Steven Laws: Good morning. I'm Steven Laws, a research analyst with Raymond James, that covers iStar Financial. Happy to be here today to introduce Jay. For those that don't know iStar, it's a CRA investment company mainly focused on first mortgages, mezzanine loans, net lease investments, as well as developing, operating, and repositioning its own real estate portfolio.

Steven Laws: The company's focused currently on monetizing some of the legacy investments, re-deploying these proceeds into new investments in their core business lines. As the company executes the strategy, we expect improved ROE's and increased earnings visibility as we move forward. Unlike many of its peers, iStar in internally managed and recently made some additions to its management team, which we'll cover here in a second.

Steven Laws: So, with that brief introduction, I'd like to introduce CEO and chairman Jay Sugarman. Good morning, Jay.

Jay Sugarman: Thanks Steve.

Steven Laws: I guess I touched on it in my introduction, but over the past two years there have been a number of positive developments on the legacy assets, the capital markets, and new investments feels like kinda an inflection point here. Can you maybe talk about how the company is refocused and changed recently?

Jay Sugarman: Sure. There's really three pillars to our strategy over the last couple of years and going forward. Um, we've always had a differentiated approach to providing capital, we're looking for opportunities where we can bring a unique skill set, have some competitive advantage that allows us to stay out of the very competitive commodity-like capital situations. So we're looking to have one on one conversations with long term relationships. We've been doing this for twenty five years. And really start with the question, “What are you trying to achieve?” And because we are an owner, operator, lender, net lease, ground lease, player, we kinda look up and down the capital structure for ways to unlock value for owners of real estate. And that puts us in a slightly different category than others who, I think, are much more focused on either a single type of financing or a more volume oriented approach.

Jay Sugarman: So, pillar one is our historical approach of how we provide capitol it's in a differentiated way, keeps us out of the mainstream where we've seen both pricing compress and a lot of new capitol come in. I think the second piece, as you mentioned, is working through the legacy asset portfolio, we had about three or four billion dollars of real estate that we put our best folks on, and said, “Reimagine, reposition this for the future.”

Jay Sugarman: Well that future is now. A lot of those assets have been repositioned, we've sold about two and a half billion of those assets, we've generated about seven hundred million in gains, about a billion and a half to go. We've said over the next, I would say, 12 to 24 months another 700 to a billion dollars of those will be sold. And that has kind of a compounded effect on our go-forward strategy. One, it brings back a significant amount of capitol, two, in many cases it'll generate gains, there some of those assets that we will pull the plug and take a loss on but overall we think there's a lot of value remaining in that portfolio.

Jay Sugarman: And then last thing, and probably most importantly, is it brings back some of our best investing resources and our best investment people who have been working really tirelessly over the last five years to figure out how to unlock value in real estate assets. And having that skillset attached to some fairly sophisticated financing and net lease skills makes those folks really powerful ambassadors for what we do.

Jay Sugarman: But, over the last five years, they've been sitting in front of assets trying to figure it out, now we're gonna put them in front of our long-term customer relationships and say, now we can really deploy that on a go-forward investment basis.

Jay Sugarman: So, pretty exciting to get those resources back, that capitol back, to free up our teams with these incredible skill sets to go sit and solve problems. And that's how you generate excess returns. Just waiting for a broker to ask for money, we don't think is a very attractive business right now.

Jay Sugarman: And a third pillar, and the one that is still in it's very early innings, is our ground lease business. And that ties into both of the first two things. We think the ground lease opportunity is a key part of iStar's story going forward. And I can spend a lot of time talking about our ground lease business that we spun off last year, but that's a whole different conversation. What I would say is that the uniqueness of that approach allows us now to sit in front of owners of real estate and fundamentally show them something they're not seeing anywhere else. There's nobody else having that conversation with them, offering them a capitol structure that we think is fundamentally better structured for many of the people we do business with. So it adds another very powerful gun to our holster, it allows us to have proprietary conversations that nobody else is having.

Jay Sugarman: And oftentimes what that allows us to do is take that investment professional who's come back, get them into the mix with something unique, and who knows where that goes. Sometimes that conversation ends up as a financing opportunity, sometimes it's gonna be a net lease opportunity, but we have done a lot of work on this ground lease sector, and think it is a perfect fit for what iStar has done for it's last twenty-five years. And we would certainly expect to be able to do what we've done in the finance and net-lease businesses which is build a very unique, differentiated practice in that business.

Steven Laws: Great, and we'll dive into a couple of questions on each of those businesses but first, maybe, to talk about the recent executive hires. You mentioned some of the current employees refocused on current investments, but you've recently brought on Andy Richardson, Marco Alvarado, can you maybe touch on the two recent hires?

Jay Sugarman: As we sharpen the focus of the company, as we see the path forward in terms of growth, we saw some pieces we need to adjust. And one of the most important is who's gonna go out and help us really attack the market. Marco set down about twenty-five billion dollars of deals while he was with [Starward 00:06:09] Capitol, had a great network of that 35 to 45 year old deal makers in our space. And that's something, candidly, that iStar didn't have. We had very strong senior people, we had a great junior team, unbelievably trained, but we had a number of our top professionals had gone off to run their own enterprises and own funds, and we were really missing that middle layer. Marco's coming in gives us access to the top deal-makers in the business, and again with the suite of things and differentiated approach that we have, we think that he's gonna be able to unlock a lot of future growth for us.

Jay Sugarman: With Andy, we also had an opportunity to think about the assets in our development book that are gonna be longer-term in nature. And we thought about it, how do we kill two birds with one stone, the ability to have somebody who had been CFO of Howard Hughes, had seen how do you tell a story to the marketplace around longer lived assets, development-like assets, is going to be part of the iStar story. It's going to be a smaller part going forward, but was a key part and Andy is a former iStar employee so it just kinda worked out perfectly that he was available. We needed that land person, and he could actually play our CFO role as well. So a little bit rationalization of how do we get the biggest bang for the buck, and it worked out great.

Steven Laws: Great, as you think about the current investment environment, what's your view where there may be heightened risks, where you see the most opportunities today as you're looking to re-deploy and recycle capitol?

Jay Sugarman: I'm a little bit old school, start with everything on a supply-demand curve, and it pretty much tells you the story, certainly in the finance world the supply of capitol coming out of the downturn was pulled back, the banks pulled back, there was a big opportunity, it was actually a really good market to invest in. Over the last two years, a lot of new capitol has come back, I think the banks have gotten a little more comfortable stretching, and so we've seen pricing come down. Which is inevitably a result of more supply of capitol for the same or not enough demand. So that business, and I would say the same thing has happened in the net lease, forces you to find a way to have a differentiated approach, to find a competitive advantage.

Jay Sugarman: So we've tried to stay out of the mainstream capitol flows, typically we have a proprietary opportunity with the relationship, that's always gonna be the best opportunity. It means we can't do the same volumes as other people can, we don't want to do. Because we're taking a much more custom tailored approach, we're focusing on long-term relationships. And you saw that really in the fourth quarter and the first quarter, the bulk of the done deals we did were with people... either people or assets we have done deals with in the past. And I think that's a big part of our story going forward, is going back to the DNA of iStar, how do we differentiate our capitol, how do we go back to our customers with something unique and different. And again I think the ground lease piece of that puzzle really has opened up a brand new avenue to re-approach folks and say we've got something better for you that you haven't seen before.

Steven Laws: And moving into that idea, last year you launched safety and coming growth. iStar manages and owns forty percent of the company. Can you talk about the opportunities in the ground-lease business that you find attractive? What's the difference today with the ground lease investments you're doing versus the old-fashioned business? And how do these assets perform in a rising-rate environment?

Jay Sugarman: Okay, that's a lot. Usually takes me about and hour to go through that. So let's break it down really quickly.

Jay Sugarman: There is an old-fashioned ground lease, and nobody has modernized it in thirty years. While the finance world has gotten very sophisticated, the net lease world has gotten very sophisticated, the ground lease world has not gotten sophisticated. And we started with the same approach we had twenty-five years ago in finance. When you think about the first mortgage business in 1990, people looked at it and said a first mortgage is a first mortgage, you own a first mortgage. And the insight back then was, no, actually a first mortgage is triple-a bond, a double-a bond, a single-a bond, a triple-b bond, a double-b bond, and a single-b bond, all stacked together in this asset. And if we strip out each of those layers of risk and reward and sell it to the most efficient buyer, where that is exactly what they want, when you sum up all those parts you get more than the whole.

Jay Sugarman: Fast forward ten years, 2000, we look at the net-lease market, and everybody looks at it as a single thing, it's a single investment. We say no, it's actually three investments. It's a real estate investment, it's a corporate credit investment, and it's actually a capitol markets investment. The bumps structures, the CPI structures can be priced in the capitol markets completely differently than they are in the real estate and the corporate credit markets. So if you take those three elements, corporate credit, real estate, capitol markets, one plus one plus one equaled four. And that started a five billion dollar business for us, just that insight of finding the right buyers of each of those components.

Jay Sugarman: Fast forward another fifteen years, lets look at the overall real estate market. How do we own real estate in this industry? We basically say to somebody, who says, “I think I'm really good at buying, operating, leasing, marketing, managing, designing, and constructing buildings.” We say that's a really interesting business, what do you think you're gonna make for your investors on that business? And they say “Ah, multi-family I'm gonna make a 12 ROE.” And we say okay, I'm gonna make you think about your business a little bit differently. The business that you just talked about related entirely to the building. And the building you just talked about based on your [pro-form 00:11:53] of the building, and the equity that goes into the building component, actually makes a 19 ROE, not a 12.

Jay Sugarman: The reason it makes a 12, and the reason we all think it makes a 12, is it is tethered to the land. And the land is 99-year triple-a bond, that makes about four percent. So think about the entire real estate industry saying, the person who's really good at the skillset that creates a 19% return on equity for the thing they do well, must go out every time they do their business and take 50% more capitol and buy a 99-year triple-a bond. What business in the world would work if you required the people who have this skillset to buy this? We don't make triple-a buyers buy single-b bonds. They're different buyers. The risk-reward is so fundamentally different, it's a different skillset.

Jay Sugarman: But what do we do in the ownership and real estate? We make the person who's trying to own and effect the equity component, the 19 ROE component, also take a big chunk of capitol and own a triple-a bond forever. And we said that can't be the most efficient way to own real estate. So we took a very hard look at ground leases and said why hasn't this business done what every other business has done and taken the components of risk and reward and sell them to the best owners? And the truth is the ground lease business grew up because someone owned a piece of land and you said you want to build on it, here's my terms. There was no hey lets figure out how to create value here through the capitol structure. Lets figure out how to create the best structure and sell the components to the right people. It was basically, I own the land, I'm a family, I'm a hospital, I'm a university, and you can do it or not but these are my terms.

Jay Sugarman: So our insight here is, this is an opportunity to do what we did in finance twenty-five years ago, and net lease fifteen years ago, is really find a way to sell the components to the people who do them best, and build the buyer, the ultimate category-killing buyer, of this land component. But not in a way that destroys value, not in a way that restricts your ability to get lending capacity, not in the way that would make the cap-rate different when you go to sell, but figure out as a lender, as an owner, as a seller of real estate, how to eliminate everything that destroys value, and has destroyed value in past ground lease structures, and build this new modern ground lease that enhances value, that creates value for owners of real estate. And it is very clear to us that one plus one equals more than two. And we can say that with conviction because over the last two years at iStar, we have sold an enormous percentage of our deals as ground leases and leasehold. And we've seen one plus one equals more than two. If it was worth one-hundred million as a fee, we're getting one-hundred and five million as a ground lease and a leasehold.

Jay Sugarman: So there's a lot of misconceptions about that industry, that's great, it means it's wide-open territory, it's complete white space for what we've always done well. The bad news is we have to basically change the way people have thought about this business for the last thirty years, and I will just anecdotally tell you what's exciting to us is we've had a lot of first meetings that have gone great.

What typically happens is we go “Let's do it, this makes perfect sense, you've just convinced me, I wanna make 19, not 12, I wanna go to my equity investors and say, same building, same [pro-form 00:15:29], same everything, but now it's a 19 not a 12. That's super powerful, I'm gonna raise a lot more equity, I'm gonna look a lot better than my competitors, let's do it.”

Jay Sugarman: A week goes by, and they go, “Eh, it's not really... I talked to my partners, they think ground-leases are terrible.” And we say okay, well, lets hear why they say that. And everything they're saying relates to the old fashioned ground lease, it's complete fallacy compared to what we're doing. So we've convinced the partners and now we're all good, we're going for it, it's gonna work, we're gonna do a deal together.

Jay Sugarman: Two weeks go by, “Eh, I don't think we're going to be able to do it.” Why? “I talked to my lawyers, they say ground leases don't work.” I say okay, get your lawyer on the phone, okay, tell me what anecdote do you have? “Well, the lipstick building, the [libre 00:16:14] house building...” We say eh, those are like 90% LTD ground leases. We're talking about 30%. They're talking about deals that have fair market value resets. We say of course that destroys value. So the lawyer goes, “Oh, okay now I understand, you guys have been really thoughtful, you've created something that's really modern, yeah, that's really lender-friendly, yeah, that's really cap-rate friendly, great. I'm on board too.”

Jay Sugarman: Week goes by, we get the call. “Man, my mortgage broker says I can't get a leasehold loan.” I said, did they try? They say, “No, they just know it doesn't work, 12 years ago they tried, it doesn't work.” I go okay, get them on the phone. Tell me why you're having problems, “Well, nobody will do it.” I said well we just did a deal with [Starward 00:16:53] and MetLife, and Fannie Mae, and Regional Bank, and Money Center Bank, which one of them did you call? “Well I didn't call any of them.” Well, we'll do it for you. We'll help you do it. In fact, if you don't wanna do it, iStar might do that loan, and we'll go find the lender. “Oh, okay well that makes me feel better.”

Jay Sugarman: And then the last call, the fifth call that comes in, is, “I talked to the broker who sold me the building, they said if you do a ground lease, we won't be able to sell the leasehold.” I said really? Get them on the phone. We go, why don't you think you can sell the leasehold? “Oh, I tried 12 years ago, I had a building it didn't sell.” I said, well here's what we've sold over the last 24 months at iStar, for four cap, for six cap, six one cap, which one of these do you think couldn't sell? “Actually, yeah, the way you're doing it, yeah that would work.”

Jay Sugarman: But that took five weeks and five phone calls to five different parties to actually execute. Now here's the good news, the parties that have actually gone through that, and actually done a deal with us, every one of them has come back and said I wanna do more. Every one. So this is not a question of “Eh, I tried it, I didn't like it.” It's a question of how do we get people to actually do one. So it's a trial question, not adoption. And that dialogue, as frustrating as it is to have those five phone calls, as iStar, every moment along the way I'm learning more about what you're trying to do. What buildings you have, what things you're struggling with, what people are not doing well for you, what lenders have not stood up for you. And we're taking all that data and we're going hey, we may get a ground lease out of this, but at the very lease I'm having a one on one proprietary conversation with the decision-makers in your firm.

Jay Sugarman: And most of the markets we play in are top-25 markets, most of the customers are top-tier customers, this is an investment of time, effort, and money for iStar. And we've think coming out the other end, again we go back to what we were good at which was being different, providing a solution that maybe nobody else can provide, and being able to do it in a way that's a one on one proprietary dialogue. That's the only time this business is fun. It is not fun to get a broker book and say, ten people are bidding, who's the lowest price. It is not fun to say I have four other bids, would you like to give up the rights you normally get. It is really fun to solve problems for customers, and walk out of the room where both of you have won. One plus one didn't equal 1.8, one plus one equally 2.4, and we both get something extra out of it, and by the way, in that dynamic you build long-term relationships, you build repeat customers, you build a franchise, and a franchise that will trade in a multiple.

Jay Sugarman: Now we're early innings, this is still the beginning, I'm not gonna bore you with the other hour of things we've figured out and interesting angles that iStar and Safe can do together and things Safe is gonna do to re strip the instrument it has to say, hey, this isn't just one thing, a ground lease is not just one thing, it's a rent stream, it's a residual, it's a CPI bump, it's a fixed income bump, these are all interesting components to play with if we get a big enough portfolio. That's a note for another time. But what I can tell you is the dynamic that we wanna get people focused on is, you are really smart at owning buildings, leasing buildings, managing buildings, selling buildings, why are you buying with a third of your equity, a 99-year triple-a bond? Why would you ever do that? You don't tell the LBO guys, oh by the way, when you buy a billion dollar company, you have to take another 50% of your capitol and you have to go buy a treasury bond. No business forces you to do that. Real estate forces you to do that, implicitly and explicitly.

Jay Sugarman: So we're gonna try to undo thirty years of real estate practice, by creating something better, it's gonna take time, but I think we've seen enough people respond to the concept, see the financial impact it can have on their return profile, that if you give us a little bit of time we're gonna be able to come back here next year and say this actually is a way that most people should at least consider thinking about owning, managing, leasing, designing, and we want to be the category killer in the space. We wanna be the ones between iStar's skillset, and Safe's skillset, providing something that nobody else can provide.

Steven Laws: Great, thanks for that overview on Safe. (laughs) As we think more about iStar, and shift back to the portfolio there, your current strategy is really monetizing legacy assets, about 1.6 billion today, roughly 35% of total assets as you mentioned, goal of the next one to two years is to monetize 700 million to a billion of assets, can you talk about the pipeline, the visibility into the timing of those monetizations, how you think about returns on new investments as you redeploy that capitol, and maybe just talk about the strategy that you have going on at iStar today?

Jay Sugarman: We've publicly said we're gonna sharpen our focus, we're gonna go back to these three pillars. Selling the legacy assets has been a process that we've been going through over, I'd say, the last 12 months. It's pretty significant acceleration of sales in the first quarter. Most of these assets are things that there's a moment at which they're mature and they're ready, and we sell them. That's a natural process.

Jay Sugarman: I think what the market is asked is would you be willing to go further than that and be unnatural? Would you sell things before they're fully realized? And I would say over the last three years we've said no, we won't do that. Because we have enormous earnings potential buried in this portfolio, we wanna let the market see that.

Jay Sugarman: So last year I think we made two dollars and fifty plus sense on a ten dollar stock, we thought the market would go holy-moley that's incredible, fantastic! It didn't. It said we don't understand, there's too many variables in your company. So we're taking a little more judicious approach this year and saying, well it's not just about how much earnings we can generate or how much liquidity, it's about the story we can tell and the resources we can recapture, for our go-forward businesses. So you'll see us accelerate not just the assets that are ready to be sold, but probably some assets that if we played on, we'd actually make more money, but we'd be tying up resources, we'd have to tell people, look, you need to understand, this project on the west coast, and this type of project on the east coast and this complication with the government agencies that we're dealing on this project... and it was just too much.

Jay Sugarman: So we're gonna whittle that down to a couple key assets that we think people will understand, the biggest of which will be our Asbury Park asset. Phenomenal piece of land, probably never in our lifetimes again will we see it, it's a mile of oceanfront, an hour south of New York City, we have almost complete control of the entire residential development along that waterfront. And we've invested about 300 million dollars to date, we have a new tower coming out of the ground that just topped off, that has changed the pricing in that market from 200 dollars per square foot, that building, we think, is gonna achieve 1100 dollars a square foot. So we've radically changed the value of the land surrounding it that we control and own.

Jay Sugarman: And we haven't really told that story to the market yet, this summer's kinda our coming out party. You'll see a lot of press about these early projects, but what I want you to do is think about, that's the fist 10% of the land we control. It's not the end, it's just the beginning. And you'll see our footprints, they're pretty heavy footprints, we fixed everything we could touch. We've built a much higher elevated opportunity because we saw an opportunity between a ten million dollar home community to the North, multi-million dollar home communities to the South. And we can control the mile of oceanfront between them in a town that has historic architecture, fantastic nightlife, great food, totally walkable, public transportation to get you there. There's nothing like it. And when you compare it to the other possibilities for someone sitting in North Jersey, New York, Brooklyn. Yeah you can go to Montague, two and a half hours, three hours, very expensive. You can go to the Hamptons, even more expensive. You can go to Fire Island, very expensive. You can go to Asbury Park right now and get something that doesn't exist on the East coast, the highest quality design, the best ocean views, and you can do it at a fraction of the price.

Jay Sugarman: And we've seen early feedback from customers going wow, I wanna reserve it before you're even allowed to give me a reservation for it. So we think there is a pent up demand for this quality, this vibrant community that's cool and eclectic and weird and fun. And nobody goes down there and doesn't come back saying, “That place is really fun! That place is really interesting.” And now we're gonna give them a place to live where they can go, you need to come stay with me and see this thing.

Jay Sugarman: So those kind of things get us excited, they're different, they're unique, they're not cookie cutter, but we're gonna pair down the list to a few of those, everything else we're gonna slowly but surely convert to cash and redeploy into areas where we think we have some special sauce that are very efficient for our people to work on.

Steven Laws: Great, with a few minutes left, I'll stop now and take any questions for Jay that you may have.

Speaker 3: The ground lease process you're describing seems like you were [inaudible 00:26:57] service, where would you guys [inaudible 00:27:02] now-

Jay Sugarman: We own the ground lease, we buy it.

Speaker 3: [inaudible 00:27:05] ground leases?

Jay Sugarman: We own about 600 million right now, we think the market size is quite large, but we're gonna be very patient. We are trying to change people's minds, there is a lot of bad stories about ground leases out there. So we literally have to one by one get people to understand, we're the good guys. We're the white hats. We're trying to help create value, not destroy value. Here's why intellectually, philosophically, it makes sense for you to do this. Just try it once with us. Don't take your whole portfolio, just try one. And let us show you it does work, it can work. We just did a deal in DC on a hundred million dollar multi that allowed a small local buyer to beat a large public company out on the asset. It couldn't have happened in a conventional form, so this is a tool that people need to look at as a way to win deals, extract value, create a better capitol stack, but I'm not expecting you to-

Speaker 3: [inaudible 00:28:10] [pre-owned 00:28:10]?

Jay Sugarman: No, no, that was property for sale. They approached us with the property, for financing. We said here's the way you can win, here's a way to actually get your return hurdles in a new and different way.

Speaker 3: What's your... So you're at the top of that, capitol structure that you're describing, [inaudible 00:28:32] ground lease, is that [inaudible 00:28:34]?

Jay Sugarman: It's a four percent, treasury's plus one-hundred to one-hundred and fifty business.

Speaker 3: So don't you need... Double-b minus credit to really make that business work? Wouldn't you have to be not only investment [inaudible 00:28:46]?

Jay Sugarman: You've gotta come to our Safe meeting, because that's what we're gonna talk about. We spun that business off into a new public company, because iStar's mix of assets doesn't get us the cost of capitol we need to prosecute that business. So it's a completely separate business. But iStar owns 40% of it, is its outside manager, we are the employees who actually make that business happen.

Steven Laws: Great, any other questions?

Speaker 4: How much capitol has cumulatively been invested in Asbury Park? What future capitol investments do you envision, and if the sales start to go well, will it catalyze that market, or are you gonna constantly be selling parcels to other developers [inaudible 00:29:30] in order to be capitol efficient takes risk off the table and you can put that capitol into your go-forward business?

Jay Sugarman: Spot on, we have about 300 million invested, the majority of that is in this latest tower, if we can set the price point, if we can get people excited, if we can get people to understand how unique and special this community is, we are not sitting here saying we're gonna develop out the remaining 90% of the land there are some extraordinary parcels that we may wanna continue on with. But we own fifteen to twenty developable parcels along the waterfront, along the boardwalk, along the ocean, I can't see a scenario where we are the developer of all of those from now til the end.

Jay Sugarman: But we needed to control everything upfront to really reset people's thought bubble around Asbury Park. We think we've started to do that, we think... We've got the number one rated new hotel next year, we built out an old Salvation Army, we're opening Asbury Lanes which is a historic 1960s bowling alley and venue with a really unique event on June 18th you'll read a lot about that, and then the Asbury Ocean Club, this tower on the water is gonna reset people's ideas of how they can live on the ocean in the tri-state area. There's nothing else like it. And for those who think that is how they wanna live, this is the place they're gonna wanna go.

Steven Laws: Great, Jay. Thanks a lot for being here.

Jay Sugarman: Thanks, Steve.