THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

STAR - Q1 2014 IStar Financial Inc Earnings Conference Call

EVENT DATE/TIME: APRIL 29, 2014 / 2:00PM GMT

CORPORATE PARTICIPANTS

Jason Fooks *iStar Financial - VP, IR, Marketing*

Jay Sugarman *iStar Financial - Chairman, CEO*

Dave DiStaso *iStar Financial - CFO*

CONFERENCE CALL PARTICIPANTS

Mike Kim *CRT Capital Group - Analyst*

Jade Rahmani *Keefe, Bruyette & Woods - Analyst*

PRESENTATION

Operator

Ladies and gentlemen. Thank you for standing by. Good day and welcome to iStar Financial's first quarter 2014 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.

Jason Fooks - *iStar Financial - VP, IR, Marketing*

Thank you, John. Good morning everyone. Thank you for joining us today to review iStar Financial's first quarter 2014 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. Dial-in for replay is 1-800-475-6701 with the confirmation code of 324797.

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 Sugarman - *iStar Financial - Chairman, CEO*

Thanks, Jason. And thank you for joining us this morning. Our first quarter results continue the trend of improving performance, as we invest idle cash, lower our interest costs and push in our commercial operating and land portfolios to begin contributing to the bottom line. Investment activities continue to build with over $200 million in fundings in the quarter, and more importantly, a growing pipeline of opportunities in process and under LOI. While markets are competitive, we continue to work our existing portfolio for opportunities, and we're looking for ways to capture off-market transactions. We expect to see some of those efforts show up in the coming quarters.

Let me do a brief overview of our various business lines. In Real Estate Finance, segment profit was $9.3 million versus $10.8 million last quarter. We noted an increase in yield within the portfolio to 8.6% from 8.0% in the fourth quarter, due to higher yielding originations funded, as well as pay-offs of lower yielding loans, while prepayment fees ended a little bit lower. There is a lot of cash sitting on the balance sheet, we're getting involved in more transactions, which should lead to increased investment activity and future revenue growth.

In Net Lease, we closed our JV with the sovereign wealth fund and contributed the first asset purchased for the fund. Our team is looking for assets we have a particular view on and continue to be disciplined in evaluating new situations. Financial metrics associated with our net lease portfolio remain strong, including segment profit of $11.3 million up from $9.8 million last quarter, a consistent yield of 7.5%, and more than 11 years of weighted average remaining lease term.

Profit in the Operating Portfolio improved from $5.5 million last quarter to $11.3 million this quarter, due in part to increase in condo gains. In addition, our stabilized commercial properties generated an 8.3% yield while our transitional properties saw an increase in occupancy to 61% and an increase in yields of 3.1% due to some additional leasing activity.

In our Land portfolio, we continue to push on value-creating strategies. After many years of work, we reached successful entitlement milestones in Long Beach, New York, and in Los Angeles, California, and began significant development in Naples, Florida. Signing an agreement with a national home builder covering approximately 25% of the loss. The income impact of these will take time to develop, and the portfolio is still generating a segment loss, $17.9 million this quarter versus $22.5 million last quarter, but it feels like we're making good progress on a number of fronts.

With that, let me turn it over to Dave now to review the numbers for the quarter in more detail. Dave?

Dave DiStaso - *iStar Financial - CFO*

Thanks Jay, and good morning everyone.

Let me begin by discussing our financial results and capital markets activities for the first quarter, before moving on to investments and the performance of our business segment.

For the quarter, our adjusted income was a loss of $5.5 million, or $0.07 per common share, compared to a loss of $300,000 for the same quarter last year.

The change in adjusted income was the result of a $19 million reduction in earnings from equity method investments, as the prior period included $15 million of income associated with our LNR investment, which we sold in the second quarter of 2013. Last year's period also included $13 million more in real estate gains, primarily because we had higher levels of condominium inventory during that period. This was partially offset by a $15 million increase in our revenues, as a result of additional operating lease income due to new leases and increased interest income due to current quarter investment activity. In addition, interest expense declined year-over-year by $14 million due to lower overall debt levels as well as lower cost of capital.

Our net loss allocable to common shareholders for the quarter was a loss of $26.6 million, or $0.31 per diluted common share, compared to a loss of $41.3 million, or $0.49 per diluted common share for the same period last year. In addition to the reasons I mentioned before, the year-over-year decrease in net loss was also driven by a $14 million improvement in our loan loss provision, and lower loss on early extinguishment of debt as last year's period included the repricing of our 2013 secured credit facility.

During the quarter we repaid $46 million on our 2013 secured credit facility, reducing the remaining balance to $1.3 billion. This puts our collateral coverage at the end of the quarter at just over 1.375x. When our coverage remains between 1.375x - 1.5x, we're able to retain 50% of the proceeds from principal repayments and sales of underlying collateral. This will slow our deleveraging and provide us with additional capital to reinvest. We also repaid $13 million on our 2012 secured credit facility bringing the remaining balance to $418 million.

Our weighted average effective cost of debt for the first quarter continued trending lower, down to 5.6% from 5.7% for the fourth quarter of 2013. Our leverage increased slightly to 2.1x at the end of the quarter from 2.0x at the end of the prior quarter. But still remains at the low end of our targeted range of 2.0x - 2.5x.

During the quarter, Fitch upgraded our credit rating while also revising our outlook to positive. We were pleased to see the rating agency recognize the significant progress we've made in extending our maturity profile, reducing our cost of capital, and improving the credit profile of the portfolio.

Let me turn now to investment activity in our real estate and loan portfolios. We invested $229 million during the first quarter, including $181 million of new originations during the quarter. We generated $268 million of proceeds from our portfolio this quarter, which included $103 million from repayments and sales of loans in our real estate finance portfolio, $48 million from sales of operating properties, $76 million from sales of net lease assets, and $41 million in proceeds across other segments. We ended the quarter with $410 million of cash, which we expect to primarily use to fund future investment activity.

At the end of the first quarter, our total portfolio had a carrying value of $5.2 billion, which represents the Company's carrying value gross of $433 million of accumulated depreciation, and $31 million of general loan loss reserves.

Let me discuss each of our four business segments. Our Real Estate Finance portfolio increased from $1.4 billion to $1.5 billion at the end of the quarter, as a result of the new loan originations we recently funded. The portfolio includes approximately $1.3 billion of performing loans, comprised of $660 million of first mortgages or senior loans, and $645 million of mezzanine or subordinated debt. The performing loans generated a weighted average effective yield for the quarter of 8.6%, an improvement from the 8.0% we generated during the fourth quarter.

At the end of the quarter, we had $203 million of NPLs consistent with the prior quarter's level. We expect to resolve additional NPLs in the coming months, which could reduce this balance.

For the quarter, we recorded a $3 million reversal of the loan loss provision, compared to a provision for loan losses of $10 million in the first quarter of 2013. Our total reserve from loan losses at March 31st was $370 million, comprised of $339 million of asset specific reserves, and $31 million of general reserves.

Now let me provide a brief update on certain key metrics relating to our net lease portfolio. At the end of the quarter we had $1.6 billion of net lease assets, gross of $343 million of accumulated depreciation. Our net lease portfolio totaled 20 million square feet across 33 states. This portfolio was 94% leased at the end of the quarter, with a weighted average remaining lease term of more than 11 years. For the quarter, our total net lease portfolio generated an unleveraged weighted average effective yield of 7.5%. As we announced on our last earnings call, we partnered with a sovereign wealth fund to form a vehicle that will jointly invest in net lease assets. The net lease ventures first investment is a property net leased to AT&T, which was acquired by the venture during the first quarter.

Next I'll turn to our operating properties portfolio. Our operating properties totaled $947 million, gross of $86 million of accumulated depreciation. The portfolio was comprised of $747 million of commercial and $200 million of residential real estate properties. The commercial properties represented a diverse pool of real estate asset, across a broad range of geographies and property types, such as office, retail and hotel properties. They generated $34 million of revenue, offset by $22 million of expenses during the quarter.

At the end of the quarter, we had $132 million of stabilized commercial operating properties. These properties were 86% leased resulting in an 8.3% unleveraged weighted average effective yield for the quarter. The remaining $615 million of commercial operating properties are transitional real estate properties that were 61% leased, and generated a 3.1% unleveraged weighted average effective yield. We are continuing to actively lease these properties in order to maximize their value. During the quarter, we executed commercial operating property leases covering approximately 184,000 square feet.

The residential operating properties were comprised of 521 condominium units remaining in inventory at the end of the quarter. These units are generally located in projects characterized as luxury buildings in major cities throughout the United States.

During the quarter, we sold 96 condos for $48 million in proceeds, resulting in $18 million of income offset by $6 million of expenses.

That brings me to our land portfolio. At the end of the quarter, our land portfolio totaled $973 million, and included 11 master plan communities, ten infill land parcels and six waterfront land parcels. Master planned communities generally represent large scale residential projects that we may entitle, plan and develop. We currently have entitlement to these projects for more than $25,000 lots. Our infill and waterfront parcels are currently entitled for 6,000 residential units, and select properties include commercial, retail and office space. The projects in the portfolio are well-diversified in locations such as California, the New York metro area, Florida, and several markets in the mid-Atlantic and Southwest regions.

During the quarter, we invested $15.1 million in our land portfolio through capital expenditures. At the end of the quarter we had six land projects in production, 10 in development and 11 in the pre-development phase. We have continued to make headway on our land projects, as discussed in the earnings release, by obtaining entitlements, increasing horizontal construction, and developing site improvements. We have also continued to build relationships with homebuilders and other key partners in order to maximize the value of our projects. With our expectation that land will become a more meaningful contributor to our business, we began presenting revenues and costs associated with land sales on our income statement this quarter. We believe this presentation will allow investors to track the progress of our land efforts.

This quarter, land sales revenues were $4.1 million, and were associated with two projects where we are actively selling lots: Magnolia Green and Tetherow. Magnolia Green is a 3,550-lot master planned community in the suburbs of Richmond, Virginia. The community features resort-style amenities including the Jack Nicklaus-designed Westham Golf Club. Tetherow is a 125-lot master planned community near Bend, Oregon. The project is situated on the edge of the Willamette National Forest and features an 18-hole championship golf course. Costs associated with these land sales were $3.7 million for the quarter.

We're working to position our land projects for increased contributions to earnings next year and look forward to updating you on our land development activities as well as additional projects moving to production in the coming quarters. With that, let me turn it back to Jay. Jay.

Jay Sugarman - *iStar Financial - Chairman, CEO*

Thanks Dave. So no big surprises this quarter, but we have some pretty good momentum heading into the middle of the year, and I think if a few things break our way, we should be continue to move toward overall profitability on an adjusted basis. We'll keep you updated as the year progresses.

Operator, would you please open up the line for questions.

QUESTIONS AND ANSWERS

Operator

Certainly. (Operator Instructions). We will take as many questions as time permits, and proceed in the order that you signal us. (Operator Instructions). We'll pause for just a moment to assemble the roster. And first in line with Mike Kim with CRT Capital Group. Please go ahead.

Mike Kim - *CRT Capital Group - Analyst*

Hi, good morning guys, and nice quarter. I guess my question is really kind of focused on the land side. I guess the income statement is showing a breakout of land sales revenues and land cost of sales. You mentioned Magnolia Green and Tetherow. I was just wondering if we could get a little more granular detail, in terms of how many lots were sold in each and the kind of the revenue per lot or the gross margin per lot between the two, and at a higher level I guess just thinking about the progression of land sales over the next couple of years, if you could give us some guidance on, sort of projects, when they might come online and start contributing to the income statement? I know that you mentioned the deal or the lot purchase agreement with Naples; to develop and deliver initial lots by early next year. But just wondering if you would help us think about how the progression of land sales will be? Will it be kind of a steady rise or lumpy in nature? Presumably some seasonality but may not based on geographic mix, also the progression of gross margins on land sales, if we can kind of expect that to increase from the implied numbers from these two initial sales, or if that kind of slowly grow over the next couple of years? Thanks.

Jay Sugarman - *iStar Financial - Chairman, CEO*

Mike, sure. Let's talk a little bit about how we're thinking about our land and the best way to share information with you. As Dave said, we're going to start breaking it out. We think it's time to do that. We do think over the next 12 to 24 months we've got enough projects coming online, that you'll start to see some material metrics that we can share with you.

I think in terms of Tetherow and Magnolia Green, we're very early in both of those projects. Magnolia being quite large, Tetherow not quite so much. So the one thing we've always hesitated about is that people kind of divide total loss by sales in a quarter, and tell us how many years of supply we have, because we are still early in the game on both of those, but in this quarter I think we were just under 40 lots between them; call Magnolia 30-ish and Cascade 10. Not really meaningful metrics yet. Both in terms of the costs we're having to spend up front to accelerate those sales, but also just in terms of the overall magnitude of the portfolio. There's really nothing to be gotten from those two statistics yet.

Mike Kim - *CRT Capital Group - Analyst*

Okay.

Jay Sugarman - *iStar Financial - Chairman, CEO*

And I think as we go through the year, and as we bring more of the master planned communities and some of the urban stuff online, then I think you're going to start seeing us disclose details that we think are representative of those projects. But I will tell you it's still a little early to do that, so we'll probably come up with a formal way to share those going forward but it's probably premature to do that.

Mike Kim - *CRT Capital Group - Analyst*

Okay. And is your expectation that those metrics will be similar to I guess the public home builders or land developers?

Jay Sugarman - *iStar Financial - Chairman, CEO*

Yes, we're going to try to give you stuff that is representative and meaningful, and I don't think we're going to vary too differently from what we've seen from others who have projects that are fully ramped midstream, then you can start seeing a steady state; okay, now I see where this is going. For something like Magnolia where we're talking about 30 lots in a 3,000-lot development, where we're just kicking off some big initiatives, it's probably not a relevant metric yet.

Mike Kim - *CRT Capital Group - Analyst*

Got you. Okay. I appreciate that.

Jay Sugarman - *iStar Financial - Chairman, CEO*

And on the when, in terms of other projects coming online, again we've been somewhat circumspect, just because the land business has taught us to be patient and thoughtful before we start to project things. We do feel like as we've said before, 2014, a lot of milestones crossed this year, and 2015, really the year where we start to see real fundamental progress, in terms of sales and certainly potentially profitability begin. That's the game plan right now. I think in terms of getting stuff online, it's easier for us to predict something like Naples, where we're in the ground, and we've moved 2 million cubic feet of dirt, and you can kind of see the story from here to there. I think some of the other ones where we're still battening down the last pieces of the entitlement process or political process, much more difficult to give you a quarterly projection. We certainly think 2015 is the yearly projection. We're not yet ready to narrow in a down to the quarters where we're going to bring stuff online.

Mike Kim - *CRT Capital Group - Analyst*

I see. I guess from your perspective as you sit here today, I mean for 2015, I guess how many projects do you expect to be away from stuff that's still being negotiated or kind of worked through, but as it stands today in terms of certainty, and lot purchase agreements, and what not, how many active projects do you expect for 2015, would you say?

THOMSON REUTERS

Jay Sugarman - *iStar Financial - Chairman, CEO*

Dave's got a great schedule on that. Right now the projection is 11 things online, and some of those are vertical, some of those are single family. That's probably a good number to think about. Some of those are relatively big and quite interesting from a P&L perspective, some of them as we have said in the past, we're just grinding through to get our money back with a small return on it. So I think you will see us highlight the ones where we think there are material P&L possibilities, and as we get better metrics around those, you will see us give you some guideposts, so you can kind of see where we think they're headed with always the caveat that in this business we've learned it's a slow-moving business, and things are not always as predictable as some of our other businesses. We feel pretty confident that throughout 2014 will continue to highlight progress in individual projects, put them on your radar, and then hopefully in 2015 you'll start to see some P&L impacts.

Mike Kim - *CRT Capital Group - Analyst*

Excellent. Great. I really appreciate it. Thank you.

Operator

Ladies and gentlemen, just a quick reminder. (Operator Instructions). We will go to line to Jade Rahmani with KBW.

Jade Rahmani - *Keefe, Bruyette & Woods - Analyst*

Good morning, thanks for taking the questions. Can you discuss the investment pipeline and what you're seeing in terms of opportunities and competition, any color on yields, LTVs, or deal types would be helpful?

Jay Sugarman - *iStar Financial - Chairman, CEO*

Thanks. I think I've said in the past that we fundamentally believe particularly in a market like this, where there's a lot of competition for yield that we need to play to our historical strength, which is looking for crossover markets. There's a real estate component, there's a corporate and credit component. There's the capital markets component. There's a capital structure. The complexity. Those are the places we're finding the most interesting opportunities. Particularly within existing relationships or existing deals. We're redoubling our efforts to kind of dig underneath the covers and go, what can we do here that would be a better risk/reward than what we see in the broader markets?

The big theme is still we think that the banks have kind of found their comfort zone. They've left a big piece of the capital structure out there for folks like ourselves and others to fill. And everybody is sort of jockeying to figure out how to fill it. In some cases that takes the whole thing down as we did in Times Square, in some cases it's just going to be taking just the mezzanine or B note, or something in the 65% to 75%, maybe 80% zone. That piece of paper is still bouncing around. It's nice and simple and can be bid out, it's pretty tight out there. We're not doing any of those. The person who puts it together, the person who figures out how to solve the complexities, the person who's there early and comes up with the way to make it a strong deal from a capital structure standpoint, gets to charge the premium. We're thinking the air is a lot thinner there. There are probably two or three other people who we see regularly. We're all getting pretty much our fair share. And that market segment is still quite interesting to us. So at least on the finance side, there's a big chunk of the market that we think we can play in and play in effectively. It's going to be, for us at least currently, it's going to be in the high-single digits, probably typically going to be on a floating rate basis.

On the mezz stuff, it can be a double-digit, low teen kind of situation. And if you're going above 80% or 85%, you're certainly looking for some sort of special kicker or call protection, or something that gives you good convexity. It's really not different than anything we've seen over 20 years. It's a little more competitive I would say for things that are clean and simple and easy, and ten people can bid on them. But those situations where it's not quite so clean and simple and easy, where somebody has to dig in and actually figure it out, and bring a lot of skill sets to bear. We still have gain there. So that's where we'll focus and that's where we think we're winning the best deals.

Jade Rahmani - *Keefe, Bruyette & Woods - Analyst*

Can you say a little bit more about what would characterize those deals, where there's only two or three others, looking at that, and that can solve for it? Is it acquisition financing? Is it just the development involved, or the lack of stabilization on the underlying assets? Is it property time, is it size, exactly what is it do you think?

Jay Sugarman - *iStar Financial - Chairman, CEO*

Yes, I think you hit on a lot of them. I mean certainly in transitional where we are an underwriting a business plan, you're going to have dig in and do a lot of deep dive work to get comfortable with that. That's been interesting. Large capital structures we've talked about. Size is still a limiter. Keeps the composition down so larger deals, larger deals in situations where there are lots of moving pieces like would be in a corporate situation, or it can be in a borrower, who don't know exactly how much they need or when they need it, but they know they're going to do the deal. That little bit of uncertainty you would be surprised makes it very hard for the typical intermediary to get their hands around, what am I asking for? What am I telling people that have to show up? How fast do people have to move. Typically that's the situation. We could be very helpful either to the borrower directly, or to the intermediary and say don't worry about it.

Tell us the business proposition, tell us what you're trying to achieve, tell us why the equity is going to be successful here, and we'll figure out the rest of the capital structure whether it's senior or junior or combined, we're really good at that. That's our $35 billion or $40 billion of track record comes into play. But in terms of product type, in terms of very specific things, is it a time to be pretty opportunistic. We have seen some good development deals. We have seen good transitional stuff. We've seen very good stabilized stuff in a large portfolio corporate context. So I can't give you the one theme or the two themes, because there aren't any right now but the big market, there are holes in it right now. There are a couple clever folks trying to figure them who have the capital capacity like we do, and right now it's a pretty good market. It's not great. There's competition but there's plenty of room for the four or five people we see regularly.

Jade Rahmani - *Keefe, Bruyette & Woods - Analyst*

Just on the increased competition which we've definitely been hearing a lot about, I mean do you view it as a normalization in the market, participants that haven't been as active over the last couple of years, feeling confident enough in real estate where we are in the economic cycle, to make loans or are there things in underwriting that are a cause for concern to you?

Jay Sugarman - *iStar Financial - Chairman, CEO*

I think it's much more the former, but I wouldn't say it's that they're more comfortable. I would say that in a world starved for yields, some of the larger investment complexes have all decided they needed to have exposure to this sector, have committed resources and talents, and are doing what we have been doing for 20 years. We saw that opportunity in 1992, and have been playing it ever since. You can create very good risk adjusted returns in a hard asset class like this, with knowledge and expertise and the right capital structures, and I think other people are gravitating to that same combination. But I think the banks pulling back and really finding a comfort zone has opened up the space, so it can accommodate more folks like that, and we certainly think we're one of the biggest and most experienced so we'll get our fair share.

Jade Rahmani - *Keefe, Bruyette & Woods - Analyst*

Okay, thanks. Just a couple of quick ones. First, can you give color around what drove the impairment charge, and then secondly, when do you think it's realistic to forecast a return to profitability? Is that something that happens by the fourth quarter, or is that really in 2015? Thanks a lot.

Jay Sugarman - *iStar Financial - Chairman, CEO*

Sure. The impairment was a small property in Silicon Valley. We got into a situation where to get a tenant in, we had to give them a purchase option at the bottom of the market. We didn't think they would hit it. They've turned out to be quite successful, so they purchased the asset at a price that cost us on a book basis. It was a low-yielding asset so frankly we will take those proceeds and reinvest them at a higher rate but that's where it came from.

Jade Rahmani - *Keefe, Bruyette & Woods - Analyst*

Okay. And on the return to profitability?

Jay Sugarman - *iStar Financial - Chairman, CEO*

That's the $64,000 question, as I said on an adjusted basis, we kind of targeted 2015 as the year we're going to make that turn. There are things in the hopper that could accelerate that, but I think realistically from now, I would still point you to 2015.

Jade Rahmani - *Keefe, Bruyette & Woods - Analyst*

Great. Thanks a lot. Appreciate all of the color.

Operator

Mr. Fooks, we have no further questions in queue.

Jason Fooks - *iStar Financial - VP, IR, Marketing*

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

Operator

Certainly. Ladies and gentlemen this conference will be available for replay. It starts today at 12.30 PM Eastern. It will last until May 13th at Midnight. You may access the replay at any time by dialing 1-800-475-6701, and entering the access code 324797. That does conclude your conference for today. Thank you for your participation. You may now disconnect.
