THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

STAR - Q4 2016 iStar Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 24, 2017 / 3:00PM GMT

CORPORATE PARTICIPANTS

Jason Fooks *iStar Inc. - VP of IR and Marketing*

Jay Sugarman *iStar Inc. - Chairman and CEO*

Geoff Jervis *iStar Inc. - COO and CFO*

CONFERENCE CALL PARTICIPANTS

Jade Rahmani *Keefe, Bruyette & Woods - Analyst*

Ben Zucker *JMP Securities - Analyst*

Andrew Molloy *BofA Merrill Lynch - Analyst*

PRESENTATION

Operator

Good day and welcome to iStar's fiscal year 2016 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 Inc. - VP of IR and Marketing*

Thank you, John, and good morning, everyone. Thank you for joining us today to review iStar's fiscal year 2016 earnings report. With me today are Jay Sugarman, Chairman and Chief Executive Officer; and Geoff Jervis, our Chief Operating Officer and Chief Financial Officer. This morning's call is being webcast on our website at iStar.com, in the investors section. There will be a replay of the call beginning at 12:30 Eastern time today. The dial in for the replay is 1-800-475-6701, with a confirmation code of 418324.

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 report. IStar disclaims any intent or obligation to update these forward-looking statements except as expressly required by law.

Now I would like to turn the call over to iStar's Chairman and CEO, Jay Sugarman. Jay?

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

Thanks, Jason. As our press release this morning noted, 2016 saw progress on multiple fronts at iStar. Earnings climbed solidly. Profitable sales took place throughout the portfolio, and share count was significantly reduced. Our goal in 2017 is to build on this progress and begin to translate progress into shareholder returns.

Our internal earnings target for 2017 is $1.50 per share in adjusted income and $0.65 for net income. This compares to the $1.15 and $0.55 per share in adjusted income and net income, respectively, reported for 2016.

Earnings will be driven by a combination of increased investments, better balance sheet and cash management, and a number of value realizations from portfolio assets that we believe have significant embedded gains.

Turning to 2016 full-year and fourth-quarter results, we successfully completed many sales and value realizations during the year but also saw certain sales slide into 2017. Fourth-quarter earnings did not benefit from the larger asset sales and realizations we had seen in the second and third quarters, but adjusted income remained positive and helped us exceed our year-over-year goal of growing earnings in excess of 50%.

Investment fundings were higher in the fourth quarter and helped push total fundings for the year above 2015. But repayments also bumped higher, and significantly outpaced investment fundings for both the fourth-quarter and full-year. Now, with growing liquidity, we anticipate investment fundings in 2017 to exceed levels we saw in 2016. You'll see us work to begin growing the balance sheet as we move deeper into 2017.

Geoff has quite a bit of information to share, so let me turn it over to him at this point. Geoff?

Geoff Jervis - *iStar Inc. - COO and CFO*

Thank you, Jay, and good morning, everyone. Results for the full year were strong, with net income and adjusted income coming in at $0.55 and $1.15 per diluted common share, respectively. Full-year results exceeded our guidance of 50% year-over-year earnings growth. Consistent with our stated business plan to intelligently monetize non-core assets, 2016 results included material gains from the sale of operating properties, and land and development assets.

While we have a relative degree of certainty with respect to the Company's longer-term earnings trajectory, quarter-to-quarter results have and will continue to be volatile as we continue to transition the character of our earnings to a more recurring profile. Fourth-quarter results are a perfect example of this volatility: the net loss of $0.27 per share and adjusted income of $0.04 per share, versus $0.44 and $0.47 per share in the third quarter, respectively.

As we look forward, we are targeting full-year 2017 net income of $0.65 per diluted share, and full-year 2017 adjusted income of $1.50 per diluted share. These estimates represent material growth from 2016 results as we expect continued significant activity in all parts of our portfolio.

Switching to investment activity, during the year we originated nearly $700 million of new investments comprised of $432 million of new loans and $260 million of new net lease investments. This is also consistent with our stated business plan to invest proceeds from the monetization of non-core assets into our primary loan and net leased business lines.

During the year we funded $767 million of capital into a combination of new and previously originated investments, as well as ongoing developments. On the inflow side we realized $1.3 billion of sales and repayments during the year. Ultimately, investments and fundings will exceed sales and repayment activity. However, the high volume of sales this year has created a net reduction in invested assets. We continue to ramp up originations in our pipeline and expect this trend to reverse in 2017.

Moving over to the portfolio, our portfolio of investment assets stands at $4.6 billion and is comprised of our core real estate, finance, and net leased assets, as well as our operating properties and land and development assets. At year-end, our real estate finance portfolio was $1.5 billion, generating $58 million of segment profit for the year.

We break out our real estate finance portfolio into two categories: legacy loans made pre-2008; and iStar 3.0 loans made during and after the financial crisis. The vast majority of our loans, $1.2 billion, are iStar 3.0 loans. These loans continue to be 100% performing, and generated a yield of 8.9% in 2016. Our legacy loans, on the other hand, are down to only $250 million or 17% of the real estate finance portfolio. This sub-portfolio is primarily comprised of one $145 million nonperforming hotel loan.

As a reminder, our borrower on this loan has filed for bankruptcy protection; and, while we believe that we are fully covered by the collateral that secures our loan, in light of the uncertainties of litigation, in Q3 we took a $12.5 million specific reserve on this loan. As this investment is in litigation, we are unable to give further detail at this time. However, as the process progresses, we will update the market as appropriate.

It is worth noting that over the last few years, we have successfully resolved multiple billions of dollars of legacy loans; and, as of today, we're down to only one such loan of any significance.

Our net lease portfolio balance was $1.5 billion at quarter end, comprised of $1.4 billion of wholly owned investments and a $93 million equity investment in our net lease JV. As many of you know, our current net lease investment activity is primarily dedicated to our $500 million equity capital joint venture in which we share a 52/48 partnership with a single sovereign investor. The JV also carries approximately 2-to-1 leverage.

The yield on our overall net lease portfolio was 8.4% in 2016, with same-store NOI growth of 4.1%. At the end of year, portfolio occupancy and weighted average lease term were 98% and 14.7 years, respectively. And the net lease segment recorded profits of $72 million during the year.

Over to our operating portfolio, where we also made significant progress in 2016. Not only did we receive $377 million of proceeds from operating property sales, and record income of $109 million, but also we continue to migrate the character of the remaining assets into more stabilized, ready-for-monetization shape. At year end, the portfolio was comprised of 29 assets with a gross book value of $608 million.

We organize the portfolio into two categories: commercial and residential operating properties. The residential portfolio consists of 48 unsold condos with a balance of $83 million. This sub-portfolio is nearly liquidated after having sold nearly $1.3 billion of residential real estate, and realizing gains on sale of nearly $300 million.

The commercial portfolio has also come a long way. Today, over 60% of the portfolio is classified as stabilized, with only $189 million of assets classified as transitional. One year ago, the percentages were very different, with 80% of the portfolio classified as transitional, and 20% as stabilized.

The good news is the progress we have made. The bad news is that this well of gains on sale will also soon run dry. Our land and development portfolio had a balance of $1 billion at quarter end, roughly $100 million less than last year in terms of carrying value. While the book balance of land has remained relatively flat in 2016, and frankly, since 2013, the improvement, stabilization, transfer and sales of assets out of our portfolio has been material.

During the year we invested or transferred in $181 million of assets, and sold or transferred out $221 million of assets. This is the continuation of a trend, as we have sold $350 million or 30% of the balance of the land that we held in 2013. The reason the book balance of these assets has remained relatively stable is that we have invested $330 million into the remaining assets, and also transferred $90 million of assets into the account over the same period.

The fruits of our labor are that despite having foreclosed on a $1 billion portfolio of effectively unentitled land, today 30% of that book has been sold or transferred. Of the remaining portfolio, 25% is in active asset sales; 40% is in development; and, except for 10% of the portfolio, everything else is fully entitled. In short, our land portfolio is dramatically different from 2013.

On a specific note, in Q4, one of our largest land assets, Grand Vista, a 55-acre site in Surprise, Arizona, that was a former Chrysler test track facility, was leased to a Fortune 100 company for $7.5 million a year in rent, and is now subject to a purchase option. As a result, this asset was transferred out of our land portfolio and into our operating property portfolio. In 2017, we expect to continue the trend and monetize between $200 million and $400 million of land, and invest between $100 million and $150 million into the remaining assets.

On the right-hand side of the balance sheet, we remain in a position of significant liquidity as our cash and available borrowings stood at approximately $750 million at quarter end; $700 million, as of today. And we remain comfortably inside our leverage target of 2 to 2.5 times debt to equity, and in compliance with all of our covenants.

During the year we repaid $1.5 billion of debt and issued new debt of approximately $775 million. In the fourth quarter, our two convertible note securities, with an aggregate balance of $378 million, matured. And we retired these securities predominantly with cash on hand, as contemplated.

Subsequent to quarter end, we repriced the $500 million term loan we issued in 2016 and reduced our pricing by 75 basis points, resulting in a savings of $3.75 million a year. As we look forward, we expect to continue to capitalize on our improving posture with the rating agencies, banks, and debt capital markets in advance of our $925 million of maturities in 2017.

On the equity front, in 2016 we reduced basic and diluted share count by 12.5% and 30%, respectively. We accomplished this reduction by buying back 10.1 million shares of common equity in the market, and retiring the aforementioned convertible notes. Also on the equity front, in Q4, we were added to the RMZ Index as a hybrid REIT.

Before I turn it back to Jay, I want to spend a moment to give an update on our program of increased transparency and access. From a disclosure standpoint, after researching and discussing best practices with our peers, coverage analysts and investors, we have increased our disclosure, particularly our land disclosure, in the previously filed 10-Qs and in the 10-K we will file this afternoon.

In addition, the level of detail we now provide in our earnings press release, and our prepared remarks on these earnings calls, has and will continue to increase and be refined.

This is only one set of examples of the increased and reformatted information we now provide the market, as we have also created and posted multiple presentations to our website. Furthermore, as we have promised the market, we will be filing our first supplemental, with Q1 earnings, in May.

On the outreach front, we have conducted multiple equity and debt non-deal road shows, and have met with more than 50 investors over the last eight months. In addition, we have attended both debt and equity conferences, and will be attending the JPMorgan High-Yield Conference in Miami this coming Monday and Tuesday.

In closing, we thank you for your continued support and look forward to the delivery, not only of our transparency and access plan but, more important, on our performance in terms of earnings and stock price.

And with that, I'll turn it back to Jay.

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

Thanks, Jeff. I think there were two big takeaways from 2016: one, the number of assets we were able to realize and the value built up over the past few years. We've talked about these types of assets in the past, but we feel we have created significant value, but where that success doesn't show up in earnings until a realization event happens. 2016 was very good in this regard and we expect 2017 to be as good or better.

And, two, the significantly reduced share count from the beginning of the year, and really from the middle of 2015 to today; we have retired almost one-third of the diluted share count since the second quarter of 2015, and like to think of this as compressing the spring, making future successes more impactful and helping set us up for more substantial earnings growth than would have been possible with a higher share count. Delivering on the potential embedded in both these ideas will be a key focus in the coming year.

And with that, operator, let's go ahead and open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Jade Rahmani, KBW.

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

When you say the well of gains will soon run dry, can you give some more color on the underlying asset base, the magnitude of which you expect to drive those gains, and how much runway is left for gains to be a significant earnings driver?

Geoff Jervis - *iStar Inc. - COO and CFO*

Sure. So, as you are well aware, the commercial and residential portfolios of the Company have totaled about $3.3 billion when combined together historically. And we have realized $400 million-plus of gains as we have worked through that portfolio. That portfolio currently stands at roughly $600 million. So just by sheer magnitude, we have brought down the potential for further gains.

I think, in addition, when you look into the $600 million of the remaining portfolio, roughly $80 million is in residential, and that will continue to plug along. Hopefully, we will get the vast majority of that portfolio resolved in 2017.

And then the remainder, $500 million, roughly, is in the commercial portfolio. Roughly $100 million of that is the Grand Vista asset that we transferred in. So that asset is -- I would put that more in the stabilized category. I don't necessarily think that is in the monetization camp. And so we only really have about $400 million of book value assets left.

Some of those assets are, for example, the Asbury Hotel. And, ultimately, that will be monetized. We have no intention of monetizing that asset, which is about $50 million, roughly, of book balance, until we progress much further along the development cycle with the entire Asbury plant.

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

So of the $400 million, how much would you say could be monetized in 2017 and 2018?

Geoff Jervis - *iStar Inc. - COO and CFO*

Jay, we are not really giving guidance with respect to asset monetizations in that portfolio. I would say, as I mentioned, that we do expect to make significant and near-complete progress on the residential side. And with respect to what is left in the commercial portfolio, there certainly are some candidates. And we do, obviously, with the expectation we gave out with respect to guidance, we do expect some significant gains in the sales that we do execute.

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

In terms of the Grand Vista lease, can you give any more color? My understanding is that land is raw. So what's the nature of the lease, the type of company? And what do you imagine will happen? Is this company going to develop an industrial complex or something of that nature? And what's the duration of the lease you entered into?

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

We tried to give a little bit of the details in the comments. But the lease term is five years, with an extension right and a purchase option, as we mentioned. And it's, again, a very substantial Fortune 100 company that is doing it as part of their core research. This was a former test track facility, so you can guess some of the uses that it might be used for.

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

Okay. In terms of capital management, what do you expect for loan repayments and also CapEx spend for this year?

Geoff Jervis - *iStar Inc. - COO and CFO*

So on the residential front, as I mentioned in my land portfolio remarks, we expect to invest somewhere between $100 million and $150 million in that portfolio. I think we are very excited about making some progress down at Asbury this year.

And then with respect to our capital investments in the remaining commercial portfolio, it's not -- it's certainly, now that the portfolio has been reduced and primarily stabilized, those numbers are going to be dramatically reduced in 2017. I think by order of magnitude of our investments in the operating portfolio would be, call it, somewhere in the $50 million range.

And on the repayments front, there's just so many -- so much out of our control. I think we do estimate that we will put more money out than ultimately is repaid. And to the extent that repayments are less than we anticipate, obviously that will lead to portfolio growth.

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

In terms of capital allocation, it looks like originations are generating 50 basis points or so higher yield, maybe higher than that, depending on type, than net leased, but the duration is shorter. So how do you look at balancing those two, and how do those returns compare with the returns on land? CapEx?

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

I guess I'll bracket them a couple different ways. In the finance business, we are trying to stay away where most of the competition is. So we have been able to generate some higher yields in some situations where either a particular expertise or a particular leverage point we had allowed us to get extra return.

What you see cash-on-cash on the net lease business is obviously just the return on the asset. Obviously, those assets inside the JV have the potential for slightly higher returns, based on the promote structure we have; and certainly don't reflect some IRR potential, we think, in the ultimate realization value of those assets. So we don't compare those just on cash-on-cash; we compare them on an IRR and ROE basis. And we think they're both quite attractive right now.

Land itself, obviously, we think about in a higher return category than the other two. So it does have to hit a higher hurdle rate. But we think embedded in our existing portfolio are some pretty attractive, highly proprietary opportunities. And to the extent they can reach that bar, we are willing to continue to spend money on them. When they don't reach that bar, we pull back. So right now we are seeing, given the still fairly strong numbers we see in the homebuilding industry, and in some of the markets we are in, that we should be able to turn those capital investments into attractive returns that beat our hurdle.

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

As we stand here today, in terms of the debt maturity profile, how do you plan to address those quite significant 2017-2018 maturities?

Geoff Jervis - *iStar Inc. - COO and CFO*

Sure. So we have $100 million coming due in March. We have $275 million that comes due and is open to repayment in June. And then we have a $550 million piece that comes due in November that is open in August. It's 4% debt, so I would imagine we are not asked to repay that just any earlier than we have to.

The way we will address that -- obviously, we have accessed -- last year we accessed multiple markets. We accessed a bank term loan; we accessed, obviously, the revolver market; we accessed the term loan market; we accessed the unsecured market. And so we have many arrows in the quiver. And I think that our outreach efforts are paying dividends with respect to people paying attention and taking interest in iStar.

So I think, while certainly we are very diligent about it, we have the utmost confidence that we will be able to refinance that debt. And also, as you know, we carry -- today, liquidity stands at $700 million. So we have ample liquidity on hand, if you think about that. With respect to repayments, et cetera, we have a lot of levers that we control.

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

Thanks for that. Lastly, I just wanted to see if you could comment on the New York City condo market, both the standing of your existing projects and exposure, as well as how you see the current supply-demand dynamic playing out.

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

I think we saw actually a little bit of a pop here, as it went into the new year. I ascribe that to really a slowdown around the election cycle last year, some uncertainty. It feels like some of those sales came back into the market. I wouldn't expect that to continue, that strength. But we did see consistent buying through the first 45 days of this year.

I'd say the good news for us is that our basis in our remaining New York condo stuff is really safe. So we really don't feel like we have much exposure to the market right now. We do think there is supply that has touched the market that is going to make new projects face some headwinds. But I think that can also be an opportunity. So as we see our existing portfolio reach either full realization or repayment, we will continue to look and see if there's any opportunities in that market.

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

Thanks very much for taking the questions.

Operator

Ben Zucker, JMP Securities.

Ben Zucker - *JMP Securities - Analyst*

Thanks for taking my questions. The first one is kind of just high-level. In the L&D portfolio, I noticed that you mentioned the portfolio was entitled for 30,000 lots on the last earnings report, and that number was now 15,000. And I was just wondering is that related to the Grand Vista migration, or has there been any kind of change in plans or strategy there?

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

You got it, Ben.

Ben Zucker - *JMP Securities - Analyst*

Just Grand Vista?

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

Yes.

Ben Zucker - *JMP Securities - Analyst*

Cool. And then turning to the lending side, it looks like roughly half of all of last year's repayments came in the fourth quarter. And now that we sit almost 2 months through first quarter of 2017, I'm curious, has the level of repayment subsided? Or is it still elevated?

And if I could go one further, and see if you could offer up any kind of nearer-term outlook for originations or repayments for the real estate finance segment, maybe just for like the first half of 2017, where you have better visibility, that would be helpful.

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

Yes. I think we had a very large repayment in the fourth quarter, so that was a bit of a one-timer. We do continue to receive repayments in the ordinary course of business. So you will see, I think we said in the past, a couple hundred million dollars of money going out the door, and expect something less than that this year, per quarter, coming in the door. It will be, again, dependent on some idiosyncratic factors. But our goal is to bump up originations. We have lots of liquidity. We have lots of sources of capital. Some of them are quite attractively priced right now.

So I think the goal is to have those dollars going out the door increase over time. And we think the dollars coming back this year -- we are not expecting anything crazy. So not inconsistent with what you saw last year, on an average basis.

Ben Zucker - *JMP Securities - Analyst*

Okay, that's very helpful. And then maybe on the same theme of capital deployment, I was just wondering how you guys view or feel about additional buybacks here at the [$17.50] level. I know you still have a buyback in place, and in the past you have certainly shown a willingness to use it. And your comments around growth in earnings, tightening of the coil and managing cash balances better -- it just -- it seems like something that could be may be coming back in play.

Is that a fair characterization? Or, given the debt maturities and all the moving pieces, is that just still more defensive at this point, and for optionality purposes?

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

So obviously we've made a lot of progress in that front. I think we've just been -- in share repurchases over the last 18 months, we've probably done 17 million, 18 million shares at under $10. We think that was a good use of capital for the Company. We will continue to evaluate weakness in the stock. We will always look at a potential opportunity to redeploy some of the capital into our own balance sheet. But hopefully we are also seeing some pretty interesting investment opportunities. So it will be -- we will weigh both, and see which one has the best impact for us.

Ben Zucker - *JMP Securities - Analyst*

Makes sense. Well, that's it for me. Congrats on a strong year; and nice job hitting your targets, guys.

Operator

Andrew Molloy, Bank of America Merrill Lynch.

Andrew Molloy - *BofA Merrill Lynch - Analyst*

I just wanted to turn back to the original question about your debt maturity schedule. Can you provide any more color in terms of some of the levers that you would like to pull? I know you are mentioning that you have access to many markets. Do you have any idea, as you look forward on the $925 million through this year, what markets are most attractive to you and how you think about the refinance?

Geoff Jervis - *iStar Inc. - COO and CFO*

Sure, absolutely. I think that as we have stated multiple times with conviction, and we continue to state with conviction, we are a committed unsecured borrower. We have a substantial unsecured borrowing base. And we would envision a substantial amount of whatever we do would occur in the unsecured market.

Andrew Molloy - *BofA Merrill Lynch - Analyst*

Thank you. And just turning more high-level, can you walk us through or remind us on what your thoughts are on the optimal capital structure for the Company? And what would you see with the five preferreds that are callable in March, and if there is anything that you might do with those securities?

Geoff Jervis - *iStar Inc. - COO and CFO*

Sure. I think the optimal capital structure for the Company, as we've mentioned in the past, our target leverage level is 2 to 2.5 times. The preferred are an important part of our capital structure. That said, we have significantly shrunk the common equity capital base. And so, if we wanted to keep the ratios in line, I think we do, from time to time, look at rightsizing the preferred. We have nothing pending, but it certainly is something that we consider. And obviously we look at both the equity and debt markets and see what looks attractive relative to the preferred we have in place.

But I think that talking about the optimal capital structure, I think it goes without saying that our maturity profile -- we would like to grab, carefully grab more duration. I think that we are a little reluctant to go out and look in the seven-to-10-year range, just because of the cost. But I think that we like anywhere in that three, five, seven would be nice to add and to push out duration a little bit.

That said, I think that as all of our remarks have consistently confirmed, we believe that we are in a period of transformation. And so we are going to measure that desire to get a little more duration against the fact that this Company is making a lot of positive moves with respect to assets and liabilities. And taking duration right now needs to be measured against that.

Andrew Molloy - *BofA Merrill Lynch - Analyst*

Thank you. And one last question on the preferred. If you need to, can you remind us that -- do all six of those tranches have the ability to defer the dividend payment on those, if you need to pull that lever?

Geoff Jervis - *iStar Inc. - COO and CFO*

Yes, they do.

Andrew Molloy - *BofA Merrill Lynch - Analyst*

Thank you very much.

Operator

Mr. Fooks, we have no further questions.

Jason Fooks - *iStar Inc. - VP of IR and Marketing*

Okay. 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 give the conference call replay instructions once again?

Operator

Certainly. And ladies and gentlemen, the replay starts today at 12:30 PM Eastern time today, and will last until March 10 at midnight. The dial in for the replay is 1-800-475-6701, and the access code, 418324. That does conclude your conference for today. Thank you for your participation. You may now disconnect.
