

EPR PROPERTIES

Form 10-Q

July 31, 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: 001-13561

EPR PROPERTIES

(Exact name of registrant as specified in its charter)

Maryland 43-1790877
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

909 Walnut Street, Suite 200 64106
Kansas City, Missouri
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (816) 472-1700

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

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

Large accelerated filer 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 standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

At July 30, 2018, there were 74,349,321 common shares outstanding.

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

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

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

• Global economic uncertainty and disruptions in financial markets;

• Reduction in discretionary spending by consumers;

• Adverse changes in our credit ratings;

• Fluctuations in interest rates;

• Unsuccessful development, operation, financing or compliance with licensing requirements of the planned casino and resort development by the third-party lessee;

• Risks related to overruns for the construction of common infrastructure at our planned casino and resort development for which we would be responsible;

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

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

• A borrower's bankruptcy or default;

• Our ability to renew maturing leases with theatre tenants on terms comparable to prior leases and/or our ability to lease any re-claimed space from some of our larger theatres at economically favorable terms;

• Risks of operating in the entertainment industry;

• Our ability to compete effectively;

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

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

• The ability of our build-to-suit education tenants to achieve sufficient enrollment within expected timeframes and therefore have capacity to pay their agreed upon rent, including the ability of our early education tenant, Children's Learning Adventure, to successfully negotiate a restructuring and secure capital necessary to achieve positive cash flow;

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

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

• Risks associated with our level of indebtedness;

• Risks associated with use of leverage to acquire properties;

• Financing arrangements that require lump-sum payments;

• Our ability to raise capital;

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

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

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

• The ability of our subsidiaries to satisfy their obligations;

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

Our forward-looking statements represent our intentions, plans, expectations and beliefs and are subject to numerous assumptions, risks and uncertainties. Many of the factors that will determine these items are beyond our ability to control or predict. For further discussion of these factors see Item 1A - "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the Securities and Exchange Commission ("SEC") on March 1, 2018, as supplemented by Part II, Item 1A- "Risk Factors" in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2018 filed with the SEC on May 9, 2018.

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

TABLE OF CONTENTS

	Page
<u>PART I</u>	<u>1</u>
Item 1. Financial Statements	<u>1</u>
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	<u>32</u>
Item 3. Quantitative and Qualitative Disclosures About Market Risk	<u>50</u>
Item 4. Controls and Procedures	<u>51</u>
<u>PART II</u>	<u>51</u>
Item 1. Legal Proceedings	<u>51</u>
Item 1A. Risk Factors	<u>53</u>
Item 2. Unregistered Sale of Equity Securities and Use of Proceeds	<u>54</u>
Item 3. Defaults Upon Senior Securities	<u>54</u>
Item 4. Mine Safety Disclosures	<u>54</u>
Item 5. Other Information	<u>54</u>
Item 6. Exhibits	<u>55</u>

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

EPR PROPERTIES

Consolidated Balance Sheets

(Dollars in thousands except share data)

	June 30, 2018 (unaudited)	December 31, 2017
Assets		
Rental properties, net of accumulated depreciation of \$810,604 and \$741,334 at June 30, 2018 and December 31, 2017, respectively	\$4,853,188	\$ 4,604,231
Land held for development	31,076	33,692
Property under development	268,090	257,629
Mortgage notes and related accrued interest receivable	641,428	970,749
Investment in direct financing leases, net	58,305	57,903
Investment in joint ventures	4,999	5,602
Cash and cash equivalents	3,017	41,917
Restricted cash	11,283	17,069
Accounts receivable, net	97,804	93,693
Other assets	135,034	109,008
Total assets	\$6,104,224	\$ 6,191,493
Liabilities and Equity		
Liabilities:		
Accounts payable and accrued liabilities	\$122,359	\$ 136,929
Common dividends payable	26,765	25,203
Preferred dividends payable	6,036	4,982
Unearned rents and interest	79,121	68,227
Debt	2,983,975	3,028,827
Total liabilities	3,218,256	3,264,168
Equity:		
Common Shares, \$.01 par value; 100,000,000 shares authorized; and 77,195,820 and 76,858,632 shares issued at June 30, 2018 and December 31, 2017, respectively	772	769
Preferred Shares, \$.01 par value; 25,000,000 shares authorized:		
5,399,050 Series C convertible shares issued at June 30, 2018 and December 31, 2017; liquidation preference of \$134,976,250	54	54
3,447,381 and 3,449,115 Series E convertible shares issued at June 30, 2018 and December 31, 2017, respectively; liquidation preference of \$86,184,525	34	34
6,000,000 Series G shares issued at June 30, 2018 and December 31, 2017; liquidation preference of \$150,000,000	60	60
Additional paid-in-capital	3,491,561	3,478,986
Treasury shares at cost: 2,847,949 and 2,733,552 common shares at June 30, 2018 and December 31, 2017, respectively	(129,048)	(121,591)
Accumulated other comprehensive income	17,497	12,483
Distributions in excess of net income	(494,962)	(443,470)
Total equity	\$2,885,968	\$ 2,927,325
Total liabilities and equity	\$6,104,224	\$ 6,191,493

See accompanying notes to consolidated financial statements.

EPR PROPERTIES

Consolidated Statements of Income

(Unaudited)

(Dollars in thousands except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Rental revenue	\$ 137,019	\$ 123,410	\$ 269,943	\$ 234,196
Other income	646	1,304	1,276	1,996
Mortgage and other financing income	65,202	23,068	86,616	40,702
Total revenue	202,867	147,782	357,835	276,894
Property operating expense	7,334	6,072	14,898	12,422
General and administrative expense	12,976	10,660	25,300	21,717
Litigation settlement expense	2,090	—	2,090	—
Costs associated with loan refinancing or payoff	15	9	31,958	14
Gain on early extinguishment of debt	—	(977)	—	(977)
Interest expense, net	34,079	32,967	68,416	63,659
Transaction costs	405	218	1,014	275
Impairment charges	16,548	10,195	16,548	10,195
Depreciation and amortization	37,582	33,148	75,266	61,225
Income before equity in income from joint ventures and other items	91,838	55,490	122,345	108,364
Equity in (loss) income from joint ventures	(88)	59	(37)	51
Gain on sale of real estate	473	25,461	473	27,465
Income before income taxes	92,223	81,010	122,781	135,880
Income tax expense	(642)	(475)	(1,662)	(1,429)
Net income	91,581	80,535	121,119	134,451
Preferred dividend requirements	(6,036)	(5,952)	(12,072)	(11,904)
Net income available to common shareholders of EPR Properties	\$ 85,545	\$ 74,583	\$ 109,047	\$ 122,547
Per share data attributable to EPR Properties common shareholders:				
Basic earnings per share data:				
Net income available to common shareholders	\$ 1.15	\$ 1.02	\$ 1.47	\$ 1.79
Diluted earnings per share data:				
Net income available to common shareholders	\$ 1.15	\$ 1.02	\$ 1.47	\$ 1.78
Shares used for computation (in thousands):				
Basic	74,329	73,159	74,238	68,621
Diluted	74,365	73,225	74,273	68,689

See accompanying notes to consolidated financial statements.

EPR PROPERTIES

Consolidated Statements of Comprehensive Income

(Unaudited)

(Dollars in thousands)

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
Net income	\$91,581	\$80,535	\$121,119	\$134,451
Other comprehensive income (loss):				
Foreign currency translation adjustment	(4,068)	4,548	(9,468)	6,222
Change in net unrealized gain (loss) on derivatives	5,084	(3,456)	14,482	(4,258)
Comprehensive income	\$92,597	\$81,627	\$126,133	\$136,415

See accompanying notes to consolidated financial statements.

EPR PROPERTIES

Consolidated Statements of Changes in Equity

Six Months Ended June 30, 2018

(Unaudited)

(Dollars in thousands)

	EPR Properties Common Stock		Shareholders' Preferred Stock		Additional paid-in capital	Treasury shares	Accumulated other comprehensive income (loss)	Distributions in excess of net income	Total
	Shares	Par	Shares	Par					
Balance at December 31, 2017	76,858,632	\$769	14,848,165	\$148	\$3,478,986	\$(121,591)	\$12,483	\$(443,470)	\$2,927,325
Restricted share units issued to Trustees	23,571	—	—	—	—	—	—	—	—
Issuance of nonvested shares, net	295,202	3	—	—	3,971	—	—	—	3,974
Purchase of common shares for vesting	—	—	—	—	—	(7,155)	—	—	(7,155)
Amortization of nonvested shares and restricted share units	—	—	—	—	7,462	—	—	—	7,462
Share option expense	—	—	—	—	147	—	—	—	147
Foreign currency translation adjustment	—	—	—	—	—	—	(9,468)	—	(9,468)
Change in unrealized gain on derivatives	—	—	—	—	—	—	14,482	—	14,482
Net income	—	—	—	—	—	—	—	121,119	121,119
Issuances of common shares	11,873	—	—	—	693	—	—	—	693
Conversion of Series E Convertible Preferred shares to common shares	800	—	(1,734)	—	—	—	—	—	—
	5,742	—	—	—	302	(302)	—	—	—

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Stock option exercises, net									
Dividends to common and preferred shareholders	—	—	—	—	—	—	—	(172,611)	(172,611)
Balance at June 30, 2018	77,195,820	\$ 772	14,846,431	\$ 148	\$ 3,491,561	\$(129,048)	\$ 17,497	\$(494,962)	\$ 2,885,968

See accompanying notes to consolidated financial statements.

EPR PROPERTIES

Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)

	Six Months Ended	
	June 30,	
	2018	2017
Operating activities:		
Net income	\$121,119	\$134,451
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain from early extinguishment of debt	—	(977)
Impairment charges	16,548	10,195
Gain on sale of real estate	(473)	(27,465)
Gain on insurance recovery	—	(606)
Deferred income tax expense	663	684
Costs associated with loan refinancing or payoff	31,958	14
Equity in loss (income) from joint ventures	37	(51)
Distributions from joint ventures	567	442
Depreciation and amortization	75,266	61,225
Amortization of deferred financing costs	2,837	2,981
Amortization of above/below market leases and tenant allowances, net	(472)	14
Share-based compensation expense to management and Trustees	7,608	6,961
(Increase) decrease in mortgage notes accrued interest receivable	(374)	1,915
(Increase) decrease in accounts receivable, net	(5,625)	3,506
Increase in direct financing leases receivable	(401)	(804)
Increase in other assets	(3,989)	(2,195)
Decrease in accounts payable and accrued liabilities	(6,758)	(7,099)
Increase in unearned rents and interest	11,237	11,444
Net cash provided by operating activities	249,748	194,635
Investing activities:		
Acquisition of and investments in rental properties and other assets	(84,306)	(196,957)
Proceeds from sale of real estate	6,195	130,726
Investment in mortgage notes receivable	(21,079)	(101,721)
Proceeds from mortgage notes receivable paydowns	196,038	15,610
Investment in promissory notes receivable	(7,739)	(1,387)
Proceeds from promissory note receivable paydown	7,500	1,599
Additions to properties under development	(135,605)	(196,354)
Net cash used by investing activities	(38,996)	(348,484)
Financing activities:		
Proceeds from debt facilities and senior unsecured notes	840,000	915,000
Principal payments on debt	(881,684)	(601,962)
Deferred financing fees paid	(8,557)	(7,042)
Costs associated with loan refinancing or payoff (cash portion)	(28,650)	(6)
Net proceeds from issuance of common shares	530	68,352
Purchase of common shares for treasury for vesting	(7,156)	(6,729)
Dividends paid to shareholders	(169,831)	(147,845)
Net cash (used) provided by financing activities	(255,348)	219,768
Effect of exchange rate changes on cash	(90)	129
Net (decrease) increase in cash and cash equivalents and restricted cash	(44,686)	66,048
Cash and cash equivalents and restricted cash at beginning of the period	58,986	29,079

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Cash and cash equivalents and restricted cash at end of the period	\$14,300	\$95,127
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Supplemental information continued on next page.

5

EPR PROPERTIES

Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)

Continued from previous page.

	Six Months Ended June 30,	
	2018	2017
Reconciliation of cash and cash equivalents and restricted cash:		
Cash and cash equivalents at beginning of the period	\$41,917	\$19,335
Restricted cash at beginning of the period	17,069	9,744
Cash and cash equivalents and restricted cash at beginning of the period	\$58,986	\$29,079
Cash and cash equivalents at end of the period	\$3,017	\$70,872
Restricted cash at end of the period	11,283	24,255
Cash and cash equivalents and restricted cash at end of the period	\$14,300	\$95,127
Supplemental schedule of non-cash activity:		
Transfer of property under development to rental properties	\$110,742	\$206,115
Issuance of nonvested shares and restricted share units at fair value, including nonvested shares issued for payment of bonuses	\$18,252	\$23,983
Issuance of common shares for acquisition	\$—	\$657,473
Assumption of liabilities net of accounts receivable for acquisition	\$—	\$12,083
Conversion or reclassification of mortgage notes receivable to rental properties	\$155,185	\$—
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	\$75,386	\$65,623
Cash paid during the period for income taxes	\$1,105	\$654
Interest cost capitalized	\$4,538	\$5,340
(Decrease) increase in accrued capital expenditures	\$(3,394)	\$9,347
See accompanying notes to consolidated financial statements.		

EPR PROPERTIES

Notes to Consolidated Financial Statements (Unaudited)

1. Organization

Description of Business

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

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

Basis of Presentation

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates. In addition, operating results for the six month period ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

The Company consolidates certain entities when it is deemed to be the primary beneficiary in a variable interest entity (VIE) in which it has a controlling financial interest in accordance with the consolidation guidance of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC).

The consolidated balance sheet as of December 31, 2017 has been derived from the audited consolidated balance sheet at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 filed with the Securities and Exchange Commission (SEC) on March 1, 2018.

Recently Adopted Accounting Pronouncements

On January 1, 2018, the Company adopted Accounting Standards Update (ASU) No. 2016-18, Statement of Cash Flows, and certain reclassifications have been made to prior period balances to conform to current presentation in the consolidated statement of cash flows. Under ASU No. 2016-18, transfers to or from restricted cash which have been previously shown in the Company's operating activities section of the accompanying consolidated statement of cash flows are now required to be shown as part of the total change in cash and cash equivalents and restricted cash in the consolidated statements of cash flows. In addition, on January 1, 2018, the Company adopted ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments. The ASU clarifies the treatment of several cash flow issues with the objective of reducing diversity in practice. The adoption of this ASU had no impact to the Company's financial position, results of operations or presentation in the consolidated statement of cash flows.

On January 1, 2018, the Company adopted Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers (ASC 606) and ASC 610-20, Other Income: Gains and Losses from the Derecognition of Non-financial Assets (ASC 610-20) using a modified retrospective (cumulative effect) method of adoption. The core

principle of ASC 606 is that an entity will recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers when it satisfies performance obligations. The Company's primary source of revenue is from lease revenue (which is excluded from the revenue standard but will be impacted upon adoption of the lease standard in 2019 discussed in Impact of Recently Issued Accounting Standards) and mortgage and other financing income (which is not in scope of the revenue standard). ASC 610-20 provides guidance on how entities recognize sales to non-customers including presentation of gain or loss on a net basis in the consolidated statements of income. The Company has concluded that its property sales represent transactions with non-customers. The Company had two property sale transactions that occurred in 2017 in which the Company received an aggregate of \$12.3 million in mortgage notes receivable as full consideration for the sales. The mortgage notes require interest only payments until

7

maturity and the Company determined in 2017 that these transactions qualified as sales; however, the gain on each sale was deferred. Upon adoption of ASC 610-20 on January 1, 2018, the Company determined that these transactions did not qualify for de-recognition. Accordingly, the Company recorded an adjustment in the six months ended June 30, 2018 to reclassify these assets from mortgage notes receivable to rental properties on its consolidated balance sheet. All other sales of real estate were all cash transactions in which the purchaser obtained control of the property, therefore, there was no cumulative adjustment recognized to beginning retained earnings as a result of adopting ASC 610-20.

Operating Segments

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

Rental Properties

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

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

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

Real Estate Acquisitions

Upon acquisition of real estate properties, the Company evaluates the acquisition to determine if it is a business combination or an asset acquisition. In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. The update clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether acquisitions should be accounted for as business combinations or asset acquisitions. The standard is effective for annual reporting periods beginning after December 15, 2017, including interim periods within those fiscal years, with early application of the guidance permitted. The Company elected to early adopt ASU No. 2017-01 as of January 1, 2017. As a result, the Company expects that fewer of its real estate acquisitions will be accounted for as business combinations.

Costs incurred for asset acquisitions and development properties, including transaction costs, are capitalized. For asset acquisitions, the Company allocates the purchase price and other related costs incurred to the acquired tangible assets and identified intangible assets and liabilities based on recent independent appraisals or methods similar to those used by independent appraisers and management judgment. Acquisition-related costs in connection with business

combinations are expensed as incurred. Costs related to such transactions, as well as costs associated with terminated transactions, are included in the accompanying consolidated statements of income as transaction costs.

Deferred Financing Costs

Deferred financing costs are amortized over the terms of the related debt obligations or mortgage note receivable as applicable. Deferred financing costs of \$36.0 million and \$32.9 million as of June 30, 2018 and December 31, 2017, respectively, are shown as a reduction of debt. The deferred financing costs related to the unsecured revolving credit facility are included in other assets.

Allowance for Doubtful Accounts

Accounts receivable is reduced by an allowance for amounts where collection is not probable. The Company's accounts receivable balance is comprised primarily of rents and operating cost recoveries due from tenants as well as accrued rental rate increases to be received over the life of the existing leases. The Company regularly evaluates the adequacy of its allowance for doubtful accounts. The evaluation primarily consists of reviewing past due account balances and considering such factors as the credit quality of the Company's tenants, historical trends of the tenant and/or other debtor, current economic conditions and changes in customer payment terms. Additionally, with respect to tenants in bankruptcy, the Company estimates the expected recovery through bankruptcy claims and increases the allowance for amounts deemed uncollectible. These estimates have a direct impact on the Company's net income.

Revenue Recognition

Rents that are fixed and determinable are recognized on a straight-line basis over the non-cancellable terms of the leases. Straight-line rental revenue is subject to an evaluation for collectability, and the Company records a provision for losses against rental revenues if collectability of these future rents is not reasonably assured. For the six months ended June 30, 2018 and 2017, the Company recognized \$3.9 million and \$9.1 million, respectively, of straight-line rental revenue. Base rent escalation on leases that are dependent upon increases in the Consumer Price Index (CPI) is recognized when known. For both the six months ended June 30, 2018 and 2017, the Company recognized \$7.7 million of tenant reimbursements that related to the operations of its entertainment retail centers. Certain reclassifications have been made to the 2017 presentation to conform to the 2018 presentation to combine tenant reimbursements with rental revenue. In addition, most of the Company's tenants are subject to additional rents if gross revenues of the properties exceed certain thresholds defined in the lease agreements (percentage rents). Percentage rents as well as participating interest for those mortgage agreements that contain similar such clauses are recognized at the time when specific triggering events occur as provided by the lease or mortgage agreements. Rental revenue included percentage rents of \$3.0 million and \$2.5 million for the six months ended June 30, 2018 and 2017, respectively.

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

Property Sales

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

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

9

Mortgage Notes and Other Notes Receivable

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

Concentrations of Risk

American Multi-Cinema, Inc. (AMC) was the lessee of a substantial portion (34%) of the megaplex theatre rental properties held by the Company at June 30, 2018. For the six months ended June 30, 2018 and 2017, approximately \$57.4 million or 16.0% and \$57.6 million or 20.8%, respectively, of the Company's total revenues were derived from rental payments by AMC. These rental payments are from AMC under the leases, or from its parent, AMC Entertainment, Inc. (AMCE), as the guarantor of AMC's obligations under the leases. AMCE is wholly owned by AMC Entertainment Holdings, Inc. (AMCEH). AMCEH is a publicly held company (NYSE: AMC) and its consolidated financial information is publicly available at www.sec.gov.

Share-Based Compensation

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

Share-based compensation expense consists of share option expense and amortization of nonvested share grants issued to employees, and amortization of share units issued to non-employee Trustees for payment of their annual retainers. Share-based compensation included in general and administrative expense in the accompanying consolidated statements of income totaled \$7.6 million and \$7.0 million for the six months ended June 30, 2018 and 2017, respectively.

Share Options

Share options are granted to employees pursuant to the Long-Term Incentive Plan. The fair value of share options granted is estimated at the date of grant using the Black-Scholes option pricing model. Share options granted to employees vest over a period of four years and share option expense for these options is recognized on a straight-line basis over the vesting period. Expense recognized related to share options and included in general and administrative expense in the accompanying consolidated statements of income was \$147 thousand and \$361 thousand for the six

months ended June 30, 2018 and 2017, respectively.

Nonvested Shares Issued to Employees

The Company grants nonvested shares to employees pursuant to both the Annual Incentive Program and the Long-Term Incentive Plan. The Company amortizes the expense related to the nonvested shares awarded to employees under the Long-Term Incentive Plan and the premium awarded under the nonvested share alternative of the Annual Incentive

10

Program on a straight-line basis over the future vesting period (three or four years). Expense recognized related to nonvested shares and included in general and administrative expense in the accompanying consolidated statements of income was \$6.9 million and \$6.0 million for the six months ended June 30, 2018 and 2017, respectively.

Restricted Share Units Issued to Non-Employee Trustees

The Company issues restricted share units to non-employee Trustees for payment of their annual retainers under the Company's Trustee compensation program. The fair value of the share units granted was based on the share price at the date of grant. The share units vest upon the earlier of the day preceding the next annual meeting of shareholders or a change of control. The settlement date for the shares is selected by the non-employee Trustee, and ranges from one year from the grant date to upon termination of service. This expense is amortized by the Company on a straight-line basis over the year of service by the non-employee Trustees. Total expense recognized related to shares issued to non-employee Trustees was \$570 thousand and \$599 thousand for the six months ended June 30, 2018 and 2017, respectively.

Derivative Instruments

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The update amended existing guidance in order to better align a company's financial reporting for hedging activities with the economic objectives of those activities. It requires the Company to disclose the effect of its hedging activities on its consolidated statements of income and eliminated the periodic measurement and recognition of hedging ineffectiveness. The standard is effective for annual reporting periods beginning after December 15, 2018, including interim periods within those fiscal years, with early application of the guidance permitted. The Company elected to early adopt ASU No. 2017-12 as of October 1, 2017. Early adoption had no impact on the Company's financial position or results of operations.

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

The Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. For its net investment hedges, the Company has elected to assess hedge effectiveness using a method based on changes in spot exchange rates and record the changes in the fair value amounts excluded from the assessment of effectiveness into earnings on a systematic and rational basis. The Company may enter into derivative contracts that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting.

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

Impact of Recently Issued Accounting Standards

In February 2016, the FASB issued ASU No. 2016-02, Leases, which amends existing accounting standards for lease accounting and is intended to improve financial reporting related to lease transactions. The ASU will require lessees to classify leases as either finance or operating leases based on certain criteria and to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Lessor accounting will remain largely unchanged from current U.S. GAAP. The standard eliminates current real estate-specific provisions and changes the

guidance on sale-leaseback transactions and will require new disclosures within the notes accompanying the consolidated financial statements.

Although the Company is primarily a lessor, ASU No. 2016-02 will impact the Company's consolidated financial statements and disclosures as it has certain operating land leases and other arrangements for which it is the lessee and will be required to recognize these arrangements on the consolidated financial statements. For the land lease arrangements, the Company is also, in substantially all cases, in a sub-lessor position and passes the obligation to pay the monthly land lease payments on to its sublessees. The Company has completed its initial inventory and evaluation of the land leases and other arrangements and expects that it will be required to recognize a right-of-use asset and a lease liability for the present value of the minimum lease payments. The Company is in the process of preparing the initial estimates of the amount of its right-of-use assets and lease liabilities. Based on the current contracts under which the Company is a lessee, it is estimated that its right-of-use assets and lease liabilities to be recognized upon adoption will be less than 4% of total assets. However, the ultimate impact of adopting ASU No. 2016-02 will depend on the Company's lease portfolio as of the adoption date.

A substantial portion of the Company's lease contracts (under which it is lessor) are triple-net leases, which require the tenants to make payments to third parties for operating expenses such as property taxes, insurance and common area maintenance costs associated with the properties. The Company currently does not include these payments made by the lessee to third parties in rental revenue or property operating expenses. Because of applying the guidance in ASU No. 2016-02, the Company may be required to show certain payments made by its tenants on a gross basis in its consolidated statements of income. Although no impact to net income or cash flows is expected as a result of a gross presentation, it would have the impact of increasing both reported revenues and property operating expenses. The Company is continuing to evaluate the impact of this potential presentation.

The ASU will become effective for the Company for interim and annual reporting periods in fiscal years beginning after December 15, 2018. The Company expects to adopt the new standard on its effective date. The standard offers several practical expedients for transition and certain expedients specific to lessees or lessors. Both lessees and lessors are permitted to make an election to apply a package of practical expedients available for implementation under the standard. The Company has concluded it will apply the package of practical expedients and certain other transition expedients, including the expedient to not evaluate existing or expired land easements. For transition, the Company intends to recognize all effects of transition in the beginning of the adoption reporting period on January 1, 2019. The Company will continue its implementation work in 2018 including enhancements to the Company's internal control framework, accounting systems and related documentation surrounding its lease accounting processes and the preparation of any additional disclosures that will be required.

In June 2016, the FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments, which amends ASC Topic 326, Financial Instruments - Credit Losses. The ASU changes the methodology for measuring credit losses on financial instruments and timing of when such losses are recorded. The amendments in ASU No. 2016-13 require the Company to measure all expected credit losses based upon historical experience, current conditions and reasonable and supportable forecasts that affect the collectability of financial assets and eliminates the incurred losses methodology under current U.S. GAAP. ASU No. 2016-13 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2019. The Company is currently evaluating the impact that the ASU will have on its consolidated financial statements and related disclosures.

3. Rental Properties

The following table summarizes the carrying amounts of rental properties as of June 30, 2018 and December 31, 2017 (in thousands):

	June 30, 2018	December 31, 2017
Buildings and improvements	\$4,390,112	\$4,123,356
Furniture, fixtures & equipment	89,559	87,630
Land	1,158,347	1,108,805
Leasehold interests	25,774	25,774
	5,663,792	5,345,565
Accumulated depreciation	(810,604)	(741,334)
Total	\$4,853,188	\$4,604,231

Depreciation expense on rental properties was \$72.9 million and \$59.3 million for the six months ended June 30, 2018 and 2017, respectively.

4. Impairment Charges

In July 2018, the Company entered into a new lease agreement with Children's Learning Adventure USA (CLA) related to 21 open schools which replaces the prior lease arrangements and provides for a one-month term for rent of \$1.0 million expiring on August 31, 2018. If the new lease is not extended, CLA will be required to expeditiously vacate these properties, in which case the Company intends to lease some or all of the 21 schools to other operators. The Company had \$250.9 million classified in rental properties, net, in the accompanying consolidated balance sheets at June 30, 2018 for these 21 schools, and determined that the estimated undiscounted future cash flow exceed the carrying values of these properties. In addition, CLA also agreed to relinquish control of four of the Company's properties that were still under development as the Company no longer intends to develop these properties for CLA. As a result, the Company revised its estimated undiscounted cash flows for these four properties, considering shorter expected holding periods, and determined that those estimated cash flows were not sufficient to recover the carrying values of these four properties. During the three months ended June 30, 2018, the Company determined the estimated fair value of these properties using Level 3 inputs, including independent appraisals of these properties, and reduced the carrying value of these assets to \$9.8 million, recording an impairment charge of \$16.5 million. The charge is primarily related to the cost of improvements specific to the development of CLA's prototype.

5. Investments and Dispositions

The Company's investment spending during the six months ended June 30, 2018 totaled \$238.5 million, and included investments in each of its primary operating segments.

Entertainment investment spending during the six months ended June 30, 2018 totaled \$49.3 million, including spending on build-to-suit development and redevelopment of megaplex theatres, entertainment retail centers and family entertainment centers, as well as a \$7.5 million megaplex theatre acquisition.

Recreation investment spending during the six months ended June 30, 2018 totaled \$150.6 million, including spending on build-to-suit development of golf entertainment complexes and attractions, redevelopment of ski areas, a \$7.8 million acquisition of a recreation facility, an investment of \$10.3 million in a mortgage note secured by one other recreation facility and the acquisition of one attraction property described below.

On June 22, 2018, the Company acquired one attraction property located in Pagosa Springs, Colorado for approximately \$36.4 million. The property is a natural hot springs resort and spa on approximately eight acres and is subject to a long-term, triple-net lease.

Education investment spending during the six months ended June 30, 2018 totaled \$38.6 million, including spending on build-to-suit development and redevelopment of public charter schools, early education centers and private schools, as well as \$8.4 million on two early education center acquisitions.

Mortgage Notes

On February 16, 2018, a borrower exercised its put option to convert its mortgage note agreement, totaling \$142.9 million and secured by 28 education facilities including both early education and private school properties, to a lease agreement. As a result, the Company recorded the rental property at the carrying value, which approximated fair value, of the mortgage note on the conversion date and allocated this cost on a relative fair value basis. The properties are leased pursuant to a triple-net master lease with a 23-year remaining term.

On March 11, 2018, the Company received payment in full on one mortgage note receivable of \$1.5 million that was secured by land located in California. Additionally, on March 26, 2018, the Company received payment in full on one mortgage note receivable of \$9.0 million that was secured by real estate in Washington. There were no prepayment fees received in connection with these note payoffs.

On May 7, 2018, Boyne USA, Inc. (Boyne) purchased seven ski properties from Och-Ziff Real Estate (OZRE) that partially secured the Company's mortgage note receivable due from OZRE. Following the acquisition by Boyne, OZRE made a partial prepayment to the Company of \$175.4 million on this mortgage note receivable, leaving a carrying value of \$74.6 million at June 30, 2018 that is secured by the remaining six ski properties. In connection with the partial prepayment of this note, the Company recognized a prepayment fee totaling \$45.9 million that is included in mortgage and other financing income in the accompanying consolidated statements of income for the three and six months ended June 30, 2018.

On May 29, 2018, the Company received a partial prepayment of \$8.0 million on one mortgage note receivable that is secured by the observation deck of the John Hancock Tower in Chicago, Illinois. In connection with the partial prepayment of this note, the Company recognized a prepayment fee of \$1.4 million that is included in mortgage and other financing income in the accompanying consolidated statements of income for the three and six months ended June 30, 2018.

Dispositions

During the six months ended June 30, 2018, the Company completed the sales of two entertainment parcels located in Illinois for net proceeds totaling \$4.2 million. In connection with these sales, the Company recognized a gain on sale of \$0.5 million during the six months ended June 30, 2018. Additionally, the Company completed the sale of one early education center for net proceeds of \$1.6 million. No gain or loss was recognized on this sale.

Subsequent to June 30, 2018, pursuant to a tenant purchase option, the Company completed the sale of one public charter school located in California for net proceeds totaling \$11.9 million. In connection with this sale, the Company will recognize a gain on sale of \$1.9 million during the third quarter of 2018.

6. Accounts Receivable, Net

The following table summarizes the carrying amounts of accounts receivable, net as of June 30, 2018 and December 31, 2017 (in thousands):

	June 30, 2018	December 31, 2017
Receivable from tenants	\$17,766	\$ 19,923
Receivable from non-tenants	4,745	3,932
Receivable from Sullivan County Infrastructure Revenue Bonds	16,883	14,718
Straight-line rent receivable	67,903	62,605
Allowance for doubtful accounts	(9,493)	(7,485)

Total

\$97,804 \$ 93,693

14

The above totals include receivables from tenants of approximately \$7.2 million and \$6.0 million from CLA, which were fully reserved in the allowance for doubtful accounts at June 30, 2018 and December 31, 2017, respectively. See Note 14 for further discussion related to CLA. During the three months ended June 30, 2018, the Company recorded impairment charges of \$16.5 million related to four properties classified in land held for development. See Note 4 for further discussion on impairment charges recognized related to CLA properties.

7. Investment in Direct Financing Leases

The Company's investment in direct financing leases relates to the Company's leases of six public charter school properties as of June 30, 2018 and December 31, 2017, with affiliates of Imagine Schools, Inc. (Imagine). Investment in direct financing leases, net represents estimated unguaranteed residual values of leased assets and net unpaid rentals, less related deferred income. The following table summarizes the carrying amounts of investment in direct financing leases, net as of June 30, 2018 and December 31, 2017 (in thousands):

	June 30, 2018	December 31, 2017
Total minimum lease payments receivable	\$109,294	\$ 112,411
Estimated unguaranteed residual value of leased assets	47,000	47,000
Less deferred income ⁽¹⁾	(97,989)	(101,508)
Investment in direct financing leases, net	\$58,305	\$ 57,903

⁽¹⁾ Deferred income is net of \$0.8 million of initial direct costs at June 30, 2018 and December 31, 2017.

During the year ended December 31, 2017, the Company recorded an impairment charge of \$9.6 million, which included an allowance for lease loss of \$7.3 million and a charge of \$2.3 million related to estimated unguaranteed residual value. The Company determined that no additional allowance for losses was necessary at June 30, 2018.

Additionally, during the year ended December 31, 2017, the Company performed its annual review of the estimated unguaranteed residual value on its other properties leased to Imagine and determined that the residual value on one of these properties was impaired. As such, the Company recorded an impairment charge of the unguaranteed residual value of \$0.6 million during the year ended December 31, 2017.

The Company's direct financing leases have expiration dates ranging from approximately 14 to 16 years. Future minimum rentals receivable on these direct financing leases at June 30, 2018 are as follows (in thousands):

	Amount
Year:	
2018	\$3,184
2019	6,490
2020	6,685
2021	6,885
2022	7,092
Thereafter	78,958
Total	\$109,294

Subsequent to June 30, 2018, the Company completed the sale of four public charter school properties leased to Imagine, located in Arizona, Ohio and Washington D.C for net proceeds of \$43.4 million. In connection with this sale, the Company expects to recognize a gain on sale of \$5.5 million during the third quarter of 2018.

8. Debt and Capital Markets

On January 2, 2018, the Company prepaid in full a mortgage note payable totaling \$11.7 million with an annual interest rate of 6.19%, which was secured by one theatre property.

Additionally, on February 28, 2018, the Company redeemed all of its outstanding 7.75% Senior Notes due July 15, 2020. The notes were redeemed at a price equal to the principal amount of \$250.0 million plus a premium calculated pursuant to the terms of the indenture of \$28.6 million, together with accrued and unpaid interest up to, but not including the redemption date of \$2.3 million. In connection with the redemption, the Company recorded a non-cash write off of \$3.3 million in deferred financing costs. The premium and non-cash write off were recognized as costs associated with loan refinancing or payoff in the accompanying consolidated statements of income for the six months ended June 30, 2018.

On April 16, 2018, the Company issued \$400.0 million in aggregate principal amount of senior notes due April 15, 2028 pursuant to an underwritten public offering. The notes bear interest at an annual rate of 4.95%. Interest is payable on April 15 and October 15 of each year beginning on October 15, 2018 until the stated maturity date of April 15, 2028. The notes were issued at 98.883% of their face value and are unsecured. The notes contain various covenants, including: (i) a limitation on incurrence of any debt which would cause the ratio of the Company's debt to adjusted total assets to exceed 60%; (ii) a limitation on incurrence of any secured debt which would cause the ratio of the Company's secured debt to adjusted total assets to exceed 40%; (iii) a limitation on incurrence of any debt which would cause the Company's debt service coverage ratio to be less than 1.5 times and (iv) the maintenance at all times of the Company's total unencumbered assets such that they are not less than 150% of the Company's outstanding unsecured debt. Net proceeds from the note offering were used to pay down the Company's unsecured revolving credit facility.

9. Variable Interest Entities

The Company's variable interest in VIEs currently are in the form of equity ownership and loans provided by the Company to a VIE or other partner. The Company examines specific criteria and uses its judgment when determining if the Company is the primary beneficiary of a VIE. Factors considered in determining whether the Company is the primary beneficiary include risk and reward sharing, experience and financial condition of other partner(s), voting rights, involvement in day-to-day capital and operating decisions, representation on a VIE's executive committee, existence of unilateral kick-out rights or voting rights, and level of economic disproportionality between the Company and the other partner(s).

Consolidated VIEs

As of June 30, 2018, the Company had invested approximately \$30.0 million included in rental properties in the accompanying consolidated balance sheet for one real estate project which is a VIE. This entity does not have any other significant assets or liabilities at June 30, 2018 and was established to facilitate the development of a theatre project.

Unconsolidated VIE

At June 30, 2018, the Company's recorded investment in two unconsolidated VIEs totaled \$180.4 million. The Company's maximum exposure to loss associated with these VIEs is limited to the Company's outstanding mortgage notes and related accrued interest receivable of \$180.4 million. These mortgage notes are secured by three recreation properties and one public charter school. While these entities are VIEs, the Company has determined that the power to direct the activities of these VIEs that most significantly impact the VIEs' economic performance is not held by the Company.

10. Derivative Instruments

All derivatives are recognized at fair value in the consolidated balance sheets within the line items "Other assets" and "Accounts payable and accrued liabilities" as applicable. The Company's derivatives are subject to a master netting arrangement and the Company has elected not to offset its derivative position for purposes of balance sheet presentation and disclosure. The Company had derivative liabilities of \$0.6 million and \$0.1 million recorded in

“Accounts payable and accrued liabilities” in the consolidated balance sheet at June 30, 2018 and December 31, 2017, respectively. The Company had derivative assets of \$40.7 million and \$25.8 million recorded in “Other assets” in the consolidated balance sheet at June 30, 2018 and December 31, 2017, respectively. The Company had not posted or received collateral with its derivative counterparties as of June 30, 2018 or December 31, 2017. See Note 11 for disclosures relating to the fair value of the derivative instruments as of June 30, 2018 and December 31, 2017.

Risk Management Objective of Using Derivatives

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

Cash Flow Hedges of Interest Rate Risk

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

As of June 30, 2018, the Company had two interest rate swap agreements to fix the interest rate at 2.64% on \$300.0 million of borrowings under the unsecured term loan facility from July 6, 2017 to April 5, 2019. Additionally, as of June 30, 2018, the Company had three additional interest rate swap agreements to fix the interest rate at 3.15% on an additional \$50.0 million of borrowings under the unsecured term loan facility from November 6, 2017 to April 5, 2019 and on \$350.0 million of borrowings under the unsecured term loan facility from April 6, 2019 to February 7, 2022.

The change in the fair value of interest rate derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income (AOCI) and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings within the same income statement line item as the earnings effect of the hedged transaction. During the six months ended June 30, 2018 and 2017, such derivatives were used to hedge the variable cash flows associated with existing variable-rate debt.

Amounts reported in AOCI related to derivatives will be reclassified to interest expense as interest payments are made on the Company's variable-rate debt. As of June 30, 2018, the Company estimates that during the twelve months ending June 30, 2019, \$2.4 million will be reclassified from AOCI to a reduction of interest expense.

Cash Flow Hedges of Foreign Exchange Risk

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

As of June 30, 2018, the Company had USD-CAD cross-currency swaps with a fixed original notional value of \$100.0 million CAD and \$98.1 million USD. The net effect of these swaps is to lock in an exchange rate of \$1.05 CAD per USD on approximately \$13.5 million of annual CAD denominated cash flows on the properties through July 1, 2018. Additionally, on August 30, 2017, the Company entered into a cross-currency swap that became effective July 1, 2018 with a fixed original notional value of \$100.0 million CAD and \$79.5 million USD. The net effect of this swap is to lock in an exchange rate of \$1.26 CAD per USD on approximately \$13.5 million of annual CAD denominated cash flows on the properties through June 2020. On June 29, 2019, the Company entered into two cross-currency swap agreements designated as net investment hedges and are described below.

The change in the fair value of foreign currency derivatives designated and that qualify as cash flow hedges of foreign exchange risk is recorded in AOCI and subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings within the same income statement line item as the earnings effect of the hedged transaction.

As of June 30, 2018, the Company estimates that during the twelve months ending June 30, 2019, \$0.4 million of gains will be reclassified from AOCI to other income.

Net Investment Hedges

As discussed above, the Company is exposed to fluctuations in foreign exchange rates on its four Canadian properties. As such, the Company uses currency forward agreements to hedge its exposure to changes in foreign exchange rates. Currency forward agreements involve fixing the USD-CAD exchange rate for delivery of a specified amount of foreign currency on a specified date. The currency forward agreements are typically cash settled in USD for their fair value at or close to their settlement date. In order to hedge the net investment in four of the Canadian properties, on June 13, 2013, the Company entered into a forward contract with a fixed notional value of \$100.0 million CAD and \$94.3 million USD with a July 2018 settlement. The exchange rate of this forward contract is approximately \$1.06 CAD per USD. Additionally, on February 28, 2014, the Company entered into a forward contract with a fixed notional value of \$100.0 million CAD and \$88.1 million USD with a July 2018 settlement date. The exchange rate of this forward contract was approximately \$1.13 CAD per USD.

On June 29, 2018, the Company de-designated these CAD to USD currency forward agreements in conjunction with entering into new agreements, described below, effectively terminating the currency forward agreements. These contracts were previously designated as net investment hedges. Subsequent to June 30, 2018, the Company received \$30.8 million of cash in connection with the settlement of the CAD to USD currency forward agreements. The corresponding change in value of the forward contracts for the period from inception through settlement of \$30.8 million will be reported in AOCI and will be reclassified into earnings upon a sale or complete or substantially complete liquidation of the Company's investment in its four Canadian properties.

Additionally, on June 29, 2018, the Company entered into two cross-currency swaps, designated as net investment hedges that became effective July 1, 2018 with a total fixed notional value of \$200.0 million CAD and \$151.6 million USD with a maturity date of July 1, 2023. Included in this net investment hedge, the Company locked in an exchange rate of \$1.32 CAD per USD on approximately \$4.5 million of additional annual CAD denominated cash flows on the properties through July 1, 2023.

For foreign currency derivatives designated as net investment hedges, the change in the fair value of the derivatives are reported in AOCI as part of the cumulative translation adjustment. Amounts are reclassified out of AOCI into earnings when the hedged net investment is either sold or substantially liquidated.

Below is a summary of the effect of derivative instruments on the consolidated statements of changes in equity and income for the three and six months ended June 30, 2018 and 2017.

Effect of Derivative Instruments on the Consolidated Statements of Changes in Equity and Income for the Three and Six Months Ended June 30, 2018 and 2017

(Dollars in thousands)

Description	Three Months		Six Months Ended	
	Ended June 30, 2018	2017	2018	2017
Cash Flow Hedges				
Interest Rate Swaps				
Amount of Gain (Loss) Recognized in AOCI on Derivative	\$2,115	\$(297)	\$6,893	\$207
Amount of Income (Expense) Reclassified from AOCI into Earnings (1)	275	(913)	262	(1,984)
Cross-Currency Swaps				
Amount of Gain (Loss) Recognized in AOCI on Derivative	447	(209)	1,062	(375)
Amount of Income Reclassified from AOCI into Earnings (2)	621	697	1,175	1,359
Net Investment Hedges				
Cross-Currency Swaps				
Amount of Loss Recognized in AOCI on Derivative	(591)	—	(591)	—
Amount of Income Reclassified from AOCI into Earnings	—	—	—	—
Currency Forward Agreements				
Amount of Gain (Loss) Recognized in AOCI on Derivative	4,009	(3,166)	8,555	(4,715)
Amount of Income Reclassified from AOCI into Earnings	—	—	—	—
Total				
Amount of Gain (Loss) Recognized in AOCI on Derivatives	\$5,980	\$(3,672)	\$15,919	\$(4,883)
Amount of Income (Expense) Reclassified from AOCI into Earnings	896	(216)	1,437	(625)

Interest expense, net in accompanying consolidated statements of income 34,079 32,967 68,416 63,659

Other income in accompanying consolidated statements of income 646 1,304 1,276 1,996

(1) Included in "Interest expense, net" in the accompanying consolidated statements of income for the three and six months ended June 30, 2018 and 2017.

(2) Included in "Other income" in the accompanying consolidated statements of income for the three and six months ended June 30, 2018 and 2017.

Credit-risk-related Contingent Features

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

As of June 30, 2018, the fair value of the Company's derivatives in a liability position related to these agreements was \$0.6 million. If the Company breached any of the contractual provisions of these derivative contracts, it would be required to settle its obligations under the agreements at their termination value, after considering the right of offset, of \$0.6 million. As of June 30, 2018, the Company had not posted any collateral related to these agreements and was not in breach of any provisions in these agreements.

11. Fair Value Disclosures

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

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

Derivative Financial Instruments

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

Although the Company determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives also use Level 3 inputs, such as estimates of current credit spreads, to evaluate the likelihood of default by itself and its counterparties. As of June 30, 2018, the Company assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives and therefore, classified its derivatives as Level 2 within the fair value reporting hierarchy.

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The table below presents the Company's financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2018 and December 31, 2017 aggregated by the level in the fair value hierarchy within which those measurements are classified and by derivative type.

Assets and Liabilities Measured at Fair Value on a Recurring Basis at
June 30, 2018 and December 31, 2017
(Dollars in thousands)

Description	Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Assets (Liabilities) Balance at end of period
June 30, 2018				
Cross-Currency Swaps*	\$	— \$ 794	\$	— \$ 794
Cross-Currency Swaps**	—	(591)	—	(591)
Currency Forward Agreements*	\$	— \$ 30,791	\$	— \$ 30,791
Interest Rate Swap Agreements*	\$	— \$ 9,127	\$	— \$ 9,127
December 31, 2017				
Cross-Currency Swaps*	\$	— \$ 1,041	\$	— \$ 1,041
Cross-Currency Swaps**	\$	— \$ (134)	\$	— \$ (134)
Currency Forward Agreements*	\$	— \$ 22,235	\$	— \$ 22,235
Interest Rate Swap Agreements*	\$	— \$ 2,496	\$	— \$ 2,496

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

**Included in "Accounts payable and accrued liabilities" in the accompanying consolidated balance sheets.

Non-recurring Fair Value Measurements

The table below presents the Company's assets measured at fair value on a non-recurring basis during the six months ended June 30, 2018 aggregated by the level in the fair value hierarchy within which those measurements fall.

Assets Measured at Fair Value on a Non-Recurring Basis During the Six Months Ended June 30, 2018
(Dollars in thousands)

Description	Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at end of period
June 30, 2018				
Land held for development	\$	— \$	— \$ 9,805	\$ 9,805

As discussed further in Note 4, during the three months ended June 30, 2018, the Company recorded impairment charges totaling \$16.5 million related to land held for development and property under development. Management estimated the fair values of these investments taking into account various factors including the independent appraisals, the shortened hold period and current market conditions. The Company determined, based on inputs, that its valuation of land held for development and property under development classified within Level 3 of the fair value hierarchy as many of the assumptions are not observable.

Fair Value of Financial Instruments

The following methods and assumptions were used by the Company to estimate the fair value of each class of financial instruments at June 30, 2018 and December 31, 2017:

Mortgage notes receivable and related accrued interest receivable:

The fair value of the Company's mortgage notes and related accrued interest receivable is estimated by discounting the future cash flows of each instrument using current market rates. At June 30, 2018, the Company had a carrying value of \$641.4 million in fixed rate mortgage notes receivable outstanding, including related accrued interest, with a weighted average interest rate of approximately 8.67%. The fixed rate mortgage notes bear interest at rates of 7.00% to 11.43%. Discounting the future cash flows for fixed rate mortgage notes receivable using rates of

7.50% to 11.50%, management estimates the fair value of the fixed rate mortgage notes receivable to be approximately \$666.1 million with an estimated weighted average market rate of 9.37% at June 30, 2018.

At December 31, 2017, the Company had a carrying value of \$970.7 million in fixed rate mortgage notes receivable outstanding, including related accrued interest, with a weighted average interest rate of approximately 8.42%. The fixed rate mortgage notes bear interest at rates of 7.00% to 11.31%. Discounting the future cash flows for fixed rate mortgage notes receivable using rates of 7.00% to 11.50%, management estimates the fair value of the fixed rate mortgage notes receivable to be \$992.6 million with an estimated weighted average market rate of 8.79% at December 31, 2017.

Investment in direct financing leases, net:

At June 30, 2018 and December 31, 2017, the Company had an investment in direct financing leases with a carrying value of \$58.3 million and \$57.9 million, respectively, and with a weighted average effective interest rate of 11.98% for both periods. At June 30, 2018 and December 31, 2017, the investment in direct financing leases bear interest at effective rates of 11.90% to 12.38%. The carrying value of the investment in direct financing leases approximated the fair value at June 30, 2018 and December 31, 2017.

Derivative instruments:

Derivative instruments are carried at their fair value.

Debt instruments:

The fair value of the Company's debt is estimated by discounting the future cash flows of each instrument using current market rates. At June 30, 2018, the Company had a carrying value of \$455.0 million in variable rate debt outstanding with a weighted average interest rate of approximately 2.71%. The carrying value of the variable rate debt outstanding approximated the fair value at June 30, 2018.

At December 31, 2017, the Company had a carrying value of \$635.0 million in variable rate debt outstanding with a weighted average interest rate of approximately 2.58%. The carrying value of the variable rate debt outstanding approximated the fair value at December 31, 2017.

At June 30, 2018 and December 31, 2017, \$350.0 million of the Company's variable rate debt, discussed above, had been effectively converted to a fixed rate through February 7, 2022 by interest rate swap agreements.

At June 30, 2018, the Company had a carrying value of \$2.57 billion in fixed rate long-term debt outstanding with a weighted average interest rate of approximately 4.86%. Discounting the future cash flows for fixed rate debt using June 30, 2018 market rates of 3.11% to 5.26%, management estimates the fair value of the fixed rate debt to be approximately \$2.55 billion with an estimated weighted average market rate of 4.85% at June 30, 2018.

At December 31, 2017, the Company had a carrying value of \$2.43 billion in fixed rate long-term debt outstanding with an average weighted interest rate of approximately 5.15%. Discounting the future cash flows for fixed rate debt using December 31, 2017 market rates of 2.49% to 4.56%, management estimates the fair value of the fixed rate debt to be approximately \$2.53 billion with an estimated weighted average market rate of 4.04% at December 31, 2017.

12. Earnings Per Share

The following table summarizes the Company's computation of basic and diluted earnings per share (EPS) for the three and six months ended June 30, 2018 and 2017 (amounts in thousands except per share information):

	Three Months Ended June 30, 2018			Six Months Ended June 30, 2018		
	Income (numerator)	Shares (denominator)	Per Share Amount	Income (numerator)	Shares (denominator)	Per Share Amount
Basic EPS:						
Net income	\$91,581			\$121,119		
Less: preferred dividend requirements	(6,036)			(12,072)		
Net income available to common shareholders	\$85,545	74,329	\$ 1.15	\$109,047	74,238	\$ 1.47
Diluted EPS:						
Net income available to common shareholders	\$85,545	74,329		\$109,047	74,238	
Effect of dilutive securities:						
Share options	—	36			35	
Net income available to common shareholders	\$85,545	74,365	\$ 1.15	\$109,047	74,273	\$ 1.47
	Three Months Ended June 30, 2017			Six Months Ended June 30, 2017		
	Income (numerator)	Shares (denominator)	Per Share Amount	Income (numerator)	Shares (denominator)	Per Share Amount
Basic EPS:						
Net income	\$80,535			\$134,451		
Less: preferred dividend requirements	(5,952)			(11,904)		
Net income available to common shareholders	\$74,583	73,159	\$ 1.02	\$122,547	68,621	\$ 1.79
Diluted EPS:						
Net income available to common shareholders	\$74,583	73,159		\$122,547	68,621	
Effect of dilutive securities:						
Share options	—	66		—	68	
Net income available to common shareholders	\$74,583	73,225	\$ 1.02	\$122,547	68,689	\$ 1.78

The additional 2.1 million common shares that would result from the conversion of the Company's 5.75% Series C cumulative convertible preferred shares and the additional 1.6 million common shares that would result from the conversion of the Company's 9.0% Series E cumulative convertible preferred shares and the corresponding add-back of the preferred dividends declared on those shares are not included in the calculation of diluted earnings per share for the three and six months ended June 30, 2018 and 2017, respectively, because the effect is anti-dilutive.

The dilutive effect of potential common shares from the exercise of share options is included in diluted earnings per share for the three and six months ended June 30, 2018 and 2017. However, options to purchase 86 thousand and 5 thousand common shares at per share prices ranging from \$56.94 to \$76.63 and ranging from \$61.79 to \$76.63, were outstanding for the three and six months ended June 30, 2018 and 2017, respectively, but were not included in the computation of diluted earnings per share because they were anti-dilutive.

13. Equity Incentive Plan

All grants of common shares and options to purchase common shares were issued under the Company's 2007 Equity Incentive Plan prior to May 12, 2016 and under the 2016 Equity Incentive Plan on and after May 12, 2016. Under the 2016 Equity Incentive Plan, an aggregate of 1,950,000 common shares, options to purchase common shares and restricted share units, subject to adjustment in the event of certain capital events, may be granted. At June 30, 2018, there were 1,309,271 shares available for grant under the 2016 Equity Incentive Plan.

Share Options

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

	Number of options	Option price per share	Weighted avg. exercise price
Outstanding at December 31, 2017	257,606	\$19.02 –\$76.63	\$ 51.81
Exercised	(5,742)	45.20 –61.79	52.42
Granted	3,835	56.94 –56.94	56.94
Forfeited/Expired	(205)	51.64 –61.79	59.02
Outstanding at June 30, 2018	255,494	\$19.02 –\$76.63	\$ 51.87

The weighted average fair value of options granted was \$3.03 and \$7.91 during the six months ended June 30, 2018 and 2017, respectively. The intrinsic value of share options exercised was \$0.1 million and \$0.5 million for the six months ended June 30, 2018 and 2017, respectively. At June 30, 2018, share-option expense to be recognized in future periods was \$0.2 million.

The expense related to share options included in the determination of net income for the six months ended June 30, 2018 and 2017 was \$0.1 million and \$0.4 million, respectively. The following assumptions were used in applying the Black-Scholes option pricing model at the grant dates for the six months ended June 30, 2018: risk-free interest rate of 2.7%, dividend yield of 7.6%, volatility factors in the expected market price of the Company's common shares of 18.9%, 0.74% expected forfeiture rate and an expected life of approximately six years. The Company uses historical data to estimate the expected life of the option and the risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. Additionally, expected volatility is computed based on the average historical volatility of the Company's publicly traded shares.

The following table summarizes outstanding options at June 30, 2018:

Exercise price range	Options outstanding	Weighted avg. life remaining	Weighted avg. exercise price	Aggregate intrinsic value (in thousands)
\$ 19.02 - 19.99	11,097	0.9		
20.00 - 29.99	—	—		
30.00 - 39.99	1,428	1.5		
40.00 - 49.99	84,509	3.6		
50.00 - 59.99	76,474	5.7		
60.00 - 69.99	79,771	6.6		
70.00 - 76.63	2,215	8.7		
	255,494	5.1	\$ 51.87	\$ 3,328

The following table summarizes exercisable options at June 30, 2018:

Exercise price range	Options outstanding	Weighted avg. life remaining	Weighted avg. exercise price	Aggregate intrinsic value (in thousands)
\$ 19.02 - 19.99	11,097	0.9		
20.00 - 29.99	—	—		
30.00 - 39.99	1,428	1.5		
40.00 - 49.99	84,509	3.6		
50.00 - 59.99	72,639	5.5		
60.00 - 69.99	58,593	6.6		
70.00 - 76.63	554	8.7		
	228,820	4.8	\$ 50.68	\$ 3,234

Nonvested Shares

A summary of the Company's nonvested share activity and related information is as follows:

	Number of shares	Weighted avg. grant date fair value	Weighted avg. life remaining
Outstanding at December 31, 2017	620,122	\$ 68.07	
Granted	295,202	56.94	
Vested	(244,852)	65.33	
Forfeited	(38)	56.94	
Outstanding at June 30, 2018	670,434	\$ 64.17	1.40

The holders of nonvested shares have voting rights and receive dividends from the date of grant. These shares vest ratably over a period of three to four years. The fair value of the nonvested shares that vested was \$16.0 million and \$15.0 million for the six months ended June 30, 2018 and 2017, respectively. At June 30, 2018, unamortized share-based compensation expense related to nonvested shares was \$27.1 million.

Restricted Share Units

A summary of the Company's restricted share unit activity and related information is as follows:

	Number of shares	Weighted avg. grant date fair value	Weighted avg. life remaining
Outstanding at December 31, 2017	19,030	\$ 70.91	
Granted	23,571	61.25	
Vested	(19,030)	70.91	
Outstanding at June 30, 2018	23,571	\$ 61.25	0.92

The holders of restricted share units receive dividend equivalents from the date of grant. The share units vest upon the earlier of the day preceding the next annual meeting of shareholders or a change of control. The settlement date for the shares is selected by the non-employee Trustee, and ranges from one year from the grant date to upon termination of service. At June 30, 2018, unamortized share-based compensation expense related to restricted share units was \$1.3 million.

14. Other Commitments and Contingencies

As of June 30, 2018, the Company had an aggregate of approximately \$110.8 million of commitments to fund development projects including 12 entertainment development projects for which it had commitments to fund approximately \$24.7 million, five recreation development projects for which it had commitments to fund approximately \$52.2 million and seven education development projects for which it had commitments to fund approximately \$33.9 million. Development costs are advanced by the Company in periodic draws. If the Company determines that construction is not being completed in accordance with the terms of the development agreement, it can discontinue funding construction draws. The Company has agreed to lease the properties to the operators at pre-determined rates upon completion of construction.

Additionally as of June 30, 2018, the Company had a commitment to fund approximately \$201.2 million, of which \$86.1 million had been funded, to complete an indoor waterpark hotel and adventure park at its casino and resort project in Sullivan County, New York. The Company is also responsible for the construction of the casino and resort project common infrastructure. In June 2016, the Sullivan County Infrastructure Local Development Corporation issued \$110.0 million of Series 2016 Revenue Bonds which is expected to fund a substantial portion of such construction costs. The Company received reimbursements of \$43.4 million and \$23.9 million of construction costs during the years ended December 31, 2016 and 2017, respectively. During the six months ended June 30, 2018, the Company received an additional reimbursement of \$6.9 million. Construction of infrastructure improvements is currently expected to be completed in the remainder of 2018.

The Company has certain commitments related to its mortgage note investments that it may be required to fund in the future. The Company is generally obligated to fund these commitments at the request of the borrower or upon the occurrence of events outside of its direct control. As of June 30, 2018, the Company had five mortgage notes receivable with commitments totaling approximately \$18.6 million. If commitments are funded in the future, interest will be charged at rates consistent with the existing investments.

The Company has provided guarantees of the payment of certain economic development revenue bonds totaling \$24.7 million related to two theatres in Louisiana for which the Company earns a fee at an annual rate of 4.00% over the 30-year terms of the related bonds. The Company recorded \$13.3 million as a deferred asset included in other assets and \$13.3 million included in other liabilities in the accompanying consolidated balance sheet as of June 30, 2018 related to these guarantees. No amounts have been accrued as a loss contingency related to these guarantees because payment by the Company is not probable.

In connection with construction of its development projects and related infrastructure, certain public agencies require posting of surety bonds to guarantee that the Company's obligations are satisfied. These bonds expire upon the completion of the improvements or infrastructure. As of June 30, 2018, the Company had six surety bonds outstanding totaling \$22.8 million.

Resort Project in Sullivan County, New York

Prior proposed casino and resort developers Concord Associates, L.P., Concord Resort, LLC and Concord Kiamesha LLC, which are affiliates of Louis Cappelli and from whom the Company acquired the Resorts World Catskills resort property (the Cappelli Group), commenced litigation against the Company beginning in 2011 regarding matters relating to the acquisition of that property and the Company's relationship with the Empire Resorts, Inc. and certain of its subsidiaries. This litigation involved three separate cases filed in state and federal court. Two of the cases, a state and the federal case, were previously closed and resulted in no liability by the Company.

The remaining case was filed on October 20, 2011 by the Cappelli Group against the Company and two of its affiliates in the Supreme Court of the State of New York, County of Westchester (the Westchester Action), asserting a claim for breach of contract and the implied covenant of good faith, and seeking damages of at least \$800 million, based on

allegations that the Company had breached a casino development agreement, dated June 18, 2010. On June 29, 2018, the Company entered into a settlement agreement with the Cappelli Group whereby each of the parties fully settled all disputes between and among them. The terms of the settlement agreement include, among other terms, the Company's payment of \$2.0 million to the Cappelli Group, the mutual release of all parties, and the dismissal of the Westchester

Action with prejudice. Additionally, during the three months ended June 30, 2018, the Company paid approximately \$90 thousand in professional fees associated with the settlement.

Early Childhood Education Tenant

During 2017, cash flow of CLA was negatively impacted by challenges brought on by its rapid expansion and related ramp up to stabilization and by adverse weather conditions in Texas during the third quarter of 2017. As a result, CLA initiated negotiations with the Company and other landlords regarding a potential restructuring. However, CLA did not secure the investments necessary to accomplish the restructuring. As a result, the Company sent CLA notices of lease termination on October 12, 2017 for the following CLA properties: (i) Broomfield, Colorado, (ii) Ashburn, Virginia, (iii) West Chester, Ohio, (iv) Chanhassen, Minnesota, (v) Ellisville, Missouri, (vi) Farm Road-Las Vegas, Nevada, (vii) Fishers, Indiana, (viii) Tredyffrin, Pennsylvania, and (ix) Westerville, Ohio.

On December 18, 2017, ten subsidiaries of CLA Parent filed separate voluntary petitions for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code with the United States Bankruptcy Court for the District of Arizona (Jointly Administered under Case No. 2:17-bk-14851-BMW). The CLA Debtors consist of CLA Properties SPE, LLC, CLA Maple Grove, LLC, CLA Carmel, LLC, CLA West Chester, LLC, CLA One Loudoun, LLC, CLA Fishers, LLC, CLA Chanhassen, LLC, CLA Ellisville, LLC, CLA Farm, LLC, and CLA Westerville, LLC. CLA Parent has not filed a petition for bankruptcy. The CLA Debtors include each of the Company's direct or indirect tenants on 24 out of the Company's 25 CLA properties, including 21 operating properties, two partially completed properties and one unimproved land parcel. The only CLA tenant unaffected by the bankruptcy is CLA King of Prussia, LLC, which is the CLA tenant entity for an unimproved land parcel located in Tredyffrin, Pennsylvania. It is the Company's understanding that the CLA Debtors filed bankruptcy petitions to stay the termination of the remaining CLA leases and delay the eviction process.

On January 8, 2018, the Company filed with the Court (i) motions seeking rent for the post-petition period beginning on December 18, 2017, and (ii) motions seeking relief from the automatic stay seeking the right to terminate the remaining leases and evict the CLA Debtors from the properties. On March 14, 2018, the CLA Parties and the Company entered into a Stipulation providing that (a) the CLA Parties will pay monthly rent for the months of March, April, May, June and July in the amounts of \$750 thousand, \$750 thousand, \$750 thousand, \$1.0 million and \$1.0 million, respectively, (b) resolution of restructuring of the leases between the Company and the CLA Parties will be concluded no later than July 31, 2018 (the Forbearance Period), (c) relief from stay is granted with respect to the Company's properties as needed to implement the Stipulation, (d) the parties will not commence or prosecute litigation against any other party during the Forbearance Period, and (e) the deadline for any motion by the CLA Debtors to assume or reject the leases under the U.S. Bankruptcy Code was extended to July 31, 2018. On May 7, 2018, the Court entered an order approving the Stipulation. The CLA Parties have made all of the required rent payments since entering into the Stipulation.

In July 2018, the Company entered into a new lease agreement with CLA related to the 21 operating properties which replaces the prior lease arrangements and provides for a one-month term for rent of \$1.0 million expiring on August 31, 2018. The Company may agree to extend this lease, in its sole discretion, if the Company believes CLA is making adequate progress towards a satisfactory restructuring. If the new lease is not extended, CLA will be required to expeditiously vacate these properties, in which case the Company intends to lease some or all of the 21 schools to other operators. CLA also agreed to relinquish control of the four properties that were still under development as the Company no longer intends to develop these properties for CLA.

CLA continues to negotiate with third parties regarding a restructuring that would permit CLA to continue operation of the CLA properties. In addition, the Company is actively pursuing other alternatives for these properties, including replacement tenants and operators. There can be no assurances as to the ultimate outcome of such actions or the Company's pursuit of its legal remedies with respect to the CLA properties.

15. Segment Information

The Company groups investments into four reportable operating segments: Entertainment, Recreation, Education and Other. The financial information summarized below is presented by reportable operating segment:

Balance Sheet Data:

	As of June 30, 2018					
	Entertainment	Recreation	Education	Other	Corporate/Unallocated	Consolidated
Total Assets	\$2,376,492	\$2,050,032	\$1,420,034	\$201,976	\$ 55,690	\$ 6,104,224

	As of December 31, 2017					
	Entertainment	Recreation	Education	Other	Corporate/Unallocated	Consolidated
Total Assets	\$2,380,129	\$2,102,041	\$1,429,992	\$199,052	\$ 80,279	\$ 6,191,493

Operating Data:

	Three Months Ended June 30, 2018					
	Entertainment	Recreation	Education	Other	Corporate/Unallocated	Consolidated
Rental revenue	\$74,640	\$ 34,443	\$ 25,649	\$2,287	\$ —	\$ 137,019
Other income	4	—	—	—	642	646
Mortgage and other financing income	2,100	57,540	5,562	—	—	65,202
Total revenue	76,744	91,983	31,211	2,287	642	202,867
Property operating expense	5,816	24	644	689	161	7,334
Total investment expenses	5,816	24	644	689	161	7,334
Net operating income - before unallocated items	70,928	91,959	30,567	1,598	481	195,533

Reconciliation to Consolidated Statements of Income:

General and administrative expense	(12,976))
Litigation settlement expense	(2,090))
Costs associated with loan refinancing or payoff	(15))
Interest expense, net	(34,079))
Transaction costs	(405))
Impairment charges	(16,548))
Depreciation and amortization	(37,582))
Equity in loss from joint ventures	(88))
Gain on sale of real estate	473)
Income tax expense	(642))
Net income	91,581)
Preferred dividend requirements	(6,036))
Net income available to common shareholders of EPR Properties	\$ 85,545)

Operating Data:

	Three Months Ended June 30, 2017					Consolidated
	Entertainment	Recreation	Education	Other	Corporate/Unallocated	
Rental revenue	\$69,403	\$29,384	\$22,333	\$2,290	\$—	\$123,410
Other income	606	—	1	—	697	1,304
Mortgage and other financing income	1,096	13,104	8,868	—	—	23,068
Total revenue	71,105	42,488	31,202	2,290	697	147,782
Property operating expense	5,545	29	32	353	113	6,072
Total investment expenses	5,545	29	32	353	113	6,072
Net operating income - before unallocated items	65,560	42,459	31,170	1,937	584	141,710

Reconciliation to Consolidated Statements of Income:

General and administrative expense	(10,660))
Costs associated with loan refinancing or payoff	(9))
Gain on early extinguishment of debt	977	
Interest expense, net	(32,967))
Transaction costs	(218))
Impairment charges	(10,195))
Depreciation and amortization	(33,148))
Equity in income from joint ventures	59	
Gain on sale of real estate	25,461	
Income tax expense	(475))
Net income	80,535	
Preferred dividend requirements	(5,952))
Net income available to common shareholders of EPR Properties	\$74,583	

Operating Data:

	Six Months Ended June 30, 2018					Consolidated
	Entertainment	Recreation	Education	Other	Corporate/Unallocated	
Rental revenue	\$ 149,488	\$ 67,875	\$ 48,034	\$ 4,546	\$ —	\$ 269,943
Other income	4	62	—	—	1,210	1,276
Mortgage and other financing income	2,902	71,245	12,469	—	—	86,616
Total revenue	152,394	139,182	60,503	4,546	1,210	357,835
Property operating expense	12,045	57	1,473	1,003	320	14,898
Total investment expenses	12,045	57	1,473	1,003	320	14,898
Net operating income - before unallocated items	140,349	139,125	59,030	3,543	890	342,937

Reconciliation to Consolidated Statements of Income:

General and administrative expense	(25,300)
Litigation settlement expense	(2,090)
Costs associated with loan refinancing or payoff	(31,958)
Interest expense, net	(68,416)
Transaction costs	(1,014)
Impairment charges	(16,548)
Depreciation and amortization	(75,266)
Equity in loss from joint ventures	(37)
Gain on sale of real estate	473
Income tax expense	(1,662)
Net income	121,119
Preferred dividend requirements	(12,072)
Net income available to common shareholders of EPR Properties	\$ 109,047

Operating Data:

	Six Months Ended June 30, 2017					Consolidated
	Entertainment	Recreation	Education	Other	Corporate/Unallocated	
Rental revenue	\$138,243	\$46,683	\$44,690	\$4,580	\$	— \$234,196
Other income	612	—	1	—	1,383	1,996
Mortgage and other financing income	2,275	21,010	17,417	—	—	40,702
Total revenue	141,130	67,693	62,108	4,580	1,383	276,894
Property operating expense	11,380	57	32	693	260	12,422
Total investment expenses	11,380	57	32	693	260	12,422
Net operating income - before unallocated items	129,750	67,636	62,076	3,887	1,123	264,472
Reconciliation to Consolidated Statements of Income:						
General and administrative expense						(21,717)
Costs associated with loan refinancing or payoff						(14)
Gain on early extinguishment of debt						977
Interest expense, net						(63,659)
Transaction costs						(275)
Impairment charges						(10,195)
Depreciation and amortization						(61,225)
Equity in income from joint ventures						51
Gain on sale of real estate						27,465
Income tax expense						(1,429)
Net income						134,451
Preferred dividend requirements						(11,904)
Net income available to common shareholders of EPR Properties						\$122,547

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

The following discussion should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in this Quarterly Report on Form 10-Q of EPR Properties (the "Company", "EPR", "we" or "us"). The forward-looking statements included in this discussion and elsewhere in this Quarterly Report on Form 10-Q involve risks and uncertainties, including anticipated financial performance, business prospects, industry trends, shareholder returns, performance of leases by tenants, performance on loans to customers and other matters, which reflect management's best judgment based on factors currently known. See "Cautionary Statement Concerning Forward-Looking Statements" which is incorporated herein by reference. Actual results and experience could differ materially from the anticipated results and other expectations expressed in our forward-looking statements as a result of a number of factors, including but not limited to those discussed in Item 1A - "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on March 1, 2018, as supplemented by Part II, Item 1A - "Risk Factors" in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2018 filed with the SEC on May 9, 2018.

Overview

Business

Our principal business objective is to enhance shareholder value by achieving predictable and increasing Funds From Operations ("FFO") and dividends per share. Our prevailing strategy is to focus on long-term investments in a limited number of categories in which we maintain a depth of knowledge and relationships, and which we believe offer sustained performance throughout all economic cycles. Our investment portfolio includes ownership of and long-term mortgages on entertainment, recreation and education properties. Substantially all of our owned single-tenant properties are leased pursuant to long-term, triple net leases, under which the tenants typically pay all operating expenses of the property. Tenants at our owned multi-tenant properties are typically required to pay common area maintenance charges to reimburse us for their pro-rata portion of these costs.

It has been our strategy to structure leases and financings to ensure a positive spread between our cost of capital and the rentals or interest paid by our tenants. We have primarily acquired or developed new properties that are pre-leased to a single tenant or multi-tenant properties that have a high occupancy rate. We have also entered into certain joint ventures and we have provided mortgage note financing. We intend to continue entering into some or all of these types of arrangements in the foreseeable future.

Historically, our primary challenges have been locating suitable properties, negotiating favorable lease or financing terms (on new or existing properties), and managing our portfolio as we have continued to grow. We believe our management's knowledge and industry relationships have facilitated opportunities for us to acquire, finance and lease properties. Our business is subject to a number of risks and uncertainties, including those described in Item 1A - "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on March 1, 2018, as supplemented by Part II, Item 1A - "Risk Factors" in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2018 filed with the SEC on May 9, 2018.

We group our investments into four reportable operating segments: Entertainment, Recreation, Education and Other. As of June 30, 2018, our total assets were approximately \$6.1 billion (after accumulated depreciation of approximately \$0.8 billion) which included investments in each of our four operating segments with properties located in 43 states, the District of Columbia and Ontario, Canada.

Our Entertainment segment included investments in 151 megaplex theatre properties, seven entertainment retail centers (which include seven additional megaplex theatre properties) and 11 family entertainment centers. Our portfolio of owned entertainment properties consisted of 13.3 million square feet and was 99% leased, including

megaplex theatres that were 100% leased.

Our Recreation segment included investments in 18 ski areas, 21 attractions, 31 golf entertainment complexes and ten other recreation facilities. Our portfolio of owned recreation properties was 100% leased.

32

Our Education segment included investments in 65 public charter school properties, 67 early education centers and 14 private schools. Our portfolio of owned education properties consisted of 4.7 million square feet and was 98% leased. Our Other segment consisted primarily of land under ground lease, property under development and land held for development related to the Resorts World Catskills casino and resort project in Sullivan County, New York.

The combined owned portfolio consisted of 21.2 million square feet and was 99% leased. As of June 30, 2018, we had a total of approximately \$268.1 million invested in property under development.

Our total investments (a non-GAAP financial measure) were approximately \$6.7 billion at June 30, 2018. We define total investments as the sum of the carrying values of rental properties and rental properties held for sale (before accumulated depreciation), land held for development, property under development, mortgage notes receivable (including related accrued interest receivable), investment in direct financing leases, net, investment in joint ventures, intangible assets, gross (before accumulated amortization and included in other assets) and notes receivable and related accrued interest receivable (included in other assets). Total investments is a non-GAAP financial measure. See "Non-GAAP Financial Measures" for the calculation of total investments and reconciliation of total investments to "Total assets" in the consolidated balance sheet at June 30, 2018 and December 31, 2017.

Of our total investments of \$6.7 billion at June 30, 2018, \$3.0 billion or 44% related to our Entertainment segment, \$2.1 billion or 32% related to our Recreation segment, \$1.4 billion or 21% related to our Education segment and \$179.3 million or 3% related to our Other segment.

Operating Results

Our total revenue, net income available to common shareholders per diluted share and Funds From Operations As Adjusted ("FFOAA") per diluted share (a non-GAAP financial measure) are detailed below for the three and six months ended June 30, 2018 and 2017 (in millions, except per share information):

	Three Months			Six Months		
	Ended June			Ended June		
	30,			30,		
	2018	2017	Increase	2018	2017	Increase
			%			(decrease)
Total revenue (1)	\$202.9	\$147.8	37 %	\$357.8	\$276.9	