THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

STAR - Q1 2015 iStar Financial Inc Earnings Call

EVENT DATE/TIME: APRIL 29, 2015 / 2:00PM GMT

CORPORATE PARTICIPANTS

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

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 first quarter 2015 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 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, and good morning, everyone. Thank you for joining us today to review iStar Financial's first quarter 2015 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. They'll be a replay of the call beginning at 12.30 p.m. eastern time today. Dial-in for the replay is 1-800-475-6701, with a confirmation code of 358123.

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'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?

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

Thanks, Jason. Thanks to all of you for joining us this morning.

Our first quarter was something of a table-setter for us, as we moved closer to laying out our vision for the future. Work continued on a number of projects that should be strong contributors to profitability in the coming 24 months, and our investment activity remained focus on themes we have touched on over the past several quarters.

We solidified our liability structure with a new $250-million revolver and creatively monetized several assets to create a sizable liquidity position. Our goal now is to build on this progress and present a comprehensive overview of the Company early in June during the NAREIT meetings in New York.

With respect to our major business lines, we saw profitability continue in the real estate finance, net lease, and operating portfolio segments, with levels consistent with past quarters, while land remained a sizable negative, despite growing revenues in several projects.

Investments continue to be in the $200 million per quarter range, while the forward commitment book has enabled us to remain selective in choosing where to deploy capital. And while overall adjusted income was positive this quarter, we expect future quarters to benefit from increased lending volumes and increased profitability, being driven by several of the land-development projects. We'll have more detail on these to share at our June meeting.

With that quick summary, let me turn it over to Dave to review the numbers. Dave?

David DiStaso - *iStar Financial Inc. - CFO*

Thanks, Jay, and good morning, everyone.

Let me begin by discussing our financial results for the first quarter of 2015, before moving on to investment activity and the performance of our business segments. Finally, I'll finish with an update on recent capital markets activity.

For the quarter, our adjusted income allocable to common shareholders increased to $9 million, or $0.10 per diluted common share, from a loss of $6 million, or a loss of $0.07 per diluted common share for the same quarter last year.

Year-over-year improvement included a $7-million increase in interest income due to growth in our performing loan portfolio and an increase in the average yield of our loans.

In addition, sales of real estate, primarily condominiums, and earnings from equity-method investments contributed an additional $10 million of adjusted income this quarter. This was partially offset by $4 million less in operating lease and other income, as we contributed several net-lease properties into our net-lease joint venture and sold certain other properties over the past year.

Our net income allocable to common shareholders for the quarter was a loss of $23 million, compared to a loss of $27 million for the same period last year.

In addition to the explanations for the year-over-year improvement just discussed, net income included a $4-million general provision for loan losses, largely attributable to the origination of new lending investments, which increased general reserves.

Let me now turn to investment activity in our real estate and loan portfolios.

During the quarter, we committed to $274 million of new investments, of which we funded $163 million. In addition, we funded $62 million associated with prior financing commitments and ongoing developments, resulting in $225 million of total investment fundings during the quarter.

We generated $207 million of proceeds from our portfolio this quarter, which included $144 million from sales of operating properties, $41 million from repayments of loans in our real estate finance segment, and $23 million in proceeds from land, net lease, and other investments.

At the end of the first quarter, our portfolio totaled $5.2 billion, which is gross of $452 million of accumulated depreciation and $38 million of general loan loss reserves.

Let me discuss each of our four business segments.

Our real estate finance portfolio totaled $1.6 billion at the end of the quarter. The portfolio includes approximately $1.5 billion of performing loans, comprised of $777 million of first mortgages, or senior loans, and $735 million of mezzanine debt.

Our performing loans generated a yield of 9.5% for the quarter, compared to an 8.6% yield for the same period last year, and had a weighted average last loan-to-dollar value of 70%.

At the end of the quarter, we had $65 million of NPLs, which decreased from $203 million at the end of the first quarter last year. Our total reserve for loan losses at the end of the quarter was $103 million, including $38 million of general reserves and $65 million of specific reserves.

Now let me provide a brief update on key metrics pertaining to our net lease portfolio. At the end of the quarter, we had $1.7 billion of net lease assets, gross of $371 million of accumulated depreciation. This portfolio was 96% leased at the end of the quarter, with a weighted-average remaining-lease term of approximately 15 years. For the quarter, our total net lease portfolio generated an unleveraged yield of 7.3%. At the end of the quarter, our net lease fund had a total of $333 million of assets, gross of depreciation.

Next, I'll turn to our operating properties portfolio. Our operating properties totaled $732 million, gross of $73 million of accumulated depreciation. The portfolio was comprised of $599 million of commercial and $133 million of residential real estate properties. The commercial properties generated $31 million of revenue, offset by $23 million of expenses during the quarter.

At quarter end, we had $108 million of stabilized commercial operating properties. These properties were 88% leased, resulting in an 8.2% unleveraged yield for the quarter.

In March, an entity in which we are a 90% partner sold a leasehold interest in One Detroit Center, one of our transitional commercial operating properties in Detroit, Michigan, for $94 million in net proceeds.

We retained our fee interest in the land and entered into a 99-year ground lease with the buyer in conjunction with the sale. Our partnership will receive an initial annual rent of $2.5 million under the ground lease, which provides for fixed and inflation-based rental increases during the term of the lease.

The remaining $491 million of commercial operating properties are transitional real estate properties that were 56% leased and generated 3.5% unleveraged yield for the quarter. We are continuing to actively lease these properties in order to maximize their value.

Within our 5 million square feet of commercial operating space, we executed leases covering approximately 123,000 square feet during the quarter. The residential operating properties were comprised of 263 luxury condominium units remaining in inventory at the end of the quarter. During the quarter, we sold 69 condos for a total of $50 million in proceeds and recorded $19 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 14 infill land parcels, and 6 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 and hotel units, and select projects 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.

At quarter-end, we had 7 land projects in production, 12 in development, and 12 in the predevelopment phase. We invested $22 million into our land portfolio this quarter.

We've begun to close on sales at Sage, our 72-unit urban infill condominium development in Scottsdale, Arizona, and accordingly moved that project into production this quarter. Sales are taking place at the second phase of the project, building on the successful sell-out of the first phase.

For the quarter, our land portfolio generated $9 million of revenue and $3 million of earnings from equity-method investment, offset by $7 million of land-development cost of sales. This compares to $5 million of revenue, offset by $4 million of cost of sales one year ago.

Let me finish by providing an update on our capital markets activities, which have continued to strengthen our balance sheet.

We entered into a new $250-million secured revolving credit facility during the quarter. Based on our current credit ratings, the revolver's interest rate is LIBOR +275.

The interest rate drops by up to 25 basis points for a one-notch credit upgrade and up to 50 basis points for two notches. The revolver matures in March 2018, at which time we have the option to convert any outstanding balance into a term loan that would mature in March 2019.

Our weighted-average cost of debt for the first quarter is 5.5%, down from 5.6% for the first quarter of last year. Our leverage was 2.1x at the end of the quarter and remains at the low end of our targeted range of 2.0 to 2.5x.

Lastly, during March we repurchased 44,000 shares of our stock at a price of $12.66 per share. Our remaining authorization for share repurchases is $28 million.

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

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

Okay, thanks, Dave. I think we'll just go ahead and open it up for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(operator instruction) Jade Rahmani, KBW.

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

Morning, and thanks for taking my questions. I was wondering if you could provide your view of the state of the current commercial real estate market. Would you characterize overall fundamentals as continuing to improve? And on the other hand, do you believe there's too much capital chasing real estate? Could you identify any pockets of frostiness? And also, how do you expect to differentiate iStar to compete in this environment and maintain underwriting standards?

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

Jade, I think we've touched on this in past calls. We do think the market is fairly competitive. It's a strong-yielding asset in a world where yield is very rare right now, so we're seeing lots of new entrants into the market.

There's been a pretty strong tailwind. Certainly, we've been playing that theme in the largest gateway city markets. We do believe there are some fairly significant technological changes taking place that impact real estate. We've been looking to play that theme a little bit. We'll go into a lot more of that, I think, in our June meeting. We'll give you a comprehensive overview of how we see the world.

I would say that this is a big market. There are always pockets to play in. I think part of our skillset has been to try to find those pockets. And again, you'll hear us talk a lot more about that in June.

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

Okay. And just on the lending side specifically, what types of loans are you focused on writing? We've seen in the media a couple of very large construction loans on mixed-use developments. Is that the core focus, large loans, construction-weighted, or are you also broadening to other areas?

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

We're not constrained to any particular area, I would say. We've talked in the past, again, about larger deals seem to have less competition, require more specialized, sophisticated skillsets. That fits up nicely with us.

We're also looking in some areas that we think demographically are going to be driven over the next couple years, and we think we might be able to get an early entry point into some interesting businesses.

So we're going where we think the best risk-reward returns are, and right now, large gateway city stuff, whether it's construction or not -- we're looking for high-quality real estate that we can be in a safe place in the capital stack.

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

Okay. With the focus on transitional properties amongst real estate investors, is there an opportunity for iStar to accelerate the sales and dispositions of its un-stabilized commercial operating property portfolio? Or do you think that continuing to stabilize assets, lease them up yourselves, put in whatever CapEx is necessary, and then sell one-off, is more likely the strategy?

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

Where we think we have the in-house capabilities to do that -- we're not going to give anybody a discount for their skillset -- we'll do it ourselves and then sell it to the stabilized market, which is, as you point out, very deep and lots of capital flowing.

Where we don't have that particular skillset, we'd either try to JV with somebody, or we will sell outright. Obviously, in Detroit we thought -- we sold to a buyer who had a very significant presence on the ground, certainly had relationships and leasing capabilities that might have been better than ours; and we were able to structure a pretty clever deal where both sides got what they want. I think a lot of value was created in a short period of time, some of which will accrue to them, but some of which will accrue to us, as well.

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

On that asset in particular, could you consider selling your ground-lease interest to someone with a lower cost of capital?

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

Well, the game is not done yet, and we had to get the deal structured and completed. And now we have a number of options to look at how to monetize what we think is a pretty rare and exceptional ground lease that is inflation-indexed, and certainly in a 100% leased building, probably the nicest building in that market, should have substantial value.

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

On the net-lease side -- and I apologize for asking so many questions -- I don't know if there are other people in the queue, but please do let me know -- but on the net-lease side, I was wondering if you could comment on your plans for that business, whether you expect to grow it on a net basis, is also the JV -- I think you indicated the asset base, but whether you expect to grow that or just get to the $500-million target.

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

Net lease has been a core business for us for almost 20 years, now. It'll come in cycles. There'll be moments where we'll push and lean on that business harder. Right now, it's pretty competitive. We're sticking to the things where we think we have a competitive advantage, but those are typically, again, where we bring a more sophisticated skillset to bear and they tend not to be cookie-cutter deals so they have longer lead times to get done.

So we continue to have a pipeline of things we think are quite interesting. They just take a bit of time to gestate and get to the finish line.

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

Okay. And turning to the land side, can you just characterize homebuilder appetite regarding potential joint ventures or bulk-lot acquisitions? I think that we've seen some modest pullback in terms of the types of land deals they're willing to do at this stage in the cycle.

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

It's an interesting market. It feels strong, and then it feels next quarter less strong, and then it feels strong again. I think it's very idiosyncratic, depending on market and depending on what supplies and demands that the homebuilder community sees in those individual markets.

We think where we have good land and scarce markets we have not seen any pullback. Where you've seen markets with homebuilders who have loaded up on lots, they certainly have taken a pause to digest what they bought.

But we're pretty confident if you put the right product out there, there's a number of people who show up on our doorstep. So we're not concerned that there's been any diminution in interest over the long term.

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

Okay. And lastly, I was wondering if you could comment on the convertible perpetual preferreds and what you expect to happen with those securities -- when you might anticipate more converting?

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

We assume those investors are sophisticated. They'll maximize the value of the embedded options, which means -- I don't think they're in a rush, but certainly we expect share-price performance to put them in the money. And when they do need to make that decision, I would fully expect to be in a position where that will convert. But we can't say today what they're thinking.

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

Okay. Thank you very much for taking the questions, look forward to the June investor presentation.

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

Thanks, Jade.

Operator

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

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

Great. Thanks, John, and 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 replay will start at 12.30 p.m. eastern time today. The dial-in number for the replay is 1-800-475-6701, with the access of code of 358123.

That does conclude your conference for today. Thank you for your participation. You may now disconnect.
