million in fixed rate mortgage notes receivable outstanding, including related accrued interest, with a weighted average interest rate of approximately 8.69%. The fixed rate mortgage notes bear interest at rates of 7.00% to 11.43%. Discounting the future cash flows for fixed rate mortgage notes receivable using rates of 7.50% to 10.00%, management estimates the fair value of the fixed rate mortgage notes receivable to be approximately \$555.2 million with an estimated weighted average market rate of 8.70% at March 31, 2019.

At December 31, 2018, the Company had a carrying value of \$517.5 million in fixed rate mortgage notes receivable outstanding, including related accrued interest, with a weighted average interest rate of approximately 8.67%. The fixed rate mortgage notes bear interest at rates of 7.00% to 11.43%. Discounting the future cash flows for fixed rate mortgage notes receivable using rates of 7.50% to 10.00%, management estimates the fair value of the fixed rate mortgage notes receivable to be \$544.6 million with an estimated weighted average market rate of 8.68% at December 31, 2018.

#### Investment in direct financing leases, net:

At March 31, 2019 and December 31, 2018, the Company had an investment in direct financing leases with a carrying value of \$20.6 million and a weighted average effective interest rate of 12.04%. At March 31, 2019 and December 31, 2018, the investment in direct financing leases bears interest at effective rates of 11.93% to 12.38%. The carrying value of the investment in direct financing leases approximated the fair value at March 31, 2019 and December 31, 2018.

#### Derivative instruments:

Derivative instruments are carried at their fair value.

Debt instruments:

The fair value of the Company's debt is estimated by discounting the future cash flows of each instrument using current market rates. At March 31, 2019, the Company had a carrying value of \$513.6 million in variable rate

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debt outstanding with a weighted average interest rate of approximately 2.94%. The carrying value of the variable rate debt outstanding approximated the fair value at March 31, 2019.

At December 31, 2018, the Company had a carrying value of \$455.0 million in variable rate debt outstanding with a weighted average interest rate of approximately 2.84%. The carrying value of the variable rate debt outstanding approximated the fair value at December 31, 2018.

At March 31, 2019 and December 31, 2018, \$350.0 million of the Company's variable rate debt, discussed above, had been effectively converted to a fixed rate through February 7, 2022 by interest rate swap agreements. Subsequent to March 31, 2019, an additional \$50.0 million was converted to fixed rate debt by another interest rate swap agreement. See Note 10 for additional information related to the Company's interest rate swap agreements.

At March 31, 2019, the Company had a carrying value of \$2.57 billion in fixed rate long-term debt outstanding with a weighted average interest rate of approximately 4.86%. Discounting the future cash flows for fixed rate debt using March 31, 2019 market rates of 3.51% to 4.56%, management estimates the fair value of the fixed rate debt to be approximately \$2.64 billion with an estimated weighted average market rate of 4.17% at March 31, 2019.

At December 31, 2018, the Company had a carrying value of \$2.57 billion in fixed rate long-term debt outstanding with an average weighted interest rate of approximately 4.86%. Discounting the future cash flows for fixed rate debt using December 31, 2018 market rates of 3.48% to 4.99%, management estimates the fair value of the fixed rate debt to be approximately \$2.57 billion with an estimated weighted average market rate of 4.69% at December 31, 2018.

## 12. Earnings Per Share

The following table summarizes the Company's computation of basic and diluted earnings per share (EPS) for the three months ended March 31, 2019 and 2018 (amounts in thousands except per share information):

	Three Months Ended March 31, 2019		
	Income (numerator)	Shares (denominator)	Per Share Amount
Basic EPS:			
Net income	\$65,349		
Less: preferred dividend requirements	(6,034 )		
Net income available to common shareholders	\$59,315	74,679	\$ 0.79
Diluted EPS:			
Net income available to common shareholders	\$59,315	74,679	
Effect of dilutive securities:			
Share options	—	46	
Net income available to common shareholders	\$59,315	74,725	\$ 0.79

	Three Months Ended March 31, 2018		
	Income	Shares	Per Share
	(numerator)	(denominator)	Amount
Basic EPS:			
Net income	\$29,538		
Less: preferred dividend requirements	(6,036 )		
Net income available to common shareholders	\$23,502	74,146	\$ 0.32
Diluted EPS:			
Net income available to common shareholders	\$23,502	74,146	
Effect of dilutive securities:			
Share options	—	34	
Net income available to common shareholders	\$23,502	74,180	\$ 0.32

The additional 2.1 million common shares that would result from the conversion of the Company's 5.75% Series C cumulative convertible preferred shares and the additional 1.6 million common shares that would result from the conversion of the Company's 9.0% Series E cumulative convertible preferred shares and the corresponding add-back of the preferred dividends declared on those shares are not included in the calculation of diluted earnings per share for the three months ended March 31, 2019 and 2018, respectively, because the effect is anti-dilutive.

The dilutive effect of potential common shares from the exercise of share options is included in diluted earnings per share for the three months ended March 31, 2019 and 2018. However, options to purchase 4 thousand and 87 thousand common shares at per share prices ranging from \$73.84 to \$76.63 and \$56.94 to \$76.63 were outstanding for the three months ended March 31, 2019 and 2018, respectively, but were not included in the computation of diluted earnings per share because they were anti-dilutive.

### 13. Equity Incentive Plan

All grants of common shares and options to purchase common shares were issued under the Company's 2007 Equity Incentive Plan prior to May 12, 2016 and under the 2016 Equity Incentive Plan on and after May 12, 2016. Under the 2016 Equity Incentive Plan, an aggregate of 1,950,000 common shares, options to purchase common shares and restricted share units, subject to adjustment in the event of certain capital events, may be granted. At March 31, 2019, there were 1,127,827 shares available for grant under the 2016 Equity Incentive Plan.

#### Share Options

Share options granted under the 2007 Equity Incentive Plan and the 2016 Equity Incentive Plan have exercise prices equal to the fair market value of a common share at the date of grant. The options may be granted for any reasonable term, not to exceed 10 years, and for employees typically become exercisable at a rate of 25% per year over a four-year period. The Company generally issues new common shares upon option exercise. A summary of the Company's share option activity and related information is as follows:

	Number of options	Option price per share	Weighted avg. exercise price
Outstanding at December 31, 2018	234,875	\$19.02 –\$76.63	\$ 51.98
Exercised	(111,815)	19.02 –61.79	49.58
Granted	1,941	73.84 –73.84	73.84
Outstanding at March 31, 2019	125,001	\$19.02 –\$76.63	\$ 54.47

The weighted average fair value of options granted was \$4.64 and \$3.03 during the three months ended March 31, 2019 and 2018, respectively. The intrinsic value of share options exercised was \$2.5 million for the three months

ended March 31, 2019. There were no share option exercises during the three months ended March 31, 2018. At March 31, 2019, share-option expense to be recognized in future periods was \$24 thousand.

The expense related to share options included in the determination of net income for the three months ended March 31, 2019 and 2018 was \$2 thousand and \$73 thousand, respectively. The following assumptions were used in applying the Black-Scholes option pricing model at the grant dates for the three months ended March 31, 2019: risk-free interest rate of 2.4%, dividend yield of 6.7%, volatility factors in the expected market price of the Company's common shares of 19.1%, 0.75% expected forfeiture rate and an expected life of approximately six years. The Company uses historical data to estimate the expected life of the option and the risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. Additionally, expected volatility is computed based on the average historical volatility of the Company's publicly traded shares.

The following table summarizes outstanding options at March 31, 2019:

Exercise price range	Options outstanding	Weighted avg. life remaining	Weighted avg. exercise price	Aggregate intrinsic value (in thousands)
\$ 19.02 - 19.99	3,699	0.1		
20.00 - 29.99	—	—		
30.00 - 39.99	—	—		