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SFI - Q4 2011 iStar Financial Earnings Conference Call

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OVERVIEW:

SFI reported full-year 2011 net loss of $62m or $0.70 per diluted common share. 4Q11 net loss was $35m or $0.43 per diluted common share.

CORPORATE PARTICIPANTS

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

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

David DiStaso *iStar Financial Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Jonathan Feldman *Nomura Securities - Analyst*

Joshua Barber *Stifel Nicolaus - Analyst*

Michael Kim *CRT Capital Group - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, good day and welcome to iStar Financial's fourth-quarter and fiscal-year 2011 earnings conference call. (Operator Instructions). As a reminder today's conference is being recorded.

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

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

Thank you, John, and good morning, everyone. Thank you for joining us today to review iStar Financial's fourth-quarter and fiscal-year 2011 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 p.m. Eastern time today. The dial-in for the replay is 1-800-475-6701 with the confirmation code of 236132.

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?

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

Thanks, Jason, and thank you all for joining us on the call this morning. During the fourth quarter we continued our efforts to reposition and streamline the balance sheet. We sold substantially all our interest in Oak Hill Advisors at a gain and monetized other assets at or prior to maturity. We reduced overhead where possible, made investments where returns were being compelling. We continue to bring down leverage and are in the process of launching a new financing that will help address our 2012 debt maturities.

Our goal through all this is to enable us to maximize the value of our diversified portfolio of assets over time and create a stronger foundation for the company.

While the credit markets have firmed and certain real estate markets have nicely recovered, we still have a large percentage of assets that do not yet generate GAAP earnings. We continue to invest in many assets that require repositioning before their full value can be realized. As a result we reported a net loss of 35 million for the quarter and a net loss of 62 million for the full year.

Excluding depreciation and non-cash provisions and impairments, net income for the quarter was a positive $5 million and net income for the year was approximately positive $70 million.

Liquidity remained solid at over $350 million in cash at the end of the year, helped by loan repayments and asset sales. We also continued to selectively invest in both new opportunities and existing portfolio assets, spending just over $80 million during the quarter with approximately $40 million coming from a new origination and senior debt acquisition and the remainder representing add-on investments and existing portfolio assets.

Lastly, on the liability side of the balance sheet, we've seen strong performance in the secured collateral pool for our 2011 secured financing facility, and believe this new 2012 secured financing facility we are launching will enjoy strong performance as well. These financings, together with continued asset monetizations, should give us a clear runway to focus on ways to enhance shareholder value throughout the rest of the year.

As we enter 2012, our goals are to better match our asset and liability profile, attract capital to our successful net lease and financing businesses, and demonstrate the growing potential in our owned real estate and land development platforms. While progress will take time, with low interest rates and a slowly improving macro backdrop, we believe each of these businesses can begin to move forward and position themselves for making attractive investments as we continue to strengthen the overall corporate balance sheet. With that quick update let me turn it over to Dave for more of the details. Dave.

David DiStaso - *iStar Financial Inc. - CFO*

Thanks Jay and good morning, everyone. I'll begin by discussing our financial results for the fourth-quarter and fiscal-year 2011 before moving to investment activity and credit quality. And I'll end with an update on liquidity, including the launch of the new financing that we announced this morning.

For the quarter, we reported a net loss of $35 million or a loss of $0.43 per diluted common share, compared to a net loss of $67 million or a loss of $0.73 per diluted common share for the fourth quarter 2010. The year-over-year improvement was due to lower loan loss provisions of $16 million versus $54 million for the same period last year, as well as increased earnings from equity method investments as a result of the sale of our interest in Oak Hill Advisors. This was partially offset by lower revenues from a smaller overall asset base and increased interest expense.

Adjusted EBITDA for the fourth quarter was $100 million compared to $103 million for the same period last year. The year-over-year results included lower revenue from a smaller asset base, offset by increased earnings from equity method investments and lower general and administrative costs.

For the full year 2011, we reported a net loss of $62 million, or a loss of $0.70 per diluted common share, compared to income of $36 million or $0.39 per diluted common share in 2010. Results for the prior year included $270 million of gains primarily associated with the sale of a large net lease asset portfolio, as compared to $25 million of such gains in the current year. In addition, the year-over-year change is due to lower revenues from a smaller overall asset base, partially offset by lower provision for loan losses of $46 million versus $332 million in the prior year.

Adjusted EBITDA for the year was $377 million, compared to $769 million for the full year 2010. The main driver of the year-over-year decrease was lower gains from discontinued operations of $25 million in the current year versus $270 million in the prior year, as well as lower revenues from a smaller overall asset base. This was partially offset by increased earnings from equity method investments.

During the quarter we paid down $110 million of debt on the 2011 A-1 tranche facility, bringing the outstanding balance down to $962 million at the end of the year. Cumulatively, we paid the 2011 A-1 tranche down by approximately $538 million, exceeding the $200 million minimum amortization required to be paid by the end of 2011 and the $450 million minimum amortization required to be paid in June 30, 2012.

In addition, we repurchased $38 million of senior unsecured notes effectively at par.

At the end of the quarter, our net leverage was 2.7x at December 31, 2011, a decrease from 2.8x as of the prior quarter. After adding back specific reserves, our gross leverage was 2.1x at the end of the quarter. Our weighted average effective cost of debt was 5.8%, a slight increase from 5.7% at the end of the third quarter.

During the fourth quarter we generated $244 million of proceeds from our portfolio, comprised of $138 million of principal repayments, $39 million from sales of other real estate owned, or OREO assets, $37 million from the sale of net lease assets, $11 million from loan sales and $18 million from other investments. In addition, we invested $80 million during the quarter.

In addition to these proceeds, as we previously announced, we also sold substantially all of our interest in Oak Hill Advisors and recorded a $30 million gain associated with this transaction during the fourth quarter. We continue to retain an interest in certain limited partnerships in various Oak Hill Funds.

For the year, this brings our total proceeds generated from the portfolio to $1.7 billion, comprised of $1.2 billion in loan principal repayments and $535 million from asset sales. In addition, we funded a total of $216 million of investments during the year.

Let me now turn to the portfolio and credit quality. At the end of the fourth quarter, our total portfolio had a carrying value of $7 billion, gross of general reserves. This was comprised of approximately $2.9 billion of loans and other lending investments, $1.7 billion of net lease assets, $1.9 billion of owned real estate and $458 million of other investments.

At the end of the quarter, our $2.2 billion of performing loans and other lending investments had a weighted average LTV of 77% and a maturity of 3.2 years. The performing loans consisted of 51% floating rate loans that generated a weighted average effective yield of 5.8% for the quarter and 49% fixed rate loans that generated a weighted average effective yield of 8.1% for the quarter. The weighted average risk rating of our performing loans was 3.29 at the end of the quarter, an improvement from 3.35 at the end of the prior quarter. Included in our performing loans were $136 million of watch list loans, an increase from $42 million last quarter.

At the end of the fourth quarter, our non-performing loans or NPLs had a carrying value of $771 million, net of $557 million of specific reserves, a decrease from $1 billion, net of $613 million of specific reserves, at the end of the prior quarter, and a decrease from $1.35 billion, net of $668 million of specific reserves, at December 31, 2010.

Our NPLs consist primarily of 38% apartment / residential, 27% land, 10% of entertainment / leisure, 9% of retail and 9% hotel assets. Our $1.7 billion of net lease assets, which are recorded net of $346 million of accumulated depreciation, were 92% leased with a weighted average remaining lease term of over 12 years. They had a weighted average risk rating of 2.67, an improvement from 2.70 in the prior quarter.

For the quarter our occupied net leased assets generated a weighted average effective yield of 9.8%, while our total net lease portfolio generated a weighted average effective yield of 8.4%.

Let me now turn to our real estate investment portfolio. At the end of the quarter we had $678 million of OREO assets. OREO assets are considered held for sale based on our current intention to market the assets and sell them in the near term. Also, $1.2 billion of assets were classified as real estate held for investment, based on our current intention and ability to hold them for longer period of time.

During the quarter, we took title to properties with a carrying value of $310 million. We also recorded $8 million of impairments within the OREO portfolio. Additionally, we recorded $6 million of income from sales of residential property units within the OREO portfolio during the quarter. For the quarter, our owned real estate portfolio generated $13 million of revenue, offset by $22 million of expenses. In addition, we funded $17 million of capital expenditures.

Let me move on to reserves. We recorded a $16 million provision for loan losses in the fourth quarter versus $9 million last quarter. While we have seen provisions tend lower over the past year, we expect to continue to see quarterly fluctuations.

At the end of the quarter, our reserves totaled $647 million, consisting of $573 million of asset-specific reserves and $74 million of general reserves. Our reserves represent 19% of the total gross carrying value of loans. This compares to loan loss reserves of $710 million, or 18% of total gross carrying value of loans, at September 30, 2011.

Finally, let me conclude with a discussion of the new facility we are launching and an update on liquidity. We have engaged Barclays Capital to arrange up to $900 million in new senior secured credit facilities. These facilities will be comprised of a 2012 A-1 tranche due March 2016 and a 2012 A-2 tranche due March 2017. The two tranches are expected to have differing interest rates.

Amortization payments will be applied first to the 2012 A-1 tranche and then to the 2012 A-2 tranche. We expect that the proceeds from the new credit facilities will be used to refinance our 2012 unsecured debt maturities.

Outstanding borrowings under the facilities will be collateralized by a $1.1 billion pool of diversified collateral of loans, net lease assets and real property. This new financing will allow us to better align our asset and liability profile as we seek to build on the positive momentum for the coming year.

Let me remind you, however, that we are still in the syndication process, so there can be no assurance that the terms I just discussed will not change materially, or that we will be successful in our efforts to complete this transaction.

Let me update you on our liquidity and debt profile for the year. We ended the year with $357 million of unrestricted cash versus $217 million at the end of the prior quarter. This year, our total unsecured debt maturities and minimum amortization payments on our 2011 A-1 secured facility totaled $1.6 billion. We expect to repay our unsecured notes due on March 1 with cash on hand.

Regarding the remaining $1.3 billion of maturities, we plan to utilize the $900 million of proceeds from the new facility as well as proceeds from repayments and asset sales to meet these obligations, which will allow us to further de-lever and right-size the balance sheet.

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

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

Thanks, Dave. There was a lot of information in there, so why don't we just go ahead and open it up for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Jonathan Feldman, Nomura Securities.

Jonathan Feldman - *Nomura Securities - Analyst*

Good morning. Congratulations. Just was wondering if you guys can talk about what you're seeing in terms of the condo market? Obviously it's been strong. And what your expectations are in terms of monetizing or otherwise selling the apartment residential assets that are categorized as NPL and OREO?

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

Sure. We've got a pretty long track record here over the last three or four years of selling -- I don't know, almost $60 million to $100 million a month. So we have got in most of these markets a pretty good sense of where pricing trends are and velocity trends.

The portfolio right now is skewed more towards a luxury product in our book in some of the markets that have nicely recovered. We still have some exposure in places like Phoenix which we think are finally on the cusp of turning around a little bit. We've seen nice sales velocity there at price points that we believe the market will take up quite a bit of inventory. So it's really a function in each of the markets we are in of looking at, historically, where we see the depth of the buyer market and trying to meet that market with both the product and the pricing.

We are not looking to blow stuff out; never have. We're looking for nice consistent buyer patterns and we're seeing that in almost every market. But the luxury product is a little bit longer buy process; people tend to come back a couple more times. So we don't expect the sort of high velocity turnaround we saw in some of the markets earlier, like Hawaii and some of the properties we had down in Miami. It's going to be slow and steady, but at this point it's getting fairly productive.

Jonathan Feldman - *Nomura Securities - Analyst*

Got you. And also, can you just talk about your current thoughts around the REHI assets? And I guess you've talked on recent calls about that being a longer-term opportunity, but I was hoping to get some more color and/or thoughts on that as we headed into 2012. Any new thoughts on that topic in terms of just your ability to generate value there?

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

Look, I think you and most people know that the REHI portfolio is primarily made up of our land platform, as we've spent the last couple years trying to aggregate and put together a team to really help realize the value. We think it's a pretty unique portfolio at this point. It's got some well-located master plan community opportunities. It's got some urban waterfront locations.

As the market is slowly building, we think many of those positions are nicely located for the demand we see coming.

And I think the story, and I saw it in Buffett's letter and we started to hear it on the road as we talk to capital, people are believing that the supply/demand in a lot of these markets is turning. The affordability indexes are at historic highs. The rent versus buy equation is starting to favor buy. You've got governmental pressure to try to keep rates low for new buyers, so we are seeing a lot of dynamics that are really compelling and on top of that is this demographic wave where we see household formations inevitably are going to go up just based on the demographics underlying the next decade. So the story for our REHI is really one of riding a long demographic wave with some strong macroeconomic metrics in key markets.

It still takes time. That's a business where you can't snap your fingers and make things happen. We're working closely with governmental agencies. We're working closely with building departments, so it's not something we are expecting to see in the very near term. But over the next three, four, five years we think that platform has real upside and we are devoting resources and obviously spending the money because we believe that.

Jonathan Feldman - *Nomura Securities - Analyst*

And then my final question is just around thinking about the future and sort of iStar in terms of the next phases. How are you thinking about that? How are you thinking about the growth opportunities that you see? And as we look to the future where you are not as focused on debt maturities, how do you see the next phase of the company's growth development playing out in terms of what you would like to do?

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

Well, I think as you heard in my comments, we need a strong foundation to work from, and we have thought for a while that de-leveraging is one of the key components of that. So you'll see us continue to shrink the debt on the right side of the balance sheet to get to a place where we think that foundation is very strong.

Once that's in place, and that will probably begin throughout this year and next year, we do think the net lease business is a great business right now. Long-term stable yields with inflation protection is an ideal investment class. We've got $4 billion of track record at very high rates of return, with very low beta, so we think that business is one we want to focus on.

I mentioned the land platform; we think long-duration, high multiple business in terms of capital. So we think there's a good opportunity there.

I think the financing business, Jonathan, is dependent on our cost of funds. We continue to see really attractive opportunities, but more in a one-off way than any single big rich vein of opportunity. And we can only really do the ones that have a high enough return profile that our cost of funds today make sense.

We'd like to get that cost of funds down. We'd like to get back to being an unsecured borrower certainly in the 2013 and '14 context. But that's going to drive a lot of the financing business.

So we look at the finance business, the net lease business and the real estate investment and development business and see opportunities in all three of them, but part of that is building the strong corporate foundation from which to work.

Jonathan Feldman - *Nomura Securities - Analyst*

Got you. Thank you very much. Congratulations once again.

Operator

Joshua Barber, Stifel Nicolaus.

Joshua Barber - *Stifel Nicolaus - Analyst*

Good morning. I'm wondering if you could talk a little bit more about your cash needs for 2012, specifically what you are budgeting for CapEx and for any additional funding commitments.

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

Yes, hi, Josh. Regarding 2012, we've got some funding commitments related to existing assets. Those approximate about $50 million for the year. And then, as we said, there is additional capital expenditure on the net lease side as well as the REO side that would total probably $150 million. So all in all, we are expecting $200 million in additional expenditures for 2012.

Joshua Barber - *Stifel Nicolaus - Analyst*

When you guys are looking at the pace of non-performing loans and foreclosures and workout that you've seen in the last few months, obviously it picked up with the NPL list coming down significantly in the fourth quarter. How has that trended so far in the first quarter?

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

It's probably a little early to tell. A number of the assets that are still on that list we're trying to resolve litigation, but we have had good success moving through the process. And some of these foreclosure processes are pretty long in the tooth now. So no real trend in the first 60 days of this year, but certainly we hope that we'll continue to be able to resolve a majority of the assets that are there.

Joshua Barber - *Stifel Nicolaus - Analyst*

Okay. When you're looking at your 2012 performing loan maturities, can you give us just a general sense of how many of those loans have interest reserves on them, and if that was something that had to do with the big pickup, at least in watch list assets, in the fourth quarter?

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

The watch list really was two particular situations, one really tied to the European turmoil, and one here domestically which has a late 2012 maturity that we are starting to watch very carefully to understand what's going to happen at the end. So neither one really had much to do with an interest reserve. I couldn't really answer what percentage of interest reserves attached to that.

Joshua Barber - *Stifel Nicolaus - Analyst*

All right. And are there any plans for authorizing additional buybacks of shares? I had to ask, I'm sorry.

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

I know, I know. We continue to believe that every day we have excess capital, we have a decision to make. In the past we have certainly thought our shares are an attractive use of those excess proceeds. We are spending as you saw a little bit of money on new transactions as well to make sure we are still a player in the marketplace. But as long as there is that kind of disconnect between share price and tangible book obviously that's something that's on the table.

Joshua Barber - *Stifel Nicolaus - Analyst*

Okay. Thanks very much.

Operator

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

Michael Kim - *CRT Capital Group - Analyst*

Good morning and thank you for taking my questions. Just had a number of questions regarding the proposed bank debt transaction. I'm just curious, of the $1.1 billion in collateral for the proposed bank debt transaction that you announced, could you provide a breakdown between performing loans, non-performing loans, net lease assets, REO, real estate held for investment that would be comprised of this collateral package? Would the composition be pretty similar to the existing bank debt collateral? Or I guess conversely what would the unencumbered collateral pool look like by asset type on a pro forma basis?

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

Hey, Mike. We've got a lender meeting on Thursday, so we are going to probably save a lot of the details for that meeting. But I can tell you that we are big believers in not reinventing the wheel. So we think the 2011 secured financing facility was well received by the market. It was well understood. The collateral mix was something that the market found attractive, so we are not going to vary too far from what we know that the market wants, likes, and what we've heard from a lot of our creditors they would be looking for in a 2012 deal. But let's leave it there in terms of details so we can have a formal launch on Thursday.

Michael Kim - *CRT Capital Group - Analyst*

Sure. I guess assuming a successful syndication to address your 2012 unsecured debt maturities, have you started to think about 2013 and '14? I guess would you look to recast the collateral package for the tranching of the existing tranche A-1 and A-2 when the call price comes down later this year?

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

Yes, so let me walk you through how we think about that. As I said, one of the key things we are focused on is corporate deleveraging. We think we'll be in continued deleveraging mode through the end of this year and into next year. We think we've got a very significant unencumbered asset base that gives us a lot of flexibility in terms of how we go about it.

I think we also have in terms of 2013 a lot of views on, can we get back in the unsecured market? So I think right now we think there is a lot of choices, a lot of flexibility. We certainly think we'll have maybe a lot of progress on a number of the assets that are still transitioning. So this transaction for 2012 gives us and should give us a nice runway here to be able to take advantage of that incremental deleveraging, the flexibility from the size of our unencumbered asset base, and hopefully position us at some point here to go back to the unsecured side of the world.

Michael Kim - *CRT Capital Group - Analyst*

Right. I guess shifting gears to the portfolio, with the improvement in the non-performing loan balance, what are your expectations for resolutions this year? I guess do you have a lot of visibility on what could be resolved through the end of the year, maybe items that might be associated with litigation. Is there a targeted balance that you would potentially share with us?

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

You know, it's a little bit tricky. We do track every one of them on a schedule, but you saw in the fourth quarter a bunch of things come to fruition. We don't necessarily see that same kind of point in time where a lot of them get resolved. They are going to happen over the course of the year. Some of them are going to take longer. Unfortunately, it's expensive process. We are really not able to predict them, but we do think the trend is pretty clear, and we expect that balance to continue to go down.

Michael Kim - *CRT Capital Group - Analyst*

Right. I know this has been disclosed in the 10-K historically, but is there any way you could provide us with a breakout of scheduled maturities for the performing loan portfolio by year? I guess how much is scheduled to mature this year, 2013 and '14?

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

I think there is a schedule in the 10-K to that effect. The last numbers I saw was just under $1 billion. Some of that collateral is in the 2011 financing. Some will likely be in 2012, so I can't break that further down for you. I think the 2012 number was something just under $1 billion.

Michael Kim - *CRT Capital Group - Analyst*

Under $1 billion, okay.

And just lastly on the net lease assets, what was the NOI contribution pro forma for some of these asset sales for 2011, just thinking about a run rate basis for going forward?

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

I can't do it off the top of my head. You can assume that somewhere in the 8% to 10% cap rate zone for most deals these days. Some are going to be lower than that. Some might even be much higher, but it's going to end up on average in that zone. You can follow up with Jason. He'll give you a better number if you need one.

Michael Kim - *CRT Capital Group - Analyst*

Okay, great. I appreciate it. Thank you.

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

Thanks, Mike.

Operator

Mr. Fooks, we have no further questions.

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

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

Operator

Certainly. Ladies and gentlemen, this conference is available for replay. It starts today at 12.30 p.m. Eastern time, Will last until March 13 at midnight. You may access the replay at any time by dialing 800-475-6701 and entering the access code 236132.

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