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SFI - Q1 2012 iStar Financial Earnings Conference Call

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OVERVIEW:

SFI reported 1Q12 net loss of $55m or loss of $0.43 per diluted common share.

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CORPORATE PARTICIPANTS

Jason Fooks *iStar Financial Inc. - VP, IR & Marketing*

Jay Sugarman *iStar Financial Inc. - Chairman and CEO*

David DiStaso *iStar Financial Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Jonathan Feldman *Nomura Securities - Analyst*

Josh Barber *Stifel Nicolaus - Analyst*

Michael Kim *CRT Capital Group - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to iStar Financial's first-quarter 2012 earnings conference call. (Operator Instructions). As a reminder, today's conference is being recorded.

At this time, for opening remarks and introductions, I would like to turn the conference over to Jason Fooks, Vice President of Investor Relations and Marketing. Please go ahead, sir.

Jason Fooks - *iStar Financial Inc. - VP, IR & Marketing*

Thank you, John, and good morning, everyone. Thank you for joining us today to review iStar Financial's first-quarter 2012 earnings report. With me today are Jay Sugarman, Chairman and Chief Executive Officer; and David DiStaso, our Chief Financial Officer. This morning's call is being webcast on our website at istarfinancial.com in the Investor Relations section. There will be a replay of the call beginning at 12.30 PM Eastern Time today. The dial-in for the replay is 1-800-475-6701 with a confirmation code of 244393.

Before I turn the call over to Jay, I would like to remind everyone that statements in this earnings call which are not historical facts will be forward-looking. iStar Financial's actual results may differ materially from these forward-looking statements. And the risk factors that could cause these differences are detailed in our SEC reports.

In addition, as stated more fully in our SEC reports, iStar disclaims any intent or obligation to update these forward-looking statements, except as expressly required by law.

Now I would like to turn the call over to iStar's Chairman and CEO, Jay Sugarman. Jay?

Jay Sugarman - *iStar Financial Inc. - Chairman and CEO*

Thanks, Jason, and thanks for joining us on the call this morning. Our first quarter continued many of the themes from the previous quarter. We continue to pay down debt, extend debt maturities, and make additional investments to maximize the value in our real estate portfolio. Many parts of the portfolio showed steady progress, and assets in the repositioned for sale residential portfolio in particular are beginning to register steady gains. These gains were offset to some extent, however, by weakness in retail and European assets.

Our goal throughout 2012 will be to continue paying down outstanding debt and improving our asset positioning as we begin preparing for the next step in aligning our assets and liabilities on a long-term basis.

The earnings story continues to reflect this transition period. Performing loans, net lease assets, stabilized owned real estate, and certain strategic investments continue to carry most, if not all, of the debt service and overhead of the Company; while nonperforming loans and real estate assets that have not yet stabilized generate losses and impairments that create a negative weight on earnings.

As a result, we reported a net loss of $55 million for the quarter. But excluding depreciation and non-cash provisions, impairments and gains, results were close to break-even in the quarter, at negative $7 million. The balance sheet was also strengthened by the $880 million 2012 secured financing we closed in March and the continued leveraging of the 2011 secured financing facility. The new facility extending debt maturities to more closely match the duration of the underlying assets completes the second phase of our long-term financing strategy, and our goal remains to use a mix of secured and unsecured debt to fund our business.

New investments were limited this quarter, as we focused on our debt execution, but we found a few places to deploy capital at attractive rates of return and continued to invest through our interests in LNR Property.

And with that quick update, let me turn it over to Dave for more of the details.

David DiStaso - *iStar Financial Inc. - CFO*

Thanks, Jay, and good morning, everyone. I'll begin by discussing our financial results for the first quarter 2012 before moving to investment activity and credit quality. And I will finish with an update on liquidity.

For the quarter, we reported a net loss of $55 million, or a loss of $0.66 per diluted common share compared to net income of $67 million, or $0.71 per diluted common share for the first quarter 2011. The year-over-year decrease was primarily due to lower gains from the early extinguishment of debt of $2 million recognized this quarter, versus $107 million for the same period last year; increased interest expense, and higher provisions for loan losses and impairments. This was partially offset by increased earnings from equity method investments and income from sales of residential property.

Prior to the effects of depreciation, loan loss provisions and impairments, and gains on early extinguishment of debt -- all of which are non-cash items -- we reported a net loss for the quarter of $7 million compared to a net loss of $5 million for the first quarter 2011.

Adjusted EBITDA for the first quarter was $95 million compared to $90 million for the same period last year. The year-over-year improvement was due to increases in earnings from equity method investments, and income from sales of residential property, partially offset by lower revenue from a smaller overall asset base.

As previously announced, during the quarter we entered into a new $880 million senior secured credit agreement providing for two tranches of term loans; a $410 million 2012 A-1 tranche due March 2016, and a $470 million 2012 A-2 tranche due March 2017. The structure of the new facility is very similar to the structure of the facility we closed last year. Outstanding borrowings under the new financing are collateralized by a lien on a fixed pool of collateral, initially comprised of approximately $1.1 billion of assets.

Proceeds from the new financing were used to repurchase $124 million of unsecured notes and to repay the $244 million remaining on an unsecured revolving credit facility, all of which mature in 2012. The remaining debt proceeds are held on our balance sheet as restricted cash, and will be used to refinance unsecured debt maturing in 2012.

Separately during the quarter, we repurchased $96 million of senior unsecured notes and repaid the remaining $170 million of the 5.15% senior unsecured notes due March 2012. We also repaid $90 million on the A-1 tranche of our 2011 secured credit facility, bringing the balance of the 2011 A-1 tranche to $872 million at the end of the quarter.

Subsequent to quarter-end, we repaid an additional $145 million, bringing the balance down to $727 million. As a result, we have exceeded all minimum amortization requirements of this tranche prior to its maturity in June 2013. All of the activity that occurred during the quarter resulted in total debt paydowns of $724 million, leaving us with $610 million of cash, including cash reserves for repayment of debt at the end of the quarter. Our leverage was 2.7x, unchanged from the prior quarter, and our weighted average effective cost of debt for the quarter was 5.8%.

During the first quarter, we generated a total of $215 million of proceeds from our portfolio, comprised of $136 million of principal repayments; $51 million from sales of OREO assets; $7 million from sales of net lease assets; and $21 million from other investments. In addition, we invested $23 million during the quarter.

Let me now turn to the portfolio and credit quality. At the end of the first quarter, our total portfolio had a carrying value of $6.8 billion, gross of general reserves. This was comprised of approximately $2.7 billion of loans and other lending investments; $1.7 billion of net lease assets; $2 billion of owned real estate; and $469 million of other investments.

At the end of the quarter, our $2 billion of performing loans and other lending investments had a weighted average LTV of 76% and a maturity of 3.1 years. The performing loans consisted of 50% floating-rate loans that generated a weighted average effective yield of 5.8% for the quarter, and 50% fixed-rate loans that generated a weighted average effective yield of 8.3% for the quarter. The weighted average risk rating of our performing loans was 3.27 at the end of the quarter, a slight improvement from 3.29 at the end of the prior quarter. Included in our performing loans were $170 million of watch list loans, compared to $136 million last quarter.

At the end of the first quarter, our nonperforming loans, or NPLs, had a carrying value of $663 million, net of $477 million of specific reserves. This was a decrease from $771 million, net of $557 million of specific reserves, at the end of the prior quarter. Our NPLs consist primarily of 32% land; 21% apartment/residential; 17% hotel assets; 12% of entertainment/leisure; and 10% retail assets.

Our $1.7 billion of net lease assets, which are recorded net of $347 million of accumulated depreciation, were 91% leased, with a weighted average remaining lease term of over 12 years. They had a weighted average risk rating of 2.63, a slight improvement from 2.67 in the prior quarter.

For the quarter, our occupied net lease assets generated a weighted average effective yield of 10.2%, while our total net lease portfolio generated a weighted average effective yield of 9.1%. During the quarter, we recorded a $14 million impairment on one asset within our net lease portfolio.

Let me now turn to our owned real estate portfolio. At the end of the quarter, we had $776 million of OREO assets. OREO assets are considered held for sale, based on our current intention to market the assets and sell them in the near term. Also, $1.2 billion of assets were classified as real estate held for investment, based on our current intention and ability to hold them for a longer period of time.

During the quarter, we took title to properties with a carrying value of $140 million. In addition, we also recorded $3 million of impairments within the OREO portfolio. For the quarter, our owned real estate portfolio generated $14 million of revenue and $7 million of gains from condo sales, offset by $22 million of expenses. In addition, we funded $11 million of capital expenditures.

Let me move on to reserves. We recorded an $18 million provision for loan losses in the first quarter versus $16 million last year. While our provisions continue to be significantly lower from the levels recorded in 2010 and before, we still expect to see some quarterly fluctuations in our loan loss provisions. At the end of the quarter, our reserves totaled $567 million, consisting of $493 million of asset-specific reserves and $74 million of general reserves. Our reserves represent 18% of the total gross carrying value of loans. This compares to loan loss reserves of $647 million or 19% at the end of the prior quarter.

Finally, let me conclude with a discussion on our liquidity. As I mentioned before, we ended the quarter with $610 million of cash, including cash reserved for debt repayment, and have approximately $750 million of remaining unsecured debt maturities this year. Other expected uses of cash for the remainder of 2012 include approximately $50 million of loan and investment fundings, and approximately $100 million of capital expenditures that we expect to invest in our owned real estate portfolio.

With that, let me turn it back to Jay. Jay?

Jay Sugarman - *iStar Financial Inc. - Chairman and CEO*

Thanks, Dave. Before we open it up for questions, I want to touch briefly on some of the positive results we've been able to achieve in the owned real estate portfolio, and the condo portfolio in particular. Many of you have asked for more detail from the owned real estate side of the portfolio, and we would like to share some details with you for those assets that have moved through their life cycle and established appropriate positioning in the market.

While much work remains to be done, our asset managers have continued to demonstrate our core skill at repositioning many types of assets. And we'll be offering examples throughout this year's earnings calls to demonstrate the added value we've been able to bring to these investments.

For this call, let me focus primarily on the overall for sale residential side of our owned real estate portfolio. At March 31, we controlled 18 properties with approximately 1,700 units of unsold inventory. iStar's net book value, excluding outside party interest, totaled just over $600 million in these projects.

During the first quarter, we sold over $65 million worth of units, generating solid profits. And we project healthy unlevered IRRs on all 18 projects, based on their current book value.

I think it is probably worth noting that our largest assets in this category represent some of the finest properties in their markets. In Philadelphia, we own the only new build condominiums project directly on Rittenhouse Square, designed by Robert K. Stern and targeted at high-end residents. In Atlanta, we own the Mandarin Hotel and Residences in the high-profile Buckhead submarket. In South Beach, we created an ultra-exclusive property located directly in the beach, and repositioned its design and layout with our own newly created concept known as Ocean House.

In Miami, we led the renovation of repositioning of Paramount Bay, working with Lenny Kravitz and his design team to create an urban oasis lifestyle that has generated strong sales. In Battery Park City here in New York, we remodeled an existing project and are actively selling family-friendly units directly on Rector Park that offer innovative public spaces, water views, and generous floor plans.

In Las Vegas, we re-invented a newly built but relatively generic condominium into The Martin, a highly amenitized, creatively designed high-rise directly overlooking the $9 billion city center complex and offering the most compelling views over the strip. In Honolulu, we're upgrading and redesigning the iconic Ilikai Hotel, giving existing owners and new buyers a series of upgrades and improvements that represent an attention to detail the property has lacked under prior owners.

And, lastly, in Jersey City, we remade the Trump Plaza with the help of Ivanka Trump and designer Benjamin Noriega Ortiz, into one of the top-selling properties, and have begun enhancing the remaining penthouse level units to bring them to market shortly.

In each case, our goal has been to identify a key market segment not being served; invest needed capital to create a distinctive offering that would increase demand; and to generate attractive returns on investment for iStar. With recovery in many of these markets, we look forward to sharing the results of these efforts in the coming quarters.

And with that, why don't we go ahead and open it up for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Michael Kim, CRT Capital Group.

Michael Kim - *CRT Capital Group - Analyst*

Jay, I really appreciate the detail on the real estate owned assets. As you are booking these gains and looking at the rest of the portfolio within real estate owned, is there any sense of an average premium as a percent of book value that you can extrapolate? Or is that pretty difficult right now?

Jay Sugarman - *iStar Financial Inc. - Chairman and CEO*

I wouldn't want to give you a specific number. But as I said, we think there are pretty healthy profits embedded in those, both on an IRR standpoint and in terms of a premium to book. But it's going to be project by project. But we think the embedded gains that you are seeing show up in earnings will continue for quite a while.

Michael Kim - *CRT Capital Group - Analyst*

Okay, thanks. And my next question is just on the strategy for asset sales over the coming quarters. In the 10-K, you provided some guidance around the level of potential asset sales, or unencumbered assets that have been marked for asset sales this year. What is the strategy? Do you plan on casting a wide net and putting a number of assets for sale? Or is there a number of releasing activities that needs to occur before you can put certain assets into the market? And just thinking about the timeline of certain transactions, can give us a sense of the timeline in terms of closing on these transactions before the fourth quarter?

Jay Sugarman - *iStar Financial Inc. - Chairman and CEO*

I think, if I understand your question, it's good insight. We do try to maximize the value of our assets before widely marketing them. As you know, probably over the last three or four years we've had a lot of reverse inquiry and a lot of unsolicited offers. And certainly we will evaluate those and consider those. But within the sort of planned asset sale program, we know which assets we think are ripe and ready to be widely marketed.

There are specific buyers who may come in early and try to preempt that process. But we have scheduled out, really since late 2009, how to think about the different waves coming through the portfolio. Right now, obviously, the condominium piece is ripe, and we are seeing good traction there. We continue to work on the land piece. You saw some interesting statistics start to come out in the last six months. I think I saw something this morning about some of these markets having very limited supply.

We think we are positioning a big piece of our land portfolio to capture that tightening. But not this quarter, not next quarter; but over the relevant time period for us, which is the next several years. So each part of the portfolio is in its own life cycle. Obviously, we think sale leaseback today is extremely valuable, with a high yield, long duration and information protection.

We think all of those different parts of the portfolio have a natural sales rhythm. And we will continue to work the parts of the portfolio that aren't quite ready for prime time. And we see those as future possibilities to either redeploy that capital or continue to invest in those assets.

Michael Kim - *CRT Capital Group - Analyst*

And just to follow up on the land side, in our coverage of the public home builders, we have been hearing a lot more positive commentary about absorption trends in submarkets where you do have exposure on the land side. Could you just give us an idea of the state of completion for the land that you have on the books; the $803 million of land assets under real estate held for investment? I guess, a range in terms of the state of completion for those land assets.

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Jay Sugarman - *iStar Financial Inc. - Chairman and CEO*

Well, I think it is fair to say they are near-ready medium-term. And then there are some long-term assets in there that I would say are not ready to hit the market in the near future. So I can't give you a generic metric that is going to be useful. But I can tell you, certainly, in Southern California and certain markets on the East Coast, those markets are recovering. We do see good supply and demand balance starting to be achieved. We think affordability in those markets is leaning towards a home purchase versus rent.

So those are probably the near-term opportunities. Medium-term, our positions where we think we need to change the entitlements to really hit the market correctly; either they were mis-entitled, or we just don't think they are maximizing their value. Those are going to take longer. That is not a quick process.

And then we have some long-life land positions that have enormous long-term embedded potential. But the market just hasn't reached them yet. And those are going to take longer. I'm giving you a generic breakdown of a third; a third is probably not that helpful. But I would say it is probably a little bit more skewed to the near-term and medium-term than it is to the very long-term.

Michael Kim - *CRT Capital Group - Analyst*

Understood. As my last question, we spent a lot of time identifying your real estate assets and pretty much identified the majority of them. In doing this work, I observe the tenant exposure to AMF Bowling. What is the impact to iStar if AMF Bowling went into restructuring? How would the leases be treated? Are these subject to a massive lease agreement? Thank you.

Jay Sugarman - *iStar Financial Inc. - Chairman and CEO*

Sure. I think, again, typical in most of our large sale leasebacks; we try to create a mission-critical position in a company so that we are a key player. In the case of AMF, we control the vast majority of the owned portfolio at AMF. We have very significant coverage to our rent. There is no issue, certainly, in our portfolio at this point that gives us pause.

Corporately, given the leverage of the parent level, they have thought the best solution is to continue to work the portfolio. And we continue to be thoughtful with them about how to maximize the value in their overall control of land. So, I think it's a position we're quite happy with, continue to be happy with, continues to perform well; but, obviously, we would like AMF as a company to grow and prosper as well.

Jason Fooks - *iStar Financial Inc. - VP, IR & Marketing*

Thanks, Mike.

Michael Kim - *CRT Capital Group - Analyst*

Thanks.

Operator

Josh Barber, Stifel Nicolaus.

Josh Barber - *Stifel Nicolaus - Analyst*

Following up on Mike's question, it looks like you guys took an impairment on your CTL portfolio. Was that related to AMF? Or was that related to a different tenant?

Jay Sugarman - *iStar Financial Inc. - Chairman and CEO*

No, that was a property that has been vacant. And the market is moving in a way that we think is going to impair our ability to release it. It's a single asset; did not have any of the dynamics in some of the larger CTLs that we think have a fundamentally different dynamic.

Josh Barber - *Stifel Nicolaus - Analyst*

But that was one of your larger assets, because occupancy did dip fairly sharply.

Jay Sugarman - *iStar Financial Inc. - Chairman and CEO*

Is an asset that we inherited from the TriNet transaction 12 years ago. The lead tenant left. We had a number of prospects that we have been chasing, but I think it is our evaluation that the market itself is not going to be able to replace that tenant at anywhere near the kind of rents the former tenant had.

Josh Barber - *Stifel Nicolaus - Analyst*

Can you clarify a little bit the pickup in loan loss reserves and what is going on with the watch list? What do you guys think in terms of credit? Because it seems like the portfolio sales are picking up, and otherwise the fundamentals seemed okay. How can the watch list and the reserves have sort of gone up for the last two or three quarters?

Jay Sugarman - *iStar Financial Inc. - Chairman and CEO*

It is a big portfolio. We're quite pleased with the majority of the positions. We do see them benefiting from the seminal recovery here in the US. The European side is not quite as favorable, particularly in positions where we have junior liens. That's a much more difficult animal to predict. And we have been taking a very hard look at that stuff and taking reserves where appropriate.

We also think in different parts of the market -- we called out retail little bit -- we just haven't seen the same uplift. So we are working hard on that as well. We are spending money on those markets to try to position those assets correctly. But if we push out the day of return to profitability, on a book basis we are required to take reserves.

Josh Barber - *Stifel Nicolaus - Analyst*

Can you remind us what your total European exposure is and break out between senior and junior?

Jay Sugarman - *iStar Financial Inc. - Chairman and CEO*

That's been going down. It's a little bit under $300 million at this point? And some of the positions are quite solid. But some of the positions, I would say, are going to be impacted by the overall macro conditions over there.

Josh Barber - *Stifel Nicolaus - Analyst*

$300 million is gross or net of reserves?

Jay Sugarman - *iStar Financial Inc. - Chairman and CEO*

I think it is under $300 million, and it is net of reserves.

Josh Barber - *Stifel Nicolaus - Analyst*

Okay. And last question -- I know that we have talked about it before, but is there any change in your posture and thinking on share buybacks given guess the amounts of cash you will be paying down in the next couple of months on the debt payments? And also with maturity schedule looking pretty clear for the next nine months after that?

Jay Sugarman - *iStar Financial Inc. - Chairman and CEO*

We haven't announced anything. And again it is literally an alternative use of capital depending on what we see in the investment world, what we see in our own portfolio opportunities, and where we see the potential opportunities in our capital structure.

We do want to continue to do some deleveraging. Paying down debt will ultimately benefit shareholders. So we think that has been job one going into 2012. But certainly we continue to consider all of appropriate uses of any free cash.

Josh Barber - *Stifel Nicolaus - Analyst*

Thanks.

Jason Fooks - *iStar Financial Inc. - VP, IR & Marketing*

Thanks, Josh.

Operator

(Operator Instructions) Jonathan Feldman, Nomura Securities.

Jonathan Feldman - *Nomura Securities - Analyst*

Good morning. Just a question in terms of any thoughts that you guys have in terms of prospectively lowering your cost of debt capital, particularly as you approach the maturity of the 2011 A-1 tranche. Do you see an opportunity to, whether it be in the CMBS market or otherwise, lower your cost of debt capital prospectively?

David DiStaso - *iStar Financial Inc. - CFO*

Well, we have been pleased to see, as the 2011 secured facility has seasoned, we have seen it trade quite well in the marketplace. And obviously that gives us some viewpoint on where capital in our Company can be priced. I wouldn't say, Jonathan, we're going to be all about optimistic about materially lowering the cost of funds until we do more deleveraging, until we're able to get an upgrade from the agencies.

So right now we have done the kind of financing that we think are appropriate, but longer term, yes, we're going to try to create an interesting mix of financing capabilities and bring the costs in line with what we think the underlying strength of the portfolio is.

Jonathan Feldman - *Nomura Securities - Analyst*

Gotcha. That's all from me. Thank you very much.

Operator

And I'll turn in back to our presenters for any closing comments.

Jason Fooks - *iStar Financial Inc. - VP, IR & Marketing*

Thanks, John. And thanks to everyone for joining us this morning. If you have any additional questions on today's earnings release, please feel free to contact me directly. John, would you please give the conference call replay instructions once again? Thank you.

Operator

Certainly. Ladies and gentlemen, this conference is available for replay. It starts today at 12.30 PM Eastern; will last until May 11 at midnight. You may access the replay at any time by dialing 800-475-6701 and entering the access code 244393. That does conclude your conference for today. Thank you for your participation. You may now disconnect.
