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Q1 2021 iStar Inc Earnings Call

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PRESENTATION

Operator

Good morning, and welcome to iStar's First Quarter 2021 Earnings Conference Call. (Operator Instructions) As a reminder, today's conference is being recorded. At this time, for opening remarks and introduction, I would like to turn the conference over to Jason Fooks, Senior Vice President of Investor Relations and Marketing. Please go ahead, sir.

Jason Fooks ***iStar Inc. - SVP of IR & Marketing***

Thank you, and good morning, everyone. Thank you for joining us today to review iStar's first quarter 2021 earnings. With me today are Jay Sugarman, Chairman and Chief Executive Officer; Marcos Alvarado, our President and Chief Investment Officer; and Jeremy Fox-Geen, our Chief Financial Officer.

This morning, we published an earnings presentation highlighting our results, and our call will refer to these slides, which can be found on our website at istar.com in the Investors section. There will be a replay of the call beginning at 2:00 p.m. Eastern Time today. The replay is accessible on our website or by dialling 1 (866) 207-1041 with a confirmation code of 4108868.

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. 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 S. Sugarman ***iStar Inc. - Executive Chairman & CEO***

Thanks, Jason, and good morning, everyone. We kicked off 2021 by continuing to focus on building our ground lease business and reducing our legacy asset portfolio. This is consistent with our previously announced plan to use the next 2 years to ensure the full value of our portfolio and strategy is reflected in the price of iStar shares. During the first quarter, Safehold continued to expand its business and achieved strong debut credit ratings based on the underlying principal safety of its ground lease assets, the growing scale and diversification of its portfolio and the conservative balance sheet strategies that has followed.

Importantly, Safehold has also begun to highlight for shareholders a framework for valuing its portfolio of residual ownership interest that has continued to grow in scale as its portfolio of ground leases has grown. By growing Safehold, increasing its capital efficiency and spotlighting what we believe is significant value, not yet reflected in the share price, we expect to be able to capture additional value for iStar and create additional gains on our very sizable ownership stake in Safehold.

While continuing to grow the modern ground lease business, we've also been reducing our exposure to legacy assets. Progress in monetizing both the long-term and short-term pools of legacy assets has reduced them as a percentage of the portfolio below our 15% target, and we continue to redeploy repatriated capital into the ground lease ecosystem and into prudent share repurchases.

With that quick recap, let me turn it over to Jeremy for more detail on the quarter. Jeremy?

Jeremy Fox-Geen ***iStar Inc. - CFO***

Thank you, Jay, and good morning, everyone. My comments will refer to the earnings presentation we published this morning on our website. And I'll begin on Slide 3 with an update on our strategy of scaling Safehold, strengthening our balance sheet and simplifying our business.

Our investment in Safehold stands at $2.4 billion, which represents a $1.5 billion unrealized gain for iStar shareholders. Our balance sheet remains strong, with $4.8 billion of unencumbered assets and a weighted average debt maturity of 4.1 years, allowing us significant financial flexibility in support of our strategy. And we continue to monetize our legacy asset portfolio with $56 million of sale proceeds, representing a net 6% reduction in that portfolio.

On Slide 4, you can see that Safehold saw steady investment activity during the quarter, originating $166 million of new ground leases with a weighted average effective yield of 5.3%. Safehold again expressed confidence in achieving its medium-term target of growing its portfolio to at least $6 billion by the end of 2023. Safehold used its newly awarded investment-grade ratings to recast its prior $600 million secured revolving credit facility to a new $1 billion unsecured facility, which also resulted in a rate reduction of 30 basis points.

Yesterday, Safehold issued its inaugural unsecured bond, a $400 million 10-year offering priced at T + 125 with robust demand. Access to the unsecured financing market should provide Safehold with new competitive advantages to deliver its capital even more efficiently to its customers as it continues to scale its business. And at the end of the quarter, Safehold had $770 million of liquidity from cash on hand and revolver availability to pursue new transactions.

To Slide 5. During the quarter, we sold legacy assets for a total of $56 million, recognizing a $7 million gain and reducing the size of the total legacy asset portfolio by a net 6% to $681 million. The remaining legacy portfolio is composed of 19 assets in our short-term pool with a gross book value of $199 million, which is down $23 million from $222 million last quarter and 3 larger assets within our long-term pool with a gross book value of $482 million, down $21 million from $503 million last quarter.

On Slide 6, you can see that we invested $105 million during the quarter. $88 million primarily within our loan and net lease portfolio, including 2 investments made in connection with a SAFE X STAR One-Stop Capital Solution. $12 million repurchasing our stock and $5 million of CapEx.

Slide 7 shows our portfolio, which stands at $6.3 billion, inclusive of Safehold's market value at the end of the quarter. Our investments in Safehold and net lease represent approximately 75% of our portfolio. And we continue to monetize our real estate finance portfolio, which is down $159 million from last quarter and now represents less than 10% of our assets. Land and development decreased from the fourth quarter by a net $42 million as a result of the legacy asset sales just discussed.

Slide 8 details our earnings. We reported a net loss for the quarter of $0.4 million or a loss of $0.01 per share compared to a net loss of $21.5 million or a loss of $0.28 per share in the same period last year. This quarter, adjusted earnings were $22.7 million or $0.30 per share as compared to $10.7 million or $0.14 per share in the prior year period.

You can see from the income statement on Slide 21 that earnings were notably impacted by an $11 million reduction in stock-based compensation expenses and an $8 million swing in provisions for loan losses. Stock-based compensation expense in the prior year period was driven by the mark-to-market impact on certain of our iPIP long-term incentive plans from the significant appreciation in Safehold share price during that quarter.

And the swing in provisions for loan losses was driven partly by reserve recoveries as loans paid off this quarter and partly by the evolution of economic forecasts used in our CECL modelling, rapidly worsening in Q1 2020 and becoming more positive in this quarter. Our weighted average share count decreased by 3.5 million shares over the past year as a result of stock repurchases. Adjusted earnings per share this quarter was also impacted by approximately 3 million shares of dilution from our September 2022 convertible bonds that are now in the money with a strike price of $14.14 per share. The dilution calculation is based on net share settlement, meaning the $288 million of principal will be repaid in cash and any excess conversion value above principal will be settled with stock.

Slide 9 shows our book value per share and illustrates the value created through Safehold, but not recognized in our reported financial statements. Including SAFE's market value as of March 31, our common equity value per share is $26.63. And when adjusted for depreciation, amortization and CECL allowance, our common equity value per share stands at $31.31. This quarter, the share count also includes the impact of the convertible dilution I previously mentioned.

In conclusion, the quarter represented continued progress on our goals with steady investment activity at Safehold and legacy asset sales.

With that, let me hand it back to Jay.

Jay S. Sugarman ***iStar Inc. - Executive Chairman & CEO***

Great, Jeremy. So just to sum up with the economy on a path to reopening and the real estate market seeing more transaction activity. We think iStar is well-positioned to execute its strategy, helping Safehold continue to grow in scale and value and delivering strong returns to iStar shareholders.

Okay, operator, let's go ahead and open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Jade Rahmani with KBW.

Jade Joseph Rahmani ***Keefe, Bruyette, & Woods, Inc., Research Division - Director***

Looks like Safehold is continuing to make progress with its inaugural investment-grade bond issuance. So congratulations on that. Was wondering if you've looked at a company in the U.K., it's a ground lease company. They've issued securitizations, I believe it's called Fairhold Securitisation Limited. Have you looked at that structure? And does that potentially offer any template for how investors might think about further unlocking of embedded value in the ground lease portfolio?

Jay S. Sugarman ***iStar Inc. - Executive Chairman & CEO***

Hey Jay, thanks. Yes. No, we looked at that in the past, I think we believe the unsecured format is actually the best for delivering what we think is valuable to our customers. We've had those viewpoints since we went public that being the most flexible, creating the lowest cost, longest term capital, best positions us to create this whole new modern ground lease industry at scale. That's not to say there aren't opportunities to look at other structures to see if they can create even more benefits. But we worked hard to get to the investment-grade unsecured ratings because we think right now that is the best way to open this market up.

Jade Joseph Rahmani ***Keefe, Bruyette, & Woods, Inc., Research Division - Director***

You've been discussing the value and the portfolio in the Safehold portfolio, the very bright and plans to enunciate what you believe is not appreciated by the market. Is the main action we should expect at least over the next 2 years as part of iStar's strategic plan to come in the form of communication? Or is there some kind of capital or structural action that may also take place to unlock that value?

Jay S. Sugarman ***iStar Inc. - Executive Chairman & CEO***

Yes. I think step one is definitely education and communication. We just began laying out what we have believed would unlock that value for Safehold shareholders. And obviously, that reflects back into iStar's ownership stakes value. So, we're just at the very, very beginning. I think we're week or 2 into this. And we've got a quite positive response. People are starting to really dig in to think about it. I think they see now a little more clearly what we have been tracking for them as a very substantial asset in the Safehold value equation and one that we had historically said, we're not going to talk about till it's large enough, diversified enough, has proved out enough of the variables that it will be obvious not only to real estate-centric investors, but basically investors across almost any investment strategy.

And we think that's the next big exciting part of the Safehold story. The business continues to grow. That growth continues to add value throughout the portfolio. But we did expect and have now finally shared with the market why we think there's a big part of that story that's not yet being valued. So we'll continue to educate, communicate. There are a number of ways that certainly you could envision capturing that value, separate and apart from the cash flow stream of the portfolio. But I think that you have to start with giving people the tools across the shareholder base that we have and the even more expanded one we want to have, we want to make sure people understand what it is, why we're so excited about it, and then we can start thinking about is there an even more optimal way to capture that value for shareholders.

Jade Joseph Rahmani ***Keefe, Bruyette, & Woods, Inc., Research Division - Director***

Could you provide any color on the $88 million of capital deployment in the real estate finance and net lease segments? I think you mentioned 2 of the deals were in the SAFE/STAR program, but just wondering if you could provide some color on them?

Jay S. Sugarman ***iStar Inc. - Executive Chairman & CEO***

Yes. We continue to look for places where we can enhance the overall ground lease ecosystem. One place we've seen with certain customers is to provide both a ground lease from Safehold and a first mortgage loan from iStar. We don't do it that often because the markets typically are fast enough and liquid enough that they've been the best source of capital for that first mortgage. But when the opportunity presents itself, we think the risk-adjusted returns are quite attractive there as well. So that's the lending piece of it.

And then on the net lease side, we continue to finish out the investment period for our joint venture with the sovereign wealth fund, continue to see opportunities in that market before that investment period runs out later this year.

Jade Joseph Rahmani ***Keefe, Bruyette, & Woods, Inc., Research Division - Director***

And just finally on credit, any changes in the outlook with respect to the loan portfolio as of today?

Jay S. Sugarman ***iStar Inc. - Executive Chairman & CEO***

Well, I think as Jeremy said in his remarks, we received quite a number of payoffs, and we're able to reverse some reserves based on the market environment today versus where it's been. We see the markets starting to open up, get a little more liquid. Not to say there aren't going to be challenges across different parts of the commercial real estate world, but certainly the liquidity in the market has increased significantly. So we continue to see our customers, borrowers on the loan book access capital either to repay us, pay us down, improve whatever credit position we have. So, you'll see those reserves this quarter being unwound as we see those market conditions improving.

Operator

Our next question comes from Stephen Laws with Raymond James.

Stephen Albert Laws ***Raymond James & Associates, Inc., Research Division - Research Analyst***

Jay, I appreciate the comments earlier on SAFE and then certainly the growth opportunity last week. I wanted to touch here on the iStar legacy stuff, a lot of progress. Looks like sales and selling those at slight gains actually during the quarter. What's remaining? Can you talk about things that -- how much were resolutions or maybe monetization timelines delayed with COVID now that that's kind of a year back, and you can look in the rearview mirror, even though it's certainly not completely behind us, but how many assets were able to continue to kind of move at the uninterrupted pace towards resolution? And how many of those legacies were really extended and by how much?

Jay S. Sugarman ***iStar Inc. - Executive Chairman & CEO***

Yes. Thanks, Steve. I guess the toughest part of COVID certainly was that the March to Labor Day period, the markets were pretty much frozen. So not a lot of progress during that period on some of the assets that we had been teeing up. Coming out of Labor Day, we certainly saw the beginnings of a revival in those conversations. And now as we head into 2021, certainly the tone is much better. The level of engagement is much higher. So we think we lost maybe 6, 9 months in some of those conversations.

But pretty pleased actually, our asset management team has been doing a great job of preparing things, putting them on the market, monetizing them. You've seen the success, as Jeremy walked through, just in terms of reducing that portfolio. Made some progress. Obviously, we talked about peak Asbury being around in the latter part of last year. So you've seen some good progress there in reducing our capital. So on all fronts, we feel like certainly the direction is good and positive, which some of the stuff could have happened a little bit earlier. But candidly, we've given ourselves this 2-year window to move all these chess pieces down the board. And right now, all the vectors are pointing in the right direction.

Stephen Albert Laws ***Raymond James & Associates, Inc., Research Division - Research Analyst***

And when you think about uses of cash between dividends, buyback and buying SAFE shares, there's been a number of points in the past year or 2 where you've been able to do concurrent private placements and invest significant amounts of money into SAFE. With the new debt in place there and kind of the growth outlook, that opportunity, I don't know, may not happen as frequently or in as much size. But can you talk about how you think about that allocation of dividend buybacks and SAFE purchases and maybe what levels you really focus when looking at those options?

Jay S. Sugarman ***iStar Inc. - Executive Chairman & CEO***

Sure. I mean, we start with the premise of we wanted to build a really strong balance sheet, create a very safe corridor, no pun intended, to help scale Safehold into what we think is kind of the next big milestone, which is about $5 billion of ground leases. So that's really been the goal, first and foremost, to make sure we had that strong foundation. Then when we create excess capital, we do have some choices to make. We deploy money into things that expand the ground lease ecosystem, which we think enhances the value of our overall SAFE position. And then we prudently use it to buy in shares because we think they're still materially undervalue, not just the value of Safehold and the rest of our portfolio today, but as you heard us talk about, we think there's a whole another leg to the Safehold valuation that isn't even reflected in the share price in any material way today.

So we think we can really create a double barrel effect by continuing to grow Safehold, continuing to get the market to understand the full value of what it's building and then be thoughtful and prudent about buying shares when it makes sense. And so whether it's SAFE, whether it's STAR, we think our mission is pretty clear, create the value and then capture it for shareholders.

Stephen Albert Laws ***Raymond James & Associates, Inc., Research Division - Research Analyst***

Great. And then I guess last one on the buyback, Jay, is there anything from a structural or covenant standpoint that limits how much STAR shares you'd be willing to repurchase?

Jay S. Sugarman ***iStar Inc. - Executive Chairman & CEO***

Yes. Look, again, it's really a question of prudence and creating this very strong window to continue executing on our business plan. Other than saying we want to be prudent and we want to make sure that we have a very strong balance sheet, that's our commitment to both our Board and our creditors. I think we have some flexibility. We've been building liquidity. We think we've grown substantial value on the balance sheet through the SAFE position. So I think it's really just a matter of prudence at this point in terms of executing the optimal strategy to, again, create the value, capture the value. We don't want to do anything that might upset that applecart.

Stephen Albert Laws ***Raymond James & Associates, Inc., Research Division - Research Analyst***

Great. Well, congratulations on the progress in Q1, and appreciate the update this morning.

Jay S. Sugarman ***iStar Inc. - Executive Chairman & CEO***

Thanks, Steve.

Operator

(Operator Instructions) Mr. Fooks, we have no further question.

Jason Fooks ***iStar Inc. - SVP of IR & Marketing***

Okay. Great. Thank you for tuning in. And if you should have any additional questions on today's earnings release, please feel free to contact me directly. Operator, would you please give the conference call replay instructions once again? Thanks.

Operator

Yes. Thank you. Ladies and gentlemen, this conference will be available for replay after 2:00 p.m. Eastern Time today through May 13 at midnight. You may access the executive replay system at any time by dialling 1 (866) 207-1041 and entering the access code 4108868.

Those numbers again are 1 (866) 207-1041 with the access code of 4108868. That does conclude our conference for today. Thank you for your participation. You may now disconnect.