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STAR - Q4 2014 iStar Financial Inc Earnings Call

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

David DiStaso *iStar Financial Inc - CFO*

CONFERENCE CALL PARTICIPANTS

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

PRESENTATION

Operator

Good day and welcome to iStar Financial's Fourth Quarter and FY14 Earnings Conference Call.

(Operator Instructions)

As a reminder, today's conference is being recorded. At this time, for opening remarks and introductions, I'd like to turn the conference over to Mr. Jason Fooks, Vice President of Investor Relations and Marketing. Please go ahead, sir.

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

Thank you, John. Good morning, everyone. Thank you for joining us today to review iStar Financial's fourth quarter and FY14 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 www.istarfinancial.com in the Investor Relations section.

There'll 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 the confirmation code of 352604.

Before I turn the call over to Jay, I'd 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'd like to turn the call over to iStar's Chairman and CEO, Jay Sugarman.

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

Thanks, Jason, and thanks to those of you joining us this morning. Our fourth quarter was our most active in terms of investments and topped off a year in which we began to meaningfully capitalize on our multi-disciplinary platform and core competitive strength. By taking advantage of year-end market volatility, we were able to close on over $450 million of new investment commitments in the quarter, bringing full-year investments and commitments to $1.3 billion.

The latest transactions continued our theme of investing in top markets and high-quality locations, while seeking well-capitalized sponsors and attractive risk-adjusted spreads. A combination of increased investment activity, along with improving valuations in the existing portfolio, helped us again generate positive adjusted income for the quarter and almost $100 million of adjusted income for the year. Now here's a brief overview of our major business lines.

In real estate finance, segment profit was approximately $15 million after interest and G&A allocation. We ramped up investments late in the quarter and have not yet fully funded all those deals, so there's good forward momentum going into the new year. Full-year segment profit was $72 million versus $24 million in 2013.

In net lease, we got a small pop from the sale of several small properties within the portfolio and continued to seek out interesting investments for our joint venture. Net lease segment profits for the fourth quarter was $20 million compared to $12 million last quarter, and $54 million for the year versus $38 million in 2013.

Segment profit in the operating portfolio was also $15 million, continuing the strong performance from this business line. Continued gains in the residential portfolio have driven profitability in this segment, as we continue to reposition and re-lease much of the commercial portfolio. Full-year profit in the operating portfolio was $55 million versus prior year of $73 million.

Lastly, in our land portfolio, segment loss was $13.1 million, trending better to last quarter's $16 million loss. These numbers should continue to trend better as we bring more projects to full entitlement and ultimate salability. Full-year loss in land was $64 million compared to loss of $75 million in 2013.

With that, let me turn it over to Dave to provide the details of the quarter and the year. Dave.

David DiStaso - *iStar Financial Inc - CFO*

Thanks, Jay, and good morning, everyone. Let me begin by discussing our financial results for the fourth quarter and FY14 before moving onto investment activity and the performance of our business segments. Finally, I'll finish up with an update on our balance sheet.

For the quarter, our adjusted income allocable to common shareholders increased to $13 million or $0.14 per diluted common share from a loss of $19 million or $0.23 per diluted common share for the same quarter last year. There were several factors that contributed to this improvement, including an increase of $14 million of income from sales of real estate and $6 million of additional revenues from other income.

We also reduced interest expense by $7 million due to the reduction in total debt outstanding and a decrease in the weighted average cost of our debt. Real estate expenses decreased by $6 million as we continue to make progress on our land development and property repositioning efforts.

Also, G&A expense decreased $6 million, in part due to lower compensation expense for the quarter. The benefits were partially offset by a $5 million reduction to earnings from lower equity method investment income. Our net income loss allocable to common shareholders for the quarter was a loss of $28 million or $0.33 per common share compared to a loss of $58 million or $0.68 per diluted common share for the same period last year.

In addition to the explanations provided earlier for the year-over-year improvement, earnings benefited from a $5 million smaller loss on early extinguishment of debt related to the redemption of bonds we refinanced in the prior period, offset by an additional $4 million of asset-related provisions. For the full year 2014, we reported adjusted income of $94 million or $0.88 per diluted common share compared to a loss of $22 million or $0.26 per diluted common share in 2013.

The $116 million improvement was driven by several factors: new investments in our real estate finance portfolio and favorable NPL and operating property resolutions led to an increase in revenues year-over-year. In addition, we reduced our interest expense by $42 million this year; again, primarily due to a decrease in our outstanding debt balance and cost of capital.

Sales of real estate, including those held as equity method investments, contributed an additional $19 million to adjusted income this year over last year, which was partially offset by $6 million of additional real estate expense. Our net loss allocable to common shareholders for the year was a loss of $49 million or $0.57 per diluted common share compared to a loss of $156 million or $1.83 per diluted common share for 2013.

Let me now turn to investment activity in our real estate and loan portfolios. During the quarter, we committed to $456 million of new investments; of which, we funded $246 million. In addition, we funded $57 million associated with ongoing developments and prior financing commitments. The fourth quarter's activity brings our total investment commitments for the year to $1.3 billion, which represents our highest level of investing in a number of years.

We generated $151 million of proceeds from our portfolio this quarter, which included $58 million from repayments and sales of loans in our real estate finance segment, $14 million from sales of net lease properties, $72 million from sales of operating properties, and $7 million in proceeds from land and other investment. For the full year, our portfolio generated a total of $1.1 billion of proceeds. We ended the quarter with $472 million of available cash.

At the end of the fourth quarter, our portfolio totaled $5.2 billion, which is gross of $469 million of accumulated depreciation and $34 million of general loan-loss reserves. Let me discuss each of our four business segments. Our real estate finance portfolio totaled $1.4 billion at the end of the quarter. The portfolio includes approximately $1.3 billion of performing loans, which generated a yield of 9.8% for the quarter compared to an 8% yield for the same period last year.

Our performing loans are comprised of $662 million of first mortgages or senior loans and $684 million of mezzanine debt. At the end of the quarter, we had $65 million of NPLs, which decreased from $93.2 million at the end of the third quarter and down from $204 million at the end of 2013.

For the quarter, we recorded a $5 million loan loss provision, which included $3 million of general provisions associated with the growth of our performing loan portfolio. Our total reserve for loan losses at December 31 was $98 million.

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 $1.7 billion of net lease assets, gross of $364 million of accumulated depreciation. This portfolio is 96% leased at the end of the quarter, with a weighted average remaining lease term of nearly 12 years.

For the quarter, our total net lease portfolio generated an unleveraged yield of 7.8% compared to a yield of 7.5% for the same period last year. In addition, we recorded a $6 million gain associated with net lease properties sold during the quarter. At the end of the quarter, our net lease fund had a total of $333 million of assets gross of depreciation. Our equity stake in these assets is $125 million and we have contributed 48% of our total commitment to the fund.

Next, I'll turn to our operating properties portfolio. Our operating properties totaled $900 million gross of $96 million of accumulated depreciation. The portfolio was comprised of $744 million of commercial and $156 million of residential real estate properties. The commercial properties generated $29 million of revenue offset by $22 million of expenses during the quarter.

At quarter end, we had $109 million of stabilized commercial operating properties. These properties were 88% leased, resulting in a 7.8% unleveraged yield for the quarter.

The remaining $635 million of commercial operating properties are transitional real estate properties that were 58% leased and generated a 2.5% unleveraged yield for the quarter. We are continuing to actively lease these properties in order to maximize their value. Of our 6 million square feet of commercial operating space, we executed leases covering approximately 445,000 square feet during the quarter.

The residential operating properties were comprised of 332 luxury condominium units remaining in inventory at the end of the quarter. During the quarter, we sold 127 condos for a total of $71 million in proceeds and recorded $24 million of income, offset by $5 million of expenses.

That brings me to our land portfolio. At the end of the quarter, our land portfolio totaled $1.1 billion and included 11 master planned communities, 15 infill land parcels, and six waterfront land parcels. Our master planned communities are currently entitled for approximately 25,000 lots.

Our infill and waterfront parcels are currently entitled for 6,000 residential units and select projects include commercial, retail, and office. 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.

At quarter end, we had six land projects in production, 13 in development, and 13 in the pre-development phase. During the quarter, iStar and our co-lenders took title to an infill land asset in Las Vegas, Nevada in satisfaction of a loan we had previously made. In addition, we successfully rezoned an owned property which we expect to develop as part of our land strategy.

We had a total of 67 lot sales this quarter, which includes properties we hold through equity method investment. These lot sales generated $5.8 million of revenues, offset by $5.2 million of cost of land sales.

During the quarter, we recorded a $12 million impairment on the first phase of one asset, due to a change in business strategy which we believe will create value for the remaining phases at the project. We also invested $22 million in our overall land portfolio.

Let me finish by providing an update on our capital markets activities during the year, which have continued to strengthen our balance sheet. In 2014, we repaid our largest secured credit facility, which had a principal balance of $1.3 billion, and refinanced it with 4% and 5% unsecured notes. In the process, we unencumbered $2 billion of high-quality collateral and reduced our secured debt to just 15% of our total debt outstanding.

In addition, during the year, we repaid $73 million on our 2012 secured credit facility, including $24 million during the fourth quarter, bringing the balance of that facility down to $359 million. Our weighted average cost of debt for the fourth quarter was 5.5%, down from 5.7% for the fourth quarter of last year. Our leverage was 2.0x at the end of the quarter and remains at the low end of our targeted range of 2.0x - 2.5x.

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

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

Thanks, Dave. Our goals in 2015 are to continue finding holes in the market that we can fill with attractively priced and well-structured transactions. The volatility we saw at the end of last year made that easier and ongoing volatility in the energy, currency, and political environments should create interesting places to deploy capital throughout the year.

We're also actively engaged in realizing on the hard work put into the legacy portfolio assets and while volatility may create some bumps in the road on those efforts, we think, overall, the low interest environment is well-suited to help us maximize the value of assets throughout the portfolio. With that summary, let's open it up for questions. Operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Jade Rahmani, KBW.

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

Good morning and thanks for taking my questions. I want to ask what your view is of the current lending environment and the amount of capital chasing commercial real estate? What, in particular, will you do to stay disciplined? How can you find attractive deals in this current competitive environment? What are some characteristics of the recent deals you've been able to win and also target returns for that segment?

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

We've been on the record saying the market certainly has plenty of capital and there are good, smart competitors out there, but we continue to see opportunities where we bring something special to the table. As you know, macro trend is that the banks have withdrawn from big parts of the market. Those things that require, what we historically talk about custom tailoring, our favorite ones are the ones where it's not exactly clear what the borrower needs, but you can tell where it's headed and you get involved early and you give that borrower comfort that you're going to be there still as a major competitive advantage in this market.

We think larger transactions still have less competition. CMBS World is pretty good at what they do, but we think we're pretty good at what we do. It's a pretty big market and we've been finding holes in it that we've been able to exploit, but I'm not going to tell you it's not competitive. It's just where we find opportunity is typically those deals where there's not a lot of competition.

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

What can you say about where target returns are for the types of deals you're pursuing?

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

We're still trying to earn on an unlevered basis in the high single-digits, spreads on a floating rate basis of 600 to 700 on a fixed rate somewhere in the 9% to 10% range.

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

Regarding the quarter's strong pace of origination, do you view that as outsized due to the volatility you cited at year-end or is that along the lines of sustainable going forward?

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

I wouldn't call that run rate. We always think the fourth quarter creates some year-end opportunities that are unusual and I would say it happened again this year. So I think we'll continue to have a strong pipeline, but that was probably even better than we thought.

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

Okay. On the net lease side, do you expect to grow the portfolio this year? Do you think that there's potential for portfolio trades or portfolio acquisitions opportunities as a result of any volatility and pricing in that segment?

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

Honestly, we haven't seen the same kind of volatility impact that we saw in the financing markets. I think that's a slow, steady go over there. We still believe there are going to be opportunities that are distinctly iStar in nature, but I'll tell you that's still a tough, competitive business and where we do find opportunities, they're taking a long time to get closed.

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

So in terms of growth in that portfolio, would you expect it to remain flat for the year or grow on a net basis? In addition to that, could you just update us on the sovereign wealth joint venture?

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

Yes, I think, as Dave said, we're about halfway through that venture. We've got a couple things in the pipeline for it that we're still working on. That was really a three-year venture, we're about halfway through it in terms of time, so I think we're right on schedule. We're not pushing it. We think there are good deals out there, but those that we lose, we're not crying any tears over.

We do think we're going to continue to look at that portfolio, put some new assets in there, but also look at potentially monetizing some of the existing assets. There will be some back and forth, I'd say slow net growth, but nothing that's too material.

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

Okay. On the land segment, can you talk to potential drivers of revenues this year and next year and also the number of additional assets you think you can get into production this year to add to the revenue generation?

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

That's a little trickier. Obviously, we have pretty good visibility on the finance and net lease. When we look at our land portfolio, we're looking at a bunch of variables in terms of trying to figure out when to bring things to market, how to maximize their value for the Company. But we do have a couple nice deals coming online this year. When I say online, I mean they will be fully entitled and sellable if we want to sell them in whole or we can phase them out or we can actually take them through even further into the development process.

That's the kind of analytical work we do on each asset to try to figure out when is the optimal time to sell, to maximize those values, both on a pretax and after-tax basis. So I'd say two or three interesting opportunities this year should come online and we'll describe them as they come online; one in Southern California, got a nice project up in Northern California that's very close and some of the JV work that we've been doing may come to fruition late in this year. So nothing specific that I want to point to right now, but, Jade, as the year goes along, you're going to hear us talk about some very specific asset opportunities.

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

Okay. Regarding the capital markets activity, it sounds like you did a lot of work in 2014. Do you expect to do a material amount of capital markets, either issuance or I think there is $100 million bond due, but anything on that front you can comment on?

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

I think you put your finger on it. There's nothing we have to do this year. Obviously, we're looking at a growing portfolio of opportunities on the investment side and to the extent that was to be attractive, we may look to tap the market for some additional capital, but there's nothing we have to do this year, other than the small $100 million deal.

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

Okay, thanks. Just finally a strategic question, a couple of your competitors are involved in the asset management space and I just wanted to get your thoughts on whether this is something iStar could explore? Is that something interesting to you or what you think about that?

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

I think there are some interesting business models out there. Historically, we've focused on trying to generate high returns on equity, on individual investments, we think that's where our real strengths are. We're not so interested in trying to put lots of assets on the book, at what we perceive as a pretty [tossy] point of the market, so I don't think you'll see us switch to trying to grow the balance sheet enormously right now.

We think the individual investments are good and smart ways to deploy capital and if that changes or we see a better opportunity out there, we'll certainly consider it. But right now, just given the macro factors, I'm not sure that's something we're going to consider.

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

Great. Thanks very much. Thanks for taking the questions.

Operator

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

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

Great. Thanks, John. Thanks to everyone for joining us this morning. If you should 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? Thanks.

Operator

Certainly. Ladies and gentlemen, this conference is available for replay. It starts today at 12:30 PM Eastern Time, will last until March 5 at midnight. You can access the replay at any time by dialing 800-475-6701 and the access code 352604. That number again, 800-475-6701, and the access code 352604. That does conclude your conference for today. Thank you for your participation. You may now disconnect.
