

Edgar Filing: Seritage Growth Properties - Form 10-Q

Seritage Growth Properties  
Form 10-Q  
August 03, 2018  
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 JUNE 30, 2018

or

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

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

Commission File Number 001-37420

SERITAGE GROWTH PROPERTIES

(Exact name of registrant as specified in its charter)

Maryland 38-3976287  
(State of Incorporation) (I.R.S. Employer Identification No.)

500 Fifth Avenue, Suite 1530, New York, New York 10110  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (212) 355-7800

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

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

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

Edgar Filing: Seritage Growth Properties - Form 10-Q

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

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 Exchange Act). Yes      No

As of July 27, 2018, the registrant had the following common shares outstanding:

Class	Shares Outstanding
Class A common shares of beneficial interest, par value \$0.01 per share	35,685,933
Class B common shares of beneficial interest, par value \$0.01 per share	1,322,365
Class C common shares of beneficial interest, par value \$0.01 per share	850

---

SERITAGE GROWTH PROPERTIES

QUARTERLY REPORT ON FORM 10-Q

QUARTER ENDED JUNE 30, 2018

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

	Page
Item 1.	
<u>Condensed Consolidated Financial Statements (unaudited)</u>	
<u>Condensed Consolidated Balance Sheets as of June 30, 2018 and December 31, 2017</u>	3
<u>Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2018 and 2017</u>	4
<u>Condensed Consolidated Statements of Equity for the six months ended June 30, 2018 and 2017</u>	5
<u>Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2018 and 2017</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	8

Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	33
---------	--	----

Item 3.	<u>Quantitative and Qualitative Disclosure about Market Risk</u>	45
---------	--	----

Item 4.	<u>Controls and Procedures</u>	45
---------	--------------------------------	----

PART II. OTHER INFORMATION

Item 1.	<u>Legal Proceedings</u>	46
---------	--------------------------	----

Item 1A.	<u>Risk Factors</u>	46
----------	---------------------	----

Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	46
---------	--	----

Item 3.	<u>Defaults upon Senior Securities</u>	46
---------	--	----

Item 4.	<u>Mine Safety Disclosures</u>	46
---------	--------------------------------	----

Item 5.	<u>Other Information</u>	46
---------	--------------------------	----

Item 6.	<u>Exhibits</u>	47
---------	-----------------	----

<u>SIGNATURES</u>	48
-------------------	----

## PART I. FINANCIAL INFORMATION

## Item 1. Unaudited Condensed Consolidated Financial Statements

## SERITAGE GROWTH PROPERTIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, amounts in thousands, except share and per share amounts)

	June 30, 2018	December 31, 2017
<b>ASSETS</b>		
Investment in real estate		
Land	\$711,261	\$799,971
Buildings and improvements	860,739	829,168
Accumulated depreciation	(157,991 )	(139,483 )
	1,414,009	1,489,656
Construction in progress	209,237	224,904
Net investment in real estate	1,623,246	1,714,560
Real estate held for sale	15,139	—
Investment in unconsolidated joint ventures	392,743	282,990
Cash and cash equivalents	100,448	241,569
Restricted cash	166,458	175,665
Tenant and other receivables, net	43,911	30,787
Lease intangible assets, net	251,303	310,098
Prepaid expenses, deferred expenses and other assets, net	21,360	20,148
Total assets	\$2,614,608	\$2,775,817
<b>LIABILITIES AND EQUITY</b>		
<b>Liabilities</b>		
Mortgage loans payable, net	\$1,073,762	\$1,202,314
Unsecured term loan, net	144,111	143,210
Accounts payable, accrued expenses and other liabilities	97,541	109,433
Total liabilities	1,315,414	1,454,957
<b>Commitments and contingencies (Note 9)</b>		
<b>Shareholders' Equity</b>		
Class A common shares \$0.01 par value; 100,000,000 shares authorized;		
35,678,749 and 32,415,734 shares issued and outstanding as of		
June 30, 2018 and December 31, 2017, respectively	356	324
Class B common shares \$0.01 par value; 5,000,000 shares authorized;		
1,322,365 and 1,328,866 shares issued and outstanding as of		
June 30, 2018 and December 31, 2017, respectively	13	13
Class C common shares \$0.01 par value; 50,000,000 shares authorized;		
	—	31

Edgar Filing: Seritage Growth Properties - Form 10-Q

850 and 3,151,131 shares issued and outstanding as of

June 30, 2018 and December 31, 2017, respectively

Series A preferred shares \$0.01 par value; 10,000,000 shares authorized;

2,800,000 shares issued and outstanding as of June 30, 2018

and December 31, 2017; liquidation preference of \$70,000	28	28
Additional paid-in capital	1,122,251	1,116,060
Accumulated deficit	(246,650 )	(229,760 )
Total shareholders' equity	875,998	886,696
Non-controlling interests	423,196	434,164
Total equity	1,299,194	1,320,860
Total liabilities and equity	\$2,614,608	\$2,775,817

The accompanying notes are an integral part of these condensed consolidated financial statements.

## SERITAGE GROWTH PROPERTIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, amounts in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
<b>REVENUE</b>				
Rental income	\$35,839	\$42,185	\$72,918	\$91,359
Tenant reimbursements	12,517	15,708	29,215	31,932
Management and other fee income	914	—	914	—
Total revenue	49,270	57,893	103,047	123,291
<b>EXPENSES</b>				
Property operating	6,533	4,932	13,774	9,674
Real estate taxes	9,217	11,950	20,598	24,372
Depreciation and amortization	49,551	50,571	84,218	109,234
General and administrative	8,673	5,093	16,470	11,367
Provision for doubtful accounts	109	12	170	51
Total expenses	74,083	72,558	135,230	154,698
Operating loss	(24,813)	(14,665)	(32,183)	(31,407)
Equity in loss of unconsolidated joint ventures	(2,158)	(1,542)	(4,740)	(540)
Interest and other income	456	42	1,136	120
Interest expense	(17,862)	(18,431)	(34,281)	(35,023)
Unrealized loss on interest rate cap	(172)	(124)	(7)	(595)
Loss before income taxes	(44,549)	(34,720)	(70,075)	(67,445)
Provision for income taxes	(240)	(147)	(344)	(266)
Loss before gain on sale of real estate	(44,789)	(34,867)	(70,419)	(67,711)
Gain on sale of real estate	34,187	—	76,018	—
Net income (loss)	(10,602)	(34,867)	5,599	(67,711)
Net (income) loss attributable to non-controlling interests	3,831	13,648	(2,042)	26,654
Net income (loss) attributable to Seritage	\$(6,771)	\$(21,219)	\$3,557	\$(41,057)
Preferred dividends	(1,225)	—	(2,453)	—
Net income (loss) attributable to Seritage common shareholders	\$(7,996)	\$(21,219)	\$1,104	\$(41,057)
Net income (loss) per share attributable to Seritage				
Class A and Class C common shareholders - Basic	\$(0.23)	\$(0.63)	\$0.03	\$(1.22)
Net income (loss) per share attributable to Seritage				
Class A and Class C common shareholders - Diluted	\$(0.23)	\$(0.63)	\$0.03	\$(1.22)
Weighted average Class A and Class C common	35,483	33,766	35,449	33,638

Edgar Filing: Seritage Growth Properties - Form 10-Q

shares outstanding - Basic				
Weighted average Class A and Class C common				
shares outstanding - Diluted	35,483	33,766	35,588	33,638

The accompanying notes are an integral part of these condensed consolidated financial statements.

## SERITAGE GROWTH PROPERTIES

## CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(Unaudited, amounts in thousands)

	Class A		Class B		Class C		Series A		Additional		Non-	Total
	Common	Amount	Common	Amount	Common	Amount	Preferred	Amount	Paid-In	Accumulated	Controlling	Equity
	Shares		Shares		Shares		Shares		Capital	Deficit	Interests	
Balance at January 1, 2017	25,843	\$258	1,589	\$16	5,755	\$58	—	\$—	\$925,563	\$(121,338)	\$619,754	\$1,424,311
Net loss	—	—	—	—	—	—	—	—	—	(41,057 )	(26,654 )	(67,711 )
Dividends and distributions declared												
(\$0.50 per share and unit)	—	—	—	—	—	—	—	—	—	(17,002 )	(10,936 )	(27,938 )
Vesting of restricted share units	4	0	—	—	—	—	—	—	(0 )	—	—	—
Stock-based compensation	—	—	—	—	—	—	—	—	779	—	—	779
Share class exchanges, net												
(267,300 common shares)	(267 )	(2 )	—	—	267	2	—	—	—	—	—	—
Share class surrenders												
(154,098 common shares)	—	—	(154 )	(2 )	—	—	—	—	2	—	—	—
OP Unit exchanges												
(2,344,589 units)	2,344	23	—	—	—	—	—	—	69,329	—	(69,352 )	—
Balance at June 30, 2017	27,924	\$279	1,435	\$14	6,022	\$60	—	\$—	\$995,673	\$(179,397)	\$512,812	\$1,329,441



## Edgar Filing: Seritage Growth Properties - Form 10-Q

Balance at January 1, 2018	32,416	\$324	1,329	\$13	3,151	\$31	2,800	\$28	\$1,116,060	\$(229,760)	\$434,164	\$1,320,860
Net income	—	—	—	—	—	—	—	—	—	3,557	2,042	5,599
Common dividends and distributions declared (\$0.50 per share and unit)	—	—	—	—	—	—	—	—	—	(17,994 )	(10,084 )	(28,078 )
Preferred dividends declared (\$0.8750 per share)	—	—	—	—	—	—	—	—	—	(2,453 )	—	(2,453 )
Vesting of restricted share units	14	0	—	—	—	—	—	—	(0 )	—	—	—
Stock-based compensation	—	—	—	—	—	—	—	—	3,379	—	—	3,379
Preferred stock offering costs	—	—	—	—	—	—	—	—	(113 )	—	—	(113 )
Share class exchanges, net (3,150,281 common shares)	3,150	31	—	—	(3,150)	(31)	—	—	—	—	—	—
Share class surrenders (6,501 common shares)	—	—	(7 )	—	—	—	—	—	—	—	—	—
OP Unit exchanges (98,923 units)	99	1	—	—	—	—	—	—	2,925	—	(2,926 )	—
Balance at June 30, 2018	35,679	\$356	1,322	\$13	1	—	2,800	\$28	\$1,122,251	\$(246,650)	\$423,196	\$1,299,194

The accompanying notes are an integral part of these condensed consolidated financial statements.

- 5 -

---

## SERITAGE GROWTH PROPERTIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, amounts in thousands)

	Six Months Ended June 30,	
	2018	2017
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>		
Net income (loss)	\$5,599	\$(67,711 )
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Equity in loss of unconsolidated joint ventures	4,740	540
Gain on sale of real estate	(76,018 )	—
Unrealized loss on interest rate cap	7	595
Stock-based compensation	3,379	779
Depreciation and amortization	84,218	109,234
Amortization of deferred financing costs	3,590	4,061
Amortization of above and below market leases, net	(414 )	(594 )
Straight-line rent adjustment	(2,832 )	(3,479 )
Change in operating assets and liabilities		
Tenants and other receivables	(3,076 )	265
Prepaid expenses, deferred expenses and other assets	(2,968 )	461
Accounts payable, accrued expenses and other liabilities	(20 )	(22,451 )
Net cash provided by operating activities	16,205	21,700
<b>CASH FLOW FROM INVESTING ACTIVITIES</b>		
Investment in unconsolidated joint ventures	(6,160 )	(15,047 )
Distributions from unconsolidated joint ventures	8,505	7,515
Net proceeds from sale of real estate	134,599	—
Development of real estate	(142,003 )	(106,075 )
Net cash used in investing activities	(5,059 )	(113,607 )
<b>CASH FLOW FROM FINANCING ACTIVITIES</b>		
Repayment of mortgage loans payable	(131,414 )	—
Proceeds from Future Funding Facility	—	79,998
Proceeds from Unsecured Term Loan	—	85,000
Payment of deferred financing costs	(363 )	(2,449 )
Offering related costs	(113 )	—
Preferred dividends paid	(1,661 )	—
Common dividends paid	(17,865 )	(16,913 )
Non-controlling interests distributions paid	(10,058 )	(10,935 )
Net cash (used in) provided by financing activities	(161,474 )	134,701
Net increase (decrease) in cash, cash equivalents, and restricted cash	(150,328 )	42,794
Cash, cash equivalents, and restricted cash, beginning of period	417,234	139,642
Cash, cash equivalents, and restricted cash, end of period	\$266,906	\$182,436

## SERITAGE GROWTH PROPERTIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Unaudited, amounts in thousands)

	Six Months Ended June 30,	
	2018	2017
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash payments for interest	\$43,296	\$33,984
Capitalized interest	12,144	3,361
Income taxes paid	344	266
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING</b>		
<b>ACTIVITIES</b>		
Development of real estate financed with accounts payable	\$14,465	\$12,100
Dividends and distribution declared and unpaid	14,046	13,969
Decrease in real estate, net resulting from deconsolidated properties	(156,568)	—
Transfer to real estate assets held for sale	15,139	—
<b>RECONCILIATION OF CASH AND CASH EQUIVALENTS AND RESTRICTED CASH</b>		
Cash and cash equivalents	\$100,448	\$9,873
Restricted cash	166,458	172,563
Total cash, cash equivalents, and restricted cash shown in the statement of cash flows	266,906	182,436

The accompanying notes are an integral part of these condensed consolidated financial statements.

SERITAGE GROWTH PROPERTIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 – Organization

Seritage Growth Properties (“Seritage” or the “Company”) was organized in Maryland on June 3, 2015 and was initially capitalized with 100 shares of Class A common shares. The Company conducts its operations through Seritage Growth Properties, L.P. (the “Operating Partnership”), a Delaware limited partnership that was formed on April 22, 2015. Unless the context otherwise requires, “Seritage” and the “Company” refer to Seritage, the Operating Partnership, and its subsidiaries.

On June 11, 2015, Sears Holdings Corporation (“Sears Holdings” or “Sears”) effected a rights offering (the “Rights Offering”) to Sears Holdings stockholders to purchase common shares of Seritage in order to fund, in part, the \$2.7 billion acquisition of (i) 234 of Sears Holdings’ owned properties and one of its ground leased properties, and (ii) its 50% interests in three joint ventures that collectively owned 28 properties, ground leased one property and leased two properties (the “Transaction”). The Rights Offering ended on July 2, 2015, and the Company’s Class A common shares were listed on the New York Stock Exchange (“NYSE”) on July 6, 2015.

On July 7, 2015, the Company completed the Transaction with Sears Holdings and commenced operations. The Company did not have any operations prior to the completion of the Rights Offering and the Transaction.

Seritage is a fully-integrated, self-administered, self-managed real estate investment trust (“REIT”) primarily engaged in the real property business through the Company’s investment in the Operating Partnership. As of June 30, 2018, the Company’s portfolio consisted of interests in 248 properties totaling approximately 38.7 million square feet of gross leasable area (“GLA”), including 222 wholly owned properties totaling approximately 34.1 million square feet of GLA across 49 states and Puerto Rico (the “Wholly Owned Properties”), and interests in 26 joint venture properties totaling approximately 4.6 million square feet of GLA across 13 states (the “JV Properties”).

As of June 30, 2018, we leased space at 144 Wholly Owned Properties to Sears Holdings pursuant to a master lease agreement (the “Master Lease”), including 72 properties leased only to Sears Holdings and 72 properties leased to both Sears Holdings and one or more diversified, non-Sears tenants. The remaining 78 Wholly Owned Properties include 55 properties that are leased solely to diversified, non-Sears tenants and 23 unleased properties. As of June 30, 2018, space at 22 JV Properties was also leased to Sears Holdings pursuant to lease agreements similar to the Master Lease (the “JV Master Leases”). Sears Holdings is the sole tenant at nine JV Properties and 13 JV properties are leased to both Sears Holdings and one or more diversified, non-Sears tenants. Three JV Properties are leased solely to diversified, non-Sears tenants and one JV Property was unleased as of June 30, 2018.

The Master Lease and the JV Master Leases provide the Company and the JVs with the right to recapture certain space from Sears Holdings at each property for retreating or redevelopment purposes.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

These condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q of the Securities and Exchange Commission (“SEC”) and should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K, as amended, (the “Annual Report”), for the year ended December 31, 2017. Certain footnote disclosures which would substantially duplicate those contained in our Annual Report have been condensed or omitted from this quarterly report. In the opinion of management, all adjustments necessary for a fair presentation (which include only normal recurring adjustments) have been included in this quarterly report. Operating results of three and six months ended June 30, 2018 may not be indicative of the results that may be expected for any other interim period or for the year ending December 31, 2018. Capitalized terms used, but not defined in this quarterly report, have the same meanings as set forth in our Annual Report.

The accompanying condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). The condensed consolidated financial statements include the accounts of the Company, the Operating Partnership, each of their wholly-owned subsidiaries, and all other entities in which they have a controlling financial interest or entities that meet the definition of a variable interest entity (“VIE”) in which the Company has, as a result of ownership, contractual interests or other financial interests, both the power to direct activities that most significantly impact the economic performance of the VIE and the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE. All intercompany accounts and transactions have been eliminated.

If the Company has an interest in a VIE but it is not determined to be the primary beneficiary, the Company accounts for its interest under the equity method of accounting. Similarly, for those entities which are not VIEs and over which the Company has the ability to exercise significant influence, but does not have a controlling financial interest, the Company accounts for its interests under the equity method of accounting. The Company continually reconsiders its determination of whether an entity is a VIE and whether the Company qualifies as its primary beneficiary. As of June 30, 2018 and December 31, 2017, we have several unconsolidated VIEs in the form of joint ventures (see Note 4). The Company does not consolidate these entities because the Company is not the primary beneficiary and the nature of its involvement in the activities of these entities does not give the Company power over decisions that significantly affect these entities' economic performance.

To the extent such variable interests are in entities that cannot be evaluated under the VIE model, the Company evaluates its interests using the voting interest entity model. As of June 30, 2018, the Company holds a 63.9% interest in the Operating Partnership and is the sole general partner which gives the Company exclusive and complete responsibility for the day-to-day management, authority to make decisions, and control of the Operating Partnership. Through consideration of consolidation guidance effective for the Company as of January 1, 2016, it has been concluded that the Operating Partnership is a VIE as the limited partners in the Operating Partnership, although entitled to vote on certain matters, do not possess kick-out rights or substantive participating rights. Accordingly, the Company consolidates its interest in the Operating Partnership. However, as the Company holds what is deemed a majority voting interest in the Operating Partnership, it qualifies for the exemption from providing certain of the disclosure requirements associated with investments in VIEs.

The portions of consolidated entities not owned by the Company and the Operating Partnership are presented as non-controlling interests as of and during the periods presented.

#### Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant assumptions and estimates relate to fair values of acquired assets and liabilities assumed for purposes of applying the acquisition method of accounting, the useful lives of tangible and intangible assets, real estate impairment assessments, and assessing the recoverability of accounts receivables. These estimates are based on historical experience and other assumptions which management believes are reasonable under the circumstances. Management evaluates its estimates on an ongoing basis and makes revisions to these estimates and related disclosures as experience develops or new information becomes known. Actual results could differ from these estimates.

#### Segment Reporting

The Company currently operates in a single reportable segment which includes the acquisition, ownership, development, redevelopment, management, and leasing of retail properties. The Company's chief operating decision maker, its Chief Executive Officer, assesses and measures the operating and financial results for each property on an individual basis and does not distinguish or group properties based on geography, size, or type. The Company, therefore, aggregates all properties into one reportable segment due to their similarities with regard to the nature and economics of the properties, tenants, and operations.

#### Accounting for Real Estate Acquisitions

Upon the acquisition of real estate, the Company assesses the fair value of acquired assets and liabilities assumed, including land, buildings, improvements and identified intangibles such as above-market and below-market leases, in-place leases and other items, as applicable, and allocates the purchase price based on these assessments. In making

estimates of fair values, the Company may use a number of sources, including data provided by third parties, as well as information obtained by the Company as a result of its due diligence, including expected future cash flows of the property and various characteristics of the markets where the property is located.

The fair values of tangible assets are determined on an "if vacant" basis. The "if vacant" fair value allocated to land is generally estimated via a market or sales comparison approach with the subject site being compared to similar properties that have sold or are currently listed for sale. The comparable properties are adjusted for dissimilar characteristics such as market conditions, location, access/frontage, size, shape/topography, or intended use, including the impact of any encumbrances on such use. The "if vacant" value allocated to buildings and site improvements is generally estimated using an income approach and a cost approach that utilizes published guidelines for current replacement cost or actual construction costs for similar, recently developed properties. Assumptions used in the income approach include capitalization and discount rates, lease-up time, market rents, make-ready costs, land value, and site improvement value.

- 9 -

---



## Edgar Filing: Seritage Growth Properties - Form 10-Q

The estimated fair value of in-place tenant leases includes lease origination costs (the costs the Company would have incurred to lease the property to the current occupancy level) and the lost revenues during the period necessary to lease-up from vacant to the current occupancy level. Such estimates include the fair value of leasing commissions, legal costs and tenant coordination costs that would be incurred to lease the property to this occupancy level. Additionally, the Company evaluates the time period over which such occupancy level would be achieved and includes an estimate of the net operating costs (primarily real estate taxes, insurance and utilities) incurred during the lease-up period, which generally ranges up to one year. The fair value of acquired in-place tenant leases is included in lease intangible assets on the condensed consolidated balance sheets and amortized over the remaining lease term for each tenant.

Identifiable intangible assets and liabilities are calculated for above-market and below-market tenant and ground leases where the Company is either the lessor or the lessee. The difference between the contractual rental rates and the Company's estimate of market rental rates is measured over a period equal to the remaining non-cancelable term of the leases, including significantly below-market renewal options for which exercise of the renewal option appears to be reasonably assured. Above-market tenant leases and below-market ground leases are included in lease intangible assets on the condensed consolidated balance sheets; below-market tenant leases and above-market ground leases are included in accounts payable, accrued expenses and other liabilities on the condensed consolidated balance sheets. The values assigned to above-market and below-market tenant leases are amortized as reductions and increases, respectively, to base rental revenue over the remaining term of the respective leases. The values assigned to below-market and above-market ground leases are amortized as increases and reductions, respectively, to property operating expenses over the remaining term of the respective leases.

The Company expenses transaction costs associated with business combinations in the period incurred; these costs are included in acquisition-related expenses within the condensed consolidated statements of operations. The Company capitalizes transaction costs associated with asset acquisitions; these costs are allocated to the fair values of the net assets acquired, included within the condensed consolidated balance sheets and depreciated or amortized over the remaining life or term of the acquired assets.

### Real Estate Investments

Real estate assets are recorded at cost, less accumulated depreciation and amortization.

Expenditures for ordinary repairs and maintenance will be expensed as incurred. Significant renovations which improve the property or extend the useful life of the assets are capitalized. As real estate is undergoing redevelopment activities, all amounts directly associated with and attributable to the project, including planning, development and construction costs, interest costs, personnel costs of employees directly involved and other miscellaneous costs incurred during the period of redevelopment, are capitalized. The capitalization period begins when redevelopment activities are underway and ends when the project is substantially complete.

Depreciation of real estate assets, excluding land, is recognized on a straight-line basis over their estimated useful lives as follows:

Building:	25 – 40 years
Site improvements:	5 – 15 years
Tenant improvements:	shorter of the estimated useful life or non-cancelable term of lease

The Company amortizes identified intangibles that have finite lives over the period they are expected to contribute directly or indirectly to the future cash flows of the property or business acquired, generally the remaining

non-cancelable term of a related lease.

On a periodic basis, management assesses whether there are indicators that the value of the Company's real estate assets (including any related intangible assets or liabilities) may be impaired. If an indicator is identified, a real estate asset is considered impaired only if management's estimate of current and projected operating cash flows (undiscounted and unleveraged), taking into account the anticipated and probability weighted holding period, are less than a real estate asset's carrying value. Various factors are considered in the estimation process, including expected future operating income, trends and prospects and the effects of demand, competition, and other economic factors. If management determines that the carrying value of a real estate asset is impaired, a loss will be recorded for the excess of its carrying amount over its estimated fair value. No such impairment losses were recognized for the three or six months ended June 30, 2018 or June 30, 2017.

#### Real Estate Held for Sale

When a real estate asset is identified by management as held for sale, we cease depreciation of the asset and estimate its fair value, net of estimated costs to sell. If the estimated fair value, net of estimated costs to sell, of an asset is less than its net carrying value, an adjustment is recorded to reflect the estimated fair value. Properties classified as real estate held for sale generally represent properties that are under contract for sale and are expected to close within a year.

- 10 -

---

In evaluating whether a property meets the held for sale criteria, we make a determination as to the point in time that it is probable that a sale will be consummated. Given the nature of all real estate sales contracts, it is not unusual for such contracts to allow potential buyers a period of time to evaluate the property prior to formal acceptance of the contract. In addition, certain other matters critical to the final sale, such as financing arrangements, often remain pending even upon contract acceptance. As a result, properties under contract may not close within the expected time period or may not close.

#### Investments in Unconsolidated Joint Ventures

The Company accounts for its investments in unconsolidated joint ventures using the equity method of accounting as the Company exercises significant influence, but does not control these entities. These investments are initially recorded at cost and are subsequently adjusted for cash contributions, cash distributions, and earnings which are recognized in accordance with the terms of the applicable agreement.

On a periodic basis, management assesses whether there are indicators, including the operating performance of the underlying real estate and general market conditions, that the value of the Company's investments in unconsolidated joint ventures may be impaired. An investment's value is impaired only if management's estimate of the fair value of the Company's investment is less than its carrying value and such difference is deemed to be other-than-temporary. To the extent impairment has occurred, the loss is measured as the excess of the carrying amount of the investment over its estimated fair value. No such impairment losses were recognized for the three or six months ended June 30, 2018 or June 30, 2017.

#### Cash and Cash Equivalents

The Company considers instruments with an original maturity of three months or less to be cash and cash equivalents. Cash and cash equivalents balances may, at a limited number of banks and financial institutions, exceed insurable amounts. The Company believes it mitigates this risk by investing in or through major financial institutions and primarily in funds that are insured by the United States federal government.

#### Restricted Cash

Restricted cash represents cash deposited in escrow accounts which generally can only be used for the payment of real estate taxes, debt service, insurance, and future capital expenditures as required by certain loan and lease agreements, as well as legally restricted tenant security deposits.

As of June 30, 2018, the Company had approximately \$166.5 million of restricted cash, including \$136.5 million reserved for redevelopment costs, tenant allowances and leasing commissions, deferred maintenance, environmental remediation and other capital expenditures, \$26.5 million reserved for basic property carrying costs such as real estate taxes, insurance and ground rent, and \$3.5 million of other restricted cash which consisted primarily of prepaid rental income.

As of December 31, 2017, the Company had approximately \$175.7 million of restricted cash, including \$151.3 million reserved for redevelopment costs, tenant allowances and leasing commissions, deferred maintenance, environmental remediation and other capital expenditures, \$21.7 million reserved for basic property carrying costs such as real estate taxes, insurance and ground rent, and \$2.7 million of other restricted cash which consisted primarily of prepaid rental income.

#### Tenant and Other Receivables

Accounts receivable includes unpaid amounts billed to tenants, accrued revenues for future billings to tenants for property expenses, and amounts arising from the straight-lining of rent. The Company periodically reviews its

receivables for collectability, taking into consideration changes in factors such as the tenant's payment history, the financial condition of the tenant, business conditions in the industry in which the tenant operates, and economic conditions in the area where the property is located. In the event that the collectability of a receivable with respect to any tenant is in doubt, a provision for uncollectible amounts will be established or a direct write-off of the specific rent receivable will be made. For accrued rental revenues related to the straight-line method of reporting rental revenue, the Company performs a periodic review of receivable balances to assess the risk of uncollectible amounts and establish appropriate provisions.

#### Revenue Recognition

Rental income is recognized on a straight-line basis over the non-cancelable terms of the related leases. For leases that have fixed and measurable rent escalations, the difference between such rental income earned and the cash rent due under the provisions of the lease is recorded as deferred rent receivable and included as a component of tenant and other receivables on the condensed consolidated balance sheets.

- 11 -

---

In leasing tenant space, the Company may provide funding to the lessee through a tenant allowance. In accounting for a tenant allowance, the Company will determine whether the allowance represents funding for the construction of leasehold improvements and evaluate the ownership of such improvements. If the Company is considered the owner of the improvements for accounting purposes, the Company will capitalize the amount of the tenant allowance and depreciate it over the shorter of the useful life of the improvements or the related lease term. If the tenant allowance represents a payment for a purpose other than funding leasehold improvements, or in the event the Company is not considered the owner of the improvements for accounting purposes, the allowance is considered to be a lease incentive and is recognized over the lease term as reduction of rental revenue on a straight-line basis.

The Company commences recognizing revenue based on an evaluation of a number of factors. In most cases, revenue recognition under a lease begins when the lessee takes possession of or controls the physical use of the leased asset. Generally, this occurs on the lease commencement date.

Tenant reimbursement income arises from tenant leases which provide for the recovery of all or a portion of the operating expenses and real estate taxes of the respective property. This revenue is accrued in the same periods as the expenses are incurred.

#### Management and Other Fee Income

Management and other fee income represents management, leasing and development fees for services performed for the benefit of certain unconsolidated joint ventures and is reported at 100% of the revenue earned from such joint ventures in management and other fee income on the condensed consolidated statements of operations. Our share of management expenses incurred by the unconsolidated joint ventures is reported in equity in income (loss) of unconsolidated joint ventures on the condensed consolidated statements of operations and in other expenses in the combined condensed financial data in Note 4.

Based upon the new revenue recognition guidance, we determined that typical management fees, including property and asset management, construction and development management services and leasing services, needed to be evaluated for each separate performance obligation included in the contract in order to determine the timing of revenue recognition.

Management determined that property and asset management and construction and development management services each represent a series of stand-ready performance obligations satisfied over time with each day of service being a distinct performance obligation. For property and asset management, we are typically compensated for our services through a monthly management fee earned based on a specified percentage of monthly rental income or rental receipts generated from the property under management. For construction and development services, we are typically compensated for planning, administering and monitoring the design and construction of projects at our unconsolidated joint venture properties based on a percentage of project costs or a fixed fee. Revenues from such management contracts are recognized over the life of the applicable contract.

Conversely, leasing services are considered to be a single performance obligation, satisfied as of a point in time. Our fee is typically paid upon the occurrence of certain contractual event(s) that may be contingent and the pattern of revenue recognition may differ from the timing of payment. For these services, the obligation is typically the execution of the lease and, as such, revenues are recognized at the point in time when that obligation has been satisfied.

#### Accounting for Recapture and Termination Activity Pursuant to the Master Lease

**Seritage 100% Recapture Rights.** The Company generally treats the delivery of a 100% recapture notice as a modification of the Master Lease as of the date of notice. Such a notice and lease modification result in the following accounting adjustments for the recaptured property:

- Accrued rental revenues related to the straight-line method of reporting rental revenue that are deemed uncollectable as result of the lease modification are amortized over the remaining shortened life of the lease from the date of notice to the date of vacancy.
- Intangible lease assets and liabilities that are deemed to be impacted by the lease modification are amortized over the shorter of the shortened lease term from the date of notice to the date of vacancy or the remaining useful life of the asset or liability.

A 100% recapture will generally occur in conjunction with obtaining a new tenant or a real estate development project. As such, termination fees, if any, associated with the 100% recapture notice are generally capitalized as either an initial direct cost of obtaining a new lease or a necessary cost of the real estate project and depreciated over the life of the new lease obtained or the real estate asset being constructed or improved.

- 12 -

---

**Seritage 50% Recapture Rights.** The Company generally treats the delivery of a 50% recapture notice as a modification of the Master Lease as of the date of notice. Such a notice and lease modification result in the following accounting adjustments for the recaptured property:

- The portion of accrued rental revenues related to the straight-line method of reporting rental revenue that are subject to the lease modification are amortized over the remaining shortened life of the lease from the date of notice to the date of vacancy. The portion of accrued rental revenues related to the straight-line method of reporting rental revenue that is attributable to the retained space is amortized over the remaining life of the Master Lease.
- The portion of intangible lease assets and liabilities that is deemed to be impacted by the lease modification is amortized over the shorter of the shortened lease term from the date of notice to the date of vacancy or the remaining useful life of the asset or liability. The portion of intangible lease assets and liabilities that is attributable to the retained space is amortized over the remaining useful life of the asset or liability.

**Sears Holdings Termination Rights.** The Master Lease provides Sears Holdings with certain rights to terminate the Master Lease with respect to properties that cease to be profitable for operation by Sears Holdings. Such a termination would generally result in the following accounting adjustments for the terminated property:

- Accrued rental revenues related to the straight-line method of reporting rental revenue that are subject to the termination are amortized over the remaining shortened life of the lease from the date of notice to the date of vacancy.
- Intangible lease assets and liabilities that are deemed to be impacted by the termination are amortized over the shorter of the shortened lease term from the date of notice to the date of vacancy or the remaining useful life of the asset or liability.
- Termination fees required to be paid by Sears Holdings are recognized as follows:
  - ✦For the portion of the termination fee attributable to the annual base rent of the subject property, termination income is recognized on a straight-line basis over the shortened life of the lease from the date the termination fee becomes legally binding to the date of vacancy.
  - ✦For the portion of the termination fee attributable to estimated real estate taxes and property operating expenses for the subject property, prepaid rental income is recorded in the period such fee is received and recognized as tenant reimbursement revenue in the same periods as the expenses are incurred.

#### Derivatives

The Company's use of derivative instruments is limited to the management of interest rate exposure and not for speculative purposes. In connection with the issuance of the Company's Mortgage Loans and Future Funding Facility, the Company purchased for \$5.0 million an interest rate cap with a term of four years, a notional amount of \$1,261 million and a strike rate of 3.5%. The interest rate cap is measured at fair value and included as a component of prepaid expenses, deferred expenses and other assets on the condensed consolidated balance sheets. The Company has elected not to utilize hedge accounting, and therefore, the change in fair value is included within change in fair value of interest rate cap on the condensed consolidated statements of operations. For the three months ended June 30, 2018, the Company recorded a loss of \$0.2 million compared to a loss of \$0.1 million for the three months ended June 30, 2017. For the six months ended June 30, 2018, the Company recorded a loss of \$7.0 thousand compared to a loss of \$0.6 million for the six months ended June 30, 2017.

Subsequent to June 30, 2018, the Company terminated its interest rate cap concurrent with the repayment of the Mortgage Loans and the Future Funding Facility. See Note 16.

#### Stock-Based Compensation

The Company generally recognizes equity awards to employees as compensation expense and includes such expense within general and administrative expenses on the condensed consolidated statements of operations. Compensation expense for equity awards is generally based on the fair value of the common shares at the date of the grant and is recognized (i) ratably over the vesting period for awards with time-based vesting and (ii) for awards with

performance-based vesting, at the date the achievement of performance criteria is deemed probable, an amount equal to that which would have been recognized ratably from the date of the grant through the date the achievement of performance criteria is deemed probable, and then ratably from the date the achievement of performance criteria is deemed probable through the remainder of the vesting period.

#### Concentration of Credit Risk

Concentrations of credit risk arise when a number of operators, tenants, or obligors related to the Company's investments are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their

- 13 -

---



ability to meet contractual obligations, including those to the Company, to be similarly affected by changes in economic conditions. As of June 30, 2018, a majority of the Company's real estate properties were leased to Sears Holdings, and the majority of Company's rental revenues were derived from the Master Lease (see Note 5). Until the Company further diversifies the tenancy of its portfolio, an event that has a material adverse effect on Sears Holdings' business, financial condition or results of operations could have a material adverse effect on the Company's business, financial condition or results of operations. Sears Holdings is a publicly traded company that is subject to the informational filing requirements of the Securities Exchange Act of 1934, as amended, and is required to file periodic reports on Form 10-K and Form 10-Q with the SEC. Refer to [www.sec.gov](http://www.sec.gov) for Sears Holdings publicly-available financial information.

Other than the Company's tenant concentration, management believes the Company's portfolio was reasonably diversified by geographical location and did not contain any other significant concentrations of credit risk. As of June 30, 2018, the Company's portfolio of 222 Wholly Owned Properties and 26 JV Properties was diversified by location across 49 states and Puerto Rico.

#### Earnings per Share

The Company has three classes of common stock. The rights, including the liquidation and dividend rights, of the holders of the Company's Class A common shares and Class C non-voting common shares are identical, except with respect to voting. As the liquidation and dividend rights are identical, the undistributed earnings are allocated on a proportionate basis. The net earnings (loss) per share amounts are the same for Class A and Class C common shares because the holders of each class are legally entitled to equal per share distributions whether through dividends or in liquidation. Class B non-economic common shares are excluded from earnings per share computations as they do not have economic rights.

All outstanding non-vested shares that contain non-forfeitable rights to dividends are considered participating securities and are included in computing earnings per share pursuant to the two-class method which specifies that all outstanding non-vested share-based payment awards that contain non-forfeitable rights to distributions are considered participating securities and should be included in the computation of earnings per share.

#### Recently Issued Accounting Pronouncements

In February 2017, the Financial Accounting Standards Boards ("FASB") issued Accounting Standards Update ("ASU") 2017-05, "Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets" to provide guidance for recognizing gains and losses from the transfer of nonfinancial assets. The standard requires a company to derecognize nonfinancial assets once it transfers control of a distinct nonfinancial asset or distinct in substance nonfinancial assets to noncustomers. Additionally, when a company transfers its controlling interest in a nonfinancial asset, but retains a non-controlling ownership interest, the company is required to measure any non-controlling interest it receives or retains at fair value. An entity may elect to apply the amendments in ASU 2017-05 either retrospectively to each period presented in the financial statements (i.e. the retrospective approach) or retrospectively with a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption (i.e. the modified retrospective approach). We adopted this update on January 1, 2018 with no impact to beginning retained earnings/accumulated deficit because there were no open contracts at the time of adoption.

During the six months ended June 30, 2018, the Company entered into three transactions in which it sold portions of investments in previously consolidated properties and retained joint control of the assets. (See Note 4).

In January 2017, the FASB issued ASU 2017-01 which changes the definition of a business to exclude acquisitions where substantially all of the fair value of the assets acquired are concentrated in a single identifiable asset or a group of similar identifiable assets. While there are various differences between the accounting for an asset acquisition and a business combination, the Company expects that the largest impact will be the capitalization of transaction costs for

asset acquisitions which are expensed for business combinations. ASU 2017-01 is effective, on a prospective basis, for interim and annual periods beginning after December 15, 2017. The Company adopted the guidance on the issuance date effective January 5, 2017 on a prospective basis and it did not have an impact on the consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, "Classification of Certain Cash Receipts and Cash Payments." ASU 2016-15 provides classification guidance for eight specific topics including debt extinguishment costs, contingent consideration payments made after a business combination, and distributions received from equity method investees. ASU 2016-15 is effective, on a retrospective basis, for interim and annual periods beginning after December 15, 2017; early adoption is permitted. The Company adopted ASU 2016-15 on the effective date, January 1, 2018, and applied the cumulative earnings approach to classify distributions received from our equity method investees. The adoption (i) changes our statements of cash flows so that distributions from unconsolidated joint ventures in excess of cumulative equity in earnings are now classified as inflows from investing activities for each period presented and (ii) resulted in a decrease to net cash provided by operating activities and a decrease to net cash used in investing activities of \$7,515,000 for the six months ended June 30, 2017.

- 14 -

---

In February 2016, with a subsequent update made in January 2018 and finalized in March 2018, the FASB issued ASU No. 2016-02 “Leases (Topic 842)” (“ASU 2016-02”) to amend the accounting guidance for leases. The accounting applied by a lessor is largely unchanged under ASU 2016-02. However, the standard requires lessees to recognize lease assets and lease liabilities for leases classified as operating leases on the balance sheet. Lessees will recognize in the statement of financial position a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it will recognize lease expense for such leases generally on a straight-line basis over the lease term. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted.

In March 2018, the FASB finalized changes with respect to optional transition relief and approved a practical expedient for lessors that would permit lessors to make an accounting policy election to not separate non-lease components from the associated lease components, by class of underlying asset, if the following two criteria are met: (1) the timing and pattern of transfer of the lease and non-lease components are the same and (2) the lease component would be classified as an operating lease if accounted for separately. For leases where we are the lessor, we currently believe that we will elect the optional transition relief and that we will meet the noted criteria to not be required to bifurcate and separately report non-lease components, such as common area maintenance revenue, for operating leases on our consolidated statements of operations. As a result, we currently believe that leases where we are the lessor will be accounted for in a similar method to existing standards with the underlying leased asset being reported and recognized as a real estate asset. The FASB is expected to issue an Accounting Standards Update codifying these changes in the coming months. We currently expect to adopt ASU 2016-02 using the practical expedients proposed in the standard and the changes approved by the FASB and do not believe that this change will have a material impact on our consolidated financial statements.

In May 2014, with subsequent updates issued in August 2015 and March, April and May 2016, the FASB issued ASU No. 2014-09 “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”) and the related FASB ASU Nos. 2016-12 and 2016-20, which provide practical expedients, technical corrections, and improvements for certain aspects of ASU 2014-09. ASU 2014-09 was developed to enable financial statement users to better understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The update’s core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Companies are to use a five-step contract review model to ensure revenue is recognized, measured and disclosed in accordance with this principle. Those steps include the following: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to each performance obligation in the contract, and (v) recognize revenue when or as the entity satisfies a performance obligation. The Company estimates the total transaction price, which generally includes a fixed contract price and may also include variable components. Variable components of the contract price are included in the transaction price to the extent that it is probable that a significant reversal of revenue will not occur. The Company recognizes the estimated transaction price as revenue as it satisfies its performance obligations.

The Company adopted ASU 2014-09 on the effective date of January 1, 2018 using the modified retrospective method. Management concluded that the majority of total revenues consist of rental income from leasing arrangements, which is specifically excluded from the standard. As of January 1, 2018, the Company began accounting for the sale of real estate properties under Subtopic 610-20 which provides for revenue recognition based on transfer of ownership.

During the six months ended June 30, 2018, the Company contributed properties located in West Hartford, CT and Santa Monica, CA to new joint ventures and sold 50.0% and 49.9% interests in the ventures, respectively. The Company estimated the total transaction prices, each which include fixed and variable components, pursuant to ASC 606. The variable components of the transactions will be re-measured at each reporting date until stabilization. (See Note 4).

- 15 -

---

Edgar Filing: Seritage Growth Properties - Form 10-Q

Note 3 – Lease Intangible Assets and Liabilities

Lease intangible assets (acquired in-place leases, above-market leases and below-market ground leases) and liabilities (acquired below-market leases), net of accumulated amortization, were \$251.3 million and \$13.4 million, respectively, as of June 30, 2018 and \$310.1 million and \$14.5 million, respectively, as of December 31, 2017. The following table summarizes the Company's lease intangible assets and liabilities (in thousands):

June 30, 2018

Lease Intangible Assets	Gross Asset	Accumulated Amortization	Balance
In-place leases, net	\$489,593	\$ (254,180 )	\$ 235,413
Below-market ground leases, net	11,766	(609 )	11,157
Above-market leases, net	8,276	(3,543 )	4,733
Total	\$509,635	\$ (258,332 )	\$ 251,303

Lease Intangible Liabilities	Gross Liability	Accumulated Amortization	Balance
Below-market leases, net	\$ 19,658	\$ (6,228 )	\$ 13,430
Total	\$ 19,658	\$ (6,228 )	\$ 13,430

December 31, 2017

Lease Intangible Assets	Gross Asset	Accumulated Amortization	Balance
In-place leases, net	\$542,655	\$ (249,569 )	\$ 293,086
Below-market ground leases, net	11,766	(508 )	11,258
Above-market leases, net	8,925	(3,171 )	5,754
Total	\$563,346	\$ (253,248 )	\$ 310,098

Lease Intangible Liabilities	Gross Liability	Accumulated Amortization	Balance
Below-market leases, net	\$ 19,658	\$ (5,182 )	\$ 14,476
Total	\$ 19,658	\$ (5,182 )	\$ 14,476

Amortization of acquired below-market leases, net of acquired above-market leases, resulted in additional rental income of \$0.2 million and \$0.2 million for the three months ended June 30, 2018 and June 30, 2017, respectively, and \$0.5 million and \$0.5 million for the six months ended June 30, 2018 and June 30, 2017, respectively. Future amortization of these intangibles is estimated to increase rental income as set forth below (in thousands):

Remainder of 2018	\$(424)
2019	(842)
2020	(708)

Edgar Filing: Seritage Growth Properties - Form 10-Q

2021	(695)
2022	(405)

Amortization of acquired below-market ground leases resulted in additional property expense of \$51 thousand for the three months ended June 30, 2018 and June 30, 2017, respectively, and \$0.1 million for the six months ended June 30, 2018 and June 30, 2017, respectively. Future amortization of below-market ground leases is estimated to increase property expenses as set forth below (in thousands):

Remainder of 2018	\$ 101
2019	203
2020	203
2021	203
2022	203

Amortization of acquired in-place leases resulted in additional depreciation and amortization expense of \$35.2 million and \$31.4 million for the three months ended June 30, 2018 and June 30, 2017, respectively, and \$53.3 million and \$75.2 million for the six

Edgar Filing: Seritage Growth Properties - Form 10-Q

months ended June 30, 2018 and June 30, 2017, respectively. Future estimated amortization of acquired in-place leases is set forth below (in thousands):

Remainder of 2018	\$54,852
2019	30,359
2020	29,913
2021	29,144
2022	28,286

Note 4 – Investments in Unconsolidated Joint Ventures

The Company conducts a portion of its property rental activities through investments in unconsolidated joint ventures. The Company's partners in these joint ventures are unrelated real estate entities or commercial enterprises. The Company and its joint venture partners make initial and/or ongoing capital contributions to these unconsolidated joint ventures. The obligations to make capital contributions are governed by each unconsolidated joint venture's respective operating agreement and related governing documents.

As of June 30, 2018, the Company had investments in seven unconsolidated joint ventures as follows:

Unconsolidated Joint Venture	Joint Venture Partner	Seritage % Ownership	# of Properties	Total GLA
GS Portfolio Holdings II LLC				
("GGP I JV")	GGP Inc.	50.0 %	4	550,600
GS Portfolio Holdings (2017) LLC				
("GGP II JV")	GGP Inc.	50.0 %	5	1,175,600
MS Portfolio LLC	The Macerich Company	50.0 %	9	1,575,600
SPS Portfolio Holdings II LLC	Simon Property Group, Inc.	50.0 %	5	872,200
Mark 302 JV LLC	Invesco Real Estate	50.1 %	1	96,400
SI UTC JV LLC	Invesco Real Estate	50.0 %	1	226,200
SF WH Joint Venture LLC	First Washington Realty	50.0 %	1	163,700
("West Hartford JV")				

(1) Represents the Company's gross investment in each JV, including its share of the property contribution value at the formation of each JV plus its share of any development expenses incurred in each JV.

#### Mark 302 JV

In March 2018, the Company contributed its property located in Santa Monica, CA to the Mark 302 JV and sold a 49.9% interest to an investment fund managed by Invesco Real Estate based on a contribution value of \$90.0 million (the "Initial Mark 302 Contribution Value") and pre-transaction development and other costs of approximately \$10.4 million. As a result of the transaction, the Company received cash of approximately \$50.1 million and recorded a gain of \$39.1 million (the "Initial Mark 302 Gain") which is included in gain on sale of real estate within the condensed consolidated statements of operations. The Initial Mark 302 Gain is comprised of \$19.6 million attributable to the increase in fair value of the retained 50.1% interest due to application of the ASU 2017-05, while the remaining \$19.5 million is the gain on sale of the remaining 49.9% interest.

The Mark 302 JV is subject to a revaluation upon the earlier of the first anniversary of project stabilization (as defined in the operating agreement of the Mark 302 JV) or December 31, 2020. Upon revaluation, the primary inputs in determining the Initial Mark 302 Contribution Value, which consist of property operating income and total project costs, will be updated for actual results and a value (the "Final Mark 302 Contribution Value") will be calculated to yield a pre-determined rate of return to the investment fund managed by Invesco Real Estate. The Final Mark 302 Contribution Value cannot be more than \$105.0 million or less than \$60.0 million and will result in a cash settlement between the two parties.

The Company recorded the Initial Mark 302 Gain based on the Initial Mark 302 Contribution Value because it determined it to be the expected amount in the range of possible amounts. The Company made this determination based on its analysis of the primary inputs



that determine both the Initial Mark 302 Contribution Value and Final Mark 302 Contribution Value, which consist of property operating income and total project costs. The gain on sale of real estate based on the Final Mark 302 Contribution Value (the “Final Mark 302 Gain”) will not be more than \$54.1 million or less than \$9.1 million.

Each reporting period the Company re-analyzes the primary inputs that determine the Final Mark 302 Contribution Value and Final Mark 302 Gain. For the three months ended June 30, 2018, there were no adjustments to the Initial Mark 302 Contribution Value or the Initial Mark 302 Gain resulting from such analysis.

#### UTC JV

During the three months ended June 30, 2018, the Company contributed its property located in San Diego, CA to the UTC JV and sold a 50.0% interest to a separate account advised by Invesco Real Estate based on a contribution value of \$68.0 million and pre-transaction development and other costs of approximately \$19.2 million. As a result of the transaction, the Company received cash of approximately \$43.6 million and recorded a gain of \$27.5 million which is included in gain on sale of real estate within the condensed consolidated statements of operations. The gain is comprised of \$13.7 million attributable to the increase in fair value of the retained 50.0% interest due to application of the ASU 2017-05, while the remaining \$13.7 million is the gain on sale of the remaining 50.0% interest.

#### West Hartford JV

During the three months ended June 30, 2018, the Company contributed its property located in West Hartford, CT to the West Hartford JV and sold a 50.0% interest to First Washington Realty based on a contribution value of \$25.0 million (the “Initial West Hartford JV Contribution Value”) and pre-transaction development and other costs of approximately \$20.2 million. As a result of the transaction, the Company received cash of approximately \$22.6 million and recorded a gain of \$5.6 million (the “Initial West Hartford JV Gain”) which is included in gain on sale of real estate within the condensed consolidated statements of operations. The Initial West Hartford JV Gain is comprised of \$2.8 million attributable to the increase in fair value of the retained 50.0% interest due to application of the ASU 2017-05, while the remaining \$2.8 million is the gain on sale of the remaining 50.0% interest.

The West Hartford JV is subject to (i) a revaluation upon the earlier of the first anniversary of project stabilization (as defined in the operating agreement of the West Hartford JV) or December 31, 2019, and (ii) an adjustment based on the timing, method and magnitude of the reassessment of the property for real estate tax purposes between 2018 and 2022. Upon revaluation, the primary inputs in determining the Initial West Hartford JV Contribution Value, which consist of property operating income and total project costs, will be updated for actual results and a value (the “Final West Hartford JV Contribution Value”) will be calculated to yield a pre-determined rate of return to First Washington Realty. The Final West Hartford JV Contribution Value cannot be more than \$29.6 million or less than \$20.4 million. Upon adjustment for real estate tax purposes, an amount based on the difference between actual real estate taxes and tenant recoveries for such real estate taxes will be determined and the capitalized value of such amount will be applied as an adjustment to the transaction price (the “Real Estate Tax Adjustment Amount”). The Real Estate Tax Adjustment Amount, and the aggregate transaction price adjustment resulting from (i) the difference between the Initial West Hartford JV Contribution Value and the Final West Hartford JV Contribution Value, and (ii) the Real Estate Tax Adjustment Amount, cannot exceed \$4.6 million and will result in a cash settlement between the two parties.

The Company recorded the Initial West Hartford JV Gain based on the Initial West Hartford JV Contribution Value because it determined it to be the expected amount in the range of possible amounts. The Company made this determination based on its analysis of the primary inputs that determine both the Initial West Hartford JV Contribution Value and Final West Hartford JV Contribution Value, which consist of property operating income, including the difference between actual real estate taxes and tenant recoveries for such real estate taxes, and total project costs. The gain on sale of real estate based on the Final West Hartford JV Contribution Value (the “Final West Hartford JV Gain”) will not be more than \$10.2 million or less than \$1.0 million.

Each unconsolidated joint venture is obligated to maintain financial statements in accordance with GAAP. The Company shares in the profits and losses of these unconsolidated joint ventures generally in accordance with the Company's respective equity interests. In some instances, the Company may recognize profits and losses related to investment in an unconsolidated joint venture that differ from the Company's equity interest in the unconsolidated joint venture. This may arise from impairments that the Company recognizes related to its investment that differ from the impairments the unconsolidated joint venture recognizes with respect to its assets, differences between the Company's basis in assets it has transferred to the unconsolidated joint venture and the unconsolidated joint venture's basis in those assets or other items. There were no joint venture impairment charges for the three or six months ended June 30, 2018 or June 30, 2017.

- 18 -

---

Edgar Filing: Seritage Growth Properties - Form 10-Q

The following tables present combined condensed financial data for the Company's unconsolidated joint ventures (in thousands):

	June 30, 2018	December 31, 2017
<b>ASSETS</b>		
Investment in real estate		
Land	\$348,902	\$191,853
Buildings and improvements	472,256	388,363
Accumulated depreciation	(59,916 )	(48,306 )
	761,242	531,910
Construction in progress	48,012	21,000
Net investment in real estate	809,254	552,910
Cash and cash equivalents	11,050	4,549
Tenant and other receivables, net	4,516	3,843
Other assets, net	37,034	45,605
Total assets	\$861,854	\$606,907
<b>LIABILITIES AND MEMBERS INTERESTS</b>		
Liabilities		
Mortgage loans payable, net	\$134,754	\$122,875
Accounts payable, accrued expenses and other		
liabilities	44,617	28,201
Total liabilities	179,371	151,076
Members Interest		
Additional paid in capital	691,964	473,098
Retained earnings	(9,481 )	(17,267 )
Total members interest	682,483	455,831
Total liabilities and members interest	\$861,854	\$606,907

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
<b>EQUITY IN INCOME OF UNCONSOLIDATED</b>				
<b>JOINT VENTURES</b>				
Total revenue	\$12,116	\$17,168	\$23,343	\$33,512
Property operating expenses	(2,103 )	(3,195 )	(3,815 )	(6,517 )
Depreciation and amortization	(7,030 )	(16,725 )	(14,616 )	(27,697 )
Operating income	2,983	(2,752 )	4,912	(702 )
Other expenses	(7,298 )	(331 )	(14,392 )	(377 )
Net (loss) income	\$(4,315 )	\$(3,083 )	\$(9,480 )	\$(1,079 )
Equity in (loss) income of unconsolidated				
joint ventures	\$(2,158 )	\$(1,542 )	\$(4,740 )	\$(540 )

Note 5 – Leases

Master Lease

On July 7, 2015, subsidiaries of Seritage and subsidiaries of Sears Holdings entered into the Master Lease. The Master Lease generally is a triple net lease with respect to all space which is leased thereunder to Sears Holdings, subject to proportional sharing by Sears Holdings for repair and maintenance charges, real property taxes, insurance and other costs and expenses which are common to both the space leased by Sears Holdings and other space occupied by diversified, non-Sears tenants in the same or other buildings pursuant to such tenants respective leases, space which is recaptured pursuant to the Company recapture rights described below and all other space which is constructed on the properties. Under the Master Lease, Sears Holdings and/or one or more of its subsidiaries will be required to make all expenditures reasonably necessary to maintain the premises in good appearance, repair and condition for as long as they are in occupancy.

- 19 -

---

The Master Lease has an initial term of 10 years and contains three options for five-year renewals of the term and a final option for a four-year renewal. As of June 30, 2018 and June 30, 2017, the annualized base rent paid directly by Sears Holdings and its subsidiaries under the Master Lease was approximately \$88.7 million and \$117.0 million, respectively. In each of the initial and first two renewal terms, annual base rent will be increased by 2.0% per annum for each lease year over the rent for the immediately preceding lease year. For subsequent renewal terms, rent will be set at the commencement of the renewal term at a fair market rent based on a customary third-party appraisal process, taking into account all the terms of the Master Lease and other relevant factors, but in no event will the renewal rent be less than the rent payable in the immediately preceding lease year.

Revenues from the Master Lease for the three and six months ended June 30, 2018 and June 30, 2017 are as follows (in thousands and excluding straight-line rental income of (\$1.0) million and \$0.8 million for the three months ended June 30, 2018 and June 30, 2017, respectively, and (\$0.4) million and \$1.8 million for the six months ended June 30, 2018 and June 30, 2017, respectively):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Rental income	\$22,605	\$29,208	\$45,136	\$60,859
Termination fee income	—	628	174	6,765
Tenant reimbursements	10,950	13,025	24,218	27,731
Total revenue	\$33,555	\$42,861	\$69,528	\$95,355

The Master Lease provides the Company with the right to recapture up to approximately 50% of the space occupied by Sears Holdings at each of the 224 wholly owned properties initially included in the Master Lease (subject to certain exceptions). While the Company is permitted to exercise its recapture rights all at once or in stages as to any particular property, it is not permitted to recapture all or substantially all of the space subject to the recapture right at more than 50 properties under Master Lease during any lease year. In addition, Seritage has the right to recapture any automotive care centers which are free-standing or attached as “appendages” to the properties, all outparcels or outlots and certain portions of the parking areas and common areas. Upon exercise of these recapture rights, the Company will generally incur certain costs and expenses for the separation of the recaptured space from the remaining Sears Holdings space as it reconfigures and rents the recaptured space to diversified, non-Sears tenants.

The Company also has the right to recapture 100% of the space occupied by Sears Holdings at each of 21 properties initially identified under the Master Lease by making a specified lease termination payment to Sears Holdings, after which the Company can reposition and re-lease those stores. The lease termination payment is calculated as the greater of an amount specified at the time the Company entered into the Master Lease with Sears Holdings and an amount equal to 10 times the adjusted EBITDA attributable to such space within the Sears Holdings main store which is not attributable to the space subject to the separate 50% recapture right discussed above for the 12-month period ending at the end of the fiscal quarter ending immediately prior to recapturing such space. As of June 30, 2018, the Company had incurred terminations fees of \$57.1 million with respect to exercising its 100% recapture rights at 16 of the initial 21 properties with such rights. In addition, as of June 30, 2018, the Company had incurred terminations fees of \$43.8 million with respect to converting its partial recapture rights to 100% recapture rights at 16 properties and exercising such rights.

As of June 30, 2018, the Company had exercised recapture rights at 63 properties:

Edgar Filing: Seritage Growth Properties - Form 10-Q

Property	Recapture Type	Notice Date(s)
Fresno, CA	Partial	May 2018
Asheville, NC	100% (1)	March 2018
Chicago, IL (Six Corners)	100% (1)	March 2018
Clearwater, FL	100% (1)	March 2018
El Cajon, CA	100% (1)	March 2018
Fairfield, CA	100% (1)	March 2018 / December 2017
Oklahoma City, OK	Out parcel	March 2018
Plantation, FL	100% (1)	March 2018 / December 2017
Redmond, WA	100% (1)	March 2018 / September 2017
Reno, NV	100% (1)	March 2018
Tucson, AZ	100% (1)	March 2018
Anchorage, AK	100%	December 2017
Boca Raton, FL	100%	December 2017
Westminster, CA	100%	December 2017
Hicksville, NY	100%	December 2017
Orland Park, IL	100% (1)	December 2017
Florissant, MO	Out parcel	December 2017
Salem, NH	Out parcel	December 2017
Las Vegas, NV	Partial	December 2017
Yorktown Heights, NY	Partial	December 2017
Austin, TX (Tech Ridge)	100% (1)	December 2017 / September 2017
Ft. Wayne, IN	Out parcel	September 2017 / July 2016

- 20 -

Edgar Filing: Seritage Growth Properties - Form 10-Q

Property	Recapture Type	Notice Date(s)
North Little Rock, AR	Auto Center	September 2017
St. Clair Shores, MI	100%	September 2017
Canton, OH	Partial	June 2017
Dayton, OH	Auto center	June 2017
North Riverside, IL	Partial	June 2017
Roseville, CA	Auto center	June 2017
Temecula, CA	Partial	June 2017
Watchung, NJ	100%	June 2017
Anderson, SC	100% (1)	April 2017 / July 2016
Aventura, FL	100%	April 2017
Carson, CA	100% (1)	April 2017 / December 2016
Charleston, SC	100% (1)	April 2017 / October 2016
Hialeah, FL (freestanding)	100% (1)	April 2017
San Diego, CA (2)	100% (1)	April 2017
Valley View, TX	100%	April 2017
Cockeysville, MD	Partial	March 2017
North Miami, FL	100%	March 2017
Olean, NY	Partial	March 2017
Guaynabo, PR	Partial	December 2016
Santa Cruz, CA	Partial	December 2016
Santa Monica, CA (3)	100%	December 2016
Saugus, MA	Partial	December 2016
Roseville, MI	Partial	November 2016
Troy, MI	Partial	November 2016
Rehoboth Beach, DE	Partial	October 2016
St. Petersburg, FL	100%	October 2016
Warwick, RI	Auto center	October 2016
West Hartford, CT (4)	100%	October 2016
Madison, WI	Partial	July 2016
North Hollywood, CA	Partial	July 2016
Orlando, FL	100%	July 2016
West Jordan, UT	Partial + auto center	July 2016
Albany, NY	Auto center	May 2016
Bowie, MD	Auto center	May 2016
Fairfax, VA	Partial + auto center	May 2016
Hagerstown, MD	Auto center	May 2016
Wayne, NJ (5)	Partial + auto center	May 2016
San Antonio, TX	Auto center	March 2016
Braintree, MA	100%	November 2015
Honolulu, HI	100%	December 2015
Memphis, TN	100%	December 2015

(1) The Company converted partial recapture rights at this property to 100% recapture rights and exercised such rights.

(2) In May 2018, the Company contributed this property to the UTC JV and retained a 50.0% interest in the joint venture.

(3) In March 2018, the Company contributed this asset to the Mark 302 JV and retained a 50.1% interest in the joint venture.

(4) In May 2018, the Company contributed this property to the West Hartford JV and retained a 50.0% interest in the joint venture.

(5) In July 2017, the Company contributed this asset to the GGP II JV and retained a 50.0% interest in the joint venture.

The Master Lease also provides for certain rights to Sears Holdings to terminate the Master Lease with respect to wholly owned properties that cease to be profitable for operation by Sears Holdings. In order to terminate the Master Lease with respect to a certain property, Sears Holdings must make a payment to the Company of an amount equal to one year of rent (together with taxes and other expenses) with respect to such property. Sears Holdings must provide notice of not less than 90 days of their intent to exercise such termination right and such termination right will be limited so that it will not have the effect of reducing the fixed rent under the Master Lease by more than 20% per annum.

As of June 30, 2018, Sears Holdings had terminated the Master Lease with respect to 56 stores totaling 7.4 million square feet of gross leasable area. The aggregate base rent at these stores at the time of termination was approximately \$23.6 million. Sears Holdings continued to pay the Company rent until it vacated the stores and also paid aggregate termination fees of approximately \$45.1 million, amounts equal to one year of aggregate annual base rent plus one year of estimated real estate taxes and operating expense.

During the three months ended June 30, 2018, Sears Holdings provided notice that it intended to exercise its rights to terminate the Master Lease with respect to 18 additional stores totaling 2.7 million square feet of gross leasable area. The aggregate annual base rent at these stores is approximately \$10.7 million, or 4.8% of the Company's total annual base rent as of June 30, 2018, including all signed leases. Sears Holdings will continue to pay Seritage rent until it vacates the stores which is expected to occur in August 2018



Edgar Filing: Seritage Growth Properties - Form 10-Q

for nine stores, October 2018 for two stores and November 2018 for seven stores. The termination fees are approximately \$20.0 million, an amount equal to one year of the aggregate annual base rent, plus one year of estimated annual operating expenses.

As of June 30, 2018, the Company had commenced or completed redevelopment projects at 31 of the terminated properties and will continue to announce redevelopment activity as new leases are signed to occupy the space formerly occupied by Sears Holdings. During the three months ended June 30, 2018, the Company sold one of the terminated properties for \$11.4 million and recorded a gain of \$2.8 million which is included in gain on sale of real estate within the condensed consolidated statements of operations. During the six months ended June 30, 2018, the Company sold five of the terminated properties for a total of \$24.9 million and recorded a gain of \$4.9 million which is included in gain on sale of real estate within the condensed consolidated statements of operations.

The table below includes the 74 properties at which Sears Holdings has terminated the Master Lease, or provided notice of its intent to terminate the Master Lease, as of June 30, 2018:

Property	Square Feet	Notice	Termination	Announced
				Redevelopment
Alpena, MI	118,200	September 2016	January 2017	
Chicago, IL (S Kedzie)	118,800	September 2016	January 2017	
Cullman, AL	98,500	September 2016	January 2017	Q2 2017
Deming, NM	96,600	September 2016	January 2017	
Elkhart, IN	86,500	September 2016	January 2017	Q4 2016
Harlingen, TX	91,700	September 2016	January 2017	Sold
Houma, LA	96,700	September 2016	January 2017	Sold
Kearney, NE	86,500	September 2016	January 2017	Q3 2016
Manistee, MI	87,800	September 2016	January 2017	
Merrillville, IN	108,300	September 2016	January 2017	Q4 2016
New Iberia, LA	91,700	September 2016	January 2017	Q2 2017
Riverton, WY	94,800	September 2016	January 2017	
Sault Sainte Marie, MI	92,700	September 2016	January 2017	
Sierra Vista, AZ	86,100	September 2016	January 2017	Sold
Springfield, IL	84,200	September 2016	January 2017	Q3 2016
Thornton, CO	190,200	September 2016	January 2017	Q1 2017
Yakima, WA	97,300	September 2016	January 2017	Sold
Chapel Hill, OH	187,179	January 2017	April 2017	
Concord, NC	137,499	January 2017	April 2017	
Detroit Lakes, MN	79,102	January 2017	April 2017	
El Paso, TX	103,657	January 2017	April 2017	Q2 2018
Elkins, WV	94,885	January 2017	April 2017	
Henderson, NV	122,823	January 2017	April 2017	Q1 2017
Hopkinsville, KY	70,326	January 2017	April 2017	Q1 2018
Jefferson City, MO	92,016	January 2017	April 2017	Q2 2017
Kenton, OH	96,066	January 2017	April 2017	
Kissimmee, FL	112,505	January 2017	April 2017	
Layton, UT	90,010	January 2017	April 2017	
Leavenworth, KS	76,853	January 2017	April 2017	
Mount Pleasant, PA	83,536	January 2017	April 2017	Q2 2018
Muskogee, OK	87,500	January 2017	April 2017	

Edgar Filing: Seritage Growth Properties - Form 10-Q

Owensboro, KY	68,334	January 2017	April 2017	
Paducah, KY	108,244	January 2017	April 2017	Q3 2017
Platteville, WI	94,841	January 2017	April 2017	
Riverside, CA (Iowa Ave.)	94,500	January 2017	April 2017	
Sioux Falls, SD	72,511	January 2017	April 2017	
Albany, NY	216,200	June 2017	October 2017	Q1 2016
Burnsville, MN	161,700	June 2017	October 2017	
Chicago, IL (N Harlem)	293,700	June 2017	October 2017	
Cockeysville, MD	83,900	June 2017	October 2017	Q1 2017
East Northport, NY	187,000	June 2017	October 2017	Q2 2017
Greendale, WI	238,400	June 2017	October 2017	Q4 2017
Hagerstown, MD	107,300	June 2017	October 2017	Q1 2016 / Sold
Johnson City, NY	155,100	June 2017	October 2017	
Lafayette, LA	194,900	June 2017	October 2017	
Mentor, OH	208,700	June 2017	October 2017	
Middleburg Heights, OH	351,600	June 2017	October 2017	
Olean, NY	75,100	June 2017	October 2017	Q1 2017
Overland Park, KS	215,000	June 2017	October 2017	

Edgar Filing: Seritage Growth Properties - Form 10-Q

Property	Square Feet	Notice	Termination	Announced Redevelopment
Roseville, MI	277,000	June 2017	October 2017	Q3 2016
Sarasota, FL	204,500	June 2017	October 2017	
Toledo, OH	209,900	June 2017	October 2017	
Warwick, RI	169,200	June 2017	October 2017	Q3 2016 / Q3 2017
York, PA	82,000	June 2017	October 2017	
Friendswood, TX	166,000	June 2017	November 2017 (1)	
Westwood, TX	215,000	June 2017	January 2018 (1)	
Cedar Rapids, IA	141,100	April 2018	August 2018	
Citrus Heights, CA	280,700	April 2018	August 2018	
Gainesville, FL	140,500	April 2018	August 2018	Q2 2018
Maplewood, MN	168,500	April 2018	August 2018	
Pensacola, FL	212,300	April 2018	August 2018	Q2 2018
Rochester, NY	128,500	April 2018	August 2018	
Roseville, CA	121,000	April 2018	August 2018	Q2 2017 / Q1 2018
San Antonio, TX	187,800	April 2018	August 2018	Q4 2015
Warrenton, NJ	113,900	April 2018	August 2018	Q1 2018
Madison, WI	88,100	June 2018	October 2018	Q2 2016
Thousand Oaks, CA	50,300	June 2018	October 2018	Q3 2015
Chesapeake, VA	169,400	June 2018	November 2018	
Clay, NY	138,000	June 2018	November 2018	
Havre, MT	94,700	June 2018	November 2018	
Newark, CA	145,800	June 2018	November 2018	
Oklahoma City, OK	173,700	June 2018	November 2018	Q3 2017
Troy, MI	271,300	June 2018	November 2018	Q3 2016
Virginia Beach, VA	86,900	June 2018	November 2018	Q3 2015
Total square feet	10,123,687			

(1)The Company and Sears Holdings agreed to extend occupancy beyond October 2017 under the existing Master Lease terms.

#### Note 6 – Debt

Subsequent to June 30, 2018, the mortgage loans payable and unsecured term loan described below were repaid in full. See Note 16.

#### Mortgage Loans Payable

On July 7, 2015, pursuant to the Transaction, the Company entered into a mortgage loan agreement (the “Mortgage Loan Agreement”) and mezzanine loan agreement (collectively, the “Loan Agreements”), providing for term loans in an initial principal amount of approximately \$1,161 million (collectively, the “Mortgage Loans”) and a \$100 million future funding facility (the “Future Funding Facility”). Pursuant to the terms of the Loan Agreements, amounts available under the Future Funding Facility were fully drawn by the Company on June 30, 2017. Such amounts were deposited into a redevelopment reserve and will be used to fund redevelopment activity at the Company’s properties.

During the six months ended June 30, 2018, the Company reduced mortgage loans payable by \$131.4 million as a result of the sale of a 49.9% joint venture interest in The Mark 302 and 50.0% joint venture interests in UTC and West Hartford, as well as the disposition of five other assets.

As of June 30, 2018, the aggregate principal amount outstanding under the Mortgage Loans and the Future Funding Facility was \$1,079 million.

Interest under the Mortgage Loans is due and payable on the payment dates, and all outstanding principal amounts are due when the loan matures on the payment date in July 2019, pursuant to the Loan Agreements. The Company has two one-year extension options subject to the payment of an extension fee and satisfaction of certain other conditions. Borrowings under the Mortgage Loans bear interest at the London Interbank Offered Rates ("LIBOR") plus, as of June 30, 2018, a weighted-average spread of 485 basis points; payments are made monthly on an interest-only basis. The weighted-average interest rates for the Mortgage Loans and Future Funding Facility for the three months ended June 30, 2018 and June 30, 2017 were 6.46% and 5.86%, respectively. The weighted-average interest rates for the Mortgage Loans and Future Funding Facility for the six months ended June 30, 2018 and June 30, 2017 were 6.44% and 5.77%, respectively.

- 23 -

---

The Mortgage Loans and Future Funding Facility are secured by all of the Company's Wholly Owned Properties and a pledge of its equity in the JVs. The Loan Agreements contain customary covenants for a real estate financing, including restrictions that limit the Company's ability to grant liens on its assets, incur additional indebtedness, or transfer or sell assets, as well as those that may require the Company to obtain lender approval for certain major tenant leases or significant redevelopment projects. Such restrictions also include cash flow sweep provisions based upon certain measures of the Company's and Sears Holdings' financial and operating performance, including (a) where the "Debt Yield" (the ratio of net operating income for the mortgage borrowers to their debt) is less than 11.0%, (b) if the performance of Sears Holdings at the stores subject to the Master Lease with Sears Holdings fails to meet specified rent ratio thresholds, (c) if the Company fails to meet specified tenant diversification tests and (d) upon the occurrence of a bankruptcy or insolvency action with respect to Sears Holdings or if there is a payment default under the Master Lease with Sears Holdings, in each case, subject to cure rights, including providing specified amounts of cash collateral or satisfying tenant diversification thresholds.

In November 2016, the Company and the servicer for its Mortgage Loans entered into amendments to the Loan Agreements to resolve a disagreement regarding one of the cash flow sweep provisions in the Loan Agreements. The principal terms of these amendments are that the Company (i) posted \$30.0 million, and will post \$3.3 million on a monthly basis, to a redevelopment project reserve account, which amounts may be used by the Company to fund redevelopment activity and (ii) extended the spread maintenance provision for prepayment of the loan by two months through March 9, 2018 (with the spread maintenance premium for the second month at a reduced amount). As a result of this agreement and the resolution of the related disagreement, no cash flow sweep was imposed.

All obligations under the Loan Agreements are non-recourse to the borrowers and the pledgors of the JV Interests and the guarantors thereunder, except that (i) the borrowers and the guarantors will be liable, on a joint and several basis, for losses incurred by the lenders in respect of certain matters customary for commercial real estate loans, including misappropriation of funds and certain environmental liabilities and (ii) the indebtedness under the Loan Agreements will be fully recourse to the borrowers and guarantors upon the occurrence of certain events customary for commercial real estate loans, including without limitation prohibited transfers, prohibited voluntary liens, and bankruptcy. Additionally, the guarantors delivered a limited completion guaranty with respect to future redevelopments undertaken by the borrowers at the properties, and the Company must maintain (i) a net worth of not less than \$1.0 billion and (ii) a minimum liquidity of not less than \$50.0 million, throughout the term of the Loan Agreements.

The Company believes it is currently in compliance with all material terms and conditions of the Loan Agreements.

The Company incurred \$22.3 million of debt issuance costs related to the Mortgage Loans and Future Funding Facility which are recorded as a direct deduction from the carrying amount of the Mortgage Loans and Future Funding Facility and amortized over the term of the Loan Agreements. As of June 30, 2018, the unamortized balance of the Company's debt issuance costs was \$5.4 million as compared to \$8.5 million as December 31, 2017.

#### Unsecured Term Loan

On February 23, 2017, the Operating Partnership, as borrower, and the Company, as guarantor, entered into a \$200 million senior unsecured delayed draw term loan facility (the "Unsecured Delayed Draw Term Loan") with JPP, LLC and JPP II, LLC as lenders (collectively, the "Original Lenders") and JPP, LLC as administrative agent.

The total commitment of the Lenders under the Unsecured Delayed Draw Term Loan was \$200 million and the maturity date was December 31, 2017.

The principal amount of loans outstanding under the Unsecured Delayed Draw Term Loan bore a base annual interest rate of 6.50%. If a cash flow sweep period were to have occurred and been continuing under the Company's Mortgage Loan Agreement (i) the interest rate on any outstanding advances would have increased from and after such date by

1.5% per annum above the base interest rate and (ii) the interest rate on any advances made after such date would have increased by 3.5% per annum above the base interest rate. Accrued and unpaid interest was payable in cash, except that during the continuance of a cash flow sweep period under the Company's Mortgage Loan Agreement, the Operating Partnership could elect to defer the payment of interest which deferred amount would be added to the outstanding principal balance of the loans.

On February 23, 2017, the Operating Partnership paid to the Original Lenders an upfront commitment fee equal to \$1.0 million. On May 24, 2017, the Operating Partnership paid to the Original Lenders an additional, and final, commitment fee of \$1.0 million.

The Unsecured Delayed Draw Term Loan required that the Company at all times maintain (i) a net worth of not less than \$1.0 billion, and (ii) a leverage ratio not to exceed 60.0%.

- 24 -

---

## Edgar Filing: Seritage Growth Properties - Form 10-Q

The Unsecured Delayed Draw Term Loan included customary representations and warranties, covenants and indemnities. The Unsecured Delayed Draw Term Loan also had customary events of default, including (subject to certain materiality thresholds and grace periods) payment default, failure to comply with covenants, material inaccuracy of representation or warranty, and bankruptcy or insolvency proceedings. If there was an event of default, the Lenders could declare all or any portion of the outstanding indebtedness to be immediately due and payable, exercise any rights they might have under any of the Unsecured Delayed Draw Term Loan documents, and require the Operating Partnership to pay a default interest rate on overdue amounts equal to 1.50% in excess of the applicable base interest rate.

Mr. Edward S. Lampert, the Company's Chairman, is the Chairman and Chief Executive Officer of ESL, which controls JPP, LLC and JPP II, LLC. The terms of the Unsecured Delayed Draw Term Loan were approved by the Company's Audit Committee and the Company's Board of Trustees (with Mr. Edward S. Lampert recusing himself).

On December 27, 2017, the Operating Partnership, as borrower, and the Company, as guarantor, refinanced the Unsecured Delayed Draw Term Loan with a new \$200 million unsecured term loan facility (the "Unsecured Term Loan"). The principal amount outstanding under the Unsecured Delayed Draw Term Loan at termination was \$85 million. No prepayment penalties were triggered and the Unsecured Delayed Draw Term Loan terminated in accordance with its terms.

The lenders under the Unsecured Delayed Draw Term Loan, JPP, LLC and JPP II, LLC, maintained their funding of \$85 million in the Unsecured Term Loan, with JPP, LLC appointed as administrative agent under the Unsecured Term Loan. An affiliate of Empyrean Capital Partners, L.P., a Delaware limited partnership (and together with JPP, LLC and JPP II LLC, each an "Initial Lender" and collectively, the "Initial Lenders"), funded \$60 million under the Unsecured Term Loan, resulting in a total of \$145 million committed and funded under the Unsecured Term Loan at closing. Under an accordion feature, the Company has the right to increase the total commitments up to \$200 million and place an additional \$55 million of incremental loans with the Initial Lenders or new lenders. The Initial Lenders under the Unsecured Term Loan are not obligated to make all or any portion of the incremental loans.

The Company used the proceeds of the Unsecured Term Loan, among other things, to refinance the Unsecured Delayed Draw Term Loan, to fund redevelopment projects and for other general corporate purposes. Loans under the Unsecured Term Loan are guaranteed by the Company.

The Unsecured Term Loan matures on the earlier of (i) December 31, 2018 and (ii) the date on which the outstanding indebtedness under the Company's existing mortgage and mezzanine facilities are repaid in full. The Unsecured Term Loan may be prepaid at any time in whole or in part, without any penalty or premium. Amounts drawn under the Unsecured Term Loan and repaid may not be redrawn.

The principal amount of loans outstanding under the Unsecured Term Loan bears a base annual interest rate of 6.75%. Accrued and unpaid interest is payable in cash.

On December 27, 2017, the Borrower paid to each Initial Lender an upfront fee in an aggregate amount equal to 1.00% of the principal amount of the loan made by such Initial Lender.

The Unsecured Term Loan requires that the Company at all times maintain (i) a net worth of not less than \$1.0 billion, and (ii) a leverage ratio not to exceed 60.0%.

The Unsecured Term Loan includes customary representations and warranties, covenants and indemnities. The Unsecured Term Loan also has customary events of default, including (subject to certain materiality thresholds and grace periods) payment default, failure to comply with covenants, material inaccuracy of representations or warranties, and bankruptcy or insolvency proceedings. If there is an event of default, the lenders may declare all or any portion of the outstanding indebtedness to be immediately due and payable, exercise any rights they might have

under any of the Unsecured Term Loan documents, and require the Borrower to pay a default interest rate on overdue amounts equal to 1.50% in excess of the then applicable interest rate.

The Company believes it is currently in compliance with all material terms and conditions of the Unsecured Term Loan.

The Company incurred \$1.8 million of debt issuance costs related to the Unsecured Term Loan which are recorded as a direct deduction from the carrying amount of the Unsecured Term Loan and amortized over the term of the loan. As of June 30, 2018, the unamortized balance of the Company's debt issuance costs was \$0.9 million as compared to \$1.5 million as December 31, 2017.

Mr. Edward S. Lampert, the Company's Chairman, is the sole stockholder, chief executive officer and director of ESL Investments, Inc. ("ESL"), which controls JPP, LLC and JPP II, LLC. The terms of the Unsecured Term Loan were approved by the Company's Audit Committee and the Company's Board of Trustees (with Mr. Edward S. Lampert recusing himself).



## Note 7 – Income Taxes

The Company has elected to be taxed as a REIT as defined under Section 856(c) of the Code for federal income tax purposes and expects to continue to operate to qualify as a REIT. To qualify as a REIT, the Company must meet a number of organizational and operational requirements, including a requirement to currently distribute at least 90% of its adjusted REIT taxable income to its shareholders.

As a REIT, the Company generally will not be subject to federal income tax on taxable income that is distributed to its shareholders. If the Company fails to qualify as a REIT or does not distribute 100% of its taxable income in any taxable year, it will be subject to federal taxes at regular corporate rates (including any applicable alternative minimum tax) and may not be able to qualify as a REIT for four subsequent taxable years.

Even if the Company qualifies for taxation as a REIT, the Company is subject to certain state, local and Puerto Rico taxes on its income and property, and to federal income and excise taxes on its undistributed taxable income.

On December 22, 2017, H.R. 1, known as the Tax Cuts and Jobs Act (the “TCJA”) was signed into law and included wide-scale changes to individual, pass-through and corporation tax laws, including those that impact the real estate industry, the ownership of real estate and real estate investments, and REITs. We have reviewed the provisions of the law that pertain to the Company and have determined them to have no material income tax effect for financial statement purposes.

## Note 8 – Fair Value Measurements

ASC 820, Fair Value Measurement, defines fair value and establishes a framework for measuring fair value. The objective of fair value is to determine the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the “exit price”). ASC 820 establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three levels:

Level 1 - quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities

Level 2 - observable prices based on inputs not quoted in active markets, but corroborated by market data

Level 3 - unobservable inputs used when little or no market data is available

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. The Company also considers counterparty credit risk in its assessment of fair value.

### Financial Assets and Liabilities Measured at Fair Value on a Recurring or Non-Recurring Basis

All derivative instruments are carried at fair value and are valued using Level 2 inputs. The Company’s derivative instrument as of June 30, 2018 and December 31, 2017 consisted of a single interest rate cap. The Company utilizes an independent third party and interest rate market pricing models to assist management in determining the fair value of this instrument.

The fair value of the Company's interest rate cap at June 30, 2018 and December 31, 2017 was less than \$0.1 million and is included as a component of prepaid expenses, deferred expenses and other assets on the condensed consolidated balance sheets.

The Company has elected not to utilize hedge accounting, and therefore, the change in fair value is included within change in fair value of interest rate cap on the condensed consolidated statements of operations. For the three months ended June 30, 2018, the Company recorded a loss of \$0.2 million compared to a loss of \$0.1 million for the three months ended June 30, 2017. For the six months June 30, 2018, the Company recorded a loss of \$7 thousand compared to a loss of \$0.6 million for the six months ended June 30, 2017.

Subsequent to June 30, 2018, the Company terminated its interest rate cap concurrent with the repayment of the Mortgage Loans and the Future Funding Facility. See Note 16.

#### Financial Assets and Liabilities not Measured at Fair Value

Financial assets and liabilities that are not measured at fair value on the condensed consolidated balance sheets include cash equivalents and debt obligations. The fair value of cash equivalents is classified as Level 1 and the fair value of debt obligations is classified as Level 2.

Cash equivalents are carried at cost, which approximates fair value. The fair value of debt obligations is calculated by discounting the future contractual cash flows of these instruments using current risk-adjusted rates available to borrowers with similar credit ratings. As of June 30, 2018 and December 31, 2017, the estimated fair values of the Company's debt obligations were \$1.22 billion and \$1.36 billion, respectively, which approximated the carrying value at such dates as the current risk-adjusted rate approximates the stated rates on the Company's debt obligations.

Subsequent to June 30, 2018, the Company repaid all of its consolidated debt in full. See Note 16.

## Note 9 – Commitments and Contingencies

### Insurance

The Company maintains general liability insurance and all-risk property and rental value, with sub-limits for certain perils such as floods and earthquakes on each of the Company's properties. The Company also maintains coverage for terrorism acts as defined by Terrorism Risk Insurance Program Reauthorization Act, which expires in December 2020.

Insurance premiums are charged directly to each of the retail properties. The Company or its tenants may be responsible for deductibles and losses in excess of insurance coverage, which losses could be material, subject to the terms of the respective tenant leases. The Company continues to monitor the state of the insurance market and the scope and costs of coverage for acts of terrorism. However, the Company cannot anticipate what coverage will be available on commercially reasonable terms in the future.

### Environmental Matters

Under various federal, state and local laws, ordinances and regulations, the Company may be considered an owner or operator of real property or may have arranged for the disposal or treatment of hazardous or toxic substances. As a result, the Company may be liable for certain costs, including removal, remediation, government fines, and injuries to persons and property. The Company does not believe that any resulting liability from such matters will have a material effect on the condensed consolidated financial position, results of operations, or liquidity of the Company. Under the Master Lease, Sears Holdings has indemnified the Company from certain environmental liabilities at the Wholly Owned Properties existing before, or caused by Sears Holdings during, the period in which each Wholly Owned Property is leased to Sears Holdings, including removal and remediation of all affected facilities and equipment constituting the automotive care center facilities (and each JV Master Lease includes a similar requirement of Sears Holdings). As of June 30, 2018 and December 31, 2017, the Company had approximately \$10.4 million and \$10.8 million, respectively, of restricted cash in a lender reserve account to fund potential environmental costs that were identified during due diligence related to the Transaction.

### Litigation and Other Matters

In accordance with accounting standards regarding loss contingencies, the Company accrues an undiscounted liability for those contingencies where the incurrence of a loss is probable and the amount can be reasonably estimated, and the Company discloses the amount accrued and the amount of a reasonably possible loss in excess of the amount accrued or disclose the fact that such a range of loss cannot be estimated. The Company does not record liabilities when the likelihood that the liability has been incurred is probable but the amount cannot be reasonably estimated, or when the liability is believed to be only reasonably possible or remote. In such cases, the Company discloses the nature of the contingency, and an estimate of the possible loss, range of loss, or disclose the fact that an estimate cannot be made.

The Company is subject, from time to time, to various legal proceedings and claims that arise in the ordinary course of business. While the resolution of such matters cannot be predicted with certainty, management believes, based on currently available information, that the final outcome of such matters will not have a material effect on the condensed consolidated financial position, results of operations, cash flows or liquidity of the Company.

Note 10 – Related Party Disclosure

Edward S. Lampert

Edward S. Lampert is Chairman and Chief Executive Officer of Sears Holdings and is the Chairman and Chief Executive Officer of ESL. Mr. Lampert beneficially owns approximately 73.9 % of Sears Holdings' outstanding common stock (per Schedule 13D filed July 6, 2018). Mr. Lampert is also the Chairman of Seritage.

As of June 30, 2018, Mr. Lampert beneficially owned a 36.1% interest in the Operating Partnership and approximately 2.7% and 100% of the outstanding Class A common shares and Class B non-economic common shares, respectively.

- 27 -

---

Subsidiaries of Sears Holdings, as lessees, and subsidiaries of the Company, as lessors, are parties to the Master Lease (see Note 5).

#### Unsecured Term Loan

On December 27, 2017, the Operating Partnership, as borrower, and the Company, as guarantor, entered into a \$200.0 million senior unsecured term loan facility with JPP, LLC, JPP II, LLC and an affiliate of Empyrean Capital Partners, L.P. as lenders, and JPP, LLC as administrative agent.

Edward S. Lampert, the Company's Chairman, is the Chairman and Chief Executive Officer of ESL, which controls JPP, LLC and JPP II, LLC. The terms of the unsecured loan facility were approved by the Company's Audit Committee and the Company's Board of Trustees (with Mr. Edward S. Lampert recusing himself).

Subsequent to June 30, 2018, the Unsecured Term Loan was repaid in full. See Note 16.

#### Note 11 – Non-Controlling Interests

##### Partnership Agreement

On July 7, 2015, Seritage and ESL entered into the agreement of limited partnership of the Operating Partnership (the "Partnership Agreement"). Pursuant to the Partnership Agreement, as the sole general partner of the Operating Partnership, Seritage exercises exclusive and complete responsibility and discretion in its day-to-day management, authority to make decisions, and control of the Operating Partnership, and may not be removed as general partner by the limited partners.

As of June 30, 2018, the Company held a 63.9% interest in the Operating Partnership and ESL held a 36.1% interest. The portions of consolidated entities not owned by the Company are presented as non-controlling interest as of and during the periods presented.

#### Note 12 – Shareholders' Equity

##### Class A Common Shares

During the six months ended June 30, 2018, 3,150,281 net Class C non-voting common shares were converted to Class A common shares.

As of June 30, 2018, 35,678,749 Class A common shares were issued and outstanding.

##### Class B Non-Economic Common Shares

During the six months ended June 30, 2018, 6,501 Class B non-economic common shares were surrendered to the Company.

## Edgar Filing: Seritage Growth Properties - Form 10-Q

As of June 30, 2018, 1,322,365 Class B non-economic common shares were issued and outstanding. The Class B non-economic common shares have voting rights, but do not have economic rights and, as such, do not receive dividends and are not included in earnings per share computations.

### Class C Non-Voting Common Shares

During the six months ended June 30, 2018, 3,150,281 net Class C non-voting common shares were converted to Class A common shares.

As of June 30, 2018, 850 Class C non-voting common shares were issued and outstanding. The Class C non-voting common shares have economic rights, but do not have voting rights. Upon any transfer of a Class C non-voting common share to any person other than an affiliate of the holder of such share, such share shall automatically convert into one Class A common share.

### Series A Preferred Shares

In December 2017, the Company issued 2,800,000 7.00% Series A Cumulative Redeemable Preferred Shares (the "Series A Preferred Shares") in a public offering at \$25.00 per share. The Company received net proceeds from the offering of approximately \$66.7 million, after deducting payment of the underwriting discount and offering expenses, which it used the proceeds to fund its redevelopment pipeline and for general corporate purposes.

- 28 -

---

## Edgar Filing: Seritage Growth Properties - Form 10-Q

We may not redeem the Series A Preferred Shares before December 14, 2022 except to preserve our status as a REIT or upon the occurrence of a Change of Control, as defined in the Trust Agreement addendum designating the Series A Preferred Shares. On and after December 14, 2022, we may redeem any or all of the Series A Preferred Shares at \$25.00 per share plus any accrued and unpaid dividends. In addition, upon the occurrence of a Change of Control, we may redeem any or all of the Series A Preferred Shares for cash within 120 days after the first date on which such Change of Control occurred at \$25.00 per share plus any accrued and unpaid dividends. The Series A Preferred Shares have no stated maturity, are not subject to any sinking fund or mandatory redemption and will remain outstanding indefinitely unless we redeem or otherwise repurchase them or they are converted.

### Dividends and Distributions

The Company's Board of Trustees declared the following common stock dividends during 2018 and 2017, with holders of Operating Partnership units entitled to an equal distribution per Operating Partnership unit held on the record date:

Declaration Date	Record Date	Payment Date	Dividends per Class A and Class C Common Share
<b>2018</b>			
July 24	September 28	October 11	\$ 0.25
April 24	June 29	July 12	0.25
February 20	March 30	April 12	0.25
<b>2017</b>			
October 24	December 29	January 11, 2018	\$ 0.25
July 25	September 29	October 12	0.25
April 25	June 30	July 13	0.25
February 28	March 31	April 13	0.25

The Company's Board of Trustees declared the following preferred stock dividends during 2018:

Declaration Date	Record Date	Payment Date	Series A Preferred Share
<b>2018</b>			
July 24	September 28	October 15	\$0.43750
April 24	June 29	July 16	0.43750
February 20	March 30	April 16	0.43750
February 20 (1)	March 30	April 16	0.15556

(1) This dividend covers the period from, and including, December 14, 2017 to December 31, 2017.

Note 13 – Earnings per Share

The table below provides a reconciliation of net income (loss) and the number of common shares used in the computations of “basic” earnings per share (“EPS”), which utilizes the weighted-average number of common shares outstanding without regard to dilutive potential common shares, and “diluted” EPS, which includes all such shares. Potentially dilutive securities consist of shares of non-vested restricted stock and the redeemable non-controlling interests in the Operating Partnership.

All outstanding non-vested shares that contain non-forfeitable rights to dividends are considered participating securities and are included in computing EPS pursuant to the two-class method which specifies that all outstanding non-vested share-based payment awards that contain non-forfeitable rights to distributions are considered participating securities and should be included in the computation of EPS.

- 29 -

---



Edgar Filing: Seritage Growth Properties - Form 10-Q

Earnings per share has not been presented for Class B shareholders, as they do not have economic rights.

(in thousands except per share amounts)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
<b>Numerator</b>				
Net income (loss)	\$(10,602)	\$(34,867)	\$5,599	\$(67,711)
Net (income) loss attributable to non-controlling interests	3,831	13,648	(2,042)	26,654
Preferred dividends	(1,225)	—	(2,453)	—
Net income (loss) attributable to common shareholders	\$(7,996)	\$(21,219)	\$1,104	\$(41,057)
Earnings allocated to unvested participating securities	—	—	(4)	—
Net income (loss) available to common shareholders				
- Basic and diluted	\$(7,996)	\$(21,219)	\$1,100	\$(41,057)
<b>Denominator</b>				
Weighted average Class A common shares outstanding	35,372	27,922	34,527	27,835
Weighted average Class C common shares outstanding	111	5,844	922	5,803
Weighted average Class A and Class C common shares				
outstanding - Basic	35,483	33,766	35,449	33,638
Restricted shares and share units	—	—	139	—
Weighted average Class A and Class C common shares				
outstanding - Diluted	35,483	33,766	35,588	33,638
<b>Net income (loss) per share attributable to Class A and</b>				
Class C common shareholders - Basic	\$(0.23)	\$(0.63)	\$0.03	\$(1.22)
Net income (loss) per share attributable to Class A and				
Class C common shareholders - Diluted	\$(0.23)	\$(0.63)	\$0.03	\$(1.22)

No adjustments were made to the numerator for the three months ended June 30, 2018 and June 30, 2017 or the six months ended June 30, 2017 because the Company generated a net loss. During periods of net loss, undistributed losses are not allocated to the participating securities as they are not required to absorb losses.

No adjustments were made to the denominator for the three months ended June 30, 2018 and June 30, 2017 or the six months ended June 30, 2017 because (i) the inclusion of outstanding non-vested restricted shares would have had an anti-dilutive effect and (ii) including the non-controlling interest in the Operating Partnership would also require that the share of the Operating Partnership loss attributable to such interests be added back to net loss, therefore, resulting in no effect on earnings per share.

As of June 30, 2018 and December 31, 2017, there were 139,000 and 67,000 unvested participating restricted shares and share units outstanding, respectively, and 490,450 and 245,570 total unvested restricted shares and share units outstanding, respectively.

Note 14 – Stock Based Compensation

On July 7, 2015, the Company adopted the Seritage Growth Properties 2015 Share Plan (the “Plan”). The number of shares of common stock reserved for issuance under the Plan is 3,250,000. The Plan provides for grants of restricted shares, share units, other share-based awards, options, and share appreciation rights, each as defined in the Plan (collectively, the "Awards"). Directors, officers, other employees, and consultants of the Company and its subsidiaries and affiliates are eligible for Awards.

Restricted Shares and Share Units

Pursuant to the Plan, the Company has periodically made grants of restricted shares or share units. The vesting terms of these grants are specific to the individual grant and vary in that a portion of the restricted shares and share units vest in equal annual amounts over the subsequent three years (time-based vesting) and a portion of the restricted shares and share units vest on the third anniversary of the grants subject to the achievement of certain performance criteria (performance-based vesting).

In general, participating employees are required to remain employed for vesting to occur (subject to certain limited exceptions). Restricted shares and share units that do not vest are forfeited. Dividends on restricted shares and share units with time-based vesting are paid to holders of such shares and share units and are not returnable, even if the underlying shares or share units do not ultimately vest. Dividends on restricted shares and share units with performance-based vesting are accrued when declared and paid to holders of such shares on the third anniversary of the initial grant subject to the vesting of the underlying shares.

- 30 -

---

## Edgar Filing: Seritage Growth Properties - Form 10-Q

The following table summarizes restricted share activity for the six months ended June 30, 2018:

	Six Months Ended June 30, 2018	Weighted- Average Grant Date Fair Value
	Shares	
Unvested restricted shares at beginning of period	245,570	\$ 41.33
Restricted shares granted	261,059	40.80
Restricted shares vested	(14,214 )	47.08
Restricted shares forfeited	(1,965 )	39.10
Unvested restricted shares at end of period	490,450	\$ 40.89

The Company recognized \$2.5 million and \$0.4 million in compensation expense related to the restricted shares for the three months ended June 30, 2018 and June 30, 2017, respectively, and \$3.4 million and \$0.8 million for the six months ended June 30, 2018 and June 30, 2017, respectively. Such expenses are included in general and administrative expenses on the Company's condensed consolidated statements of operations. As of June 30, 2018, there were approximately \$9.4 million of total unrecognized compensation costs related to the outstanding restricted shares.

### Note 15 – Accounts Payable, Accrued Expenses and Other Liabilities

The following table summarizes the significant components of accounts payable, accrued expenses and other liabilities as of June 30, 2018 and December 31, 2017 (in thousands):

	June 30, 2018	December 31, 2017
Accrued development expenditures	\$ 14,465	\$ 21,449
Accrued real estate taxes	15,972	17,091
Dividends payable	14,540	14,559
Below-market leases	13,430	14,476
Accounts payable and accrued expenses	13,309	9,588
Environmental reserve	10,753	11,322
Prepaid rental income	5,982	4,156
Unearned tenant reimbursements	3,298	10,522
Accrued interest	3,211	3,689
Deferred maintenance	2,581	2,581
Total accounts payable, accrued expenses and other liabilities	\$ 97,541	\$ 109,433

Note 16 – Subsequent Events

On July 31, 2018, the Operating Partnership, as borrower, and the Company, as guarantor, entered into a Senior Secured Term Loan Agreement (the “Loan Agreement”) providing for a \$2.0 billion term loan facility (the “Term Loan Facility”) with Berkshire Hathaway Life Insurance Company of Nebraska (“Berkshire Hathaway”) as lender and Berkshire Hathaway as administrative agent. The Term Loan Facility provided for an initial funding of \$1.6 billion at closing (the “Initial Funding”) and includes a \$400 million incremental funding facility (the “Incremental Funding Facility”).

The Company used a portion of the proceeds from the Initial Funding to (i) repay the Mortgage Loans and Future Funding Facility due July 2019; (ii) repay the Unsecured Term Loan due December 2018; and (iii) pay transaction and related costs. The remaining proceeds from the Initial Funding, as well as borrowings under the Incremental Funding Facility, will be used to fund the Company’s redevelopment pipeline and to pay operating expenses of the Company and its subsidiaries.

Funded amounts under the Term Loan Facility bear interest at an annual rate of 7.0% and unfunded amounts under the Incremental Funding Facility are subject to an annual fee of 1.0% until drawn. The Term Loan Facility matures on July 31, 2023.

The Term Loan Facility is guaranteed by the Company and, subject to certain exceptions, will be required to be guaranteed by all existing and future subsidiaries of the Borrower. The Term Loan Facility is secured on a first lien basis by a pledge of the capital stock of the direct subsidiaries of the Borrower and the guarantors, including its joint venture interests, except as prohibited by the organizational documents of such entities or any joint venture agreements applicable to such entities, and contains a springing

requirement to provide mortgages and other customary collateral upon the breach of certain financial metrics described below, the occurrence and continuation of an event of default and certain other conditions set forth in the Loan Agreement.

The Term Loan Facility includes certain financial metrics to govern springing collateral and certain covenant exceptions set forth in the Loan Agreement, including: (i) a total fixed charge coverage ratio of not less than 1.00 to 1.00 for each fiscal quarter beginning with the fiscal quarter ending September 30, 2018 through the fiscal quarter ending June 30, 2021, and not less than 1.20 to 1.00 for each fiscal quarter thereafter; (ii) an unencumbered fixed charge coverage ratio of not less than 1.05 to 1.00 for each fiscal quarter beginning with the fiscal quarter ending September 30, 2018 through the fiscal quarter ending June 30, 2021, and not less than 1.30 to 1.00 for each fiscal quarter thereafter; (iii) a total leverage ratio of not more than 65%; (iv) an unencumbered ratio of not more than 60%; and (v) a minimum net worth of at least \$1.2 billion. Any failure to satisfy any of these financial metrics will limit the Company's ability to dispose of assets via sale or joint venture and will trigger the springing mortgage and collateral requirement, but will not result in an event of default. The Term Loan Facility also includes certain limitations relating to, among other activities, the Company's ability to: sell assets or merge, consolidate or transfer all or substantially all of its assets; incur additional debt; incur certain liens; enter into, terminate or modify certain material leases and/or the material agreements for the Company's properties; make certain investments (including limitations on joint ventures) and other restricted payments; pay distributions on or repurchase the Company's capital stock; and enter into certain transactions with affiliates.

The Term Loan Facility contains customary events of default, including (subject to certain materiality thresholds and grace periods) payment default, material inaccuracy of representations or warranties, and bankruptcy or insolvency proceedings. If there is an event of default, the lenders may declare all or any portion of the outstanding indebtedness to be immediately due and payable, exercise any rights they might have under any of the Term Loan Facility documents, and require the Company to pay a default interest rate on overdue amounts equal to 2.0% in excess of the then applicable interest rate.

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

Certain statements contained herein constitute forward-looking statements as such term is defined in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended.

Forward-looking statements are not guarantees of future performance. They represent our intentions, plans, expectations and beliefs and are subject to numerous assumptions, risks and uncertainties. Our future results, financial condition and business may differ materially from those expressed in these forward-looking statements. You can find many of these statements by looking for words such as "approximates," "believes," "expects," "anticipates," "estimates," "intends," "plans," "projects," "will," "would," "may" or other similar expressions in this Quarterly Report on Form 10-Q. Many of the factors that will determine the outcome of these and our other forward-looking statements are beyond our ability to control or predict. For further discussion of factors that could materially affect the outcome of our forward-looking statements, see "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017. 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. 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. We do not undertake any obligation to release publicly any revisions to our forward-looking statements to reflect events or circumstances occurring after the date of this Quarterly Report on Form 10-Q. The following discussion should be read in conjunction with the condensed consolidated financial statements and notes thereto included in Part 1 of this Quarterly Report.

Overview

Seritage Growth Properties (NYSE: SRG), a Maryland real estate investment trust formed on June 3, 2015, is a fully integrated, self-administered and self-managed real estate investment trust ("REIT") as defined under Section 856(c) of the Internal Revenue Code (the "Code"). Seritage's assets are held by and its operations are primarily conducted through, directly or indirectly, the Operating Partnership. Under the partnership agreement of the Operating Partnership, Seritage, as the sole general partner, has exclusive responsibility and discretion in the management and control of the Operating Partnership. Unless otherwise expressly stated or the context otherwise requires, the "Company", "we," "us," and "our" as used herein refer to Seritage, the Operating Partnership, and its owned and controlled subsidiaries.

We are principally engaged in the acquisition, ownership, development, redevelopment, management, and leasing of diversified retail real estate throughout the United States. As of June 30, 2018, our portfolio included approximately 38.7 million square feet of gross leasable area ("GLA"), consisting of 222 Wholly Owned Properties totaling 34.1 million square feet of GLA across 49 states and Puerto Rico, and interests in 26 JV Properties totaling approximately 4.6 million square feet of GLA across 13 states.

As of June 30, 2018, we leased space at 144 Wholly Owned Properties to Sears Holdings under the Master Lease, including 72 properties leased only to Sears Holdings and 72 properties leased to both Sears Holdings and one or more diversified, non-Sears tenants. The remaining 78 Wholly Owned Properties include 55 properties that are leased solely to diversified, non-Sears tenants and do not have any space leased to Sears Holdings, and 23 vacant properties. As of June 30, 2018, space at 22 JV Properties is also leased to Sears Holdings under the JV Master Leases. Sears Holdings is the sole tenant at nine JV Properties and 13 JV properties are leased to both Sears Holdings and one or more diversified, non-Sears tenants. Three JV Properties are leased solely to diversified, non-Sears tenants and one JV Property was vacant as of June 30, 2018.

We generate revenues primarily by leasing our properties to tenants, including both Sears Holdings and diversified, non-Sears tenants, who operate retail stores (and potentially other uses) in the leased premises, a business model common to many publicly traded REITs. In addition to revenues generated under the Master Lease through rent payments from Sears Holdings, we generate revenue through leases to diversified, non-Sears tenants under existing and future leases for space at our properties.

The Master Lease provides us with the right to recapture up to approximately 50% of the space occupied by Sears Holdings at each of the 224 Wholly Owned Properties initially included in the Master Lease (subject to certain exceptions and limitations). In addition, Seritage has the right to recapture any automotive care centers which are free-standing or attached as “appendages” to the properties, and all outparcels or outlots and certain portions of parking areas and common areas. Upon exercise of this recapture right, we will generally incur certain costs and expenses for the separation of the recaptured space from the remaining Sears Holdings space and can reconfigure and rent the recaptured space to diversified, non-Sears tenants on potentially superior terms determined by us and for our own account. We also have the right to recapture 100% of the space occupied by Sears Holdings at each of 21 identified Wholly Owned Properties by making a specified lease termination payment to Sears Holdings, after which we expect to be able to reposition and re-lease those stores on potentially superior terms determined by us and for our own account.

As of June 30, 2018, we had exercised recapture rights at 63 properties, including 19 properties at which we exercised partial recapture rights, 32 properties at which we exercised 100% recapture rights (16 of which were converted from partial recapture properties), and 12 properties at which we exercised our rights to recapture only automotive care centers or outparcels.

- 33 -

---

## Critical Accounting Policies

A summary of our critical accounting policies is included in our Annual Report on Form 10-K for the year ended December 31, 2017 in Management's Discussion and Analysis of Financial Condition and Results of Operations. For the six months ended June 30, 2018, there were no material changes to these policies, other than the adoption of the Accounting Standards Codification Topic 606, Revenue from Contracts with Customers and revised Sub-topic 610-20 Other Income – Gains and Losses From the Derecognition of Nonfinancial Assets, described in Note 2 to the unaudited consolidated financial statements in Part I, Item I of this Quarterly Report on Form 10-Q.

## Results of Operations

We derive substantially all of our revenue from rents received from tenants under existing leases at each of our properties. This revenue generally includes fixed base rents and recoveries of expenses that we have incurred and that we pass through to the individual tenants, in each case as provided in the respective leases.

Our primary cash expenses consist of our property operating expenses, general and administrative expenses, interest expense, and construction and development related costs. Property operating expenses include: real estate taxes, repairs and maintenance, management expenses, insurance, ground lease costs and utilities; general and administrative expenses include payroll, office expenses, professional fees, and other administrative expenses; and interest expense is primarily on our mortgage loans payable. In addition, we incur substantial non-cash charges for depreciation and amortization on our properties and related intangible assets and liabilities resulting from the Transaction.

We did not have any revenues or expenses until we completed the Transaction on July 7, 2015.

## Rental Income

For the three months ended June 30, 2018:

The Company recognized total rental income of \$35.8 million as compared to \$42.2 million for the three months ended June 30, 2017. The \$6.4 million decrease was driven primarily by (i) a reduction of rental income under the Master Lease of \$6.6 million, (ii) a reduction in straight-line rent of \$1.5 million and (iii) lower termination fee income of \$0.5 million, offset by an increase in diversified, non-Sears rental income of \$2.5 million.

Rental income attributable to Sears Holdings was \$22.6 million (excluding straight-line rental income of (\$1.0) million) or 63.8% of total rental income earned in the period. For the prior year period, the comparable rental income attributable to Sears Holdings was \$29.2 million, or approximately 74.5% of total rental income earned in the period. Rental income attributable to diversified, non-Sears tenants was \$12.8 million (excluding straight-line rental income of \$1.3 million), or 36.2% of total rental income earned in the period. For the prior year period, the comparable rental income attributable to diversified, non-Sears tenants was \$10.0 million, or approximately 25.5% of total rental income earned in the period.

Straight-line rent was \$0.4 million as compared to \$1.9 million for the prior year period. The current year period was lower primarily due to the amortization of accrued rental revenues related to the straight-line method of reporting that were deemed uncollectable as result of recapture and termination activity under the Master Lease.

For the six months ended June 30, 2018:

The Company recognized total rental income of \$72.9 million as compared to \$91.4 million for the six months ended June 30, 2017. The \$18.5 million decrease was driven primarily by (i) a reduction of rental income under the Master Lease of \$15.7 million, (ii) lower termination fee income of \$6.6 million and (iii) a reduction in straight-line rent of \$0.6 million, offset by an increase in diversified, non-Sears rental income of \$4.6 million.

Rental income attributable to Sears Holdings was \$45.1 million (excluding straight-line rental income of (\$0.4) million and termination fee income of \$0.2 million), or 64.8% of total rental income earned in the period. For the prior year period, the comparable rental income attributable to Sears Holdings was \$60.9 million, or approximately



75.6% of total rental income earned in the period.

Rental income attributable to diversified, non-Sears tenants was \$24.5 million (excluding straight-line rental income of \$3.3 million), or 35.2% of total rental income earned in the period. For the prior year period, the comparable rental income attributable to diversified, non-Sears tenants was \$19.7 million, or approximately 24.4% of total rental income earned in the period.

Straight-line rent was \$2.8 million as compared to \$3.5 million for the prior year period. The current year period was lower primarily due to the amortization of accrued rental revenues related to the straight-line method of reporting that were deemed uncollectable as result of recapture and termination activity under the Master Lease.

- 34 -

---

## Edgar Filing: Seritage Growth Properties - Form 10-Q

On an annual basis, and taking into account all signed leases, including those which have not yet commenced rental payments, rental income attributable to diversified, non-Sears tenants would have represented approximately 56.9% of total annual base rental income as of June 30, 2018.

The increase in rental income attributable to diversified, non-Sears tenants, and the reduction in rental income attributable to Sears Holdings, are driven by the Company's leasing and redevelopment activity, including signing new leases with diversified, non-Sears tenants and recapturing space from Sears Holdings.

### Tenant Reimbursements and Property Operating Expenses

Pursuant to the provisions of the Master Lease and many diversified, non-Sears leases, the Company is entitled to be reimbursed for certain property related expenses.

For the three months ended June 30, 2018:

The Company recorded tenant reimbursement income of \$12.5 million compared to property operating and real estate tax expenses totaling \$15.7 million, an expense recovery rate of 79.6%. For the three months ended June 30, 2017, the Company recorded tenant reimbursement income of \$15.7 million compared to property operating and real estate tax expenses totaling \$16.9 million, an expense recovery rate of 92.9%.

The \$1.2 million decrease in property operating and real estate taxes was primarily due to a decrease in real estate taxes as a result of the disposition of interests in certain properties, offset by an increase in utility and certain common area maintenance expenses related to properties for which Sears Holdings paid such expenses directly during the prior year period, but for which the Company now incurs the expenses (a portion of which is reimbursed by other tenants).

The 13.3% reduction in expense recovery rate was primarily due to an increase in the amount of unleased space, including unleased space for which the Company was previously recording tenant reimbursement income as a result of termination payments under the Master Lease.

For the six months ended June 30, 2018:

The Company recorded tenant reimbursement income of \$29.2 million compared to property operating and real estate tax expenses totaling \$34.4 million, an expense recovery rate of 84.9%. For the six months ended June 30, 2017, the Company recorded tenant reimbursement income of \$31.9 million compared to property operating and real estate tax expenses totaling \$34.1 million, an expense recovery rate of 93.5%.

The \$0.3 million increase in property operating and real estate taxes was primarily due to an increase in utility and certain common area maintenance expenses related to properties for which Sears Holdings paid such expenses directly during the prior year period, but for which the Company now incurs the expenses (a portion of which is reimbursed by other tenants), offset by a decrease in real estate taxes as a result of the disposition of interests in certain properties.

The 8.6% reduction in expense recovery rate was primarily due to an increase in the amount of unleased space, including unleased space for which the Company was previously recording tenant reimbursement income as a result of termination payments under the Master Lease.

### Depreciation and Amortization Expenses

Depreciation and amortization expenses consist of depreciation of real property, depreciation of furniture, fixtures and equipment, and amortization of certain lease intangible assets.

## Edgar Filing: Seritage Growth Properties - Form 10-Q

For the three months ended June 30, 2018, the Company incurred depreciation and amortization expenses of \$49.6 million as compared to depreciation and amortization expenses of \$50.6 million in the prior year period. The decrease of \$1.0 million was due primarily to (i) \$8.3 million of lower scheduled amortization resulting from an increase in fully-amortized lease intangibles and (ii) \$3.2 million of accelerated depreciation in the prior year period attributable to certain buildings that were demolished for redevelopment, offset by a \$10.5 million increase in accelerated amortization attributable to certain lease intangible assets.

For the six months ended June 30, 2018, the Company incurred depreciation and amortization expenses of \$84.2 million as compared to depreciation and amortization expenses of \$109.2 million in the prior year period. The decrease of \$25.0 million was due primarily

- 35 -

---

to (i) \$17.6 million of lower scheduled amortization resulting from an increase in fully-amortized lease intangibles and (ii) a \$7.6 million decrease in accelerated amortization attributable to certain lease intangible assets.

Accelerated amortization results from the recapture of space from, or the termination of space by, Sears Holdings. Such recaptures and terminations are deemed lease modifications and require related lease intangibles to be amortized over the shorter of the shortened lease term or the remaining useful life of the asset.

#### General and Administrative Expenses

General and administrative expenses consist of personnel costs, including stock-based compensation, professional fees, office expenses and other overhead expenses.

For the three months ended June 30, 2018, the Company incurred general and administrative expenses of \$8.7 million compared to general and administrative expenses of \$5.1 million for the prior year period. The \$3.6 million increase was driven primarily by (i) increased equity-based compensation expense of \$2.0 million resulting from the outperformance of targets related to equity awards with performance-based vesting and (ii) increased compensation and related personnel and overhead costs resulting from an increase in personnel.

For the six months ended June 30, 2018, the Company incurred general and administrative expenses of \$16.5 million compared to general and administrative expenses of \$11.4 million for the prior year period. The \$5.1 million increase was driven primarily by (i) increased stock-based compensation expense of \$2.4 million resulting from the outperformance of targets related to equity awards with performance-based vesting, (ii) the \$1.1 million write-off of certain transaction-related expenses and (iii) increased compensation and related personnel and overhead costs resulting from an increase in personnel.

#### Gain on Sale of Real Estate

During the three months ended June 30, 2018:

- The Company contributed its property located in San Diego, CA to the UTC JV and sold a 50.0% interest to a separate account advised by Invesco Real Estate based on a contribution value of \$68.0 million and pre-transaction development and other costs of approximately \$19.2 million. As a result of the transaction, the Company recorded a gain of \$27.5 million which is included in gain on sale of real estate within the condensed consolidated statements of operations.
- The Company contributed its property located in West Hartford, CT to the West Hartford JV and sold a 50.0% interest to First Washington Realty based on the Initial West Hartford JV Contribution Value of \$25.0 million and pre-transaction development and other costs of approximately \$20.2 million. As a result of the transaction, the Company recorded the Initial West Hartford JV Gain of \$5.6 million which is included in gain on sale of real estate within the condensed consolidated statements of operations.

The West Hartford JV is subject to (i) a revaluation upon the earlier of the first anniversary of project stabilization (as defined in the operating agreement of the West Hartford JV) or December 31, 2019, and (ii) an adjustment based on the timing, method and magnitude of the reassessment of the property for real estate tax purposes between 2018 and 2022. Upon revaluation, the primary inputs in determining the Initial West Hartford JV Contribution Value, which consist of property operating income and total project costs, will be updated for actual results and the Final West Hartford JV Contribution Value will be calculated to yield a pre-determined rate of return to First Washington Realty. Upon adjustment for real estate tax purposes, an amount based on the difference between actual real estate taxes and tenant recoveries for such real estate taxes will be determined and the capitalized value of such amount will be applied as the Real Estate Tax Adjustment Amount. The Final West Hartford JV Gain will not be more than \$10.2 million or less than \$1.0 million.

–

## Edgar Filing: Seritage Growth Properties - Form 10-Q

The Company sold one property located in Hagerstown, MD for \$11.5 million and recorded a gain of \$2.8 million which is included in gain on the sale of real estate within the condensed consolidated statements of operations. During the six months ended June 30, 2018, in addition to the activity described above:

- The Company contributed its property located in Santa Monica, CA to the Mark 302 JV and sold a 49.9% interest to an investment fund managed by Invesco Real Estate based on the Initial Mark 302 JV Contribution Value of \$90.0 million. As a result of the transaction, the Company recorded the Initial Mark 302 JV Gain of \$39.1 million which is included in gain on sale of real estate within the condensed consolidated statements of operations.
- The Mark 302 JV is subject to a revaluation upon the earlier of the first anniversary of project stabilization (as defined in the operating agreement of the Mark 302 JV) or December 31, 2020. Upon revaluation, the primary inputs in determining the Initial Mark 302 JV Contribution Value, which consist of property operating income and total project costs, will be updated for actual results and the Final Contribution Value will be calculated to yield a pre-determined rate of return to the investment fund managed by Invesco Real Estate. The Final Mark 302 JV Gain will not be more than \$54.1 million or less than \$9.1 million.

- 36 -

---

## Edgar Filing: Seritage Growth Properties - Form 10-Q

Each reporting period the Company re-analyzes the primary inputs that determine the Final Mark 302 Contribution Value and Final Mark 302 Gain. For the three months ended June 30, 2018, there were no adjustments to the Initial Mark 302 Contribution Value or the Initial Mark 302 Gain as a result of such analysis.

–The Company sold four properties located in Harlingen, TX, Houma, LA, Sierra Vista, AZ and Yakima, WA for \$13.5 million and recorded a gain of \$2.1 million which is included in gain on the sale of real estate within the condensed consolidated statements of operations.

### Interest Expense

For the three months ended June 30, 2018, the Company incurred \$17.9 million of interest expense (net of amounts capitalized) as compared to interest expense of \$18.4 million for the prior year period. The decrease in interest expense was driven by an increase in amounts capitalized as a result of a greater amount of construction in process, offset by an increase in interest expense driven by higher average LIBOR rates.

For the six months ended June 30, 2018, the Company incurred \$34.3 million of interest expense (net of amounts capitalized) as compared to interest expense of \$35.0 million for the prior year period. The decrease in interest expense was driven by an increase in amounts capitalized as a result of a greater amount of construction in process, offset by an increase in interest expense driven by higher average LIBOR rates.

### Unrealized Loss on Interest Rate Cap

For the three months ended June 30, 2018, the Company recorded a loss of \$0.2 million compared to a loss of \$0.1 million in the prior year period.

For the six months ended June 30, 2018, the Company recorded a loss of \$7 thousand compared to a loss of \$0.6 million in the prior year period.

### Liquidity and Capital Resources

Property rental income is our primary source of cash and is dependent on a number of factors, including occupancy levels and rental rates, as well as our tenants' ability to pay rent. Our primary uses of cash include payment of operating expenses, debt service, reinvestment in and redevelopment of properties, and distributions to shareholders and unitholders. We believe that we currently have sufficient liquidity to fund such uses in the form of, as of June 30, 2018, (i) \$100.4 million of unrestricted cash, (ii) \$166.5 million of restricted cash and (iii) anticipated cash provided by operations, and subsequent to June 30, 2018, net proceeds generated from our new \$2.0 billion term loan facility (see Note 16). We may also raise additional capital through the public or private issuance of debt securities, common or preferred equity or other instruments convertible into or exchangeable for common or preferred equity, as well as through asset sales or joint ventures.

### Summary of Cash Flows

Net cash provided by operating activities was \$16.2 million for the six months ended June 30, 2018 compared to \$21.7 million for the six months ended June 30, 2017. Significant changes in the components of net cash provided by operating activities include:

- In 2018, a decrease in operating cash inflows due to net reductions in rental income under the Master Lease and an increase in unleased properties, offset by additional diversified, non-Sears rental income; and
- In 2017, an increase in operating cash inflows due to termination fee income.

Net cash used by investing activities was \$5.1 million for the six months ended June 30, 2018 compared \$113.6 million for the six months ended June 30, 2017. Significant components of net cash used in investing activities include:

Edgar Filing: Seritage Growth Properties - Form 10-Q

- In 2018, net proceeds from the sale of real estate, \$134.6 million;
  - In 2018, development of real estate and property improvements, (\$142.0) million;
  - In 2017, development of real estate and property improvements, (\$106.1) million; and
  - In 2017, investments in unconsolidated joint ventures, (\$15.0) million.
- 37 -
-

## Edgar Filing: Seritage Growth Properties - Form 10-Q

Net cash used by financing activities was \$161.5 million for the six months ended June 30, 2018 compared to net cash provided by financing activities of \$134.7 million for the six months ended June 30, 2017. Significant components of net cash used in financings activities include:

- In 2018, repayment of mortgage loan payables, (\$131.4) million;
- In 2018, cash distributions to common stockholders and holders of Operating Partnership units, (\$27.9) million;
- In 2017, proceeds from the Future Funding Facility, \$80.0 million;
- In 2017, proceeds from the Unsecured Term Loan, \$85.0 million; and
- In 2017, cash distributions to common stockholders and holders of Operating Partnership units, (\$27.8) million.

### Dividends and Distributions

The Company's Board of Trustees declared the following common stock dividends during 2018 and 2017, with holders of Operating Partnership units entitled to an equal distribution per Operating Partnership unit held on the record date:

Declaration Date	Record Date	Payment Date	Dividends per Class A and Class C Common Share
<b>2018</b>			
July 24	September 28	October 11	\$ 0.25
April 24	June 29	July 12	0.25
February 20	March 30	April 12	0.25
<b>2017</b>			
October 24	December 29	January 11, 2018	\$ 0.25
July 25	September 29	October 12	0.25
April 25	June 30	July 13	0.25
February 28	March 31	April 13	0.25

The Company's Board of Trustees declared the following preferred stock dividends during 2018:

Declaration Date	Record Date	Payment Date	Series A Preferred Share
<b>2018</b>			
July 24	September 28	October 11	\$0.43750
April 24	June 29	July 16	0.43750
February 20	March 30	April 16	0.43750
February 20 (1)	March 30	April 16	0.15556

(1) This dividend covers the period from, and including, December 14, 2017 to December 31, 2017.

Litigation and Other Matters



In accordance with accounting standards regarding loss contingencies, the Company accrues an undiscounted liability for those contingencies where the incurrence of a loss is probable and the amount can be reasonably estimated, and the Company discloses the amount accrued and the amount of a reasonably possible loss in excess of the amount accrued or disclose the fact that such a range of loss cannot be estimated. The Company does not record liabilities when the likelihood that the liability has been incurred is probable but the amount cannot be reasonably estimated, or when the liability is believed to be only reasonably possible or remote. In such cases, the Company discloses the nature of the contingency, and an estimate of the possible loss, range of loss, or disclose the fact that an estimate cannot be made.

The Company is subject, from time to time, to various legal proceedings and claims that arise in the ordinary course of business. While the resolution of such matters cannot be predicted with certainty, management believes, based on currently available information, that the final outcome of such matters will not have a material effect on the condensed consolidated financial position, results of operations, cash flows or liquidity of the Company.

## Off-Balance Sheet Arrangements

The Company accounts for its investments in joint ventures that it does not have a controlling interest or is not the primary beneficiary using the equity method of accounting and those investments are reflected on the condensed consolidated balance sheets of the Company as investments in unconsolidated joint ventures. As of June 30, 2018 and December 31, 2017, we did not have any off-balance sheet financing arrangements.

## Retenancing and Redevelopment Projects

We are currently retenancing or redeveloping several properties primarily to convert single-tenant buildings occupied by Sears Holdings into multi-tenant properties occupied by a diversity of retailers and related concepts. The table below provides a brief description of each of the 73 new redevelopment projects originated on the Seritage platform as of June 30, 2018. These projects represent an estimated total investment of \$1.3 billion, of which approximately \$880 million remained to be spent.

### Total Project Costs under \$10 Million

Property	Description	Total Project Square Feet	Estimated Construction Start	Estimated Substantial Completion
King of Prussia, PA	Repurpose former auto center space for Outback Steakhouse, Yard House and small shop retail	29,100	Complete	
Merrillville, IN	Termination property; redevelop existing store for At Home and small shop retail	132,000	Complete	
Elkhart, IN	Termination property; existing store has been released to Big R Stores	86,500	Complete	
San Antonio, TX	Recapture and repurpose auto center space for Orvis, Jared's Jeweler, Shake Shack and small shop retail	18,900	Complete	

Edgar Filing: Seritage Growth Properties - Form 10-Q

Bowie, MD	Recapture and repurpose auto center space for BJ's Brewhouse	8,200	Complete
Troy, MI	Partial recapture; redevelop existing store for At Home	100,000	Complete
Roseville, MI	Partial recapture; redevelop existing store for At Home	100,400	Complete
Rehoboth Beach, DE	Partial recapture; redevelop existing store for andThat! and PetSmart	56,700	Complete
Henderson, NV	Termination property; redevelop existing store for At Home, Seafood City, Blink Fitness and additional retail	144,400	Complete
Cullman, AL	Termination property; redevelop existing store for Bargain Hunt, Tractor Supply and Planet Fitness	99,000	Complete
Albany, NY	Recapture and repurpose auto center space for BJ's Brewhouse, Ethan Allen and additional small shop retail	28,000	Substantially complete
Hagerstown, MD	Recapture and repurpose auto center space for BJ's	15,400	Substantially complete

Edgar Filing: Seritage Growth Properties - Form 10-Q

	Brewhouse, Verizon and additional retail			
	Note: property sold in Q2 2018			
Jefferson City, MO	Termination property; redevelop existing store for Orscheln Farm and Home	96,000	Substantially complete	
Kearney, NE	Termination property; redevelop existing store for Marshall's, PetSmart and additional junior anchors	92,500	Substantially complete	
Ft. Wayne, IN	Site densification (project expansion); new outparcels for BJ's Brewhouse and Chick-Fil-A	12,000	Substantially complete	
Guaynabo, PR	Partial recapture; redevelop existing store for Planet Fitness, Capri and additional retail and restaurants	56,100	Underway	Q3 2018
Florissant, MO	Site densification; new outparcel for Chick-Fil-A	5,000	Underway	Q3 2018
Dayton, OH	Recapture and repurpose auto center space for Outback Steakhouse	14,100	Underway	Q4 2018

Edgar Filing: Seritage Growth Properties - Form 10-Q

	and additional restaurants			
New Iberia, LA	Termination property; redevelop existing store for Rouses Supermarkets, Hobby Lobby and small shop retail	93,100	Underway	Q1 2019
North Little Rock, AR	Recapture and repurpose auto center space for LongHorn Steakhouse and additional small shop retail	17,300	Underway	Q2 2019
St. Clair Shores, MI	100% recapture; demolish existing store and develop site for new Kroger grocery store	107,200	Underway	Q2 2019
Hopkinsville, KY	Termination property; redevelop existing store for Bargain Hunt, Farmer's Furniture and additional junior anchors and small shop retail	87,900	Q3 2018	Q2 2019
Mt. Pleasant, PA	Termination property; redevelop existing store for Aldi, Big Lots and additional retail	86,300	Q3 2018	Q3 2019
Oklahoma City, OK	Site densification; new fitness center for Vasa Fitness	59,500	Q3 2018	Q3 2019

Gainesville, FL	Termination property; redevelop existing store for Florida Clinical Practice Association / University of Florida College of Medicine	139,100	Q4 2018	Q4 2019
-----------------	---	---------	---------	---------

Edgar Filing: Seritage Growth Properties - Form 10-Q

Total Project Costs \$10 - \$20 Million

Property	Description	Total Project Square Feet	Estimated Construction Start	Estimated Substantial Completion
Braintree, MA	100% recapture; redevelop existing store for Nordstrom Rack, Saks OFF 5th and additional retail	90,000	Complete	
Honolulu, HI	100% recapture; redevelop existing store for Longs Drugs (CVS), PetSmart and Ross Dress for Less	79,000	Complete	
Anderson, SC	100% recapture (project expansion); redevelop existing store for Burlington Stores, Gold's Gym, Sportsman's Warehouse, additional retail and restaurants	111,300	Complete	
West Jordan, UT	Partial recapture; redevelop existing store and attached auto center for Burlington Stores and additional retail	81,400	Substantially complete	
Madison, WI	Partial recapture; redevelop existing store for Dave &	75,300	Substantially complete	

Edgar Filing: Seritage Growth Properties - Form 10-Q

	Busters, Total Wine & More, additional retail and restaurants		
Thornton, CO	Termination property; redevelop existing store for Vasa Fitness and additional junior anchors	191,600	Substantially complete
Springfield, IL	Termination property; redevelop existing store for Burlington Stores, Binny's Beverage Depot, Marshall's, Orangetheory Fitness, Outback Steakhouse, CoreLife Eatery and additional small shop retail	133,400	Substantially complete
Orlando, FL	100% recapture; demolish and construct new buildings for Floor & Décor, Orchard Supply Hardware, LongHorn Steakhouse, Mission BBQ, Olive Garden and additional small shop retail and restaurants	139,200	Substantially complete



Edgar Filing: Seritage Growth Properties - Form 10-Q

Cockeysville, MD	Partial recapture; redevelop existing store for HomeGoods, Michael's Stores, additional junior anchors and restaurants	83,500	Underway	Q3 2018
Charleston, SC	100% recapture (project expansion); redevelop existing store and detached auto center for Burlington Stores and additional retail	126,700	Underway	Q3 2018
North Hollywood, CA	Partial recapture; redevelop existing store for Burlington Stores and Ross Dress for Less	79,800	Underway	Q3 2018
Salem, NH	Site densification; new theatre for Cinemark			
	Recapture and repurpose auto center for restaurant space	71,200	Underway	Q3 2018
Paducah, KY	Termination property; redevelop existing store for Burlington Stores, Ross Dress for Less and additional retail	102,300	Underway	Q3 2018

Edgar Filing: Seritage Growth Properties - Form 10-Q

Fairfax, VA	Partial recapture; redevelop existing store and attached auto center for Dave & Busters, Seasons 52, additional junior anchors and restaurants	110,300	Underway	Q4 2018
North Miami, FL	100% recapture; redevelop existing store for Blink Fitness, Burlington Stores, Michael's and Ross Dress for Less	124,300	Underway	Q4 2018
Hialeah, FL	100% recapture; redevelop existing store for Bed, Bath & Beyond, Ross Dress for Less and dd's Discounts to join current tenant, Aldi	88,400	Underway	Q4 2018
Warwick, RI	Termination property (project expansion); redevelop existing store and detached auto center for At Home, BJ's Brewhouse, Raymour & Flanigan and additional retail	190,700	Underway	Q4 2018
Temecula, CA	Partial recapture;	65,100	Underway	Q4 2018

Edgar Filing: Seritage Growth Properties - Form 10-Q

	redevelop existing store and detached auto center for Round One, small shop retail and restaurants			
Canton, OH	Partial recapture; redevelop existing store for Dave & Busters and restaurants	83,900	Underway	Q2 2019
North Riverside, IL	Partial recapture; redevelop existing store and detached auto center for Blink Fitness, Round One and additional junior anchors, small shop retail and restaurants	103,900	Underway	Q2 2019
Olean, NY	Termination property (project expansion); redevelop existing store for Marshall's, Ollie's Bargain Basement and additional retail	125,700	Underway	Q2 2019
Las Vegas, NV	Partial recapture; redevelop existing store for Round One and additional retail	78,800	Q3 2018	Q3 2019
Yorktown Heights, NY	Partial recapture;	85,200	Q3 2018	Q4 2019

Edgar Filing: Seritage Growth Properties - Form 10-Q

	redevelop existing store for 24 Hour Fitness and additional retail			
Santa Cruz, CA	Partial recapture; redevelop existing store for TJ Maxx, HomeGoods and additional junior anchors	62,200	Q4 2018	Q4 2019
El Paso, TX	Termination property; redevelop existing store for Ross Dress for Less, dd's Discounts and additional retail	114,700	Q4 2018	Q4 2019
Warrenton, VA	Termination property; redevelop existing store for Homegoods and additional retail	97,300	Q1 2019	Q3 2019
Pensacola, FL	Termination property; redevelop existing store for Lucky's Market, large format retail and restaurants	134,700	Q1 2019	Q1 2020
Vancouver, WA	Partial recapture; redevelop existing store for Round One and additional retail and restaurants	72,400	Q1 2019	Q2 2020



Edgar Filing: Seritage Growth Properties - Form 10-Q

Total Project Costs over \$20 Million

Property	Description	Total Project Square Feet	Estimated Construction Start	Estimated Substantial Completion
Memphis, TN	100% recapture; demolish and construct new buildings for LA Fitness, Nordstrom Rack, Ulta Beauty, Hopdoddy Burger Bar and additional junior anchors, restaurants and small shop retail	135,200		
			Substantially complete	
West Hartford, CT	100% recapture; redevelop existing store and detached auto center for Buy Buy Baby, Cost Plus World Market, REI, Saks OFF Fifth, other junior anchors, Shake Shack and additional small shop retail			
	Note: contributed to West Hartford JV in Q2 2018	147,600		
			Substantially complete	
St. Petersburg, FL	100% recapture; demolish and construct new buildings for Dick's Sporting Goods, Lucky's	142,400		
			Substantially complete	

Edgar Filing: Seritage Growth Properties - Form 10-Q

	Market, PetSmart, Five Below, Chili's Grill & Bar, Pollo Tropical, LongHorn Steakhouse, Verizon and additional small shop retail and restaurants			
Wayne, NJ	Partial recapture (project expansion); redevelop existing store and detached auto center for Cinemark, Dave & Busters and additional junior anchors and restaurants			
	Note: contributed to GGP II JV in Q3 2017	156,700	Underway	Q3 2018
Carson, CA	100% recapture (project expansion); redevelop existing store for Burlington Stores, Ross Dress for Less, Gold's Gym and additional retail	163,800	Underway	Q1 2019
Watchung, NJ	100% recapture; demolish full-line store and detached auto center and construct new buildings for	126,700	Underway	Q2 2019

Edgar Filing: Seritage Growth Properties - Form 10-Q

	Cinemark, HomeSense, Sierra Trading Post, Ulta Beauty and small shop retail and restaurants			
Santa Monica, CA	100% recapture; redevelop existing building into premier, mixed-use asset featuring unique, small-shop retail and creative office space			
	Note: contributed to Mark 302 JV in Q1 2018	96,500	Underway	Q4 2019
Aventura, FL	100% recapture; demolish existing store and construct new, multi-level open air retail destination featuring a leading collection of experiential shopping, dining and entertainment concepts alongside a treelined esplanade and activated plazas	216,600	Underway	Q4 2019
San Diego, CA	100% recapture; redevelop	206,000	Underway	Q4 2019



	existing store into two highly-visible, multi-level buildings with exterior facing retail space leased to Equinox Fitness and a premier mix of experiential shopping, dining, and entertainment concepts			
	Note: contributed to UTC JV in Q2 2018			
Roseville, CA	Termination property (project expansion): redevelop existing store and auto center for Cinemark, Round One, AAA Auto Repair Center and restaurants	147,400	Underway	Q2 2020
Austin, TX	100% recapture (project expansion); redevelop existing store for AMC Theatres, additional junior anchors and restaurants	177,400	Underway	Q3 2019
Greendale, WI	Termination property; redevelop existing store and attached auto center for Dick's	223,800	Underway	Q4 2019

Edgar Filing: Seritage Growth Properties - Form 10-Q

	Sporting Goods, Round One and additional junior anchors and restaurants			
East Northport, NY	Termination property; redevelop existing store and attached auto center for AMC Theatres, 24 Hour Fitness, Floor & Decor and small shop retail	179,700	Underway	Q4 2019
Anchorage, AK	100% recapture; redevelop existing store for Guitar Center, Safeway, Planet Fitness and additional retail to join current tenant, Nordstrom Rack	142,500	Q3 2018	Q4 2019
El Cajon, CA	100% recapture; redevelop existing store and auto center for Ashley Furniture, Bob's Discount Furniture, Burlington Stores and additional retail and restaurants	242,700	Q3 2018	Q3 2019
Tucson, AZ	100% recapture; redevelop existing store and auto center for Round One	224,300	Q3 2018	Q4 2019

Edgar Filing: Seritage Growth Properties - Form 10-Q

	and additional retail			
Reno, NV	100% recapture; redevelop existing store and auto center for Round One and additional retail	169,800	Q3 2018	Q4 2019
Fairfield, CA	100% recapture (project expansion); redevelop existing store and auto center for Dave & Busters, AAA Auto Repair Center and additional retail	146,500	Q3 2018	Q1 2020
Plantation, FL	100% recapture (project expansion); redevelop existing store and auto center for GameTime, Powerhouse Gym, additional retail and restaurants	184,400	Q4 2018	Q1 2020

## Non-GAAP Supplemental Financial Measures and Definitions

The Company makes reference to NOI, Total NOI, FFO, Company FFO, EBITDA and Adjusted EBITDA which are considered non-GAAP measures.

### Net Operating Income ("NOI") and Total NOI

We define NOI as income from property operations less property operating expenses. Other REITs may use different methodologies for calculating NOI, and accordingly, the Company's depiction of NOI may not be comparable to other REITs. We believe NOI provides useful information regarding the Company, its financial condition, and results of operations because it reflects only those income and expense items that are incurred at the property level.

The Company also uses Total NOI, which includes its proportional share of unconsolidated properties. We believe this form of presentation offers insights into the financial performance and condition of the Company as a whole given our ownership of unconsolidated properties that are accounted for under GAAP using the equity method. We also consider Total NOI to be a helpful supplemental measure of our operating performance because it excludes from NOI variable items such as termination fee income, as well as non-cash items such as straight-line rent and amortization of lease intangibles.

Due to the adjustments noted, NOI and Total NOI should only be used as an alternative measure of the Company's financial performance.

### Earnings before Interest Expense, Income Tax, Depreciation, and Amortization for Real Estate ("EBITDAre") and Company EBITDA

We define EBITDAre using the definition set forth by the National Association of Real Estate Investment Trusts ("NAREIT"), which may not be comparable to measures calculated by other companies who do not use the NAREIT definition of EBITDAre. EBITDAre is calculated as net income computed in accordance with GAAP, excluding interest expense, income tax expense, depreciation and amortization, gains (or losses) from property sales and impairment charges on depreciable real estate assets. We believe EBITDAre provides useful information to investors regarding our results of operations because it removes the impact of our capital structure (primarily interest expense) and our asset base (primarily depreciation and amortization). Management also believes the use of EBITDAre facilitates comparisons between us and other equity REITs and real property owners that are not REITs.

The Company makes certain adjustments to EBITDAre, which it refers to as Company EBITDA, to account for certain non-cash and non-comparable items, such as termination fee income, unrealized loss on interest rate cap, litigation charges, acquisition-related expenses and certain up-front-hiring and personnel costs that it does not believe are representative of ongoing operating results.

Due to the adjustments noted, EBITDAre and Company EBITDA should only be used as an alternative measure of the Company's financial performance

### Funds from Operations ("FFO") and Company FFO

We define FFO using the definition set forth by NAREIT, which may not be comparable to measures calculated by other companies who do not use the NAREIT definition of FFO. FFO is calculated as net income computed in accordance with GAAP, excluding gains (or losses) from property sales, real estate related depreciation and amortization, and impairment charges on depreciable real estate assets.

We consider FFO a helpful supplemental measure of the operating performance for equity REITs and a complement to GAAP measures because it is a recognized measure of performance by the real estate industry. FFO facilitates an

understanding of the operating performance of our properties between periods because it does not give effect to real estate depreciation and amortization which are calculated to allocate the cost of a property over its useful life. Since values for well-maintained real estate assets have historically increased or decreased based upon prevailing market conditions, the Company believes that FFO provides investors with a clearer view of the Company's operating performance.

The Company makes certain adjustments to FFO, which it refers to as Company FFO, to account for certain non-cash and non-comparable items, such as termination fee income, unrealized loss on interest rate cap, litigations charges, acquisition-related expenses, amortization of deferred financing costs and up-front-hiring and personnel costs, that it does not believe are representative of ongoing operating results. The Company previously referred to this metric as Normalized FFO; the definition and calculation remain the same.

Due to the adjustments noted, FFO and Company FFO should only be used as an alternative measure of the Company's financial performance.

- 42 -

---

# Reconciliation of Non-GAAP Financial Measures to GAAP Financial Measures

None of NOI, Total NOI, EBITDAre, Adjusted EBITDAre, FFO and Company FFO are measures that (i) represent cash flow from operations as defined by GAAP; (ii) are indicative of cash available to fund all cash flow needs, including the ability to make distributions; (iii) are alternatives to cash flow as a measure of liquidity; or (iv) should be considered alternatives to net income (which is determined in accordance with GAAP) for purposes of evaluating the Company's operating performance. Reconciliations of these measures to the respective GAAP measures we deem most comparable are presented below on a comparative basis for all periods.

The following table reconciles NOI and Total NOI to GAAP net income (loss) for the three and six months ended June 30, 2018 and June 30, 2017 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
NOI and Total NOI				
Net income (loss)	\$(10,602)	\$(34,867)	\$5,599	\$(67,711)
Termination fee income	—	(628)	(174)	(6,764)
Management and other fee income	(914)	—	(914)	—
Depreciation and amortization	49,551	50,571	84,218	109,234
General and administrative expenses	8,673	5,093	16,470	11,367
Equity in loss (income) of unconsolidated				
joint ventures	2,158	1,542	4,740	540
Gain on sale of real estate	(34,187)	—	(76,018)	—
Interest and other income	(456)	(42)	(1,136)	(120)
Interest expense	17,862	18,431	34,281	35,023
Unrealized loss on interest rate cap	172	124	7	595
Provision for income taxes	240	147	344	266
NOI	\$32,497	\$40,371	\$67,417	\$82,430
NOI of unconsolidated joint ventures	5,007	6,987	9,765	13,498
Straight-line rent adjustment (1)	(606)	(2,177)	(3,174)	(3,626)
Above/below market rental income/expense (1)	(438)	(459)	(669)	(690)
Total NOI	\$36,460	\$44,722	\$73,339	\$91,612

(1)Includes adjustments for unconsolidated joint ventures.

The following table reconciles EBITDAre and Adjusted EBITDAre to GAAP net income (loss) for the three and six months ended June 30, 2018 and June 30, 2017 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
EBITDAre and Company EBITDA				
Net income (loss)	\$(10,602)	\$(34,867)	\$5,599	\$(67,711)
Interest expense	17,862	18,431	34,281	35,023
Provision for income and other taxes	240	147	344	266
Depreciation and amortization	49,551	50,571	84,218	109,234
Depreciation and amortization (unconsolidated	3,516	8,363	7,309	13,828

Edgar Filing: Seritage Growth Properties - Form 10-Q

joint ventures)				
Gain on sale of real estate	(34,187)	—	(76,018)	—
EBITDAre	\$26,380	\$42,645	\$55,733	\$90,640
Termination fee income	—	(628 )	(174 )	(6,764 )
Unrealized loss on interest rate cap	172	124	7	595
Company EBITDA	\$26,552	\$42,141	\$55,566	\$84,471

- 43 -

---

Edgar Filing: Seritage Growth Properties - Form 10-Q

The following table reconciles FFO and Company FFO to GAAP net income (loss) for the for the three and six months ended June 30, 2018 and June 30, 2017 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
FFO and Company FFO				
Net income (loss)	\$(10,602)	\$(34,867)	\$5,599	\$(67,711 )
Real estate depreciation and amortization				
(consolidated properties)	48,985	50,271	83,098	108,675
Real estate depreciation and amortization				
(unconsolidated joint ventures)	3,516	8,363	7,309	13,828
Gain on sale of real estate	(34,187)	—	(76,018)	—
Dividends on preferred shares	(1,225 )	—	(2,453 )	—
FFO attributable to common shareholders				
and unitholders	\$6,487	\$23,767	\$17,535	\$54,792
Termination fee income	—	(628 )	(174 )	(6,764 )
Unrealized loss on interest rate cap	172	124	7	595
Amortization of deferred financing costs	1,870	2,479	3,590	4,061
Company FFO attributable to common				
shareholders and unitholders	\$8,529	\$25,742	\$20,958	\$52,684
FFO per diluted common share and unit	\$0.12	\$0.43	\$0.31	\$0.99
Company FFO per diluted common share and unit	\$0.15	\$0.46	\$0.38	\$0.95
Weighted Average Common Shares and Units Outstanding				
Weighted average common shares outstanding	35,483	33,766	35,588	33,638
Weighted average OP units outstanding	20,158	21,833	20,188	21,959
Weighted average common shares and				
units outstanding	55,641	55,599	55,776	55,597



Item 3. Quantitative and Qualitative Disclosure about Market Risk

Except as discussed below, there were no material changes in the Quantitative and Qualitative Disclosures about Market Risk set forth in our 2017 Annual Report on Form 10-K.

Interest Rate Fluctuations

As of June 30, 2018, we had \$1.22 billion of consolidated debt, including \$1.08 billion outstanding under our variable-rate Mortgage Loans and Future Funding Facility. The interest rate on the loans is the 30-day LIBOR rate plus, as of June 30, 2018, a weighted average spread of 485 basis points. We have purchased a LIBOR interest rate cap that has a LIBOR strike rate of 3.5% and a term of four years. We are subject to market risk with respect to changes in the LIBOR rate. An immediate 100 basis point change in interest rates would have affected annual pretax funding costs by approximately \$10.8 million.

Subsequent to June 30, 2018, all of our consolidated debt was refinanced with a new fixed-rate term loan facility that is not subject to interest rate fluctuations. The initial amount drawn on the new term loan facility was \$1.60 billion.

Fair Value of Debt

As of June 30, 2018, the estimated fair value of our consolidated debt was \$1.22 billion. The estimated fair value of our consolidated debt is calculated based on current market prices and discounted cash flows at the current rate at which similar loans would be made to borrowers with similar credit ratings for the remaining term of such debt.

Subsequent to June 30, 2018, all of our consolidated debt was refinanced with a new term loan facility. The initial amount drawn on the new term loan facility was \$1.60 billion.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures.

Under the supervision and with the participation of our management, including the Chief Executive Officer and the Chief Financial Officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective as of such date.

Changes in Internal Controls.

There were no changes in our internal control over financial reporting that occurred during the period ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

The information required by this Item is incorporated by reference to Note 9 of the condensed consolidated financial statements included herein.

### Item 1A. Risk Factors

Information regarding risk factors appears in our 2017 Annual Report on Form 10-K in Part I, Item 1A. Risk Factors. Other than as noted, there have been no material changes from the risk factors previously disclosed in our 2017 Annual Report on Form 10-K.

Cybersecurity incidents could cause a disruption to our operations, a compromise of confidential information and damage to our business relationships, all of which could negatively impact our business, financial condition and operating results.

Seritage is susceptible to cybersecurity risks that include, among other things, theft, unauthorized monitoring, release, misuse, loss, destruction or corruption of confidential and highly restricted data; denial of service attacks; unauthorized access to relevant systems, compromises to networks or devices; or operational disruption or failures in the physical infrastructure or operating systems of Seritage's information systems. Seritage's information systems are essential to the operation of our business and our ability to perform day-to-day operations, including for the secure processing, storage and transmission of confidential and personal information. Seritage must continuously monitor and develop its systems to protect its technology infrastructure and data from misappropriation, corruption and disruption. Cybersecurity risks may also impact properties in which we invest on behalf of clients and tenants of those properties, which could result in a loss of value in our clients' investment. In addition, due to Seritage's interconnectivity with third-party service providers and other entities with which Seritage conducts business, Seritage could be adversely impacted if any of them is subject to a successful cyber incident. Although we and our service providers have implemented processes, procedures and controls to help mitigate these risks, there can be no assurance that these measures will be effective or that security breaches or disruptions will not occur. The result of these incidents may include disrupted operations, liability for loss or misappropriation of data, stolen assets or information, increased cybersecurity protection and insurance costs, increased compliance costs, litigation, regulatory enforcement actions and damage to our reputation or business relationships.

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

None.

### Item 3. Defaults Upon Senior Securities

None.

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 5. Other Information

None.

Item 6. Exhibits

Exhibit

No.	Description	SEC Document Reference
10.1	<u>Senior Secured Term Loan Agreement, dated July 31, 2018, among Seritage Growth Properties, Seritage Growth Properties, L.P. and Berkshire Hathaway Life Insurance Company of Nebraska</u>	Incorporated by reference to Exhibit 10.1 to Seritage Growth Properties' Current Report on Form 8-K (File No. 001-37420) filed with the SEC on July 31, 2018
10.2	<u>Employment Agreement, dated May 2, 2018, among Seritage Growth Properties, Seritage Growth Properties, L.P. and Benjamin Schall</u>	Incorporated by reference to Exhibit 10.1 to Seritage Growth Properties' Current Report on Form 8-K (File No. 001-37420) filed with the SEC on May 7, 2018
10.3	<u>Employment Agreement, dated May 16, 2018, among Seritage Growth Properties, Seritage Growth Properties, L.P. and Kenneth Lombard</u>	Filed herewith.
10.4	<u>Form of Seritage Growth Properties Time-Vesting Restricted Share Unit Agreement – 2018 Incentive RSUs</u>	Filed herewith.

- 10.5      Form of Seritage      Filed herewith.  
Growth Properties  
Performance-Vesting  
Restricted Share  
Unit Agreement –  
2018 Incentive  
P-RSUs
- 31.1      Certification of      Filed herewith.  
the Chief  
Executive Officer  
pursuant to  
Section 302 of the  
Sarbanes-Oxley  
Act of 2002
- 31.2      Certification of      Filed herewith.  
the Chief  
Financial Officer  
pursuant to  
Section 302 of the  
Sarbanes-Oxley  
Act of 2002
- 32.1      Certification of      Filed herewith.  
the Chief  
Executive Officer  
pursuant to  
Section 906 of the  
Sarbanes-Oxley  
Act of 2002, 18  
U.S.C. Section  
1350
- 32.2      Certification of      Filed herewith.  
the Chief  
Financial Officer  
pursuant to  
Section 906 of the  
Sarbanes-Oxley  
Act of 2002, 18  
U.S.C. Section  
1350
- 101.INS    XBRL Instance      Filed herewith.  
Document
- 101.SCH    XBRL Taxonomy      Filed herewith.  
Extension  
Schema  
Document

101.CAL XBRL Taxonomy Filed herewith.  
Extension  
Calculation  
Linkbase  
Document

101.DEF XBRL Taxonomy Filed herewith.  
Extension  
Definition  
Linkbase  
Document

101.LAB XBRL Taxonomy Filed herewith.  
Extension Label  
Linkbase  
Document

101.PRE XBRL Taxonomy Filed herewith.  
Extension  
Presentation  
Linkbase  
Document

SIGNATURES

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

SERITAGE  
GROWTH  
PROPERTIES

Dated: August 3, 2018    /s/ Benjamin Schall  
By: Benjamin Schall  
President and Chief  
Executive Officer

Dated: August 3, 2018    /s/ Brian Dickman  
By: Brian Dickman  
Executive Vice  
President and Chief  
Financial Officer