

Edgar Filing: Seritage Growth Properties - Form 10-Q

Seritage Growth Properties  
Form 10-Q  
November 03, 2017  
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 SEPTEMBER 30, 2017

or

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

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

Commission File Number 001-37420

SERITAGE GROWTH PROPERTIES

(Exact name of registrant as specified in its charter)

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

489 Fifth Avenue, 18th Floor, New York, New York 10017  
(Address of principal executive offices) (Zip Code)

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

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

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

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

Edgar Filing: Seritage Growth Properties - Form 10-Q

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Emerging growth company

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

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

As of October 27, 2017, the registrant had the following common shares outstanding:

Class	Shares Outstanding
Class A common shares of beneficial interest, par value \$0.01 per share	28,672,642
Class B common shares of beneficial interest, par value \$0.01 per share	1,434,922
Class C common shares of beneficial interest, par value \$0.01 per share	5,280,630

---

SERITAGE GROWTH PROPERTIES

QUARTERLY REPORT ON FORM 10-Q

QUARTER ENDED SEPTEMBER 30, 2017

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

	Page
Item 1.	
<u>Condensed Consolidated Financial Statements (unaudited)</u>	
<u>Condensed Consolidated Balance Sheets as of September 30, 2017 and December 31, 2016</u>	3
<u>Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2017 and 2016</u>	4
<u>Condensed Consolidated Statements of Equity for the nine months ended September 30, 2017 and 2016</u>	5
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2017 and 2016</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7
Item 2.	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	28
Item 3.	
<u>Quantitative and Qualitative Disclosure about Market Risk</u>	40
Item 4.	
<u>Controls and Procedures</u>	40
PART II.	
<u>OTHER INFORMATION</u>	
Item 1.	
<u>Legal Proceedings</u>	41
Item 1A.	
<u>Risk Factors</u>	41
Item 2.	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	41
Item 3.	
<u>Defaults upon Senior Securities</u>	41
Item 4.	
<u>Mine Safety Disclosures</u>	41
Item 5.	
<u>Other Information</u>	41
Item 6.	
<u>Exhibits</u>	42
<u>SIGNATURES</u>	43



## PART I. FINANCIAL INFORMATION

## Item 1. Unaudited Condensed Consolidated Financial Statements

## SERITAGE GROWTH PROPERTIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

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

	September 30, 2017	December 31, 2016
<b>ASSETS</b>		
Investment in real estate		
Land	\$799,971	\$840,021
Buildings and improvements	859,782	839,663
Accumulated depreciation	(126,712 )	(89,940 )
	1,533,041	1,589,744
Construction in progress	175,516	55,208
Net investment in real estate	1,708,557	1,644,952
Investment in unconsolidated joint ventures	338,326	425,020
Cash and cash equivalents	104,153	52,026
Restricted cash	202,513	87,616
Tenant and other receivables, net	28,166	23,172
Lease intangible assets, net	327,229	464,399
Prepaid expenses, deferred expenses and other assets, net	20,284	15,052
Total assets	\$2,729,228	\$2,712,237
<b>LIABILITIES AND EQUITY</b>		
Liabilities		
Mortgage loans payable, net	\$1,200,615	\$1,166,871
Unsecured term loan, net	84,009	—
Accounts payable, accrued expenses and other liabilities	111,482	121,055
Total liabilities	1,396,106	1,287,926
Commitments and contingencies (Note 9)		
Shareholders' Equity		
Class A shares \$0.01 par value; 100,000,000 shares authorized;		
28,001,411 and 25,843,251 shares issued and outstanding as of		
September 30, 2017 and December 31, 2016, respectively	280	258
Class B shares \$0.01 par value; 5,000,000 shares authorized;		
1,434,922 and 1,589,020 shares issued and outstanding as of		
September 30, 2017 and December 31, 2016, respectively	14	16
Class C shares \$0.01 par value; 50,000,000 shares authorized;		
September 30, 2017 and December 31, 2016, respectively	59	58
5,951,861 and 5,754,685 shares issued and outstanding as of		

Edgar Filing: Seritage Growth Properties - Form 10-Q

September 30, 2017 and December 31, 2016, respectively		
Additional paid-in capital	996,047	925,563
Accumulated deficit	(177,394 )	(121,338 )
Total shareholders' equity	819,006	804,557
Non-controlling interests	514,116	619,754
Total equity	1,333,122	1,424,311
Total liabilities and equity	\$2,729,228	\$2,712,237

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

## SERITAGE GROWTH PROPERTIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
<b>REVENUE</b>				
Rental income	\$48,167	\$45,584	\$139,526	\$136,737
Tenant reimbursements	15,881	12,023	47,813	45,741
Total revenue	64,048	57,607	187,339	182,478
<b>EXPENSES</b>				
Property operating	4,311	4,505	13,985	17,176
Real estate taxes	11,335	7,965	35,707	31,101
Depreciation and amortization	61,059	44,532	170,293	121,365
General and administrative	5,272	4,252	16,639	13,104
Litigation charge	—	19,000	—	19,000
Provision for doubtful accounts	68	124	119	269
Acquisition-related expenses	—	—	—	73
Total expenses	82,045	80,378	236,743	202,088
Operating loss	(17,997)	(22,771)	(49,404)	(19,610)
Equity in (loss) income of unconsolidated joint ventures	(3,686)	1,497	(4,226)	4,495
Gain on sale of interest in unconsolidated joint venture	43,729	—	43,729	—
Gain on sale of real estate	13,018	—	13,018	—
Interest and other income	352	77	472	196
Interest expense	(18,049)	(15,931)	(53,072)	(47,297)
Unrealized loss on interest rate cap	(91)	(47)	(686)	(1,898)
Income (loss) before income taxes	17,276	(37,175)	(50,169)	(64,114)
Provision for income taxes	—	(72)	(266)	(412)
Net income (loss)	17,276	(37,247)	(50,435)	(64,526)
Net (income) loss attributable to non-controlling interests	(6,762)	16,145	19,892	27,972
Net income (loss) attributable to common shareholders	\$10,514	\$(21,102)	\$(30,543)	\$(36,554)
Net income (loss) per share attributable to Class A and Class C common shareholders - Basic				
	\$0.31	\$(0.67)	\$(0.91)	\$(1.16)
Net income (loss) per share attributable to Class A and Class C common shareholders - Diluted				
	\$0.31	\$(0.67)	\$(0.91)	\$(1.16)
Weighted average Class A and Class C common shares	33,774	31,419	33,685	31,414

outstanding - Basic				
Weighted average Class A and Class C common shares				
outstanding - Diluted	33,841	31,419	33,685	31,414

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



## SERITAGE GROWTH PROPERTIES

## CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(Unaudited, amounts in thousands)

	Class A Shares	Class B Amount Shares	Class C Amount Shares	Class C Amount Shares	Class C Amount Shares	Class C Amount Shares	Additional Paid-In Capital	Accumulated Deficit	Non- Controlling Interests	Total Equity
Balance at January 1, 2016	24,818	\$ 248	1,589	\$ 16	6,773	\$ 68	\$ 924,508	\$(38,145 )	\$ 683,382	\$ 1,570,077
Net loss	—	—	—	—	—	—	—	(36,554 )	(27,972 )	(64,526 )
Dividends and distributions declared (\$0.75 per share and unit)	—	—	—	—	—	—	—	(23,726 )	(18,133 )	(41,859 )
Vesting of restricted share units	7	0	—	—	—	—	(13 )	—	—	(13 )
Stock-based compensation	—	—	—	—	—	—	801	—	—	801
Share class exchanges, net (997,450 common shares)	997	10	—	—	(997 )	(10 )	—	—	—	—
Balance at September 30, 2016	25,822	\$ 258	1,589	\$ 16	5,776	\$ 58	\$ 925,296	\$(98,425 )	\$ 637,277	\$ 1,464,480
Balance at January 1, 2017	25,843	258	1,589	16	5,755	58	925,563	(121,338 )	619,754	1,424,311
Net loss	—	—	—	—	—	—	—	(30,543 )	(19,892 )	\$(50,435 )
Dividends and distributions declared (\$0.75 per share and unit)	—	—	—	—	—	—	—	(25,513 )	(16,394 )	(41,907 )
Vesting of restricted share	11	0	—	—	—	—	(13 )	—	—	(13 )

Edgar Filing: Seritage Growth Properties - Form 10-Q

units											
Stock-based compensation	—	—	—	—	—	—	1,166	—	—	—	1,166
Share class exchanges, net											
(197,176 common shares)	(197 )	(1 )	—	—	197	1	—	—	—	—	—
Share class surrenders											
(154,098 common shares)	—	—	(154 )	(2 )	—	—	2	—	—	—	—
OP Unit exchanges											
(2,344,589 units)	2,344	23	—	—	—	—	69,329	—	(69,352 )	—	—
Balance at September 30, 2017	28,001	\$ 280	1,435	\$ 14	5,952	\$ 59	\$ 996,047	\$(177,394 )	\$ 514,116	\$ 1,333,122	

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

## SERITAGE GROWTH PROPERTIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, amounts in thousands)

	Nine Months Ended September 30,	
	2017	2016
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>		
Net loss	\$(50,435 )	\$(64,526 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Equity in loss (income) of unconsolidated joint ventures	4,226	(4,495 )
Distributions from unconsolidated joint ventures	10,714	11,872
Gain on sale of interest in unconsolidated joint venture	(43,729 )	—
Gain on sale of real estate	(13,018 )	—
Unrealized loss on interest rate cap	686	1,898
Stock-based compensation	1,167	801
Depreciation and amortization	170,293	121,365
Amortization of deferred financing costs	6,390	4,021
Amortization of above and below market leases, net	(581 )	(520 )
Straight-line rent adjustment	(2,364 )	(11,242 )
Change in operating assets and liabilities		
Tenants and other receivables	(3,444 )	8,425
Prepaid expenses, deferred expenses and other assets	(7,300 )	8,496
Accounts payable, accrued expenses and other liabilities	(15,657 )	24,043
Net cash provided by operating activities	56,948	100,138
<b>CASH FLOW FROM INVESTING ACTIVITIES</b>		
Investments in unconsolidated joint ventures	(36,038 )	—
Net proceeds from sale of real estate	50,887	—
Net proceeds from disposition of interest in unconsolidated joint venture	189,391	—
Development of real estate	(164,070)	(47,236 )
Net cash provided by (used in) investing activities	40,170	(47,236 )
<b>CASH FLOW FROM FINANCING ACTIVITIES</b>		
Proceeds from Future Funding Facility	79,998	19,239
Proceeds from Unsecured Term Loan	85,000	—
Repayment of mortgage loans payable, net	(50,634 )	—
Payment of deferred financing costs	(2,686 )	(6 )
Common dividends paid	(25,379 )	(31,482 )
Non-controlling interests distributions paid	(16,393 )	(24,176 )
Net cash provided by (used in) financing activities	69,906	(36,425 )
Net increase in cash, cash equivalents, and restricted cash	167,024	16,477
Cash, cash equivalents, and restricted cash, beginning of period	139,642	155,342
Cash, cash equivalents, and restricted cash, end of period	\$306,666	\$171,819
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash payments for interest	\$54,026	\$45,495
Capitalized interest	7,785	2,198
Income taxes paid	266	412

**SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING  
ACTIVITIES**

Development of real estate financed with accounts payable	\$ 17,223	\$ 3,442
Dividends and distribution declared and unpaid	13,969	13,954
Decrease in assets and liabilities resulting from deconsolidated properties		
Real estate, net	(64,998 )	—
Tenant and other receivables, net	(814 )	—
Lease intangible assets, net	(13,480 )	—
Prepaid expenses, deferred expenses and other assets, net	(8 )	—
Accounts payable, accrued expenses and other liabilities	3,612	—

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

SERITAGE GROWTH PROPERTIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 – Organization

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

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

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

On July 12, 2017, the Company completed two transactions whereby it (i) sold its 50% JV Interests in eight JV Properties and (ii) sold a 50% interest in five Wholly-Owned Properties retaining a 50% JV Interest in the five new JV Properties.

Seritage is a fully-integrated, self-administered, self-managed real estate investment trust (“REIT”) primarily engaged in the real property business through the Company’s investment in the Operating Partnership. As of September 30, 2017, the Company’s portfolio consisted of interests in 258 properties, including 230 Wholly Owned Properties and 28 JV Properties. 171 of the Wholly Owned Properties were leased to Sears Holdings pursuant to a master lease agreement (the “Master Lease”) and operated under either the Sears or Kmart brand. At 85 Wholly Owned Properties, third-party tenants under direct leases occupied a portion of leasable space alongside Sears or Kmart, and 41 Wholly Owned Properties were leased only to third parties. A substantial majority of the space at the JV Properties is also leased (or subleased) by the JVs to Sears Holdings under master lease agreements (collectively, the “JV Master Leases”). The Master Lease and the JV Master Leases provide the Company and the JVs with the right to recapture certain space from Sears Holdings at each property for retenanting or redevelopment purposes.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

These condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q of the Securities and Exchange Commission (“SEC”) and should be read in conjunction with the consolidated

financial statements and notes thereto included in our Annual Report on Form 10-K, as amended, (the “Annual Report”), for the year ended December 31, 2016. Certain footnote disclosures which would substantially duplicate those contained in our Annual Report have been condensed or omitted from this quarterly report. In the opinion of management, all adjustments necessary for a fair presentation (which include only normal recurring adjustments) have been included in this quarterly report. Operating results of three and nine months ended September 30, 2017 may not be indicative of the results that may be expected for any other interim period or for the year ending December 31, 2017. Capitalized terms used, but not defined in this quarterly report, have the same meanings as set forth in our Annual Report.

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

If the Company has an interest in a VIE but it is not determined to be the primary beneficiary, the Company accounts for its interest under the equity method of accounting. Similarly, for those entities which are not VIEs and over which the Company has the ability to exercise significant influence, but does not have a controlling financial interest, the Company accounts for its interests under the equity method of accounting. The Company continually reconsiders its determination of whether an entity is a VIE and whether the Company qualifies as its primary beneficiary.

To the extent such variable interests are in entities that cannot be evaluated under the VIE model, the Company evaluates its interests using the voting interest entity model. The Company holds a 60.9% interest in the Operating Partnership and is the sole general partner which gives the Company exclusive and complete responsibility for the day-to-day management, authority to make decisions, and control of the Operating Partnership. Through consideration of new consolidation guidance effective for the Company as of January 1, 2016, it has been concluded that the Operating Partnership is a VIE as the limited partners in the Operating Partnership, although entitled to vote on certain matters, do not possess kick-out rights or substantive participating rights. Accordingly, the Company consolidates its interest in the Operating Partnership. However, as the Company holds what is deemed a majority voting interest in the Operating Partnership, it qualifies for the exemption from providing certain of the disclosure requirements associated with investments in VIEs.

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

#### Use of Estimates

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

#### Segment Reporting

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

#### Accounting for Real Estate Acquisitions

Upon the acquisition of real estate, the Company assesses the fair value of acquired assets and liabilities assumed, including land, buildings, improvements and identified intangibles such as above-market and below-market leases, in-place leases and other items, as applicable, and allocates the purchase price based on these assessments. In making estimates of fair values, the Company may use a number of sources, including data provided by third parties, as well as information obtained by the Company as a result of its due diligence, including expected future cash flows of the property and various characteristics of the markets where the property is located.

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

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

- 8 -

---



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

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

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

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

### Real Estate Investments

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

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

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

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

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

non-cancelable term of a related lease.

On a periodic basis, management assesses whether there are indicators that the value of the Company's real estate assets (including any related intangible assets or liabilities) may be impaired. If an indicator is identified, a real estate asset is considered impaired only if management's estimate of current and projected operating cash flows (undiscounted and unleveraged), taking into account the anticipated and probability weighted holding period, are less than a real estate asset's carrying value. Various factors are considered in the estimation process, including expected future operating income, trends and prospects and the effects of demand, competition, and other economic factors. If management determines that the carrying value of a real estate asset is impaired, a loss will be recorded for the excess of its carrying amount over its estimated fair value. No such impairment losses were recognized for the three or nine months ended September 30, 2017 or September 30, 2016.

#### Investments in Unconsolidated Joint Ventures

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

- 9 -

---

On a periodic basis, management assesses whether there are indicators, including the operating performance of the underlying real estate and general market conditions, that the value of the Company's investments in unconsolidated joint ventures may be impaired. An investment's value is impaired only if management's estimate of the fair value of the Company's investment is less than its carrying value and such difference is deemed to be other-than-temporary. To the extent impairment has occurred, the loss is measured as the excess of the carrying amount of the investment over its estimated fair value. No such impairment losses were recognized for the three or nine months ended September 30, 2017 or September 30, 2016.

#### Cash and Cash Equivalents

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

#### Restricted Cash

Restricted cash represents cash deposited in escrow accounts which generally can only be used for the payment of real estate taxes, debt service, insurance, and future capital expenditures as required by certain loan and lease agreements, as well as legally restricted tenant security deposits. As of September 30, 2017, the Company had approximately \$202.5 million of restricted cash, including \$174.4 million reserved for redevelopment costs, tenant allowances and leasing commissions, deferred maintenance, environmental remediation and other capital expenditures, \$22.1 million reserved for basic property carrying costs such as real estate taxes, insurance and ground rent, and \$6.0 million of other restricted cash which consisted primarily of prepaid rental income.

#### Tenant and Other Receivables

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

#### Revenue Recognition

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

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

and is recognized over the lease term as reduction of rental revenue on a straight-line basis.

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

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

- 10 -

---

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

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

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

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

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

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

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

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

### Derivatives

The Company's use of derivative instruments is limited to the management of interest rate exposure and not for speculative purposes. In connection with the issuance of the Company's Mortgage Loans and Future Funding Facility, the Company purchased for \$5.0 million an interest rate cap with a term of four years, a notional amount of \$1,261

million and a strike rate of 3.5%. The interest rate cap is measured at fair value and included as a component of prepaid expenses, deferred expenses and other assets on the condensed consolidated balance sheets. The Company has elected not to utilize hedge accounting, and therefore, the change in fair value is included within change in fair value of interest rate cap on the condensed consolidated statements of operations. For the three months ended September 30, 2017, the Company recorded a loss of \$0.1 million compared to a loss of less than \$0.1 million for the three months ended September 30, 2016. For the nine months ended September 30, 2017, the Company recorded a loss of \$0.7 million compared to a loss of \$1.9 million for the nine months ended September 30, 2016.

- 11 -

---

## Stock-Based Compensation

The Company generally recognizes equity awards to employees as compensation expense and includes such expense within general and administrative expenses on the condensed consolidated statements of operations. Compensation expense for equity awards is generally based on the fair value of the common shares at the date of the grant and is recognized (i) ratably over the vesting period for awards with time-based vesting and (ii) for awards with performance-based vesting, at the date the achievement of performance criteria is deemed probable, an amount equal to that which would have been recognized ratably from the date of the grant through the date the achievement of performance criteria is deemed probable, and then ratably from the date the achievement of performance criteria is deemed probable through the remainder of the vesting period.

## Concentration of Credit Risk

Concentrations of credit risk arise when a number of operators, tenants, or obligors related to the Company's investments are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations, including those to the Company, to be similarly affected by changes in economic conditions. As of September 30, 2017, a majority of the Company's real estate properties were leased to Sears Holdings, and the majority of Company's rental revenues were derived from the Master Lease (see Note 5). Until the Company further diversifies the tenancy of its portfolio, an event that has a material adverse effect on Sears Holdings' business, financial condition or results of operations could have a material adverse effect on the Company's business, financial condition or results of operations. Sears Holdings is a publicly traded company that is subject to the informational filing requirements of the Securities Exchange Act of 1934, as amended, and is required to file periodic reports on Form 10-K and Form 10-Q with the SEC. Refer to [www.sec.gov](http://www.sec.gov) for Sears Holdings publicly-available financial information.

Other than the Company's tenant concentration, management believes the Company's portfolio was reasonably diversified by geographical location and did not contain any other significant concentrations of credit risk. As of September 30, 2017, the Company's portfolio of 230 Wholly Owned Properties and 28 JV Properties was diversified by location across 49 states and Puerto Rico.

## Earnings per Share

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

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

## Recently Issued Accounting Pronouncements

In February 2017, the Financial Accounting Standards Boards ("FASB") issued Accounting Standards Update ("ASU") 2017-05, "Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets" to provide guidance for recognizing gains and losses from the transfer of nonfinancial assets. The standard requires a company to derecognize nonfinancial assets once it transfers control of a distinct nonfinancial asset or distinct in substance nonfinancial assets

to noncustomers. Additionally, when a company transfers its controlling interest in a nonfinancial asset, but retains a non-controlling ownership interest, the company is required to measure any non-controlling interest it receives or retains at fair value. ASU 2017-15 is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. The effective date of this guidance coincides with revenue recognition guidance. The Company is currently assessing the impact that adoption of this guidance will have on its condensed consolidated financial statements and footnote disclosures.

- 12 -

---



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

In January 2017, the FASB issued ASU 2017-01 which changes the definition of a business to exclude acquisitions where substantially all of the fair value of the assets acquired are concentrated in a single identifiable asset or a group of similar identifiable assets. While there are various differences between the accounting for an asset acquisition and a business combination, the Company expects that the largest impact will be the capitalization of transaction costs for asset acquisitions which are expensed for business combinations. ASU 2017-01 is effective, on a prospective basis, for interim and annual periods beginning after January 1, 2019; early adoption is permitted. The Company has chosen to early adopt ASU 2017-01 during the current period on a prospective basis and it did not have an impact on the condensed consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, "Statement of Cash Flows - Restricted Cash." ASU 2016-18 requires that the statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or cash equivalents. Therefore, amounts generally described as restricted cash and equivalents should be included with cash and cash equivalents when reconciling the beginning and end of period total amounts on the statement of cash flows. ASU 2016-18 is effective, on a retroactive basis, for interim and annual periods beginning after December 15, 2017; early adoption is permitted. The Company early adopted this guidance on March 31, 2017, which changes our statements of cash flows and related disclosure for all periods presented and accordingly, the following is a summary of our cash, cash equivalents, and restricted cash total as presented in our statements of cash flows for the nine months ended September 30, 2017 and September 30, 2016 (in thousands):

	Nine Months Ended	
	September 30, 2017	September 30, 2016
Cash and cash equivalents	\$ 104,153	\$ 90,029
Restricted cash	202,513	81,790
Total cash, cash equivalents, and restricted cash shown in the statement of cash flows	\$ 306,666	\$ 171,819

In August 2016, the FASB issued ASU 2016-15, "Classification of Certain Cash Receipts and Cash Payments." ASU 2016-15 provides classification guidance for eight specific topics including debt extinguishment costs, contingent consideration payments made after a business combination, and distributions received from equity method investees. ASU 2016-15 is effective, on a prospective basis, for interim and annual periods beginning after December 15, 2017; early adoption is permitted. The Company expects to retrospectively adopt ASU 2016-15 on the effective date of January 1, 2018, applying the cumulative earnings approach to classify distributions received from our equity method investees, which will impact our consolidated statements of cash flows upon adoption where distributions from unconsolidated joint ventures in excess of cumulative equity in earnings will be classified as an inflow from investing activities.

On February 25, 2016, the FASB issued Accounting Standards Codification ("ASC") 842 ("ASC 842"), "Leases" which replaces the existing guidance in ASC 840, Leases. ASC 842 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. ASC 842 requires a dual approach for lessee accounting under which a lessee would account for leases as finance leases or operating leases. Both finance leases and operating leases will result in the lessee recognizing a right-of-use (ROU) asset and a corresponding lease liability. For finance leases, the lessee would recognize interest expense and amortization of the ROU asset and for operating leases, the lessee would recognize a straight-line total lease expense. The Company is currently assessing the impact that adoption of this guidance will have on its condensed consolidated financial statements and footnote disclosures.

In September 2015, the FASB issued ASU 2015-16, which amends Topic 805, Business Combinations, and requires the recognition of purchase price allocation adjustments that are identified during the measurement period in the

reporting period in which the adjustment amounts are determined, and eliminates the requirement to retrospectively account for these adjustments. ASU 2015-16 is effective, on a prospective basis, for interim and annual periods beginning after December 15, 2015; early adoption is permitted. The Company has chosen to early adopt ASU 2015-16 during the current period on a prospective basis and it did not have an impact on the condensed consolidated financial statements.

In May 2014, with subsequent updates issued in August 2015 and March, April, May and December 2016, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers," which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. ASU 2014-09 states that "an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services." While ASU 2014-09 specifically references contracts with customers, it does not apply to contracts within the scope of ASC 840 and ASC 842 (leases) and it may apply to certain other transactions such as the sale of real estate or equipment. In July 2015, the FASB voted to defer the effective date of ASU 2014-09 by one year. Accordingly, ASU 2014-09 is effective for annual periods beginning after December 15, 2017, with early adoption permitted for annual periods beginning after December 15, 2016. The standard can be applied either retrospectively to each prior reporting period presented or as a cumulative-effect adjustment recognized as of the date of initial application. Expanded quantitative and qualitative disclosures regarding revenue recognition will be required for contracts that are subject to this guidance.

Edgar Filing: Seritage Growth Properties - Form 10-Q

We have considered the sources of revenue that will be affected by ASU 2014-09, and do not believe our revenue recognition will be impacted by the new standard, as leases (the source of the majority of the Company's revenues) are excluded from ASU 2014-09. However, once the new lease guidance goes into effect on January 1, 2019 which sets forth principles for the recognition, measurement, presentation and disclosure of leases, we believe that the new revenue standard will apply to executory costs and other components of revenue due under leases that are deemed to be non-lease components (such as common area maintenance), which could affect our recognition pattern for such revenue.

Note 3 – Lease Intangible Assets and Liabilities

Lease intangible assets (acquired in-place leases, above-market leases and below-market ground leases) and liabilities (acquired below-market leases), net of accumulated amortization, were \$327.2 million and \$15.0 million, respectively, as of September 30, 2017 and \$464.4 million and \$16.8 million, respectively, as of December 31, 2016. The following table summarizes the Company's lease intangible assets and liabilities (in thousands):

September 30, 2017

Lease Intangible Assets	Gross Asset	Accumulated Amortization	Balance
In-place leases, net	\$553,656	\$ (243,872 )	\$309,784
Below-market ground leases, net	11,766	(457 )	11,309
Above-market leases, net	8,925	(2,789 )	6,136
Total	\$574,347	\$ (247,118 )	\$327,229

Lease Intangible Liabilities	Gross Liability	Accumulated Amortization	Balance
Below-market leases, net	\$19,730	\$ (4,732 )	\$14,998
Total	\$19,730	\$ (4,732 )	\$14,998

December 31, 2016

Lease Intangible Assets	Gross Asset	Accumulated Amortization	Balance
In-place leases, net	\$592,871	\$ (146,964 )	\$445,907
Below-market ground leases, net	11,766	(305 )	11,461
Above-market leases, net	8,964	(1,933 )	7,031
Total	\$613,601	\$ (149,202 )	\$464,399

Lease Intangible Liabilities	Gross Liability	Accumulated Amortization	Balance
Below-market leases, net	\$20,011	\$ (3,184 )	\$16,827
Total	\$20,011	\$ (3,184 )	\$16,827

Amortization of acquired below-market leases, net of acquired above-market leases, resulted in additional rental income of \$0.3 million and \$0.3 million for the three months ended September 30, 2017 and September 30, 2016, respectively, and \$0.9 million and \$0.9 million for the nine months ended September 30, 2017 and September 30, 2016, respectively. Future amortization of these intangibles is estimated to increase rental income as set forth below (in thousands):

Remainder of 2017	\$(241)
2018	(961)
2019	(934)
2020	(800)
2021	(786)

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

Amortization of acquired below-market ground leases resulted in additional property expense of \$50 thousand for the three months ended September 30, 2017 and September 30, 2016, respectively, and \$150 thousand for the nine months ended September 30, 2017 and September 30, 2016, respectively. Future amortization of below-market ground leases is estimated to increase property expenses as set forth below (in thousands):

Remainder of 2017	\$51
2018	203
2019	203
2020	203
2021	203

Amortization of acquired in-place leases resulted in additional depreciation and amortization expense of \$47.5 million and \$27.4 million for the three months ended September 30, 2017 and September 30, 2016, respectively, and \$124.3 million and \$72.1 million for the nine months ended September 30, 2017 and September 30, 2016, respectively. Future estimated amortization of acquired in-place leases is set forth below (in thousands):

Remainder of 2017	\$15,521
2018	42,303
2019	40,543
2020	40,097
2021	39,313

### Note 4 – Investments in Unconsolidated Joint Ventures

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

The Company currently has investments in four unconsolidated entities: (i) GS Portfolio Holdings II LLC (the "GGP I JV"), a joint venture between Seritage and a subsidiary of GGP Inc. (together with its subsidiaries, "GGP"); (ii) GS Portfolio Holdings (2017) LLC (the "GGP II JV"), a joint venture between Seritage and a subsidiary of GGP; (iii) SPS Portfolio Holdings LLC (the "Simon JV"), a joint venture between Seritage and a subsidiary of Simon Property Group, Inc. (together with its subsidiaries, "Simon"); and (iv) MS Portfolio LLC (the "Macerich JV"), a joint venture between Seritage and a subsidiary of The Macerich Company (together with its subsidiaries, "Macerich"). A substantial majority of the space at the JV Properties is leased to Sears Holdings under the JV Master Leases which include recapture rights and termination rights with similar terms as those described under the Master Lease.

The Company's investments in unconsolidated joint ventures at September 30, 2017, consisted of (in thousands, except number of properties):

Joint Venture	Seritage % Ownership	# of Properties	Total GLA	Initial Value (1)
GGP I JV	50 %	4	598	\$37,570
GGP II JV	50 %	5	1,187	57,500
Macerich JV	50 %	9	1,572	150,000
Simon JV	50 %	10	1,714	114,012
Total		28	5,071	\$359,082

(1) Represents contribution value at formation of each JV.

On July 12, 2017, the Company completed two transactions with GGP for gross consideration of \$247.6 million whereby the Company (i) sold to GGP the Company's 50% JV Interests in eight of the 12 assets in the GGP I JV for \$190.1 million and recorded a gain of \$43.7 million which is included in gain on sale of interest in unconsolidated joint venture within the condensed consolidated statements of operations; and (ii) contributed five Wholly Owned Properties to the GGP II JV and sold a 50% interest in the new JV Properties to GGP for \$57.5 million and recorded a gain of \$13.0 million which is included in gain on sale of real estate within the condensed consolidated statements of operations.

- 15 -

---

Edgar Filing: Seritage Growth Properties - Form 10-Q

Subsequent to September 30, 2017, the Company agreed to sell to Simon the Company's 50% JV Interests in five of the ten assets in the Simon JV for \$68.0 million, subject to certain closing conditions (see Note 16).

The Company continues to own 50% interests in nine assets in the Macerich JV.

Each unconsolidated joint venture is obligated to maintain financial statements in accordance with GAAP. The Company shares in the profits and losses of these unconsolidated joint ventures generally in accordance with the Company's respective equity interests. In some instances, the Company may recognize profits and losses related to investment in an unconsolidated joint venture that differ from the Company's equity interest in the unconsolidated joint venture. This may arise from impairments that the Company recognizes related to its investment that differ from the impairments the unconsolidated joint venture recognizes with respect to its assets; differences between the Company's basis in assets it has transferred to the unconsolidated joint venture and the unconsolidated joint venture's basis in those assets; the Company's deferral of the unconsolidated joint venture's profits from land sales to the Company; or other items. There were no joint venture impairment charges for the three or nine months ended September 30, 2017 or September 30, 2016.

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

	September 30, 2017	December 31, 2016
<b>ASSETS</b>		
Investment in real estate		
Land	\$ 178,658	\$ 214,109
Buildings and improvements	510,641	598,978
Accumulated depreciation	(62,959 )	(56,324 )
	626,340	756,763
Construction in progress	15,986	48,885
Net investment in real estate	642,326	805,648
Cash and cash equivalents	4,958	3,434
Tenant and other receivables, net	3,354	6,133
Other assets, net	47,564	38,646
Total assets	\$ 698,202	\$ 853,861
<b>LIABILITIES AND MEMBERS INTERESTS</b>		
<b>Liabilities</b>		
Mortgage loans payable, net	\$ 121,665	\$ —
Accounts payable, accrued expenses and other liabilities	6,681	14,177
Total liabilities	128,346	14,177
<b>Members Interest</b>		
Additional paid in capital	580,009	830,389
Retained earnings	(10,153 )	9,295
Total members interest	569,856	839,684
Total liabilities and members interest	\$ 698,202	\$ 853,861

Edgar Filing: Seritage Growth Properties - Form 10-Q

	Three Months Ended September 30,		Nine Months Ended September September		
	2017	30, 2016	30, 2017	30, 2016	
<b>EQUITY IN INCOME OF UNCONSOLIDATED</b>					
<b>JOINT VENTURES</b>					
Total revenue	\$12,550	\$ 16,266	\$46,062	\$ 50,113	
Property operating expenses	(3,077 )	(3,103 )	(9,594 )	(9,703 )	
Depreciation and amortization	(9,509 )	(10,382 )	(37,206 )	(31,304 )	
Operating income	(36 )	2,781	(738 )	9,106	
Other expenses	(7,337 )	212	(7,714 )	(117 )	
Net (loss) income	\$(7,373 )	\$ 2,993	\$(8,452 )	\$ 8,989	
Equity in (loss) income of unconsolidated					
joint ventures		\$(3,686 )	\$ 1,497	\$(4,226 )	\$ 4,495

- 16 -



## Note 5 – Leases

## Master Lease

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

The Master Lease has an initial term of 10 years and contains three options for five-year renewals of the term and a final option for a four-year renewal. As of September 30, 2017 and September 30, 2016, the annualized base rent paid directly by Sears Holdings and its subsidiaries under the Master Lease was approximately \$108.5 million and \$134.2 million, respectively. In each of the initial and first two renewal terms, annual base rent will be increased by 2.0% per annum for each lease year over the rent for the immediately preceding lease year. For subsequent renewal terms, rent will be set at the commencement of the renewal term at a fair market rent based on a customary third-party appraisal process, taking into account all the terms of the Master Lease and other relevant factors, but in no event will the renewal rent be less than the rent payable in the immediately preceding lease year.

Revenues from the Master Lease for the three and nine months ended September 30, 2017 and September 30, 2016 are as follows (in thousands and excluding straight-line rental income of (\$1.7) million and \$2.3 million for the three months ended September 30, 2017 and September 30, 2016, respectively, and \$0.1 million and \$8.4 million for the nine months ended September 30, 2017 and September 30, 2016, respectively):

	Three Months		Nine Months Ended	
	Ended September 30, 2017	2016	September 30, 2017	2016
Rental income	\$27,889	\$33,378	\$88,748	\$99,846
Termination fee income	10,596	—	17,361	—
Tenant reimbursements	10,639	10,627	38,370	41,895
Total revenue	\$49,124	\$44,005	\$144,479	\$141,741

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

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

The Company also has the right to recapture 100% of the space occupied by Sears Holdings at each of 21 identified Wholly Owned Properties by making a specified lease termination payment to Sears Holdings, after which the Company can reposition and re-lease those stores. The lease termination payment is calculated as the greater of an amount specified at the time the Company entered into the Master Lease with Sears Holdings and an amount equal to 10 times the adjusted EBITDA attributable to such space within the Sears Holdings main store which is not attributable to the space subject to the separate 50% recapture right discussed above for the 12-month period ending at the end of the fiscal quarter ending immediately prior to recapturing such space.

- 17 -

---

Edgar Filing: Seritage Growth Properties - Form 10-Q

As of September 30, 2017, the Company had exercised certain recapture rights at 45 properties:

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

Edgar Filing: Seritage Growth Properties - Form 10-Q

- (1) In April 2017, the Company converted previously exercised partial recapture rights to 100% recapture rights.
- (2) In April 2017, the Company converted partial recapture rights to 100% recapture rights and exercised such recapture rights.
- (3) In July 2017, the Company contributed this asset to the GGP II JV and retained a 50% JV Interest in the JV. The Master Lease also provides for certain rights to Sears Holdings to terminate the Master Lease with respect to Wholly Owned Properties that cease to be profitable for operation by Sears Holdings. In order to terminate the Master Lease with respect to a certain property, Sears Holdings must make a payment to the Company of an amount equal to one year of rent (together with taxes and other expenses) with respect to such property. Sears Holdings must provide notice of not less than 90 days of their intent to exercise such termination right and such termination right will be limited so that it will not have the effect of reducing the fixed rent under the Master Lease by more than 20% per annum.

As of September 30, 2017, Sears Holdings had terminated, or provided notice that it intended to exercise its rights to terminate, the Master Lease with respect to 56 stores totaling 7.4 million square feet of gross leasable area. The aggregate base rent at these stores at the time of termination was approximately \$23.6 million. Sears Holdings continued to pay the Company rent until it vacated the stores and also paid aggregate termination fees of approximately \$45.1 million, amounts equal to one year of aggregate annual base rent plus one year of estimated real estate taxes and operating expense.

Edgar Filing: Seritage Growth Properties - Form 10-Q

As of September 30, 2017, the Company had announced redevelopment projects at 17 of the terminated properties and will continue to announce redevelopment activity as new leases are signed to occupy the space formerly occupied by Sears Holdings.

Property	Square Feet	Notice	Termination	Announced Redevelopment
Cullman, AL	98,500	September 2016	January 2017	Q2 2017
Sierra Vista, AZ	86,100	September 2016	January 2017	
Thornton, CO	190,200	September 2016	January 2017	Q1 2017
Chicago, IL	118,800	September 2016	January 2017	
Springfield, IL	84,200	September 2016	January 2017	Q3 2016
Elkhart, IN	86,500	September 2016	January 2017	Q4 2016
Merrillville, IN	108,300	September 2016	January 2017	Q4 2016
Houma, LA	96,700	September 2016	January 2017	
New Iberia, LA	91,700	September 2016	January 2017	Q2 2017
Alpena, MI	118,200	September 2016	January 2017	
Manistee, MI	87,800	September 2016	January 2017	
Sault Sainte Marie, MI	92,700	September 2016	January 2017	
Kearney, NE	86,500	September 2016	January 2017	Q3 2016
Deming, NM	96,600	September 2016	January 2017	
Harlingen, TX	91,700	September 2016	January 2017	
Yakima, WA	97,300	September 2016	January 2017	
Riverton, WY	94,800	September 2016	January 2017	
Riverside, CA	94,500	January 2017	April 2017	
Kissimmee, FL	112,505	January 2017	April 2017	
Leavenworth, KS	76,853	January 2017	April 2017	
Hopkinsville, KY	70,326	January 2017	April 2017	
Paducah, KY	108,244	January 2017	April 2017	Q3 2017
Owensboro, KY	68,334	January 2017	April 2017	
Detroit Lakes, MN	79,102	January 2017	April 2017	
Jefferson City, MO	92,016	January 2017	April 2017	Q2 2017
Henderson, NV	122,823	January 2017	April 2017	Q1 2017
Concord, NC	137,499	January 2017	April 2017	
Chapel Hill, OH	187,179	January 2017	April 2017	
Kenton, OH	96,066	January 2017	April 2017	
Muskogee, OK	87,500	January 2017	April 2017	
Mount Pleasant, PA	83,536	January 2017	April 2017	
Sioux Falls, SD	72,511	January 2017	April 2017	
El Paso, TX	103,657	January 2017	April 2017	
Layton, UT	90,010	January 2017	April 2017	
Elkins, WV	94,885	January 2017	April 2017	
Platteville, WI	94,841	January 2017	April 2017	
Sarasota, FL	204,500	June 2017	October 2017 (1)	
Chicago, IL	293,700	June 2017	October 2017 (1)	
Overland Park, KS	215,000	June 2017	October 2017 (1)	
Lafayette, LA	194,900	June 2017	October 2017 (1)	
Cockeysville, MD	83,900	June 2017	October 2017 (1)	Q1 2017
Hagerstown, MD	107,300	June 2017	October 2017 (1)	Q1 2016

Edgar Filing: Seritage Growth Properties - Form 10-Q

Roseville, MI	277,000	June 2017	October 2017 (1)	Q3 2016
Burnsville, MN	161,700	June 2017	October 2017 (1)	
Albany, NY	216,200	June 2017	October 2017 (1)	Q1 2016
East Northport, NY	187,000	June 2017	October 2017 (1)	Q2 2017
Johnson City, NY	155,100	June 2017	October 2017 (1)	
Olean, NY	75,100	June 2017	October 2017 (1)	Q1 2017
Mentor, OH	208,700	June 2017	October 2017 (1)	
Middleburg Heights, OH	351,600	June 2017	October 2017 (1)	
Toledo, OH	209,900	June 2017	October 2017 (1)	
York, PA	82,000	June 2017	October 2017 (1)	
Warwick, RI	169,200	June 2017	October 2017 (1)	Q3 2016 / Q3 2017
Friendswood, TX (2)	166,000	June 2017	October 2017 (1)	
Westwood, TX (3)	215,000	June 2017	October 2017 (1)	
Greendale, WI	238,400	June 2017	October 2017 (1)	
Total square feet	7,411,187			

(1) Sears Holdings vacated this property subsequent to September 30, 2017.

- 19 -

- (2) The Company and Sears Holdings agreed to extend occupancy, under the existing Master Lease terms, through November 2017 to support Hurricane Harvey relief efforts.
- (3) The Company and Sears Holdings agreed to extend occupancy, under the existing Master Lease terms, through January 2018 to support Hurricane Harvey relief efforts.

## Note 6 – Debt

### Mortgage Loans Payable

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

On July 12, 2017, as a result of the transaction whereby the Company contributed five Wholly Owned Properties to the GGP II JV and sold a 50% interest in the new JV Properties to GGP for \$57.5 million, the Company reduced amounts outstanding under its mortgage loan by \$50.6 million.

As of September 30, 2017, the aggregate principal amount outstanding under the Mortgage Loans and the Future Funding Facility was \$1,211 million.

Interest under the Mortgage Loans is due and payable on the payment dates, and all outstanding principal amounts are due when the loan matures on the payment date in July 2019, pursuant to the Loan Agreements. The Company has two one-year extension options subject to the payment of an extension fee and satisfaction of certain other conditions. Borrowings under the Mortgage Loans bear interest at the London Interbank Offered Rates (“LIBOR”) plus, as of September 30, 2017, a weighted-average spread of 470 basis points; payments are made monthly on an interest-only basis. The weighted-average interest rates for the Mortgage Loans and Future Funding Facility for the three months ended September 30, 2017 and September 30, 2016 were 5.97% and 5.24%, respectively. The weighted-average interest rates for the Mortgage Loans and Future Funding Facility for the nine months ended September 30, 2017 and September 30, 2016 were 5.92% and 5.19%, respectively.

The Loan Agreements contain a yield maintenance provision for the early extinguishment of the debt before March 9, 2018.

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

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

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

- 20 -

---



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

The Company incurred \$22.3 million of debt issuance costs related to the Mortgage Loans and Future Funding Facility which are recorded as a direct deduction from the carrying amount of the Mortgage Loans and Future Funding Facility and amortized over the term of the Loan Agreements. As of September 30, 2017, the unamortized balance of the Company's debt issuance costs was \$9.9 million as compared to \$14.3 million as December 31, 2016.

#### Unsecured Term Loan

On February 23, 2017 (the "Closing Date"), the Operating Partnership, as borrower, and the Company, as guarantor, entered into a \$200.0 million senior unsecured delayed draw term loan facility (the "Unsecured Term Loan") with JPP, LLC ("JPP") and JPP II, LLC, as lenders (collectively, the "Initial Lenders"), and JPP, as administrative agent (the "Administrative Agent").

Loans under the Unsecured Term Loan may be requested by the Operating Partnership at any time from the Closing Date until thirty days prior to the stated maturity date, upon five business days' prior notice to the Administrative Agent. The total commitment of the lenders under the Unsecured Term Loan is \$200.0 million. Amounts drawn under the Unsecured Term Loan and repaid may not be redrawn.

As of September 30, 2017, the total principal amount outstanding under the Unsecured Term Loan was \$85.0 million.

The Unsecured Term Loan will mature the earlier of (i) December 31, 2017 and (ii) the date on which the outstanding indebtedness under the Loan Agreements are repaid or refinanced in full. The Unsecured Term Loan may be prepaid at any time in whole or in part, without any penalty or premium.

With respect to the December 31, 2017 maturity of the Unsecured Term Loan, the Company may repay the \$85.0 million total principal amount outstanding as of September 30, 2017 with unrestricted cash on hand, seek an extension of the maturity date, or raise additional capital through a refinancing transaction or from the proceeds of asset sales or new joint ventures.

The principal amount of loans outstanding under the Unsecured Term Loan bear a base annual interest rate of 6.50%. If a cash flow sweep period were to occur and be continuing under the Company's Mortgage Loan Agreement (i) the interest rate on any outstanding advances would increase from and after such date by 1.5% per annum above the base interest rate and (ii) the interest rate on any advances made after such date would increase by 3.5% per annum above the base interest rate. Accrued and unpaid interest will be payable in cash, except that during the continuance of a cash flow sweep period under the existing mortgage loan agreement, the Operating Partnership may defer the payment of interest which deferred amount would be added to the outstanding principal balance of the loans.

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

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

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

Edgar Filing: Seritage Growth Properties - Form 10-Q

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

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

- 21 -

---

Note 7 – Income Taxes

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

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

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

Note 8 – Fair Value Measurements

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

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

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

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

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

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

All derivative instruments are carried at fair value and are valued using Level 2 input. The Company’s derivative instruments as of September 30, 2017 and December 31, 2016 consisted of a single interest rate cap. The Company utilizes an independent third party and interest rate market pricing models to assist management in determining the fair value of this instrument.

The fair value of the Company’s interest rate cap at September 30, 2017 and December 31, 2016 was less than \$0.1 million and approximately \$0.7 million, respectively, and is included as a component of prepaid expenses, deferred expenses and other assets on the condensed consolidated balance sheets.

The Company has elected not to utilize hedge accounting, and therefore, the change in fair value is included within change in fair value of interest rate cap on the condensed consolidated statements of operations. For the three months ended September 30, 2017, the Company recorded a loss of \$0.1 million compared to a loss of less than \$0.1 million for the three months ended September 30, 2016. For the nine months ended September 30, 2017, the Company recorded a loss of \$0.7 million compared to a loss of \$1.9 million for the nine months ended September 30, 2016.

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

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

Cash equivalents are carried at cost, which approximates fair value. The fair value of debt obligations is calculated by discounting the future contractual cash flows of these instruments using current risk-adjusted rates available to borrowers with similar credit ratings. As of September 30, 2017 and December 31, 2016, the estimated fair values of the Company's debt obligations were \$1.3 billion and \$1.2 billion, respectively, which approximated the carrying value at such dates as the current risk-adjusted rate approximates the stated rates on the Company's debt obligations.

Note 9 – Commitments and Contingencies

Insurance

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

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

Environmental Matters

Under various federal, state and local laws, ordinances and regulations, the Company may be considered an owner or operator of real property or may have arranged for the disposal or treatment of hazardous or toxic substances. As a result, the Company may be liable for certain costs, including removal, remediation, government fines, and injuries to persons and property. The Company does not believe that any resulting liability from such matters will have a material effect on the condensed consolidated financial position, results of operations, or liquidity of the Company. Under the Master Lease, Sears Holdings has indemnified the Company from certain environmental liabilities at the Wholly Owned Properties existing before, or caused by Sears Holdings during, the period in which each Wholly Owned Property is leased to Sears Holdings, including removal and remediation of all affected facilities and equipment constituting the automotive care center facilities (and each JV Master Lease includes a similar requirement of Sears Holdings). As of September 30, 2017 and December 31, 2016, the Company had approximately \$11.2 million and \$11.8 million, respectively, of restricted cash in a lender reserve account to fund potential environmental costs that were identified during due diligence related to the Transaction.

Litigation and Other Matters

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

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

Note 10 – Related Party Disclosure

Edward S. Lampert

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

Edward S. Lampert is Chairman and Chief Executive Officer of Sears Holdings and is the Chairman and Chief Executive Officer of ESL. Mr. Lampert beneficially owned approximately 53.9% of Sears Holdings' outstanding common stock at September 30, 2017. Mr. Lampert is also the Chairman of Seritage.

As of September 30, 2017, Mr. Lampert beneficially owned a 39.1% interest in the Operating Partnership and approximately 3.8% and 100% of the outstanding Class A common shares and Class B non-economic common shares, respectively.

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

### Unsecured Term Loan

On February 23, 2017, the Operating Partnership, as borrower, and the Company, as guarantor, entered into a \$200.0 million senior unsecured delayed draw term loan facility with JPP, LLC and JPP II, LLC as lenders, and JPP, LLC as administrative agent.

- 23 -

---

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

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

### Transition Services Agreement

On July 7, 2015, the Operating Partnership and Sears Holdings Management Corporation ("SHMC"), a wholly owned subsidiary of Sears Holdings, entered into a transition services agreement (the "Transition Services Agreement" or "TSA"). Pursuant to the TSA, SHMC was to provide certain limited services to the Operating Partnership during the period from the closing of the Transaction through the 18-month anniversary of the closing. On January 7, 2017, the TSA expired by its terms.

During the three and nine months ended September 30, 2017 the Company did not incur any fees under the TSA. During the three and nine months ended September 30, 2016, the Company incurred fees of approximately \$0.1 million for certain accounting and tax services provided in support of the Company's 2015 yearend activities. These fees are included in general and administrative expenses on the condensed consolidated statements of operations.

### Note 11 – Non-Controlling Interests

#### Partnership Agreement

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

During the nine months ended September 30, 2017, 2,344,589 Operating Partnership units were converted to Class A common shares.

As of September 30, 2017, the Company held a 60.9% interest in the Operating Partnership and ESL held a 39.1% interest. The portions of consolidated entities not owned by the Company are presented as non-controlling interest as of and during the periods presented.

### Note 12 – Shareholders' Equity

#### Class A Common Shares

During the nine months ended September 30, 2017, 2,344,589 Operating Partnership units were converted to Class A common shares and 197,176 net Class A common shares were converted to Class C non-voting common shares.

As of September 30, 2017, 28,001,411 Class A common shares were issued and outstanding.

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

Subsequent to September 30, 2017, 671,231 net Class C non-voting common shares were converted to Class A common shares.

### Class B Non-Economic Common Shares

During the nine months ended September 30, 2017, 154,098 Class B non-economic common shares were surrendered to the Company.

As of September 30, 2017, 1,434,922 Class B non-economic common shares were issued and outstanding. The Class B non-economic common shares have voting rights, but do not have economic rights and, as such, do not receive dividends and are not included in earnings per share computations.

### Class C Non-Voting Common Shares

During the nine months ended September 30, 2017, 197,176 net Class A common shares were converted to Class C non-voting common shares.

As of September 30, 2017, 5,951,861 Class C non-voting common shares were issued and outstanding. The Class C non-voting common shares have economic rights, but do not have voting rights. Upon any transfer of a Class C non-voting common share to any person other than an affiliate of the holder of such share, such share shall automatically convert into one Class A common share.

Subsequent to September 30, 2017, 671,231 net Class C non-voting common shares were converted to Class A common shares.

- 24 -

---



Dividends and Distributions

The Company’s Board of Trustees declared the following common stock dividends during 2017 and 2016, with holders of Operating Partnership units entitled to an equal distribution per Operating Partnership unit held on the record date:

Declaration Date	Record Date	Payment Date	Dividends per Class A and Class C Common Share
2017			
October 24	December 29	January 11, 2018	\$ 0.25
July 25	September 29	October 12	0.25
April 25	June 30	July 13	0.25
February 28	March 31	April 13	0.25
2016			
November 1	December 31	January 12, 2017	\$ 0.25
August 2	September 30	October 13	0.25
May 3	June 30	July 14	0.25
March 8	March 31	April 14	0.25

Note 13 – Earnings per Share

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

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

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

(in thousands except per share amounts)	Three Months		Nine Months Ended	
	Ended September 30, 2017	2016	September 30, 2017	2016
<b>Numerator</b>				
Net income (loss)	\$17,276	\$(37,247)	\$(50,435)	\$(64,526)

Edgar Filing: Seritage Growth Properties - Form 10-Q

Net (income) loss attributable to non-controlling interests	(6,762 )	16,145	19,892	27,972
Net income (loss) attributable to common shareholders	\$10,514	\$(21,102)	\$(30,543)	\$(36,554)
Earnings allocated to unvested participating securities	(21 )	-	-	-
Net income (loss) available to common shareholders -				
Basic and diluted	\$10,493	\$(21,102)	\$(30,543)	\$(36,554)
Denominator				
Weighted average Class A common shares				
outstanding	27,758	25,671	27,810	25,443
Weighted average Class C common shares				
outstanding	6,016	5,748	5,875	5,971
Weighted average Class A and Class C				
common shares outstanding - Basic	33,774	31,419	33,685	31,414
Restricted shares and share units	67	-	-	-
Weighted average Class A and Class C				
common shares outstanding - Diluted	33,841	31,419	33,685	31,414
Net income (loss) per share attributable to Class A and				
Class C common shareholders - Basic	\$0.31	\$(0.67 )	\$(0.91 )	\$(1.16 )
Net income (loss) per share attributable to Class A and				
Class C common shareholders - Diluted	\$0.31	\$(0.67 )	\$(0.91 )	\$(1.16 )

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

No adjustments were made to the numerator for the three months ended September 30, 2016 or the nine months ended September 30, 2017 or September 30, 2016 because the Company generated a net loss. During periods of net loss, undistributed losses are not allocated to the participating securities as they are not required to absorb losses.

No adjustments were made to the denominator for the three months ended September 30, 2016 or the nine months ended September 30, 2017 or September 30, 2016 because (i) the inclusion of outstanding non-vested restricted shares would have had an anti-dilutive effect and (ii) including the non-controlling interest in the Operating Partnership would also require that the share of the Operating Partnership loss attributable to such interests be added back to net loss, therefore, resulting in no effect on earnings per share.

As of September 30, 2017 and December 31, 2016, there were 245,570 and 216,348 shares, respectively, of non-vested restricted shares and share units outstanding.

### Note 14 – Stock Based Compensation

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

#### Restricted Shares and Share Units

Pursuant to the Plan, the Company made grants of restricted shares or share units during the nine months ended September 30, 2017 and September 30, 2016, as well as the period from July 7, 2015 (Date Operations Commenced) through December 31, 2015. The vesting terms of these grants are specific to the individual grant and vary in that a portion of the restricted shares and share units vest in equal annual amounts over the next three years (time-based vesting) and a portion of the restricted shares and share units vest on the third anniversary of the grants subject to the achievement of certain performance criteria (performance-based vesting). As of September 30, 2017, the performance criteria have not been met for any outstanding restricted shares or share units with performance-based vesting.

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

The following table summarizes restricted share activity for the nine months ended September 30, 2017:

	Nine Months Ended September 30, 2017 Weighted- Average Grant Date Fair Value
Shares	

Edgar Filing: Seritage Growth Properties - Form 10-Q

Unvested restricted shares at beginning of period	216,348	\$ 38.98
Restricted shares granted	62,135	45.23
Restricted shares vested	(32,345 )	33.02
Restricted shares forfeited	(568 )	45.23
Unvested restricted shares at end of period	245,570	\$ 41.33

The Company recognized \$0.4 million and \$0.3 million in compensation expense related to the restricted shares for the three months ended September 30, 2017 and September 30, 2016, respectively, and \$1.2 million and \$0.82 million in compensation expense related to the restricted shares for the nine months ended September 30, 2017 and September 30, 2016, respectively. Such expenses are included in general and administrative expenses on the Company's condensed consolidated statements of operations. As of September 30, 2017, there were approximately \$10.2 million of total unrecognized compensation costs related to the outstanding restricted shares.

Note 15 – Accounts Payable, Accrued Expenses and Other Liabilities

The following table summarizes the significant components of accounts payable, accrued expenses and other liabilities as of September 30, 2017 and December 31, 2016 (in thousands):

	September 30, 2017	December 31, 2016
Accounts payable and accrued expenses	\$ 21,905	\$ 22,424
Accrued real estate taxes	21,576	23,942
Unearned tenant reimbursements	17,133	4,039
Below-market leases	14,998	16,827
Dividends payable	14,648	14,132
Environmental reserve	11,322	11,584
Prepaid rental income	3,875	1,979
Accrued interest	3,444	3,004
Deferred maintenance	2,581	4,124
Litigation charge	—	19,000
Total accounts payable, accrued expenses and other liabilities	\$ 111,482	\$ 121,055

Note 16 – Subsequent Events

Subsequent to September 30, 2017, the Company agreed to sell to Simon the Company's 50% interest in five of the ten assets in the Simon JV for \$68.0 million, subject to certain closing conditions. Upon closing, which is expected in the fourth quarter of 2017, the Company would realize approximately \$7.0 million of value creation above its basis across the five properties and generate unrestricted cash proceeds, after closing costs and any required tax distributions, to fund its redevelopment pipeline and for general corporate purposes.

The table below presents the properties sold in the transaction and the properties remaining in the Company's JV with Simon:

Five Existing JV Assets to be Sold to Simon		Five Remaining Assets in JV with Simon	
Retail Center	Location	Retail Center	Location
Brea Mall	Brea, CA	Barton Creek Square	Austin, TX
Burlington Mall	Burlington, MA	Briarwood Mall	Ann Arbor, MI
Midland Park Mall	Midland, TX	Santa Rosa Plaza	Santa Rosa, CA
Ross Park Mall	Pittsburgh, PA	The Shops at Nanuet	Nanuet, NY
Ocean County Mall	Toms River, NJ	Woodland Hills Mall	Tulsa, OK

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

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

Forward-looking statements are not guarantees of future performance. They represent our intentions, plans, expectations and beliefs and are subject to numerous assumptions, risks and uncertainties. Our future results, financial condition and business may differ materially from those expressed in these forward-looking statements. You can find many of these statements by looking for words such as "approximates," "believes," "expects," "anticipates," "estimates," "intends," "plans," "projects," "will," "would," "may" or other similar expressions in this Quarterly Report on Form 10-Q. Many of the factors that will determine the outcome of these and our other forward-looking statements are beyond our ability to control or predict. For further discussion of factors that could materially affect the outcome of our forward-looking statements, see "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2016. For these statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. You are cautioned not to place undue reliance on our forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. All subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. We do not undertake any obligation to release publicly any revisions to our forward-looking statements to reflect events or circumstances occurring after the date of this Quarterly Report on Form 10-Q. The following discussion should be read in conjunction with the condensed consolidated financial statements and notes thereto included in Part 1 of this Quarterly Report.

### Overview

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

We are principally engaged in the acquisition, ownership, development, redevelopment, management, and leasing of diversified retail real estate throughout the United States. As of September 30, 2017, our portfolio included over 40.0 million square feet of gross leasable area ("GLA"), consisting of 230 Wholly Owned Properties totaling over 35.4 million square feet of GLA across 49 states and Puerto Rico, and interests in 28 JV Properties totaling approximately 5.1 million square feet of GLA across 15 states.

As of September 30, 2017, 171 of the Company's wholly-owned properties were leased to Sears Holdings pursuant to the Master Lease and operated under either the Sears or Kmart brand. At 85 properties, third-party tenants under direct leases occupy a portion of leasable space alongside Sears and Kmart, and 41 properties are leased only to third parties. A substantial majority of the space at the JV Properties is also leased to Sears Holdings under the JV Master Leases.

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

The Master Lease provides us with the right to recapture up to approximately 50% of the space occupied by Sears Holdings at each of the 224 Wholly Owned Properties initially included in the Master Lease (subject to certain

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

As of September 30, 2017, we had exercised recapture rights at 45 properties, including 17 properties at which we exercised partial recapture rights, 17 properties at which we exercised 100% recapture rights (five of which were converted from partial recapture properties), and 11 properties at which we exercised our rights to recapture only automotive care centers or outparcels.

- 28 -

---

## Effects of Natural Disasters

While the Company continues to assess the impact of the natural disasters (wildfires in California and Hurricanes Harvey, Irma, and Maria) that occurred during the quarter ended September 30, 2017 on our operations our ability to collect rent from tenants, we do not believe these natural disasters will have a material impact on our operating results or financial position. All stores occupied by Sears Holdings are currently open for business and the Company has not experienced interruptions in rental payments nor does it expect to incur material capital expenditures to repair any property damage.

## GGP Transactions

On July 12, 2017, the Company completed two transactions with GGP for gross consideration of \$247.6 million whereby the Company (i) sold to GGP the Company's 50% JV Interests in eight of the 12 assets in the GGP I JV for \$190.1 million and recorded a gain of \$43.7 million which is included in gain on sale of interest in unconsolidated joint venture within the condensed consolidated statements of operations; and (ii) contributed five Wholly Owned Properties to the GGP II JV and sold a 50% interest in the new JV Properties to GGP for \$57.5 million and recorded a gain of \$13.0 million which is included in gain on sale of real estate within the condensed consolidated statements of operations.

As a result of the transactions, the Company reduced amounts outstanding under its mortgage loan by \$50.6 million and received approximately \$171.6 million of additional cash proceeds before closing costs, which it intends to use to fund its redevelopment pipeline and for general corporate purposes.

## Simon Transaction

Subsequent to September 30, 2017, the Company agreed to sell to Simon the Company's 50% JV Interests in five of the ten assets in the Simon JV for \$68.0 million, subject to certain closing conditions.

Upon closing, which is expected in the fourth quarter of 2017, the Company would realize approximately \$7.0 million of value creation above its basis across the five properties and generate unrestricted cash proceeds, after closing costs and any required tax distributions, to fund its redevelopment pipeline and for general corporate purposes.

## Results of Operations

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

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

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

## Rental Income

For the three months ended September 30, 2017:



Edgar Filing: Seritage Growth Properties - Form 10-Q

- The Company recognized total rental income of \$48.2 million as compared to \$45.6 million for the three months ended September 30, 2016. The \$2.6 million increase was driven primarily by (i) termination fee income of \$10.6 million and (ii) increased third-party rental income of \$1.5 million, offset by (iii) reduced rental income under the Master Lease of \$5.4 million and (iv) reduced straight-line rent of \$4.1 million, in each case for the three months ended September 30, 2017 as compared to the prior year period.
  - Rental income attributable to Sears Holdings was \$27.9 million (excluding termination fee income of \$10.6 million and straight-line rental income of \$(1.7) million), or 72.7% of total rental income earned in the period. For the prior year period, the comparable rental income attributable to Sears Holdings was \$33.4 million, or approximately 79.0% of total rental income earned in the period.
  - Rental income attributable to third-party tenants was \$10.5 million (excluding straight-line rental income of \$0.6 million), or 27.3% of total rental income earned in the period. For the prior year period, the comparable rental income attributable to third-party tenants was \$9.0 million, or approximately 21.0% of total rental income earned in the period.
- 29 -
-

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

–Straight-line rent was (\$1.1) million as compared to \$3.0 million for the prior year period. The reduction in straight-line rent was primarily due to reduced rental income under the Master Lease and the amortization of accrued rental revenues related to the straight-line method of reporting that are deemed uncollectable as result of recapture and termination activity under the Master Lease.

For the nine months ended September 30, 2017:

- The Company recognized total rental income of \$139.5 million as compared to \$136.7 million for the nine months ended September 30, 2016. The \$2.8 million increase was driven primarily by (i) termination fee income of \$17.4 million and (ii) increased third-party rental income of \$5.2 million, offset by (iii) reduced rental income under the Master Lease of \$11.0 million and (iv) reduced straight-line rent of \$8.8 million, in each case for the nine months ended September 30, 2017 as compared to the prior year period.
- Rental income attributable to Sears Holdings was \$88.8 million (excluding termination fee income of \$17.4 million and straight-line rental income of \$0.1 million), or 74.7% of total rental income earned in the period. For the prior year period, the comparable rental income attributable to Sears Holdings was \$99.8 million, or approximately 80.0% of total rental income earned in the period.
- Rental income attributable to third-party tenants was \$30.1 million (excluding straight-line rental income of \$2.3 million), or 25.3% of total rental income earned in the period. For the prior year period, the comparable rental income attributable to third-party tenants was \$25.0 million, or approximately 20.0% of total rental income earned in the period.
- Straight-line rent was \$2.4 million as compared to \$11.2 million for the prior year period. The reduction in straight-line rent was primarily due to reduced rental income under the Master Lease and the amortization of accrued rental revenues related to the straight-line method of reporting that are deemed uncollectable as result of recapture and termination activity under the Master Lease.

On an annual basis, and taking into account all signed leases, including those which have not yet commenced rental payments, rental income attributable to third-party tenants would have represented approximately 45.4% of total annual base rental income as of September 30, 2017.

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

### Tenant Reimbursements and Property Operating Expenses

Pursuant to the provisions of the Master Lease and many third-party leases, the Company is entitled to be reimbursed for certain property related expenses. For the three months ended September 30, 2017 and September 30, 2016, the Company recorded tenant reimbursement income of \$15.9 million and \$12.0 million, respectively, compared to property operating expenses and real estate tax expense aggregating of \$15.6 million and \$12.5 million, respectively. For the nine months ended September 30, 2017 and September 30, 2016, the Company recorded tenant reimbursement income of \$47.8 million and \$45.7 million, respectively, compared to property operating expenses and real estate tax expense aggregating of \$49.7 million and \$48.3 million, respectively.

### Depreciation and Amortization Expenses

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

For the three months ended September 30, 2017, the Company incurred depreciation and amortization expenses of \$61.1 million as compared to depreciation and amortization expenses of \$44.5 million in the prior year period. The increase of \$16.6 million was due primarily to approximately \$30.2 million of additional accelerated amortization attributable to certain lease intangible assets, offset by (i) approximately \$11.0 million of lower scheduled amortization resulting from an increase in fully-amortized lease intangibles, (ii) approximately \$2.1 million of lower

depreciation resulting from the accelerated depreciation in the prior year period of certain buildings that were demolished for redevelopment, and (iii) approximately \$0.5 million of lower scheduled amortization and depreciation as a result of the contribution of five Wholly Owned Properties into the GGP II JV and sale of a 50% interest in the new JV Properties in July 2017.

For the nine months ended September 30, 2017, the Company incurred depreciation and amortization expenses of \$170.3 million as compared to depreciation and amortization expenses of \$121.4 million in the prior year period. The increase of \$48.9 million was due primarily to approximately (i) \$67.6 million of additional accelerated amortization attributable to certain lease intangible assets and (ii) \$1.1 million of additional accelerated depreciation in the current year period of certain buildings that were demolished for redevelopment, offset by (i) approximately \$19.3 million of lower scheduled amortization resulting from an increase in fully-amortized lease intangibles and (ii) approximately \$0.5 million of lower scheduled amortization and depreciation as a result of the contribution of five Wholly Owned Properties into the GGP II JV and sale of a 50% interest in the new JV Properties in July 2017.

- 30 -

---

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

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

### General and Administrative Expenses

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

For the three months ended September 30, 2017, the Company incurred general and administrative expenses of \$5.3 million compared to general and administrative expenses of \$4.3 million for the prior year period. The \$1.0 million increase was driven primarily by increased personnel costs.

For the nine months ended September 30, 2017, the Company incurred general and administrative expenses of \$16.6 million compared to general and administrative expenses of \$13.1 million for the prior year period. The \$3.5 million increase was driven primarily by increased personnel costs and an increase in fees to firms providing professional services.

### Acquisition-Related Expenses

The Company did not incur any acquisition-related expenses for the three or nine months ended September 30, 2017. For the three and nine months ended September 30, 2016, the Company recorded less than \$0.1 million of acquisition-related expenses, primarily remaining legal fees.

### Interest Expense

For the three months ended September 30, 2017, the Company incurred \$18.0 million of interest expense (net of amounts capitalized) as compared to interest expense of \$15.9 million for the prior year period. For the nine months ended September 30, 2017, the Company incurred \$53.1 million of interest expense (net of amounts capitalized) as compared to interest expense of \$47.3 million for the prior year period. The increase in interest expense in both periods was driven by higher average borrowings under the Future Funding Facility and Unsecured Term Loan, as well as higher average LIBOR rates.

### Unrealized Loss on Interest Rate Cap

For the three months ended September 30, 2017, the Company recorded a loss of \$0.1 million compared to a loss of less than \$0.1 million for the three months ended September 30, 2016. For the nine months ended September 30, 2017, the Company recorded a loss of \$0.7 million compared to a loss of \$1.9 million for the nine months ended September 30, 2016.

### Liquidity and Capital Resources

Property rental income is our primary source of cash and is dependent on a number of factors, including occupancy levels and rental rates, as well as our tenants' ability to pay rent. Our primary uses of cash include payment of operating expenses, debt service, reinvestment in and redevelopment of properties, and distributions to shareholders and unitholders. We believe that we currently have sufficient liquidity to fund such uses in the form of, as of September 30, 2017, (i) \$104.1 million of unrestricted cash, (ii) \$202.5 million of restricted cash, (iii) anticipated cash provided by operations; and subsequent to September 30, 2017, unrestricted cash proceeds, after closing costs and any required tax distributions, that we expect to receive as a result of selling certain JV Interests to Simon. We may also raise additional capital through the public or private issuance of debt securities, common or preferred equity or other instruments convertible into or exchangeable for common or preferred equity, as well as through asset sales or joint

ventures.

With respect to the Company's Unsecured Term Loan due December 31, 2017, the Company may repay the \$85.0 million total principal amount outstanding as of September 30, 2017 with unrestricted cash on hand, seek an extension of the maturity date, or raise additional capital through a refinancing transaction or from the proceeds of asset sales or new JVs.

In November 2016, the Company and the servicer for our Mortgage Loans entered into amendments to our Loan Agreements to resolve a disagreement regarding one of the cash flow sweep provisions in our Loan Agreements. The principal terms of these amendments are that the Company has (i) posted \$30.0 million, and will post \$3.3 million on a monthly basis, to a redevelopment project reserve account, which amounts may be used by the Company to fund redevelopment activity and (ii) extended the spread maintenance provision for prepayment of the loan by two months through March 9, 2018 (with the spread maintenance premium for the second month at a reduced amount).

- 31 -

---

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

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

### Summary of Cash Flows

Net cash provided by operating activities was \$56.9 million for the nine months ended September 30, 2017 and \$100.1 million for the nine months ended September 30, 2016. Significant changes in the components of net cash provided by operating activities include:

- In 2017, a decrease in operating cash inflows due the payment of a previously recorded litigation expense;
- In 2017, a decrease in operating cash inflows due to net reductions in rental income under the Master Lease and increased interest expense, offset by termination fee income and additional third-party rental income;
- In 2016, an increase in operating cash inflows due to changes in operating assets and liabilities.

Net cash provided by investing activities was \$40.2 million for the nine months ended September 30, 2017 compared to net cash used by investing activities of \$47.2 million for the nine months ended September 30, 2016. Significant components of net cash provided by and used in investing activities include:

- In 2017, proceeds from the sale of real estate and JV Interests, \$240.3 million;
- In 2017, development of real estate and property improvements, (\$164.1) million;
- In 2017, investments in unconsolidated joint ventures, (\$36.0) million; and
- In 2016, development of real estate and property improvements, (\$47.2) million.

Net cash provided by financing activities was \$69.9 million for the nine months ended September 30, 2017 compared to net cash used in financing activities of \$36.4 million for the nine months ended September 30, 2016. Significant components of net cash provided by and used in financings activities include:

- In 2017, proceeds from the Future Funding Facility, \$80.0 million;
- In 2017, proceeds from the Unsecured Term Loan, \$85.0 million;
- In 2017, repayment of mortgage loan payables, (\$50.6) million;
- In 2017, cash distributions to common stockholders and holders of Operating Partnership units, (\$41.8) million; and
- In 2016, cash distributions to common stockholders and holders of Operating Partnership units, (\$55.7) million.

### Dividends and Distributions

The Company's Board of Trustees declared the following common stock dividends during 2017 and 2016, with holders of Operating Partnership units entitled to an equal distribution per Operating Partnership unit held on the record date:

Declaration Date	Record Date	Payment Date	Dividends per Class A and Class C Common Share
<b>2017</b>			
October 24	December 29	January 11, 2018	\$ 0.25
July 25	September 29	October 12	0.25
April 25	June 30	July 13	0.25
February 28	March 31	April 13	0.25
<b>2016</b>			
November 1	December 31	January 12, 2017	\$ 0.25
August 2	September 30	October 13	0.25

Edgar Filing: Seritage Growth Properties - Form 10-Q

May 3	June 30	July 14	0.25
March 8	March 31	April 14	0.25

Litigation and Other Matters

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

- 32 -

---

but the amount cannot be reasonably estimated, or when the liability is believed to be only reasonably possible or remote. In such cases, the Company discloses the nature of the contingency, and an estimate of the possible loss, range of loss, or disclose the fact that an estimate cannot be made.

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

#### Off-Balance Sheet Arrangements

The Company accounts for its investments in joint ventures that it does not have a controlling interest or is not the primary beneficiary using the equity method of accounting and those investments are reflected on the condensed consolidated balance sheets of the Company as investments in unconsolidated joint ventures. As of September 30, 2017 and December 31, 2016, we did not have any off-balance sheet financing arrangements.

- 33 -

---



Retenancing and Redevelopment Projects

We are currently retenancing or redeveloping several properties primarily to convert single-tenant buildings occupied by Sears Holdings into multi-tenant properties occupied by a diversity of retailers and related concepts. The table below provides a brief description of each of the 55 new redevelopment projects originated on the Seritage platform as of September 30, 2017. These projects represent an estimated total investment of \$676.0 million, of which \$520.5 million remained to be spent.

Total Project Costs under \$10 Million

Property	Description	Total Project Square Feet	Estimated Construction Start	Estimated Substantial Completion
King of Prussia, PA	Repurpose former auto center space for Outback Steakhouse, Yard House and small shop retail	29,100		Substantially complete
Merrillville, IN	Termination property; redevelop existing store for At Home, Powerhouse Gym and small shop retail	132,000		Substantially complete
Elkhart, IN	Termination property; existing store has been released to Big R Stores	86,500		Substantially complete
San Antonio, TX	Recapture and repurpose auto center space for Orvis, Jared's Jeweler, Shake Shack and small shop retail	18,900		Substantially complete
Bowie, MD	Recapture and repurpose auto center space for BJ's Brewhouse	8,200		Delivered to tenant

Edgar Filing: Seritage Growth Properties - Form 10-Q

Albany, NY	Recapture and repurpose auto center space for BJ's Brewhouse and additional small shop retail	28,000	Underway	Q4 2017
Hagerstown, MD	Recapture and repurpose auto center space for BJ's Brewhouse, Verizon and additional restaurants	15,400	Underway	Q4 2017
Roseville, MI	Partial recapture; redevelop existing store for At Home	100,400	Underway	Q4 2017
Troy, MI	Partial recapture; redevelop existing store for At Home	100,000	Underway	Q4 2017
Henderson, NV	Termination property; redevelop existing store for At Home, Seafood City and additional retail	144,400	Underway	Q4 2017
Rehoboth Beach, DE	Partial recapture; redevelop existing store for Christmas Tree Shops andThat! and PetSmart	56,700	Underway	Q1 2018
Ft. Wayne, IN	Site densification; new outparcels for BJ's Brewhouse (substantially complete) and Chick-Fil-A (project	12,000	Underway	Q1 2018

Edgar Filing: Seritage Growth Properties - Form 10-Q

Kearney, NE	expansion) Termination property; redevelop existing store for Marshall's, PetSmart and additional junior anchors	92,500	Underway	Q2 2018
Jefferson City, MO	Termination property; redevelop existing store for Orscheln Farm and Home	96,000	Underway	Q2 2018
Olean, NY	Partial recapture; redevelop existing store for Marshall's and additional retail	45,000	Underway	Q2 2018
Cullman, AL	Termination property; redevelop existing store for Bargain Hunt, Tractor Supply and Planet Fitness	99,000	Underway	Q3 2018
Guaynabo, PR	Partial recapture; redevelop existing store for Planet Fitness and Capri	56,100	Underway	Q3 2018
Roseville, CA	Recapture and repurpose auto center space for AAA	10,400	Q4 2017	Q2 2018
Dayton, OH	Recapture and repurpose auto center space for Outback Steakhouse and additional restaurants	14,100	Q4 2017	Q4 2018
Florissant, MO	Site densification;	5,000	Q1 2018	Q3 2018

Edgar Filing: Seritage Growth Properties - Form 10-Q

New Iberia, LA	new outparcel for Chick-Fil-A Termination property; redevelop existing store for Rouses Supermarkets, additional junior anchors and small shop retail	93,100	Q1 2018	Q1 2019
North Little Rock, AR	Recapture and repurpose auto center space for LongHorn Steakhouse and additional small shop retail	17,300	Q2 2018	Q2 2019
St. Clair Shores, MI	100% recapture; demolish existing store and develop site for new Kroger store	107,200	Q2 2018	Q2 2019
Oklahoma City, OK	Site densification; new fitness center for Vasa Fitness	59,500	Q3 2018	Q3 2019

Edgar Filing: Seritage Growth Properties - Form 10-Q

Total Project Costs \$10 - \$20 Million

Property	Description	Total Project Square Feet	Estimated Construction Start	Estimated Substantial Completion
Braintree, MA	100% recapture; redevelop existing store for Nordstrom Rack, Saks OFF 5th and additional retail	90,000	Substantially complete	
Honolulu, HI	100% recapture; redevelop existing store for Longs Drugs (CVS), PetSmart and Ross Dress for Less	79,000	Substantially complete	
Madison, WI	Partial recapture; redevelop existing store for Dave & Busters, Total Wine & More, additional retail and restaurants	75,300	Underway	Q4 2017
West Jordan, UT	Partial recapture; redevelop existing store and attached auto center for Burlington Stores and additional retail	81,400	Underway	Q4 2017
Anderson, SC	100% recapture (project expansion); redevelop existing store	111,300	Underway	Q4 2017

Edgar Filing: Seritage Growth Properties - Form 10-Q

	for Burlington Stores, Sportsman's Warehouse, additional retail and restaurants			
Fairfax, VA	Partial recapture; redevelop existing store and attached auto center for Dave & Busters, Seasons 52, additional junior anchors and restaurants	110,300	Underway	Q1 2018
North Hollywood, CA	Partial recapture; redevelop existing store for Burlington Stores and additional junior anchors	79,800	Underway	Q1 2018
Saugus, MA	Partial recapture; redevelop existing store and detached auto center for Round One and restaurants	99,000	Underway	Q1 2018
Thornton, CO	Termination property; redevelop existing store for Vasa Fitness and additional junior anchors	191,600	Underway	Q1 2018
Orlando, FL	100% recapture; demolish and construct new buildings for Floor &	139,200	Underway	Q2 2018

Edgar Filing: Seritage Growth Properties - Form 10-Q

	Décor, Orchard Supply Hardware, LongHorn Steakhouse, Olive Garden, additional small shop retail and restaurants				
Springfield, IL	Termination property; redevelop existing store for Burlington Stores, Binny's Beverage Depot, Orange Theory Fitness, Outback Steakhouse, CoreLife Eatery, additional junior anchors and small shop retail	133,400	Underway	Q2 2018	
North Miami, FL	100% recapture; redevelop existing store for Michael's, PetSmart and Ross Dress for Less	124,300	Underway	Q2 2018	
Hialeah, FL	100% recapture; redevelop existing store for Bed, Bath & Beyond, Ross Dress for Less and additional junior anchors to join current tenant, Aldi	88,400	Underway	Q2 2018	

Edgar Filing: Seritage Growth Properties - Form 10-Q

Charleston, SC	100% recapture (project expansion); redevelop existing store and detached auto center for Burlington Stores and additional retail	126,700	Underway	Q3 2018
Warwick, RI	Termination property; repurpose auto center space for BJ's Brewhouse and additional retail  Redevelop existing store for At Home and Raymour & Flanigan (project expansion)	190,700	Underway	Q4 2018
Cockeysville, MD	Partial recapture; redevelop existing store for HomeGoods, Michael's Stores, additional junior anchors and restaurants	83,500	Q4 2017	Q2 2018
Salem, NH	Site densification; new theatre for Cinemark  Recapture and repurpose auto center for restaurant space.	71,200	Q4 2017	Q3 2018
Paducah, KY		102,300	Q1 2018	Q3 2018



Edgar Filing: Seritage Growth Properties - Form 10-Q

	Termination property; redevelop existing store for Burlington Stores and additional retail			
Santa Cruz, CA	Partial recapture; redevelop existing store for TJ Maxx, HomeGoods and Petco	62,200	Q1 2018	Q4 2018
Temecula, CA	Partial recapture; redevelop existing store and detached auto center for Round One, small shop retail and restaurants	65,100	Q1 2018	Q4 2018
Canton, OH	Partial recapture; redevelop existing store for Dave & Busters and restaurants	83,900	Q1 2018	Q2 2019
North Riverside, IL	Partial recapture; redevelop existing store and detached auto center for Round One, additional junior anchors, small shop retail and restaurants	103,900	Q1 2018	Q3 2019
Austin, TX	Partial recapture; redevelop existing store	80,500	Q2 2018	Q3 2019

for AMC  
Theatres,  
additional  
retail and  
restaurants

Edgar Filing: Seritage Growth Properties - Form 10-Q

Total Project Costs over \$20 Million

Property	Description	Total Project Square Feet	Estimated Construction Start	Estimated Substantial Completion
Memphis, TN	100% recapture; demolish and construct new buildings for LA Fitness, Nordstrom Rack, Ulta Beauty, Hopdoddy Burger Bar, additional junior anchors, restaurants and small shop retail	135,200	Delivered to tenants	
West Hartford, CT	100% recapture; redevelop existing store and detached auto center for Buy Buy Baby, Cost Plus World Market, REI, Saks OFF Fifth, other junior anchors, Shake Shack and additional small shop retail	147,600	Underway	Q1 2018
St. Petersburg, FL	100% recapture; demolish and construct new buildings for Dick's Sporting	142,400	Underway	Q2 2018

	Goods, Lucky's Market, PetSmart, Five Below, Chili's Grill & Bar, Pollo Tropical, LongHorn Steakhouse and additional small shop retail and restaurants			
Wayne, NJ	Partial recapture; redevelop existing store for Dave & Busters, additional junior anchors and restaurants			
	Recapture and repurpose detached auto center for Cinemark (project expansion)			
	NOTE: contributed to GGP II JV in July 2017	156,700	Underway	Q3 2018
Carson, CA	100% recapture (project expansion); redevelop existing store for Burlington Stores, Ross Dress for Less and additional	163,800	Underway	Q1 2019

Edgar Filing: Seritage Growth Properties - Form 10-Q

	retail			
Santa Monica, CA	100% recapture; redevelop existing building into premier, mixed-use asset featuring unique, small-shop retail and creative office space	96,500	Q4 2017	Q4 2019
Watchung, NJ	100% recapture; demolish full-line store and construct new buildings for HomeSense, Sierra Trading Post, Ulta Beauty and additional small shop retail and restaurants  Demolish detached auto center and construct a freestanding Cinemark theater	126,700	Q1 2018	Q2 2019
East Northport, NY	Termination property (notice period); redevelop existing store and attached auto center for AMC Theatres, 24	179,700	Q2 2018	Q4 2019

Hour  
Fitness,  
additional  
junior  
anchors and  
small shop  
retail

#### Non-GAAP Supplemental Financial Measures and Definitions

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

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

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

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

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

#### Earnings Before Interest Expense, Income Tax, Depreciation, and Amortization ("EBITDA") and Adjusted EBITDA

We define EBITDA as net income less depreciation, amortization, interest expense and provision for income and other taxes. EBITDA is a commonly used measure of performance in many industries, but may not be comparable to measures calculated by other companies. We believe EBITDA provides useful information to investors regarding our results of operations because it removes the impact of our capital structure (primarily interest expense) and our asset base (primarily depreciation and amortization). Management also believes the use of EBITDA facilitates comparisons between us and other equity REITs, retail property owners who are not REITs, and other capital-intensive companies.

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

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

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

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

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

We consider FFO a helpful supplemental measure of the operating performance for equity REITs and a complement to GAAP measures because it is a recognized measure of performance by the real estate industry. FFO facilitates an understanding of the operating performance of our properties between periods because it does not give effect to real estate depreciation and amortization which are calculated to allocate the cost of a property over its useful life. Since values for well-maintained real estate assets have historically increased or decreased based upon prevailing market conditions, the Company believes that FFO provides investors with a clearer view of the Company's operating performance.

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

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

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

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

Edgar Filing: Seritage Growth Properties - Form 10-Q

The following table reconciles NOI and Total NOI to GAAP net loss for the three and nine months ended September 30, 2017 and September 30, 2016 (in thousands):

	Three Months		Nine Months Ended	
	Ended September 30, 2017	2016	September 30, 2017	2016
NOI				
Net income (loss)	\$17,276	\$(37,247)	\$(50,435)	\$(64,526)
Termination fee income	(10,596)	—	(17,360)	—
Depreciation and amortization	61,059	44,532	170,293	121,365
General and administrative	5,272	4,252	16,639	13,104
Litigation charge	—	19,000	—	19,000
Acquisition-related expenses	—	—	—	73
Equity in loss (income) of unconsolidated joint ventures	3,686	(1,497)	4,226	(4,495)
Gain on sale of interest in unconsolidated joint venture	(43,729)	—	(43,729)	—
Gain on sale of real estate	(13,018)	—	(13,018)	—
Interest and other income	(352)	(77)	(472)	(196)
Interest expense	18,049	15,931	53,072	47,297
Unrealized loss on interest rate cap	91	47	686	1,898
Provision for income taxes	—	72	266	412
NOI	\$37,738	\$45,013	\$120,168	\$133,932
Total NOI				
NOI	37,738	45,013	120,168	133,932
NOI of unconsolidated joint ventures	4,830	6,431	18,328	20,057
Straight-line rent adjustment (1)	1,230	(3,100)	(2,396)	(11,526)
Above/below market rental income/expense (1)	(212)	(257)	(902)	(681)
Total NOI	\$43,586	\$48,087	\$135,198	\$141,782

(1) Includes adjustments for unconsolidated joint ventures.

The following table reconciles EBITDA and Adjusted EBITDA to GAAP net loss for the three and nine months ended September 30, 2017 and September 30, 2016 (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2017	2016	September 30, 2017	2016
EBITDA				
Net income (loss)	\$17,276	\$(37,247)	\$(50,435)	\$(64,526)
Depreciation and amortization	61,059	44,532	170,293	121,365
Depreciation and amortization (unconsolidated joint ventures)	4,755	5,191	18,583	15,653
Interest expense	18,049	15,931	53,072	47,297



Edgar Filing: Seritage Growth Properties - Form 10-Q

Provision for income and other taxes	—	72	266	412
EBITDA	\$101,139	\$28,479	\$191,779	\$120,201
Adjusted EBITDA				
EBITDA	\$101,139	\$28,479	\$191,779	\$120,201
Termination fee income	(10,596)	—	(17,360)	—
Unrealized loss on interest rate cap	91	47	686	1,898
Litigation charge	—	19,000	—	19,000
Acquisition-related expenses	—	—	—	73
Up-front hiring and personnel costs	—	—	—	328
Gain on sale of interest in unconsolidated				
joint venture	(43,729)	—	(43,729)	—
Gain on sale of real estate	(13,018)	—	(13,018)	—
Adjusted EBITDA	\$33,887	\$47,526	\$118,358	\$141,500

Edgar Filing: Seritage Growth Properties - Form 10-Q

The following table reconciles FFO and Company FFO to GAAP net loss for the three and nine months ended September 30, 2017 and September 30, 2016 (in thousands):

	Three Months		Nine Months Ended	
	Ended September 30, 2017	2016	September 30, 2017	2016
Funds from Operations				
Net income (loss)	\$17,276	\$(37,247)	\$(50,435)	\$(64,526)
Real estate depreciation and amortization				
(consolidated properties)	60,483	44,307	169,158	120,845
Real estate depreciation and amortization				
(unconsolidated joint ventures)	4,755	5,191	18,583	15,653
Gain on sale of interest in unconsolidated				
joint venture	(43,729)	—	(43,729)	—
Gain on sale of real estate	(13,018)	—	(13,018)	—
FFO attributable to common shareholders				
and unitholders	\$25,767	\$12,251	\$80,559	\$71,972
FFO per diluted common share and unit	\$0.46	\$0.22	\$1.45	\$1.29
Company Funds from Operations				
Funds from Operations attributable to Seritage				
Growth Properties	\$25,767	\$12,251	\$80,559	\$71,972
Termination fee income	(10,596)	—	(17,360)	—
Unrealized loss on interest rate cap	91	47	686	1,898
Amortization of deferred financing costs	2,329	1,340	6,390	4,020
Litigation charge	—	19,000	—	19,000
Acquisition-related expenses	—	—	—	73
Up-front hiring and personnel costs	—	—	—	328
Company FFO attributable to common				
shareholders and unitholders	\$17,591	\$32,638	\$70,275	\$97,291
Company FFO per diluted common share and unit	\$0.32	\$0.59	\$1.26	\$1.75
Weighted Average Common Shares and Units Outstanding				
Weighted average common shares outstanding	33,841	31,419	33,685	31,414
Weighted average OP units outstanding	21,832	24,176	21,916	24,176
Weighted average common shares and				
units outstanding	55,673	55,595	55,601	55,590



Item 3. Quantitative and Qualitative Disclosure about Market Risk

Except as discussed below, there were no material changes in the Quantitative and Qualitative Disclosures about Market Risk set forth in our 2016 Annual Report on Form 10-K.

Interest Rate Fluctuations

As of September 30, 2017, we had \$1.30 billion of consolidated debt, including \$1.21 billion outstanding under our variable-rate Mortgage Loans and Future Funding Facility. The interest rate on the loans is the 30-day LIBOR rate plus, as of September 30, 2017, a weighted average spread of 470 basis points. We have purchased a LIBOR interest rate cap that has a LIBOR strike rate of 3.5% and a term of four years. We are subject to market risk with respect to changes in the LIBOR rate. An immediate 100 basis point change in interest rates would have affected annual pretax funding costs by approximately \$12.1 million.

Fair Value of Debt

As of September 30, 2017, the estimated fair value of our consolidated debt was \$1.3 billion. The estimated fair value of our consolidated debt is calculated based on current market prices and discounted cash flows at the current rate at which similar loans would be made to borrowers with similar credit ratings for the remaining term of such debt.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures.

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

Changes in Internal Controls.

There were no changes in our internal control over financial reporting that occurred during the period ended September 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

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

### Item 1A. Risk Factors

Information regarding risk factors appears in our 2016 Annual Report on Form 10-K in Part I, Item 1A. Risk Factors. Except as discussed below, there have been no material changes from the risk factors previously disclosed in our 2016 Annual Report on Form 10-K.

We will be substantially dependent on Sears Holdings, as a tenant, until we further diversify the tenancy of our portfolio, and an event that has a material adverse effect on Sears Holdings' business, financial condition or results of operations could have a material adverse effect on our business, financial condition or results of operations.

Sears Holdings is the lessee of a substantial majority of our properties and accounts for a substantial majority of our revenues. Under the Master Lease, Sears Holdings is required to pay all insurance, taxes, utilities and maintenance and repair expenses in connection with these leased properties and to indemnify, defend and hold us harmless from and against various claims, litigation and liabilities arising in connection with its business, subject to proportionate sharing of certain of these expenses with occupants of the remainder of the space not leased to Sears Holdings. Sears Holdings may not in the future have sufficient assets, income and access to financing to enable it to satisfy its payment obligations under the Master Lease. In its most recent Form 10-K, Sears Holdings disclosed, among other things, that its historical operating results indicate substantial doubt exists related to Sears Holdings' ability to continue as a going concern. In addition, Sears Holdings has disclosed that its domestic pension and postretirement benefit plan obligations are currently underfunded. Sears Holdings may have to make significant cash payments to some or all of its pension and postretirement benefit plans, which would reduce the cash available for its businesses, potentially including its rent obligations under the Master Lease. The inability or unwillingness of Sears Holdings to meet its rent obligations and other obligations under the Master Lease could materially adversely affect our business, financial condition or results of operations, including our ability to pay the interest, principal and other costs and expenses under our financings, or to pay cash dividends to Seritage shareholders. For these reasons, if Sears Holdings were to experience a material adverse effect on its business, financial condition or results of operations, our business, financial condition or results of operations could also be materially adversely affected.

Our dependence on rental payments from Sears Holdings as our main source of revenues may limit our ability to enforce our rights under the Master Lease. In addition, we may be limited in our ability to enforce our rights under the Master Lease because it is a unitary lease and does not provide for termination with respect to individual properties by reason of the default of the tenant. Failure by Sears Holdings to comply with the terms of the Master Lease or to comply with the regulations to which the leased properties are subject could require us to find another master lessee for all such leased property and there could be a decrease or cessation of rental payments by Sears Holdings. In such event, we may be unable to locate a suitable master lessee or a lessee for individual properties at similar rental rates and other obligations and in a timely manner or at all, which would have the effect of reducing our rental revenues. In addition, each JV is subject to similar limitations on enforcements of remedies and risks under its respective JV Master Lease, which could reduce the value of our investment in, or distributions to us by, one or more of the JVs.

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

None.

### Item 3. Defaults Upon Senior Securities

None.

### Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

- 41 -

---

## Item 6. Exhibits

Exhibit No.	Description	SEC Document Reference
31.1	<u>Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>	Filed herewith.
31.2	<u>Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>	Filed herewith.
32.1	<u>Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350</u>	Filed herewith.
32.2	<u>Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350</u>	Filed herewith.
101.INS	XBRL Instance Document	Filed herewith.
101.SCH	XBRL Taxonomy Extension	Filed herewith.

Edgar Filing: Seritage Growth Properties - Form 10-Q

	Schema Document	
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	Filed herewith.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Filed herewith.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	Filed herewith.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	Filed herewith.



SIGNATURES

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

SERITAGE  
GROWTH  
PROPERTIES

Dated: November 3, 2017 /s/ Benjamin Schall  
By: Benjamin Schall  
President and Chief  
Executive Officer

Dated: November 3, 2017 /s/ Brian Dickman  
By: Brian Dickman  
Executive Vice  
President and Chief  
Financial Officer