

- 1
- 2
- 3
- 4
- 5
- 6
- 7

7

reasons

to invest in iStar Financial

FINANCIAL HIGHLIGHTS

(in thousands, except per share amounts)

for the year ended December 31,

	2000	1999	1998
interest income	\$268,011	\$209,848	\$112,914
operating lease income	185,956	42,186	12,378
interest expense	(173,891)	(91,184)	(44,697)
operating costs	(12,809)	(2,246)	—
net investment income	\$267,267	\$158,604	\$80,595
adjusted earnings allocable to common shareholders ¹	\$230,688	\$127,798	\$66,615
adjusted earnings per common share ²	\$2.67	\$2.07	\$1.53
dividends per common share	\$2.40	\$1.86	\$1.14

as of December 31,

	2000	1999	1998
loans and other lending investments, net	\$2,225,183	\$2,003,506	\$1,823,761
real estate subject to operating leases, net	1,670,169	1,714,284	189,942
total assets	4,034,775	3,813,552	2,059,616
debt obligations	2,131,967	1,901,204	1,055,719
total liabilities	2,240,666	2,009,644	1,088,888
total shareholders' equity	1,787,885	1,801,343	970,728
book debt to shareholders' equity	1.2X	1.1X	1.1X

adjusted earnings per share²

return on average assets³

return on average equity⁴

quarter

quarter

quarter

2000	1	\$0.64
	2	\$0.66
	3	\$0.68
	4	\$0.69

2000	1	6.6%
	2	6.7%
	3	6.7%
	4	6.8%

2000	1	15.1%
	2	15.5%
	3	16.1%
	4	16.7%

¹ adjusted earnings represents GAAP net income before depreciation and amortization and, for purposes of the fourth quarter 1999, excludes the non-recurring, non-cash charge associated with the Company's acquisition of its external advisor.

² per diluted common share.

³ return on average assets is defined as the sum of annualized quarterly adjusted earnings and preferred dividends divided by the average book value of assets outstanding during the quarter.

⁴ return on average equity is defined as annualized quarterly adjusted earnings divided by the average book value of equity outstanding during the quarter.

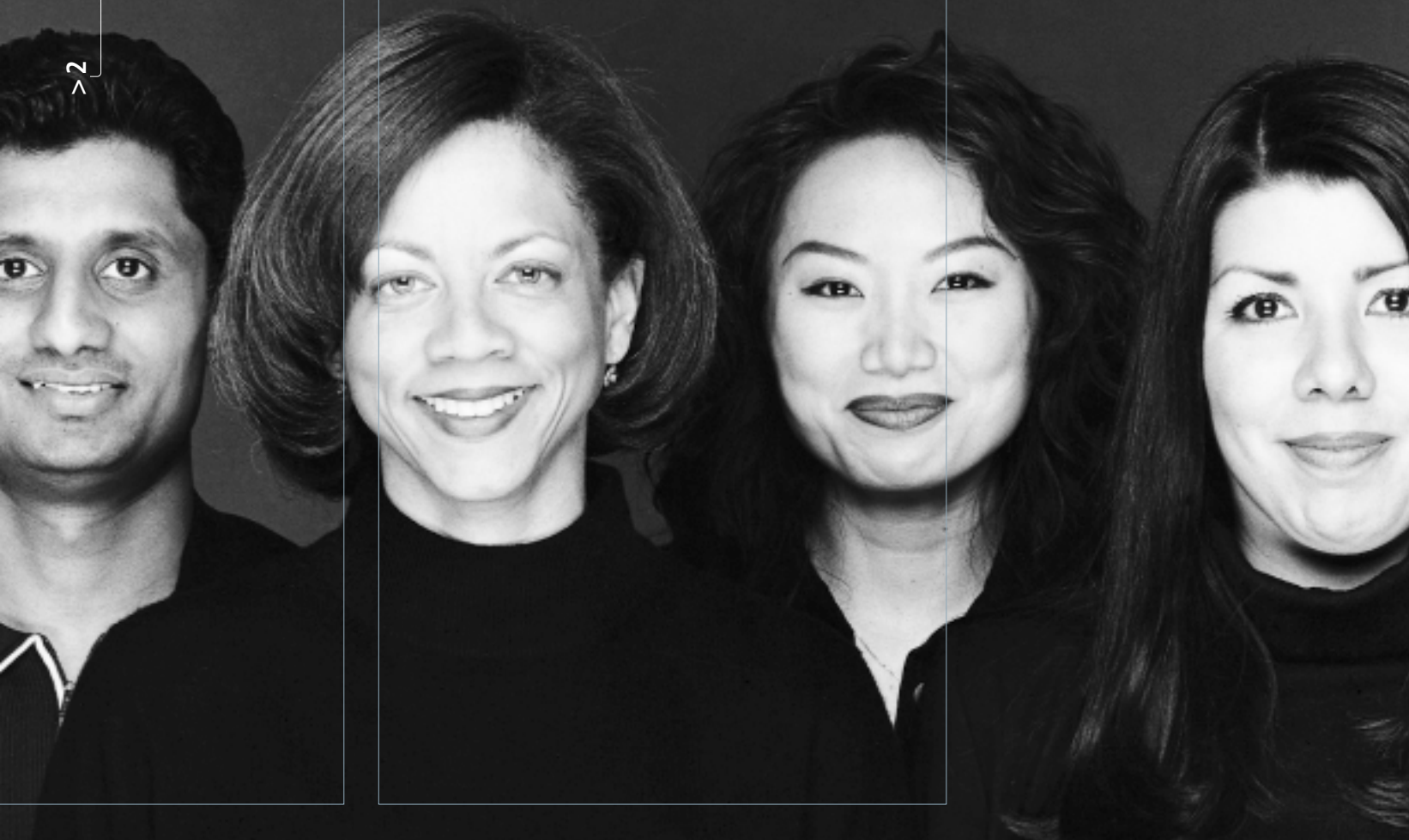
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2
3
4
5
6
|
7

reasons

to invest in iStar Financial

intro — **Company Overview**

iStar Financial is the leading publicly traded finance company focused on the commercial real estate industry. The Company provides structured financing to private and corporate owners of real estate nationwide, including senior and junior mortgage debt, corporate mezzanine and subordinated capital, and corporate net lease financing. The Company, which is taxed as a real estate investment trust, seeks to deliver superior risk-adjusted returns on equity to shareholders by providing innovative and value-added financing solutions to its customers.



intro — chairman's letter

2000 was an important year for our Company. We changed our name to iStar Financial to let the world know we were looking to the future and not to the past. We expanded and enhanced our three main business lines — structured finance, corporate lending and corporate net lease financing — closing over \$1 billion in new investments.

We solidified our position as one of the few companies able to deliver highly structured financial solutions to both private and corporate owners of real estate. We delivered solid returns to our shareholders, totaling over 30% including dividends. And we made significant progress in developing secure and stable funding sources for the future. All in all, our employees delivered outstanding performances in almost every area of the firm. However, in one key area our work has just begun.

We have a simple problem – we are not well known. Perhaps this is because we are in many ways a one-company industry, a low leveraged finance company that focuses on highly structured transactions involving real estate. With no direct competitors to compare with iStar, analysis of our Company can be difficult for equity analysts, rating agencies and investors. On the other hand, we are thrilled that no one else does exactly what we do – that is one of the fundamental premises of our business. We like having few competitors, and the time, effort and expertise we have dedicated to this business will be hard for others to match. So, the very thing that makes this a profitable and attractive business, also makes it a somewhat more difficult story for people to understand. Every day, we ask ourselves how to overcome this issue.

The annual report you are reading is one very direct way to let people know what we do and why we have become a leader in the finance industry. You will notice that our message for the year is straightforward: “7 Reasons to Invest in iStar Financial.” Please share it with a few of your friends. We think you’ll find plenty to be happy about if you are a shareholder and much of interest if you haven’t yet invested in our Company.

Highlights of the Year

Our year was filled with many meaningful milestones that our employees are proud to have accomplished. Let me share a few of them with you:

Investments – Throughout last year, we established iStar as one of the largest players providing financing for publicly traded real estate companies either going private or seeking to acquire other real estate companies. Our Leveraged Transactions Group invested approximately \$400 million in this area and was a key player in delivering custom-tailored financial solutions for both the \$1.8 billion buyout of Walden Residential and the \$1 billion buyout of Sunstone Hotel Investors.

In the credit tenant lease arena, we acquired American Corporate Real Estate Partners, a leading company in the sector, with a highly experienced investment team including Cabot Lodge, Barclay Jones and Michael Dorsch. As part of the iStar team, their goals are to target strategic corporate facilities with typical lease durations of 15 years (and not less than 10), and to capture opportunities with a minimum of competition. By focusing on longer leases and by providing creative financing and sale/leaseback alternatives, we utilized our newly-acquired corporate leasing group's experience to deliver optimal financial solutions to several new corporate customers last year.

In our other structured finance product lines, we remained somewhat cautious last year, sensing not only a slowing economy, but also rapidly deteriorating credit markets later in the year. We completed \$400 million in transactions and we expect our conservative investment posture and minimal credit issues to benefit us as we move into the new year.

Finance and Capital Markets – We achieved a number of important milestones in 2000 on the “right side” of iStar’s balance sheet. We created a unique financing program called iStar Asset Receivables, or “STARs,” to match fund our asset and liability maturities. In May, we successfully issued \$900 million of investment grade bonds under the STARs program at attractive terms to the Company. We developed this program as a recurring source of low-cost funding for our various business lines, and we expect to commence work on the next STARs offering in 2001.

We also made large strides in expanding and extending our short-term capital sources. Between January 2000 and January 2001, we increased iStar’s overall credit facility capacity from \$1.5 billion to \$2.4 billion. In doing so, we added a new unsecured credit facility and a new secured facility, and expanded and extended two other secured facilities. We now have over 15 leading financial institutions in our various credit facilities, and are pleased with the depth and breadth of support we have received from the institutional lending community.

Between STARs, our credit facilities and our various other capital markets initiatives, in 2000 we significantly lengthened iStar Financial’s debt maturity schedule and created substantial excess liquidity to drive our investment activities in the coming years.

Perhaps most importantly, we added a number of highly talented finance, accounting and investor relations professionals in 2000. I truly believe that the quality of our people in these disciplines is exceptional, as is their ability to work together as a cohesive team.

Asset Management – Under Tim O'Connor's direction, our asset and property managers worked hard to improve both the quality and stability of our corporate lease portfolio, ending the year with more than 50% investment grade tenants and extending the average lease term from just over five years to more than eight years. We continue to see great long-term opportunity in this business, and have eliminated most of the short-term uncertainty associated with the former "TriNet" portfolio. On the structured finance side, the credit quality of the portfolio remained strong, with no new assets added to our watch list during the entire year.

Loan Servicing – During 2000, our loan servicing business, iStar Asset Services (iSAS), accomplished a number of key objectives. We received favorable ratings on the strength of our servicing capabilities from both Standard & Poor's and Fitch, Inc. Furthering our goal of keeping all information regarding our investments in-house, iStar Asset Services also took on primary servicing responsibilities for our inaugural STARs financing this year. In addition, we implemented a new, state-of-the-art technology platform at iSAS to provide our managers with more comprehensive, real-time information on our asset base.

Share Price and Dividends

While we delivered strong returns for our shareholders last year, we still believe our share price does not reflect the value of all that we have built and all that we have accomplished. Our \$2.40 per share dividend for 2000 represented a 14% return on the price of our stock on January 1, 2000. In addition to the dividend, our stock price increased by 17% during the year for a total shareholder return of just over 30%. Our mission for 2001 is to deliver on the promise of our Company and make sure that our success is fully reflected in our stock price before the year is over.

My personal thanks to our employees, our customers and our friends who have helped us achieve the success we have had to date, and will help us reach our higher goals in the future. I, and all our employees, thank you for your support.

A handwritten signature in dark ink, reading "Jay Sugarman". The signature is fluid and cursive, with the first name "Jay" and last name "Sugarman" clearly distinguishable.

Jay Sugarman, Chairman and Chief Executive Officer

01/ QUALITY

plate 01 — “WE PROMISE OUR CUSTOMERS SUPERIOR LEVELS
OF SERVICE AND INNOVATIVE CAPITAL SOLUTIONS.
THE QUALITY OF OUR PROFESSIONALS ENABLES US TO
DELIVER ON THAT PROMISE.”

Jay Sugarman, Chairman and Chief Executive Officer

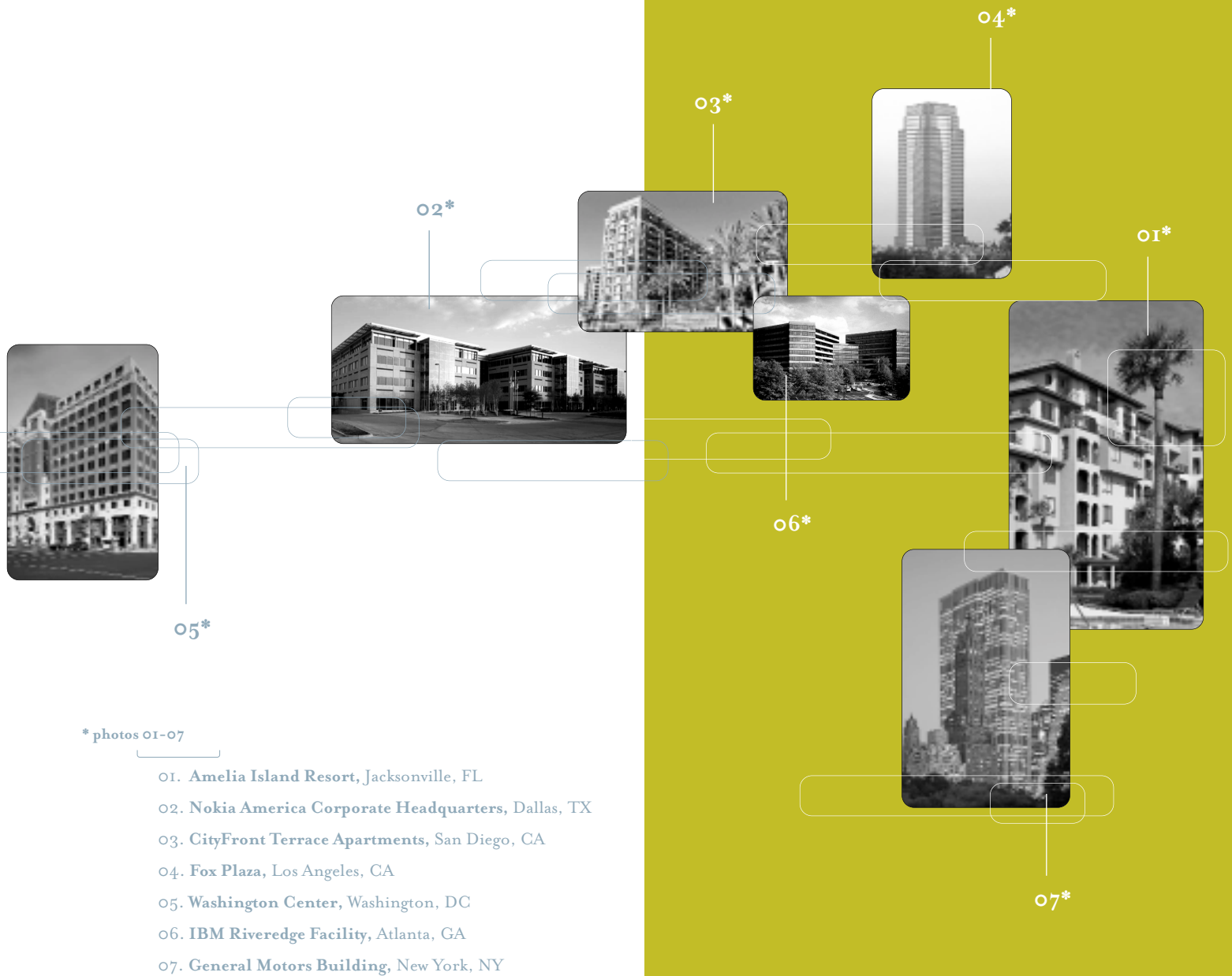


fig. 01 – Asset Quality

iStar Financial focuses on providing creative capital solutions to leading private and corporate owners of high-quality real estate located throughout the United States. iStar customers include Olympus Real Estate Corporation, FedEx Corporation, Lexmark International, Quadrangle Development, WCI Communities, Goldman Sachs' Whitehall Funds and Hilton Hotels. iStar Financial's portfolio has included investments in such premier assets as the General Motors Building in New York, the Boca Raton Resort and Club in Florida, Washington Center in Washington D.C., CityFront Terrace Apartments in San Diego, Fox Plaza in Los Angeles, and South Beach Marina Apartments in San Francisco.

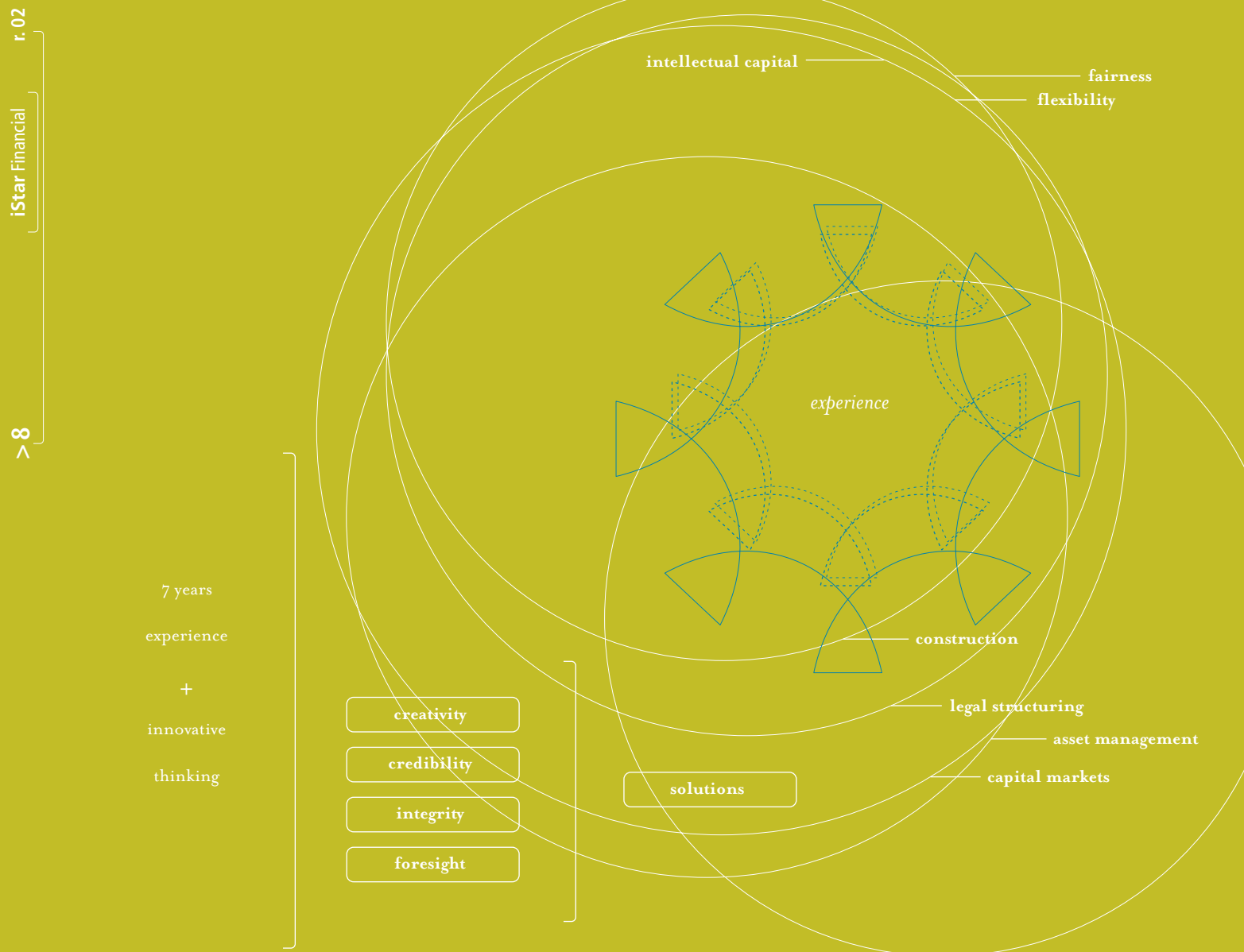
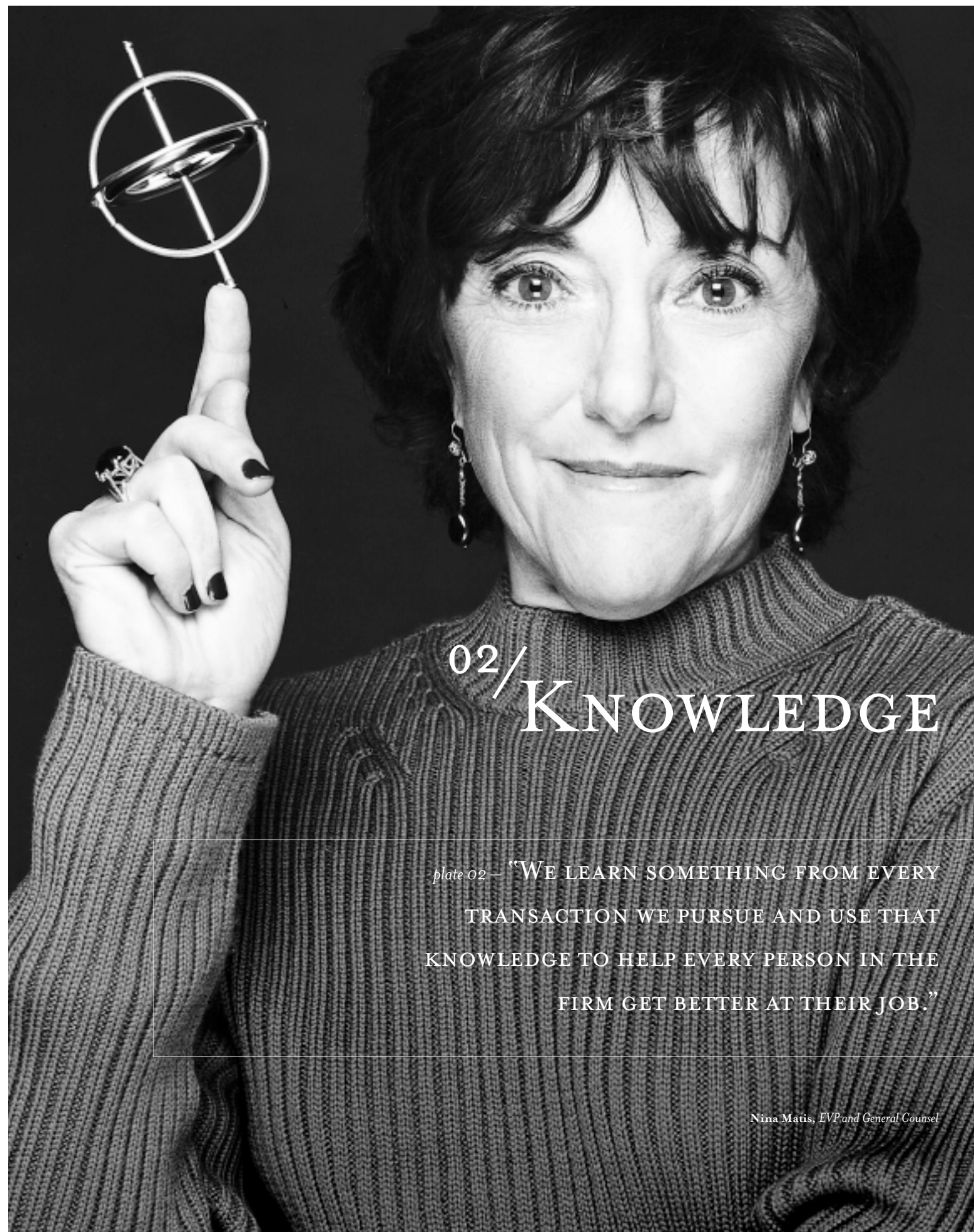


fig. 02 – **Experienced Management**

With experts drawn from the fields of private investment, capital markets, real estate, legal structuring, construction, loan servicing and asset management, iStar Financial brings the diverse strengths of its entire organization to bear on every investment it makes. This multi-disciplined approach means that iStar Financial understands how best to protect its investments and where to uncover new investment opportunities.



02/ KNOWLEDGE

plate 02 — “WE LEARN SOMETHING FROM EVERY TRANSACTION WE PURSUE AND USE THAT KNOWLEDGE TO HELP EVERY PERSON IN THE FIRM GET BETTER AT THEIR JOB.”

Nina Matis, EVP and General Counsel

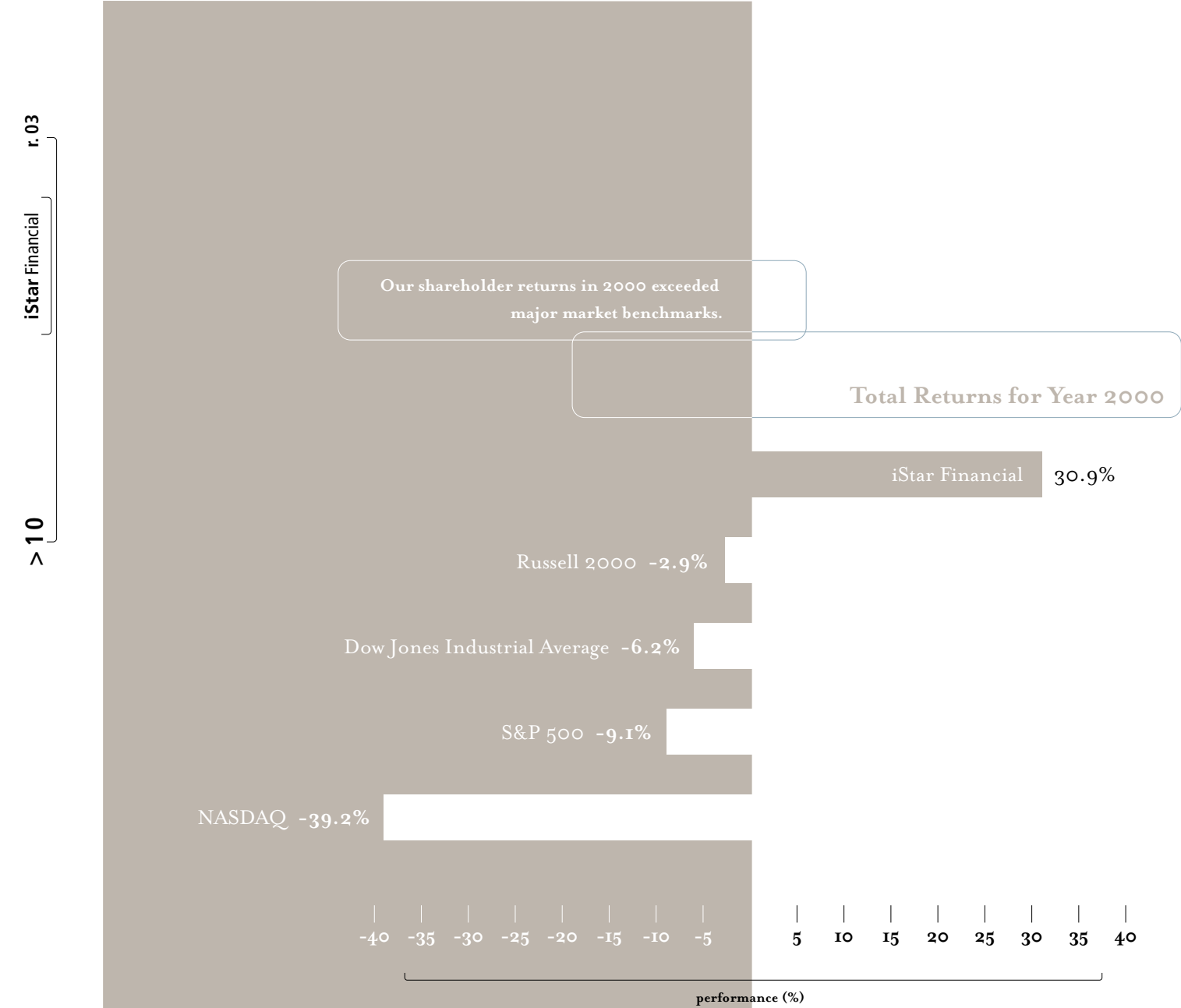
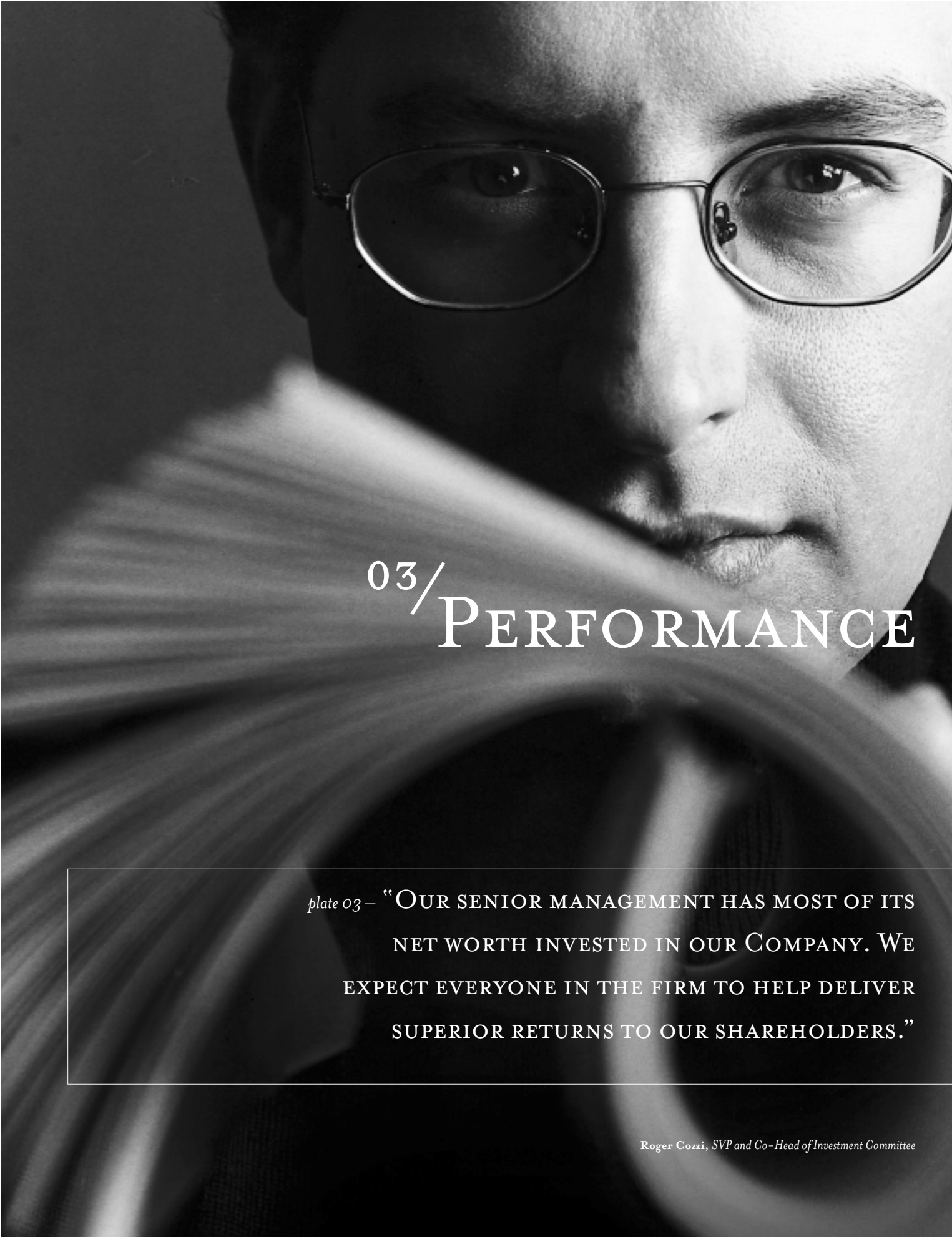


fig. 03 – **Track Record**

iStar Financial continues to deliver excellent risk-adjusted returns to shareholders through a proven and disciplined approach to the marketplace. With a highly successful track record now spanning eight years, iStar Financial delivered over a 30% total rate of return to shareholders last year, outpacing most major indices.



03/ PERFORMANCE

plate 03 – “OUR SENIOR MANAGEMENT HAS MOST OF ITS
NET WORTH INVESTED IN OUR COMPANY. WE
EXPECT EVERYONE IN THE FIRM TO HELP DELIVER
SUPERIOR RETURNS TO OUR SHAREHOLDERS.”

Roger Cozzi, SVP and Co-Head of Investment Committee

04/ DIVERSITY

plate 04 – “WHAT REALLY MAKES OUR APPROACH TO THE BUSINESS
WORK IS THE WIDE RANGE OF SKILLS WE HAVE IN-HOUSE TO
HELP ANALYZE OPPORTUNITIES FROM ALL ANGLES.”

Tim O'Connor, EVP and Chief Operating Officer

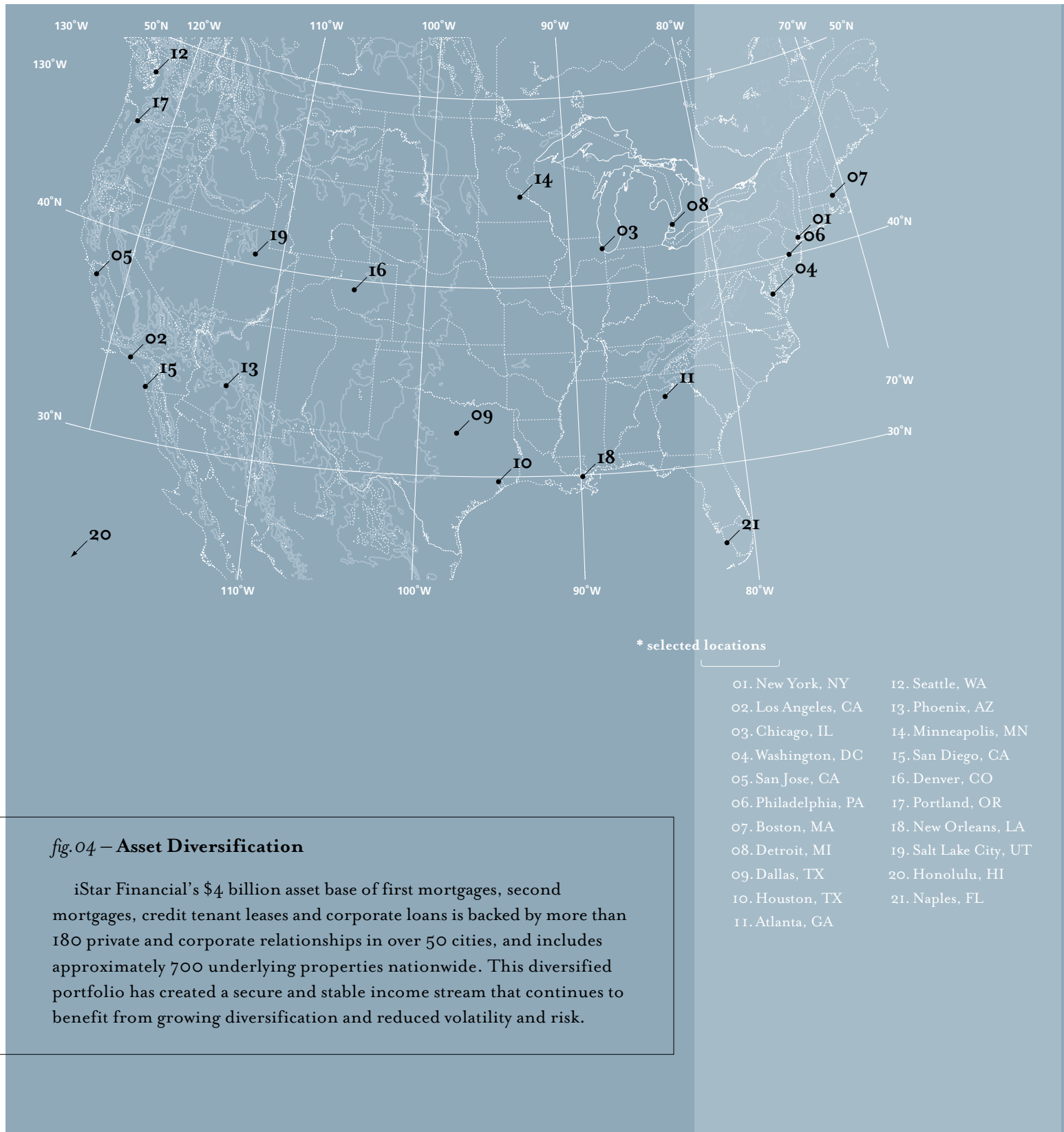


fig. 04 – Asset Diversification

iStar Financial's \$4 billion asset base of first mortgages, second mortgages, credit tenant leases and corporate loans is backed by more than 180 private and corporate relationships in over 50 cities, and includes approximately 700 underlying properties nationwide. This diversified portfolio has created a secure and stable income stream that continues to benefit from growing diversification and reduced volatility and risk.

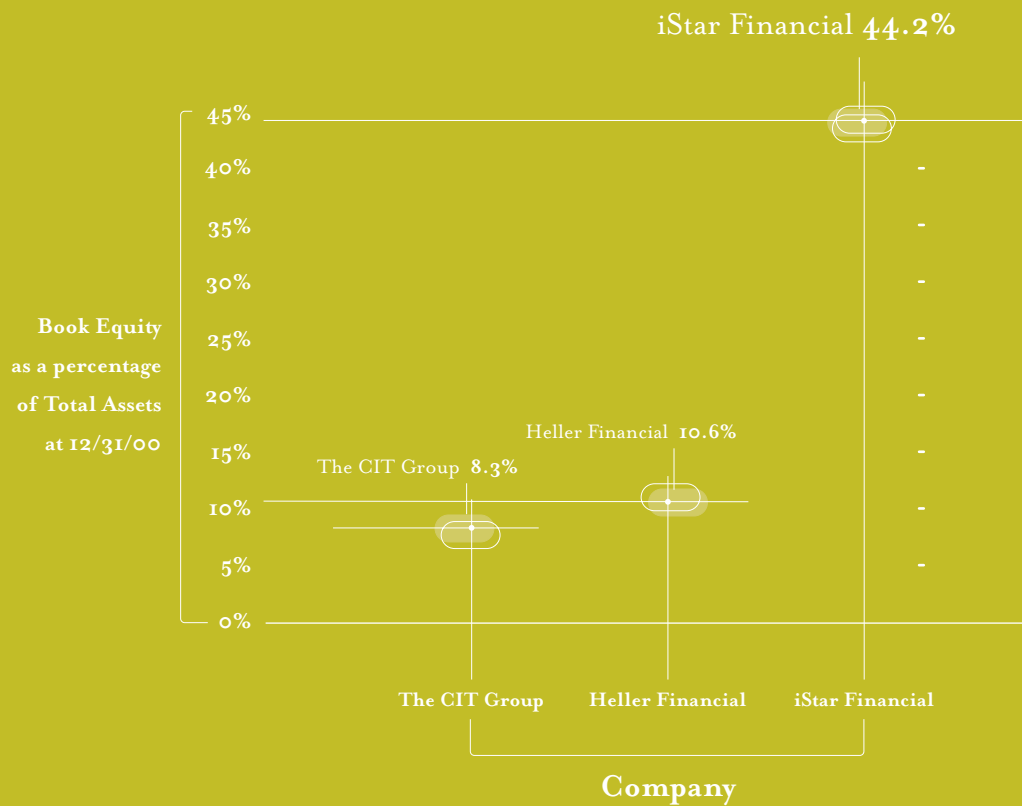


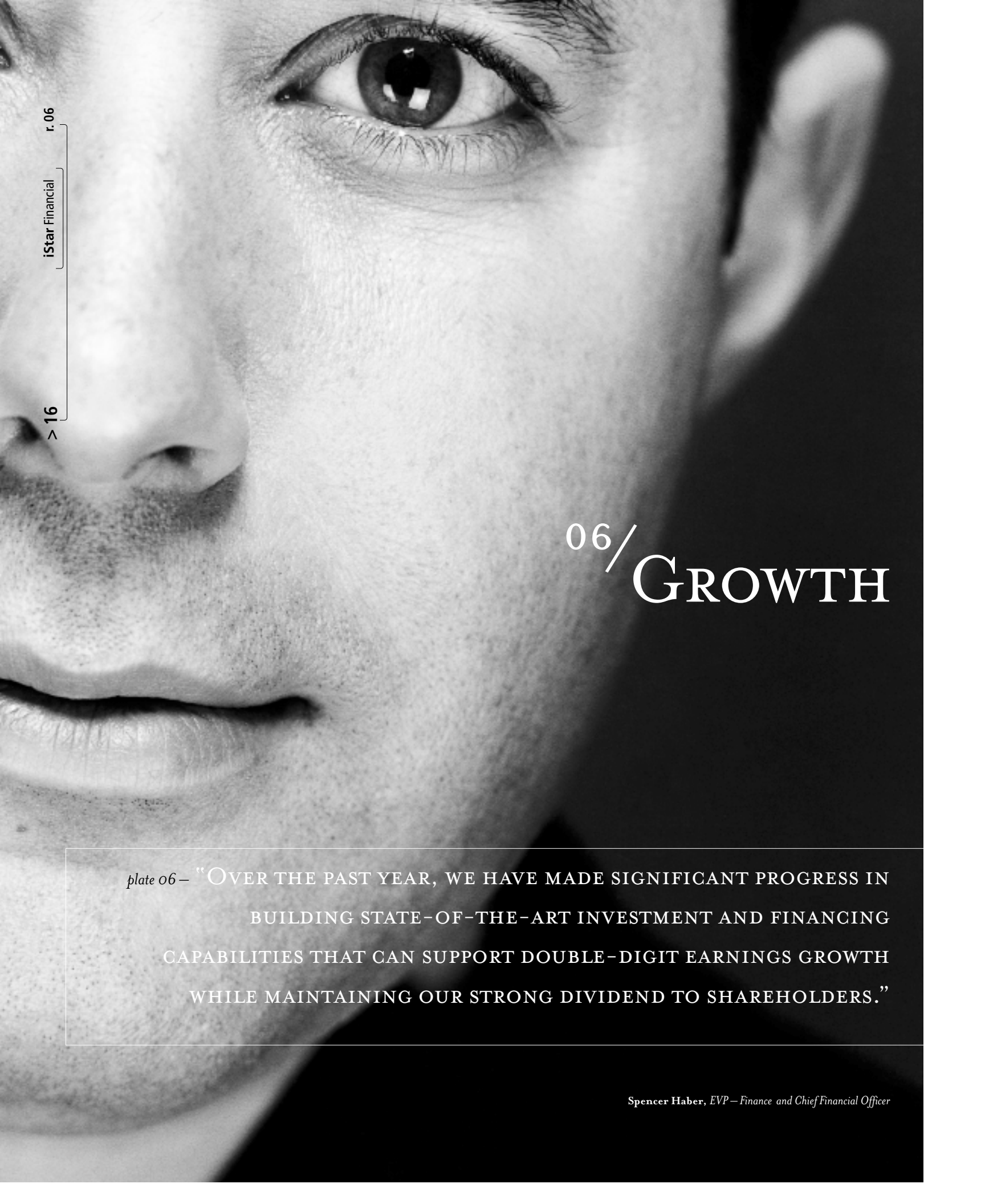
fig. 05 – Equity Base

With \$1.8 billion in tangible equity, iStar Financial is one of the strongest capitalized asset-based finance companies in the public markets, with a balance sheet that is considerably less leveraged than most commercial finance companies. iStar's business strategy is based on much lower leverage levels than most finance companies, and its shareholder base includes many of the largest institutional and private investors in the country.

05/
SCALE

plate 05 – “WE CONTINUE TO BE ABLE TO ATTRACT HIGHLY QUALIFIED PROFESSIONALS TO THE COMPANY BECAUSE OUR EQUITY BASE IS ONE OF THE LARGEST AND STRONGEST IN THE COMMERCIAL FINANCE ARENA.”

Jeff Digel, EVP and Co-Head of Investment Committee



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iStar Financial

> 16

06/ GROWTH

plate 06 – “OVER THE PAST YEAR, WE HAVE MADE SIGNIFICANT PROGRESS IN BUILDING STATE-OF-THE-ART INVESTMENT AND FINANCING CAPABILITIES THAT CAN SUPPORT DOUBLE-DIGIT EARNINGS GROWTH WHILE MAINTAINING OUR STRONG DIVIDEND TO SHAREHOLDERS.”

Spencer Haber, EVP – Finance and Chief Financial Officer

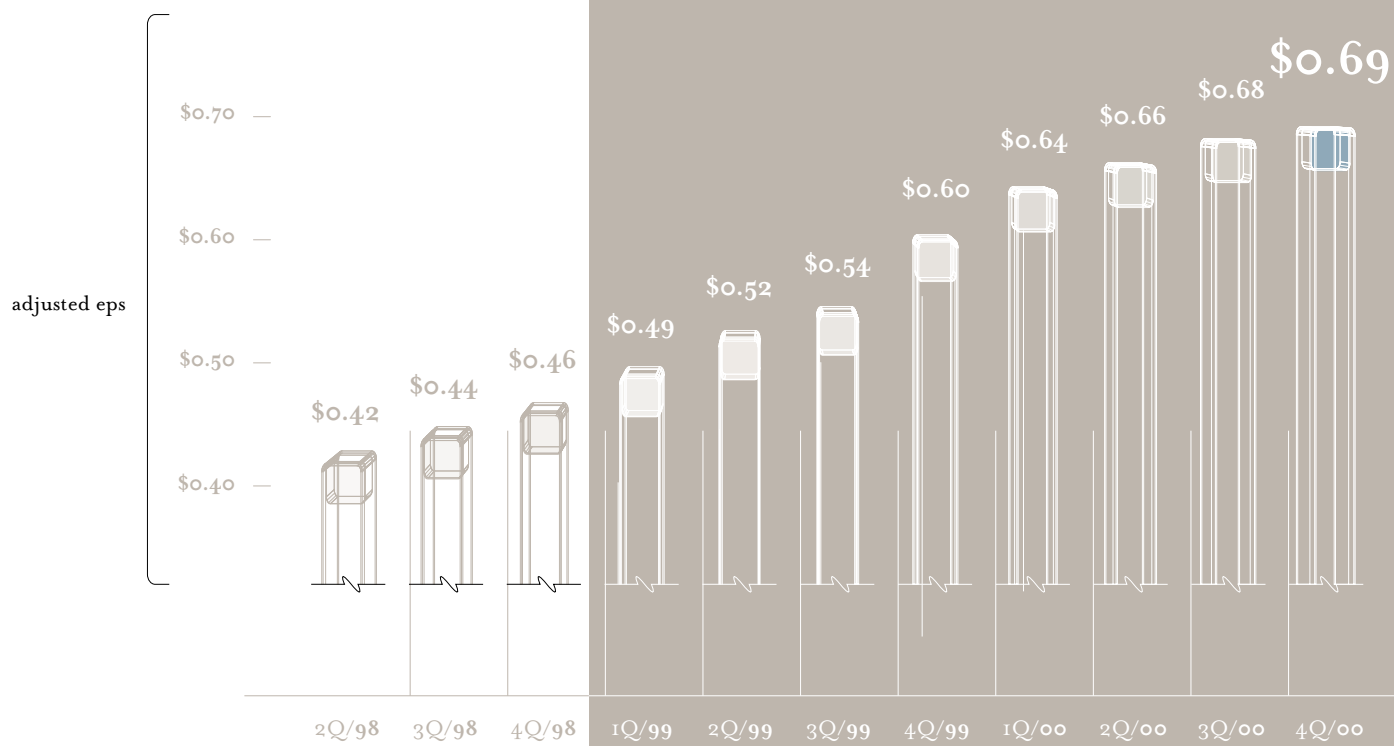


fig.06 – Earnings Growth

Since its inception eight years ago, iStar Financial has consistently grown earnings. In its 11 full quarters as a public company, adjusted earnings per share have increased by 64%. During 2000, earnings grew 29%, from \$2.07 per share to \$2.67 per share. Dividends have also grown considerably, from \$1.14 per share in 1998 to \$2.40 per share in the year 2000. Returns on equity for 2000 reached 16.3%, with average leverage of just 1.1x tangible equity.

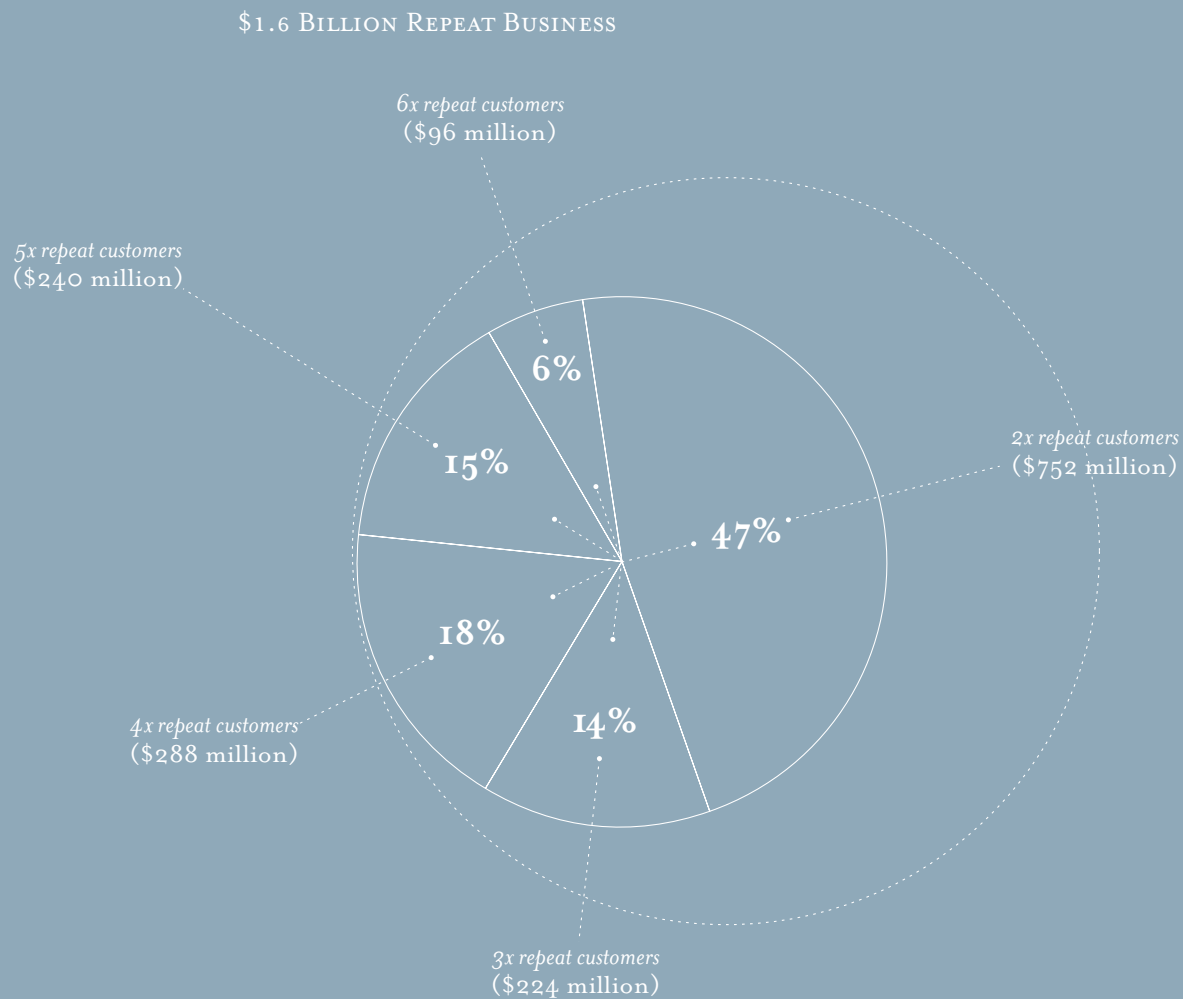
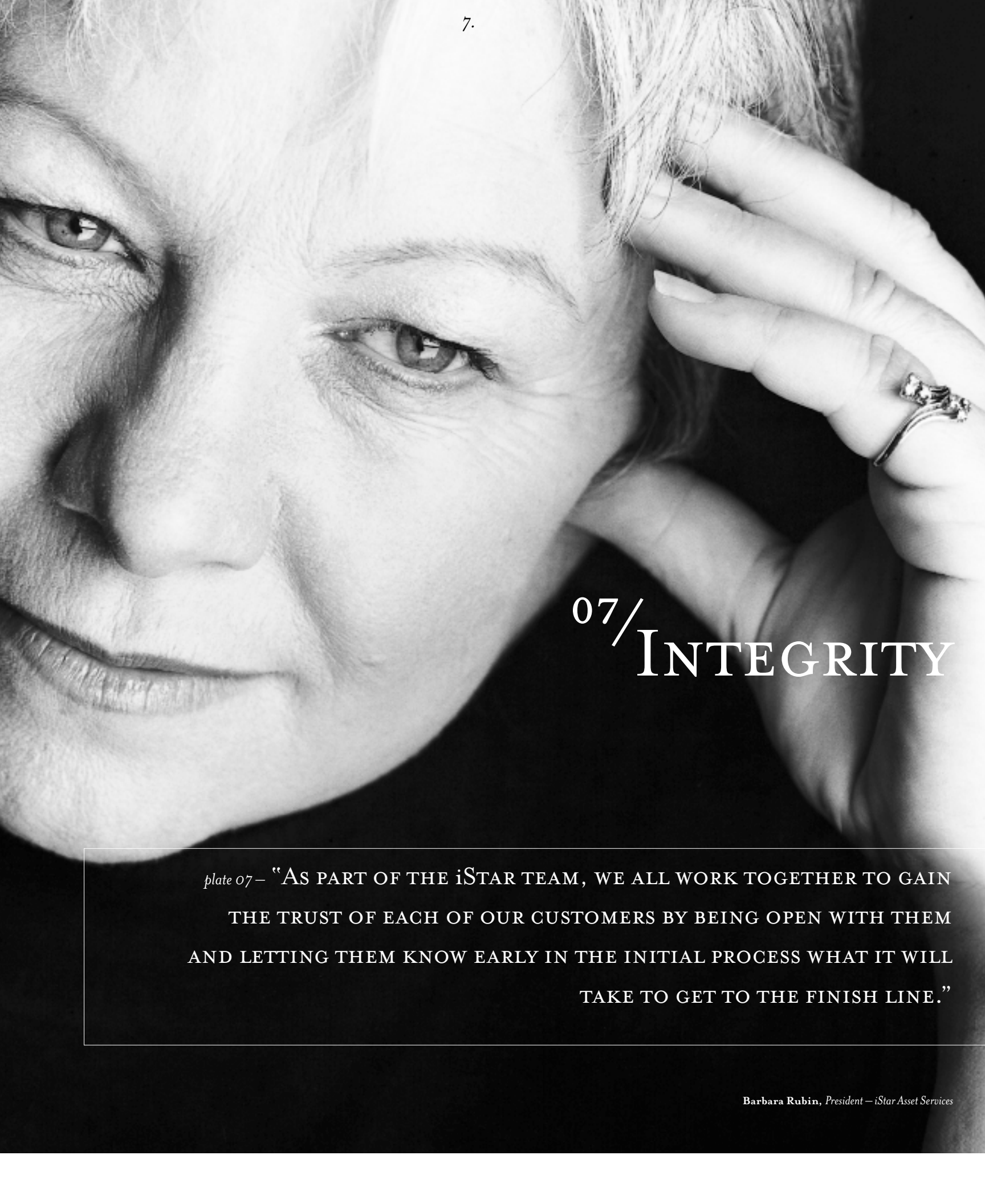


fig.07 – Credibility

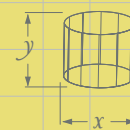
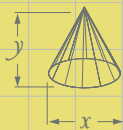
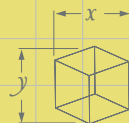
iStar Financial is committed to delivering unique financial solutions to its customers and making sure their objectives are met in the timeframe required. iStar's ability to deliver this level of service has won the Company a strong following among its customers, with over \$1.6 billion of its transactions coming from repeat customers.



07/INTEGRITY

plate 07 – “AS PART OF THE iSTAR TEAM, WE ALL WORK TOGETHER TO GAIN
THE TRUST OF EACH OF OUR CUSTOMERS BY BEING OPEN WITH THEM
AND LETTING THEM KNOW EARLY IN THE INITIAL PROCESS WHAT IT WILL
TAKE TO GET TO THE FINISH LINE.”

Financial Information



Financial Contents

Page

22	Selected Financial Data
24	Management's Discussion and Analysis of Financial Condition and Results of Operations
32	Quantitative and Qualitative Disclosures About Market Risk
34	Report of Independent Accountants
35	Consolidated Balance Sheets
36	Consolidated Statements of Operations
37	Consolidated Statements of Cash Flows
38	Consolidated Statement of Changes in Shareholders' Equity
40	Notes to Consolidated Financial Statements
64	Common Stock Price and Dividends

Selected Financial Data

The following table sets forth selected financial data on a consolidated historical basis for the Company. However, prior to the recapitalization of the Company in March 1998, discussed more fully in Note 4 to the Company's Consolidated Financial Statements (the "Recapitalization Transactions"), the Company did not have substantial capital resources or operations. Prior to the Recapitalization Transactions, the Company's structured finance operations were conducted by two investment partnerships affiliated with Starwood Capital Group, L.L.C., which contributed substantially all their structured finance assets to the Company in the Recapitalization Transactions in exchange for cash and shares of the Company.

Further, on November 4, 1999, as more fully discussed in Note 4 to the Company's Consolidated Financial Statements, the Company acquired TriNet, which increased the size of the Company's operations, and also acquired its external advisor. Operating results for the year ended December 31, 1999 reflect only the effects of these transactions subsequent to their consummation.

Accordingly, the historical balance sheet information as of and prior to December 31, 1998, as well as the results of operations for the Company for all periods prior to and including the year ended December 31, 1999, do not reflect the current operations of the Company as a well capitalized, internally-managed finance company operating in the commercial real estate industry. For these reasons, the Company believes that the information contained in the following tables relating to the 1996 and 1997 periods is not indicative of the Company's current business and should be read in conjunction with the discussions set forth in Item 7—"Management's Discussion and Analysis of Financial Condition and Results of Operations."

	Years Ended December 31,				
	2000	1999	1998	1997	1996
	<i>(in thousands, except per share data)</i>				
Operating Data:					
Interest income	\$268,011	\$209,848	\$112,914	\$ 896	\$ 478
Operating lease income	185,956	42,186	12,378	—	—
Other income	17,855	12,763	2,804	991	10
Total revenue	<u>471,822</u>	<u>264,797</u>	<u>128,096</u>	<u>1,887</u>	<u>488</u>
Interest expense	173,891	91,184	44,697	—	272
Operating costs-corporate tenant lease assets	12,809	2,246	—	—	—
Depreciation and amortization	34,514	10,340	4,287	—	—
General and administrative expense	25,706	6,269	2,583	461	639
Provision for possible credit losses	6,500	4,750	2,750	—	—
Stock option compensation expense ⁽¹⁾	2,864	412	5,985	—	—
Advisory fees	—	16,193	7,837	—	—
Costs incurred in acquiring external advisor ⁽²⁾	—	94,476	—	—	—
Total expenses	<u>256,284</u>	<u>225,870</u>	<u>68,139</u>	<u>461</u>	<u>911</u>
Income (loss) before minority interest	215,538	38,927	59,957	1,426	(423)
Minority interest in consolidated entities ⁽³⁾	(195)	(41)	(54)	(1,415)	(154)
Gain on sale of corporate tenant lease assets	2,948	—	—	—	—
Extraordinary loss on early extinguishment of debt	(705)	—	—	—	—
Net income (loss)	<u>\$217,586</u>	<u>\$ 38,886</u>	<u>\$ 59,903</u>	<u>\$ 11</u>	<u>\$ (577)</u>
Preferred dividend requirements	(36,908)	(23,843)	(944)	—	—
Net income allocable to common shareholders	<u>\$180,678</u>	<u>\$ 15,043</u>	<u>\$ 58,959</u>	<u>\$ 11</u>	<u>\$ (577)</u>
Basic earnings (loss) per common share ⁽⁴⁾	<u>\$ 2.11</u>	<u>\$ 0.25</u>	<u>\$ 1.40</u>	<u>\$ 0.01</u>	<u>\$ (1.36)</u>
Diluted earnings (loss) per common share	<u>\$ 2.10</u>	<u>\$ 0.25</u>	<u>\$ 1.36</u>	<u>\$ 0.00</u>	<u>\$ (1.36)</u>
Dividends declared per common share ⁽⁹⁾	<u>\$ 2.40</u>	<u>\$ 1.86</u>	<u>\$ 1.14</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>

	Years Ended December 31,				
	2000	1999	1998	1997	1996
	(in thousands, except per share data)				
Supplemental Data:					
Dividends declared on preferred shares	\$ 36,576	\$ 24,819	\$ 929	\$ –	\$ –
Dividends declared on common shares	205,506	116,813	60,343	–	–
Adjusted earnings allocable to common shareholders ⁽⁵⁾	230,688	127,798	66,615	11	(577)
Adjusted earnings per common Share – basic	2.69	2.19	1.59	0.01	(1.36)
Adjusted earnings per common Share – diluted	2.67	2.07	1.53	0.00	(1.36)
Cash flows from:					
Operating activities	192,469	122,549	54,915	1,271	(227)
Investing activities	(176,652)	(143,911)	(1,271,309)	(6,013)	(522)
Financing activities	(27,473)	45,660	1,226,208	4,924	–
EBITDA	423,943	251,120	116,778	–	–
Ratio of EBITDA to interest expense ⁽⁶⁾	2.44x	1.54x	2.44x	–	–
Ratio of EBITDA to combined fixed charges ⁽⁷⁾	2.01x	1.22x	2.39x	–	–
Weighted average common shares outstanding – basic ⁽⁸⁾	85,441	57,749	41,607	1,258	425
Weighted average common shares outstanding – diluted ⁽⁸⁾	86,151	60,393	43,460	2,562	425
Balance Sheet Data:					
Loans and other lending investments, net	\$ 2,225,183	\$ 2,003,506	\$ 1,823,761	\$ –	\$ –
Real estate subject to operating leases, net	1,670,169	1,714,284	189,942	–	–
Total assets	4,034,775	3,813,552	2,059,616	13,441	5,674
Debt obligations	2,131,967	1,901,204	1,055,719	–	–
Minority interest in consolidated entities ⁽³⁾	6,224	2,565	–	5,175	3,917
Shareholders' equity	1,787,885	1,801,343	970,728	6,351	1,578
Supplemental Data:					
Total debt to shareholders' equity	1.2x	1.1x	1.1x	–	–

Explanatory Notes:

- (1) Historical stock option expense represents the option value of approximately 2.5 million fully-vested options to acquire class A shares which were issued to the Company's external advisor upon consummation of the March 18, 1998 capitalization of the Company. A portion of those options were then regranted to employees of the advisor subject to vesting periods which were typically three years from the date of grant. The remainder of those options were regranted on a fully-vested basis to an affiliate of Starwood Capital Group L.L.C., which then further regranted those options to certain of its employees subject to vesting restrictions.
- (2) As more fully discussed in Note 4 to the Company's Consolidated Financial Statements, this amount represents a non-recurring, non-cash charge of approximately \$94.5 million relating to the acquisition of the Company's external advisor.
- (3) Historical minority interest for the Company for fiscal 1998, 1997 and 1996 represents a minority interest in APMT Limited Partnership which was converted into class A shares on March 18, 1998, the date the partnership was liquidated and terminated. Minority interests in fiscal 1999 reflects minority interests in certain of the Leasing Subsidiary's consolidated ventures. Minority interests in fiscal 2000 also reflects minority interests in certain of the Leasing Subsidiary's and the Parent's consolidated ventures.
- (4) Earnings per common share excludes 1% of net income allocable to the Company's class B shares prior to November 4, 1999. The class B shares were exchanged for Common Stock in connection with the acquisition of TriNet and other related transactions on November 4, 1999. As a result, the Company now has a single class of Common Stock outstanding.
- (5) Adjusted earnings represent GAAP net income before depreciation and amortization and, for the year ended December 31, 1999, exclude the non-recurring cost incurred in acquiring the Company's external advisor (see Note 4 to the Company's Consolidated Financial Statements).
- (6) The 1999 and 1998 EBITDA to interest expense and ratios are based on a pro forma basis would have been 2.83x and 2.84x, respectively (see Note 4).
- (7) Combined fixed charges are comprised of interest expense, capitalized interest, amortization of loan costs and preferred stock dividend requirements. The 1999 and 1998 EBITDA to combined fixed charges ratios on a pro forma basis would have been 2.23x and 2.44x, respectively.
- (8) As adjusted for one-for-six reverse stock split effected by the Company on June 19, 1998.
- (9) The Company generally declares common and preferred dividends in the month subsequent to the end of the quarter.

Management's Discussion and Analysis of Financial Condition and Results of Operations

General

As more fully discussed in Note 4 to the Company's Consolidated Financial Statements, on March 18, 1998, the Company completed the Recapitalization Transactions which, among other things, substantially recapitalized the Company and modified its investment policy. Effective June 18, 1998, the Company (which was organized under California law) changed its domicile to Maryland by merging with a newly-formed subsidiary organized under Maryland law, and issued new shares of the subsidiary to the Company's shareholders in exchange for their shares in the Company. Concurrently, the Company consummated a one-for-six reverse stock split.

Immediately prior to the consummation of the Recapitalization Transactions, the Company's assets primarily consisted of approximately \$11.0 million in short-term, liquid real estate investments, cash and cash equivalents.

On December 15, 1998, the Company sold \$220.0 million of preferred shares and warrants to purchase class A shares to a group of investors affiliated with Lazard Freres. Concurrent with the sale of the preferred shares and warrants, the Company purchased \$280.3 million in real estate loans and participation interests from a group of investors also affiliated with Lazard Freres. These transactions are referred to collectively as the "Lazard Transaction."

As more fully discussed in Note 4 to the Company's Consolidated Financial Statements, on November 3, 1999, the Company's shareholders approved a series of transactions including: (1) the acquisition of TriNet; (2) the acquisition of the Company's external advisor; and (3) the reorganization of the Company from a trust to a corporation and the exchange of the class A and class B shares for Common Stock. Pursuant to the TriNet acquisition, TriNet merged with and into a subsidiary of the Company, with TriNet surviving as a wholly-owned subsidiary of the Company. In the acquisition, each share of common stock of TriNet was converted into 1.15 shares of Common Stock. Each share of TriNet Series A, Series B and Series C Cumulative Redeemable Preferred Stock was converted into a share of Series B, Series C or Series D (respectively) Cumulative Redeemable Preferred Stock of the Company. The Company's preferred stock issued to the former TriNet preferred shareholders has substantially the same terms as the TriNet preferred stock, except that the new Series B, C and D preferred shares have additional voting rights not associated with the TriNet preferred stock. The Company's Series A Preferred Stock remained outstanding with the same rights and preferences as existed prior to the TriNet acquisition. As a consequence of the acquisition of its external advisor, the Company is now internally-managed and no longer pays external advisory fees.

The transactions described above and other related transactions have materially impacted the historical operations of the Company. Accordingly, the reported historical financial information for periods prior to these transactions is not believed to be fully indicative of the Company's future operating results or financial condition.

Results of Operations

Year Ended December 31, 2000 Compared to Year Ended December 31, 1999

Interest income – Interest income increased to approximately \$268.0 million for the year ended December 31, 2000 from approximately \$209.8 million for the same period in 1999. This increase is a result of the interest generated by \$721.2 million of newly-originated loan investments during fiscal 2000 and an additional \$56.0 million funded under existing loan commitments. The increase was partially offset by a reduction in interest earned as a result of principal repayments of approximately \$584.5 million made to the Company on its loan investments during the year ended December 31, 2000. In addition, the increase was in part due to higher average interest rates on the Company's variable-rate loans and other lending investments.

Operating lease income – Operating lease income increased to approximately \$186.0 million for the year ended December 31, 2000 from approximately \$42.2 million for the same period in 1999. Approximately \$134.2 million of this increase is attributable to operating lease income generated from corporate tenant lease assets acquired in the acquisition of TriNet, which were included in operations for the entire year in fiscal 2000 as compared to only approximately two months in fiscal 1999. In addition, approximately \$5.4 million resulted from income generated by \$128.4 million of new corporate tenant lease investments.

Other income – Included in other income for fiscal year 2000 are prepayment fees of approximately \$7.9 million resulting from the full or partial repayments of several loans, recognition of \$2.1 million in connection with loan defeasances, a forbearance fee of \$1.1 million resulting from the purchase of a sub-performing loan and subsequent restructuring of such loan to fully performing status, a prepayment penalty of approximately \$1.2 million resulting from the refinancing of a senior mortgage and corporate loan, and approximately \$1.4 million resulting from the repayment of a senior loan held at a discount upon the conversion of such loan to a corporate tenant lease holding pursuant to a purchase option granted to the Company in connection with its original investment in the asset.

Interest expense – The Company's interest expense increased by \$82.7 million for the year ended December 31, 2000 over the same period in the prior year. Approximately \$44.1 million of this increase is attributable to interest expense incurred by the Leasing Subsidiary subsequent to its acquisition, which was included in operations for the entire year in fiscal 2000 as compared to only approximately two months in 1999. In addition, the increase was in part due to higher average aggregate borrowings by the Company on its credit facilities, other term loans and secured notes, the proceeds of which were used to fund additional investments. The increase was also attributable to higher average interest rates on the Company's variable-rate debt obligations.

Operating costs—corporate tenant lease assets – For the year ended December 31, 2000, operating costs associated with corporate tenant lease assets increased by approximately \$10.6 million to approximately \$12.8 million, net of recoveries from tenants. Such operating costs represent unreimbursed operating expenses associated with corporate tenant lease assets. This increase is primarily attributable to operating costs generated from corporate tenant lease assets acquired in the acquisition of TriNet, which were included in operations for the entire year in fiscal 2000 as compared to only approximately two months in 1999.

Depreciation and amortization – Depreciation and amortization increased by approximately \$24.2 million to \$34.5 million for the year ended December 31, 2000 over the same period in the prior year. Approximately \$24.0 million of this increase is attributable to depreciation and amortization relating to the corporate tenant lease assets acquired in the acquisition of TriNet, which were included in operations for the entire year in fiscal 2000 as compared to only approximately two months in 1999.

General and administrative – The Company's general and administrative expenses during the year ended December 31, 2000 increased by approximately \$19.4 million to \$25.7 million compared to the same period in 1999. These increases were generally the result of the increased scope of the Company's operations associated with the acquisition of TriNet and the direct overhead costs associated with the Company's former external advisor, which impacted operations for the entire year in fiscal 2000 as compared to only approximately two months in 1999.

Provision for possible credit losses – The Company's charge for provision for possible credit losses increased to \$6.5 million from \$4.8 million as a result of expanded lending operations as well as additional seasoning of the Company's existing lending portfolio. As more fully discussed in Note 5 to the Company's Consolidated Financial Statements, the Company has not realized any actual losses on any of its loan investments to date. However, the Company has considered it prudent to establish a policy of providing reserves for potential losses in the current portfolio which may occur in the future. Accordingly, since its first full quarter as a public company (the quarter ended June 30, 1998), management has reflected quarterly provisions for possible credit losses in its operating results. The Company will continue to recognize quarterly provisions until a stabilized reserve level is attained.

Stock option compensation expense – Stock compensation expense increased by approximately \$2.5 million as a result of charges relating to grants of stock options to the Company's employees, including amortization of the deferred charge related to options granted to employees of the Company's former external advisor subsequent to such personnel becoming direct employees of the Company as of November 4, 1999.

Advisory fees – There were no advisory fees during the year ended December 31, 2000 because, subsequent to the acquisition of the Company's external advisor, the Company is now internally-managed. No further advisory fees will be incurred.

Costs incurred in acquiring external advisor – As more fully discussed in Note 4 to the Company's Consolidated Financial Statements, included in fiscal 1999 costs and expenses is a non-recurring, non-cash charge of approximately \$94.5 million relating to the acquisition of the Company's external advisor.

Gain on sale of corporate tenant lease assets – During the year ended 2000, the Company disposed of 14 corporate tenant lease assets, including six assets held in joint venture partnerships, for a total of \$256.7 million in proceeds, and recognized total gains of \$2.9 million.

Extraordinary loss on early extinguishment of debt – Certain of the proceeds from an asset disposition were used to partially repay \$8.1 million of a mortgage loan. In connection with this partial paydown, the Company incurred prepayment penalties, which resulted in an extraordinary loss of \$317,000 during the first quarter of 2000. Additionally, proceeds from a joint venture asset disposition were used to repay the third-party debt of the joint venture of \$16.4 million. In connection with this paydown, the venture incurred certain prepayment penalties, which resulted in an extraordinary loss to the Company of \$388,000 during the third quarter of 2000. There were no comparable early extinguishments of debt during the year ended December 31, 1999, including by the Leasing Subsidiary after its acquisition on November 4, 1999.

Year Ended December 31, 1999 Compared to Year Ended December 31, 1998

Interest income – During fiscal year 1999, interest income increased by approximately \$96.9 million over interest income for fiscal year 1998. This increase is a result of the interest generated by the loans and other investments contributed in the Recapitalization Transactions, as well as approximately \$663.4 million of loans and other lending investments newly-originated or acquired by the Company during 1999 and an additional \$46.4 million funded under existing commitments. The increase was partially offset by principal repayments of approximately \$561.9 million made to the Company during fiscal year 1999.

Operating lease income – Operating lease income increased by \$29.8 million from fiscal year 1998 to fiscal year 1999 due to approximately \$26.8 million in operating lease income generated from corporate tenant lease assets acquired in the acquisition of TriNet.

Other income – Included in other income for fiscal year 1999 is a fee associated with the repayment of a construction loan of approximately \$1.9 million, yield maintenance payments of approximately \$8.1 million resulting from the repayment of three loans, and approximately \$1.0 million in additional revenue from certain cash flow participation features on five of the Company's loan investments.

Interest expense – The Company's interest expense increased by \$46.5 million as a result of higher average borrowings by the Company on its credit facilities and other term loans, the proceeds of which were used to fund additional loan origination and acquisition activities. The increase was also attributable to higher average interest rates on the Company's variable-rate debt obligations. Further, interest expense includes interest incurred by the Leasing Subsidiary subsequent to its acquisition.

Operating costs—corporate tenant lease assets – Such operating costs represent unreimbursed operating expenses incurred by the Leasing Subsidiary subsequent to its acquisition.

Depreciation and amortization – Depreciation and amortization increased as a result of a full year's depreciation on the Company's pre-existing corporate tenant leasing portfolio, as well as depreciation on the Leasing Subsidiary's net leased assets subsequent to its acquisition.

General and administrative – General and administrative costs increased by approximately \$3.7 million as a result of additional costs incurred subsequent to the acquisition of the Company's external advisor, as well as additional administrative expenses associated with the Leasing Subsidiary subsequent to its acquisition.

Provision for possible credit losses – The Company's charge for provision for possible credit losses increased by approximately \$2.0 million as a result of expanded lending operations as well as additional seasoning of the Company's existing lending portfolio. As more fully discussed in Note 5 to the Company's Consolidated Financial Statements, the Company has not realized any actual losses on any of its loan investments to date. However, the Company has considered it prudent to establish a policy of providing reserves for potential losses in the current portfolio which may occur in the future. Accordingly, since its first full quarter as a public company (the quarter ended June 30, 1998), management has reflected quarterly provisions for possible credit losses in its operating results. The Company will continue to recognize quarterly provisions until a stabilized reserve level is attained.

Stock option compensation expense – Stock option compensation expense declined by approximately \$5.6 million as a result of the non-recurring charge relating to the original grant of stock options to the Company's external advisor in fiscal 1998 concurrently with the consummation of the Recapitalization Transactions.

Advisory fees – Base advisory fees increased by approximately \$5.3 million as a result of fees being incurred from June 16, 1999 through year end in the prior year and through November 4, 1999 in fiscal 1999. Further, as a result of the Company's expanded operations, incentive fees paid under the prior advisory contract increased from \$2.3 million in 1998 to \$5.4 million in 1999. Subsequent to the acquisition of the Company's external advisor, the Company is now internally-managed and no further advisory fees will be incurred.

Costs incurred in acquiring external advisor – Finally, as more fully discussed in Note 4 to the Company's Consolidated Financial Statements, included in fiscal 1999 costs and expenses is a non-recurring, non-cash charge of approximately \$94.5 million relating to the acquisition of the Company's external advisor.

Liquidity and Capital Resources

The Company requires capital to fund its investment activities and operating expenses. The Company has significant access to capital resources to fund its existing business plan, which includes the expansion of its real estate lending and corporate tenant leasing businesses. The Company's capital sources include cash flow from operations, borrowings under lines of credit, additional term borrowings, long-term financing secured by the Company's assets, unsecured financing and the issuance of common, convertible and /or preferred equity securities. Further, the Company may acquire other businesses or assets using its capital stock, cash or a combination thereof.

The distribution requirements under the REIT provisions of the Code limit the Company's ability to retain earnings and thereby replenish capital committed to its operations. However, the Company believes that its significant capital resources and access to financing will provide it with financial flexibility and market responsiveness at levels sufficient to meet current and anticipated capital requirements, including expected new lending and leasing transactions.

The Company's ability to meet its long-term (i.e., beyond one year) liquidity requirements is subject to the renewal of its credit lines and /or obtaining other sources of financing, including issuing additional debt or equity from time to time. Any decision by the Company's lenders and investors to enter into such transactions with the Company will depend upon a number of factors, such as compliance with the terms of its existing credit arrangements, the Company's financial performance, industry or market trends, the general availability of and rates applicable to financing transactions, such lenders' and investors' resources and policies concerning the terms under which they make such capital commitments and the relative attractiveness of alternative investment or lending opportunities.

Based on its monthly interest and other expenses, monthly cash receipts, existing investment commitments and funding plans, the Company believes that its existing sources of funds will be adequate for purposes of meeting its short- and long-term liquidity needs. Material increases in monthly interest expense or

material decreases in monthly cash receipts would negatively impact the Company's liquidity. On the other hand, material decreases in monthly interest expense would positively affect the Company's liquidity.

As more fully discussed in Note 7 to the Company's Consolidated Financial Statements, at December 31, 2000, the Company had existing fixed-rate borrowings of approximately \$150.7 million secured by real estate under operating leases which mature in 2009, an aggregate of approximately \$162.1 million in LIBOR-based, variable-rate loans secured by various senior and subordinate mortgage investments and real estate under operating leases which mature between fiscal 2001 and 2003, fixed-rate corporate debt obligations aggregating approximately \$356.5 million which mature between 2001 and 2017, and other variable- and fixed-rate secured debt obligations aggregating approximately \$108.6 million which mature at various dates through 2010.

In addition, the Company has entered into LIBOR-based secured revolving credit facilities of \$700.0 and \$500.0 million which expire in fiscal 2005 and 2002, respectively. As of December 31, 2000, the Company had drawn approximately \$284.4 million and \$308.0 million under these facilities, respectively. Availability under these facilities is based on collateral provided under a borrowing base calculation. The Company also has two unsecured credit facilities totaling \$450.0 million. The \$100.0 million facility had no outstanding balance as of December 31, 2000, matures in January 2002 and bears interest at LIBOR plus 2.25%. In addition, the Leasing Subsidiary's \$350.0 million unsecured credit facility had a balance of \$173.5 million as of December 31, 2000, matures on May 31, 2001 with a one-year extension period at the Company's option and bears interest at LIBOR plus 1.55%. Under the terms of this facility, the Leasing Subsidiary is generally permitted to make cash distributions to the Company in an amount equal to 85% of cash flow from operations in any rolling four-quarter period. Subsequent to year end, the Company extended the term of this facility to May 2002.

The Company has entered into LIBOR interest rate caps struck at 9.00%, 7.50% and 7.50% in notional amounts of \$300.0 million, \$40.4 million and \$38.3 million, respectively, which expire in March 2001, January 2001 and June 2001, respectively. In addition, in connection with the acquisition of TriNet, the Company acquired LIBOR interest rate caps currently struck at 7.75%, 7.75% and 7.50% in notional amounts of \$75.0 million, \$35.0 million and \$75.0 million, respectively, which expire in December 2004, December 2004 and June 2001, respectively. In connection with the closing of STARS, Series 2000-1 in May 2000, the Company entered into a LIBOR interest rate cap struck at 10.00% in the notional amount of \$312.0 million, and simultaneously sold a LIBOR interest rate cap with the same terms. Since these instruments do not reduce the Company's net interest rate risk exposure, they do not qualify as hedges and changes in their respective values are charged to earnings. As the significant terms of these arrangements are substantially the same, the effects of a revaluation of these two instruments are expected to substantially offset one another. At December 31, 2000, the net fair value of the Company's interest rate caps was approximately \$0.4 million.

The Company has entered into LIBOR interest rate swaps struck at 5.714%, 7.055% and 7.058% in notional amounts of \$92.0 million, \$125.0 million and \$125.0 million, respectively which expire in March 2001, June 2003 and June 2003, respectively. These swaps effectively fix the interest rate on a portion of the Company's floating-rate term loan obligations. In connection with the acquisition of TriNet, the Company acquired an interest rate swap which, together with certain existing interest rate cap agreements, effectively fix the interest rate on \$75.0 million of the Leasing Subsidiary's LIBOR-based borrowings at 5.58% plus the applicable margin through December 1, 2004. Management expects that it will have aggregate LIBOR-based borrowings at the Leasing Subsidiary in excess of the notional amount for the duration of the swap. The actual borrowing cost to the Company with respect to indebtedness covered by the swap will depend upon the applicable margin over LIBOR for such indebtedness, which will be determined by the terms of the relevant debt instruments. In June 2000, an interest rate swap with a notional amount of approximately \$112.0 million matured. At December 31, 2000, the fair value (liability) of the Company's interest rate swaps was (\$7.7) million.

During the year ended December 31, 1999, the Company settled an aggregate notional amount of approximately \$63.0 million that was outstanding under certain hedging agreements which the Company had entered into in order to hedge the potential effects of interest rate movements on anticipated fixed-rate borrowings. The settlement of such agreements resulted in the receipt of approximately \$0.6 million which had been deferred pending completion of the planned fixed-rate financing transaction. Subsequently, the

transaction was modified and consummated as a variable-rate financing transaction. As a result, the previously deferred receipt no longer qualified for hedge accounting treatment and the \$0.6 million was recognized as a gain and included in other income in the consolidated statement of operations for the year ended December 31, 2000.

During the year ended December 31, 1999, the Company refinanced its \$125.0 million term loan maturing March 15, 1999 with a \$155.4 million term loan maturing March 5, 2009. The new term loan bears interest at 7.44% per annum, payable monthly, and amortizes over an approximately 22-year schedule. The new term loan represented forecasted transactions for which the Company had previously entered into U.S. Treasury-based hedging transactions. The net \$3.4 million cost of the settlement of such hedges has been deferred and is being amortized as an increase to the effective financing costs of the new term loan over its effective ten-year term.

On May 17, 2000, the Company closed the inaugural offering under its proprietary matched funding program, STARS, Series 2000-1. In the initial transaction, a wholly-owned subsidiary of the Company issued \$896.5 million of investment grade bonds secured by the subsidiary's assets, which had an aggregate outstanding principal balance of approximately \$1.2 billion at inception. Principal payments received on the assets will be utilized to repay the most senior class of the bonds then outstanding. The maturity of the bonds match funds the maturity of the underlying assets financed under the program. The Company initially purchased the class F bonds at a par value of \$38.2 million, which the Company financed with a \$27.8 million repurchase agreement maturing in May 2001, which has a balance of \$24.2 million at December 31, 2000. On July 17, 2000, the Company sold, at par, \$5.0 million of the class F bonds to an institutional investor. For accounting purposes, these transactions were treated as secured financings.

On December 28, 2000, the Company expanded its existing \$675.0 million secured warehouse facility to \$700.0 million. The Company extended the original March 2001 maturity date to March 2005, including a one-year "term out" extension option to the facility's maturity during which the interest rate spread will increase 25 basis points, no additional draws under the facility will be permitted, and the outstanding principal must amortize 25% per quarter. In connection with the extension, the Company and the facility lender also increased the range of collateral eligible for inclusion in the facility. Also in connection with the extension, the Company agreed to increase the facility's interest rate from LIBOR plus 1.50% to a revised rate of LIBOR plus 1.75% to 2.25%, depending upon certain conditions.

On January 11, 2001, the Company closed a new \$700.0 million secured revolving credit facility which is led by a major commercial bank. The new facility has a three-year primary term and one-year "term out" extension option, and bears interest at LIBOR plus 1.40% to 2.15%, depending upon the collateral contributed to the borrowing base. The new facility accepts a broad range of structured finance assets and has a final maturity of January 2005.

Stock Repurchase Program: The Board of Directors approved, and the Company has implemented, a stock repurchase program under which the Company is authorized to repurchase up to 5.0 million shares of its Common Stock from time to time, primarily using proceeds from the disposition of assets and excess cash flow from operations, but also using borrowings under its credit facilities if the Company determines that it is advantageous to do so. As of December 31, 2000, the Company had repurchased approximately 2.3 million shares at an aggregate cost of approximately \$40.7 million.

Adjusted Earnings

Adjusted earnings represents net income computed in accordance with GAAP, before gains (losses) on sales of corporate tenant lease assets, extraordinary items and cumulative effect, plus depreciation and amortization, less preferred stock dividends, and after adjustments for unconsolidated partnerships and joint ventures. Adjustments for unconsolidated partnerships and joint ventures are calculated to reflect adjusted earnings on the same basis.

The Company believes that to facilitate a clear understanding of the historical operating results of the Company, adjusted earnings should be examined in conjunction with net income as shown in the Consolidated Statements of Operations. Adjusted earnings should not be considered as an alternative to net income (determined in accordance with GAAP) as an indicator of the Company's performance, or to

cash flows from operating activities (determined in accordance with GAAP) as a measure of the Company's liquidity, nor is it indicative of funds available to fund the Company's cash needs.

	For the Year Ended December 31,	
	2000	1999
	<i>(in thousands, except per share data)</i>	
	<i>(unaudited)</i>	
Adjusted Earnings:		
Net income	\$217,586	\$38,886
Add: Depreciation	34,514	11,016
Add: Joint venture depreciation	3,662	365
Add: Amortization	13,140	6,121
Add: Costs incurred in acquiring external advisor	—	94,476
Less: Preferred dividends	(36,908)	(23,843)
Less: Net income allocable to class B shares ⁽¹⁾	—	(826)
Less: Gain on sale of corporate tenant lease assets	(2,948)	—
Add: Extraordinary loss—early extinguishment of debt	705	—
Adjusted earnings allocable to common shareholders:		
Basic	<u>\$229,751</u>	<u>\$126,195</u>
Diluted	<u>\$230,688</u>	<u>\$127,798</u>
Adjusted earnings per common share:		
Basic	<u>\$ 2.69</u>	<u>\$ 2.19</u>
Diluted	<u>\$ 2.67</u>	<u>\$ 2.07</u>

Explanatory Note:

(1) For the year ended December 31, 1999, net income allocable to class B shares represents 1% of net income allocable to the Company's class B shares. On November 4, 1999, the class B shares were exchanged for common shares in connection with the Company's acquisition of TriNet and related transactions. As a result, the Company now has a single class of common shares outstanding.

New Accounting Standards

In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). On June 23, 1999, the FASB voted to defer the effectiveness of SFAS No. 133 for one year. SFAS No. 133 is now effective for fiscal years beginning after June 15, 2000, but earlier application is permitted as of the beginning of any fiscal quarter subsequent to June 15, 1998. SFAS No. 133 establishes accounting and reporting standards for derivative financial instruments and hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as: (1) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment; (2) a hedge of the exposure to variable cash flows of a forecasted transaction; or (3) in certain circumstances a hedge of a foreign currency exposure. The Company adopted this pronouncement, as amended by Statement of Financial Accounting Standards No. 137 "Accounting for Derivative Instruments and Hedging Activities-deferral of the Effective Date of FASB Statement No. 133" and Statement of Financial Accounting Standards No. 138 "Accounting for Certain Hedging Activities-an Amendment of FASB No. 133," January 1, 2001. Because the Company has primarily used derivatives as cash flow hedges of interest rate risk only, the adoption of SFAS No. 133 did not have a material financial impact on the financial position and results of operations of the Company. However, should the Company change its current use of such derivatives (see Note 9), the adoption of SFAS No. 133 could have a more significant effect on the Company prospectively.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 ("SAB 101"), Revenue Recognition in Financial Statements." In June 2000, the SEC staff amended SAB 101 to provide registrants with additional time to implement SAB 101. The Company adopted SAB 101, as required, in the fourth quarter of fiscal 2000. The adoption of SAB 101 did not have a material financial impact on the financial position or results of operations of the Company.

In March 2000, the FASB issued FASB Interpretation No. 44 ("FIN 44"), "Accounting for Certain Transactions Involving Stock Compensation." The Company was required to adopt FIN 44 effective July 1, 2000 with respect to certain provisions applicable to new awards, exchanges of awards in a business combination, modifications to outstanding awards, and changes in grantee status that occur on or after that date. FIN 44 addresses practice issues related to the application of Accounting Practice Bulletin Opinion No. 25, "Accounting for Stock Issued to Employees." The initial adoption of FIN 44 by the Company did not have a material impact on its consolidated financial position or results of operations.

Quantitative and Qualitative Disclosures About Market Risk

Market Risks

Market risk is the exposure to loss resulting from changes in interest rates, foreign currency exchange rates, commodity prices and equity prices. In pursuing its business plan, the primary market risk to which the Company is exposed is interest rate risk. Consistent with its liability management objectives, the Company has implemented an interest rate risk management policy based on match funding, with the objective that floating-rate assets be primarily financed by floating-rate liabilities and fixed-rate assets be primarily financed by fixed-rate liabilities.

The Company's operating results will depend in part on the difference between the interest and related income earned on its assets and the interest expense incurred in connection with its interest-bearing liabilities. Competition from other providers of real estate financing may lead to a decrease in the interest rate earned on the Company's interest-bearing assets, which the Company may not be able to offset by obtaining lower interest costs on its borrowings. Changes in the general level of interest rates prevailing in the financial markets may affect the spread between the Company's interest-earning assets and interest-bearing liabilities. Any significant compression of the spreads between interest-earning assets and interest-bearing liabilities could have a material adverse effect on the Company. In addition, an increase in interest rates could, among other things, reduce the value of the Company's interest-bearing assets and its ability to realize gains from the sale of such assets, and a decrease in interest rates could reduce the average life of the Company's interest-earning assets.

A substantial portion of the Company's loan investments are subject to significant prepayment protection in the form of lock-outs, yield maintenance provisions or other prepayment premiums which provide substantial yield protection to the Company. Those assets generally not subject to prepayment penalties include: (1) variable-rate loans based on LIBOR, originated or acquired at par, which would not result in any gain or loss upon repayment; and (2) discount loans and loan participations acquired at discounts to face values, which would result in gains upon repayment. Further, while the Company generally seeks to enter into loan investments which provide for substantial prepayment protection, in the event of declining interest rates, the Company could receive such prepayments and may not be able to reinvest such proceeds at favorable returns. Such prepayments could have an adverse effect on the spreads between interest-earning assets and interest-bearing liabilities.

While the Company has not experienced any significant credit losses, in the event of a significant rising interest rate environment and/or economic downturn, defaults could increase and result in credit losses to the Company which adversely affect its liquidity and operating results. Further, such delinquencies or defaults could have an adverse effect on the spreads between interest-earning assets and interest-bearing liabilities.

Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political conditions, and other factors beyond the control of the Company. As more fully discussed in Note 9 to the Company's Consolidated Financial Statements, the Company employs match funding-based hedging strategies to limit the effects of changes in interest rates on its operations, including engaging in interest rate caps, floors, swaps, futures and other interest rate-related derivative contracts. These strategies are specifically designed to reduce the Company's exposure, on specific transactions or on a portfolio basis, to changes in cash flows as a result of interest rate movements in the market. The Company does not enter into derivative contracts for speculative purposes nor as a hedge against changes in credit risk of its borrowers or of the Company itself.

Each interest rate cap or floor agreement is a legal contract between the Company and a third party (the "counterparty"). When the Company purchases a cap or floor contract, the Company makes an up-front payment to the counterparty and the counterparty agrees to make payments to the Company in the future should the reference rate (typically one- or three-month LIBOR) rise above (cap agreements) or fall below (floor agreements) the "strike" rate specified in the contract. Each contract has a notional face amount. Should the reference rate rise above the contractual strike rate in a cap, the Company will earn cap income. Should the reference rate fall below the contractual strike rate in a floor, the Company will earn floor income. Payments on an annualized basis will equal the contractual notional face amount multiplied by the difference between the actual reference rate and the contracted strike rate. The cost of the up-front payment is amortized over the term of the contract.

Interest rate swaps are agreements in which a series of interest rate flows are exchanged over a prescribed period. The notional amount on which swaps are based is not exchanged. In general, the Company's swaps are "pay fixed" swaps involving the exchange of floating-rate interest payments from the counterparty for fixed interest payments from the Company.

Interest rate futures are contracts, generally settled in cash, in which the seller agrees to deliver on a specified future date the cash equivalent of the difference between the specified price or yield indicated in the contract and the value of that of the specified instrument (e.g., U.S. Treasury securities) upon settlement. The Company generally uses such instruments to hedge forecasted fixed-rate borrowings. Under these agreements, the Company will generally receive additional cash flow at settlement if interest rates rise and pay cash if interest rates fall. The effects of such receipts or payments will be deferred and amortized over the term of the specific related fixed-rate borrowings. In the event that, in the opinion of management, it is no longer probable that a forecasted transaction will occur under terms substantially equivalent to those projected, the Company will cease recognizing such transactions as hedges and immediately recognize related gains or losses based on actual settlement or estimated settlement value.

While a REIT may freely utilize the types of derivative instruments discussed above to hedge interest rate risk on its liabilities, the use of derivatives for other purposes, including hedging asset-related risks such as credit, prepayment or interest rate exposure on the Company's loan assets, could generate income which is not qualified income for purposes of maintaining REIT status. As a consequence, the Company may only engage in such instruments to hedge such risks on a limited basis.

There can be no assurance that the Company's profitability will not be adversely affected during any period as a result of changing interest rates. In addition, hedging transactions using derivative instruments involve certain additional risks such as counterparty credit risk, legal enforceability of hedging contracts and the risk that unanticipated and significant changes in interest rates will cause a significant loss of basis in the contract. With regard to loss of basis in a hedging contract, indices upon which contracts are based may be more or less variable than the indices upon which the hedged assets or liabilities are based, thereby making the hedge less effective. The counterparties to these contractual arrangements are major financial institutions with which the Company and its affiliates may also have other financial relationships. The Company is potentially exposed to credit loss in the event of nonperformance by these counterparties. However, because of their high credit ratings, the Company does not anticipate that any of the counterparties will fail to meet their obligations. There can be no assurance that the Company will be able to adequately protect against the foregoing risks and that the Company will ultimately realize an economic benefit from any hedging contract it enters into which exceeds the related costs incurred in connection with engaging in such hedges.

The following table quantifies the potential changes in net investment income and net fair value of financial instruments should interest rates increase or decrease 200 basis points, assuming no change in the shape of the yield curve (i.e., relative interest rates). Net investment income is calculated as revenue from loans and other lending investments and operating leases (as of December 31, 2000), less related interest expense and operating costs on corporate tenant lease assets, for the year ended December 31, 2000. Net fair value of financial instruments is calculated as the sum of the value of off-balance sheet instruments and the present value of cash in-flows generated from interest-earning assets, less cash out-flows in respect of interest-bearing liabilities as of December 31, 2000. The cash flows associated with the Company's assets are calculated based on management's best estimate of expected payments for each loan based on loan characteristics such as loan-to-value ratio, interest rate, credit history, prepayment penalty, term and collateral type. Most of the Company's loans are protected from prepayment as a result of prepayment penalties and contractual terms which prohibit prepayments during specified periods. However, for those loans where prepayments are not currently precluded by contract, declines in interest rates may increase prepayment speeds. The base interest rate scenario assumes interest rates as of December 31, 2000. Actual results could differ significantly from those estimated in the table.

	Estimated Percentage Change in	
	Net Investment Income	Net Fair Value of Financial Instruments ⁽¹⁾
Change in Interest Rates:		
-200 Basis Points	1.40%	21.75%
-100 Basis Points	0.70%	10.64%
Base Interest Rate	0.00%	0.00%
+100 Basis Points	(0.66)%	(10.12)%
+200 Basis Points	(0.45)%	(19.44)%

Explanatory Note:

(1) Amounts exclude fair values of non-financial investments, primarily assets under long-term operating leases and certain forms of corporate finance investments.

Report of Independent Accountants

To the Board of Directors and Shareholders
of iStar Financial Inc.

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of iStar Financial Inc. and its subsidiaries at December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the accompanying index present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedules are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP
New York, NY
March 2, 2001

Consolidated Balance Sheets

	As of December 31,	
	2000	1999*
	<i>(in thousands, except per share data)</i>	
Assets:		
Loans and other lending investments, net	\$2,225,183	\$2,003,506
Real estate subject to operating leases, net	1,670,169	1,714,284
Cash and cash equivalents	22,752	34,408
Restricted cash	20,441	10,195
Marketable securities	41	4,344
Accrued interest and operating lease income receivable	20,167	16,211
Deferred operating lease income receivable	10,236	1,147
Deferred expenses and other assets	62,224	29,074
Investment in iStar Operating, Inc.	3,562	383
Total assets	<u>\$4,034,775</u>	<u>\$3,813,552</u>
Liabilities and Shareholders' Equity:		
Liabilities:		
Accounts payable, accrued expenses and other liabilities	\$ 52,038	\$ 54,773
Dividends payable	56,661	53,667
Debt obligations	<u>2,131,967</u>	<u>1,901,204</u>
Total liabilities	<u>2,240,666</u>	<u>2,009,644</u>
Commitments and contingencies	—	—
Minority interests in consolidated entities	6,224	2,565
Shareholders' equity:		
Series A Preferred Stock, \$0.001 par value, liquidation preference \$220,000, 4,400 shares authorized and outstanding at December 31, 2000 and December 31, 1999	4	4
Series B Preferred Stock, \$0.001 par value, liquidation preference \$50,000, 2,000 shares issued and outstanding at December 31, 2000 and December 31, 1999	2	2
Series C Preferred Stock, \$0.001 par value, liquidation preference \$32,500, 1,300 shares issued and outstanding at December 31, 2000 and December 31, 1999	1	1
Series D Preferred Stock, \$0.001 par value, liquidation preference \$100,000, 4,000 shares issued and outstanding at December 31, 2000 and December 31, 1999	4	4
Common Stock, \$0.001 par value, 200,000 shares authorized, 85,726 and 84,985 shares issued and outstanding at December 31, 2000 and December 31, 1999, respectively	85	85
Warrants and options	16,943	17,935
Additional paid in capital	1,966,395	1,953,972
Retained earnings (deficit)	(154,789)	(129,992)
Accumulated other comprehensive income (losses)	(20)	(229)
Treasury stock (at cost)	<u>(40,740)</u>	<u>(40,439)</u>
Total shareholders' equity	<u>1,787,885</u>	<u>1,801,343</u>
Liabilities and shareholders' equity	<u>\$4,034,775</u>	<u>\$3,813,552</u>

* Reclassified to conform to 2000 presentation.

The accompanying notes are an integral part of the financial statements.

Consolidated Statements of Operations

	As of December 31,		
	2000	1999*	1998*
	<i>(in thousands, except per share data)</i>		
Revenue:			
Interest income	\$ 268,011	\$209,848	\$112,914
Operating lease income	185,956	42,186	12,378
Other income	17,855	12,763	2,804
Total revenue	<u>471,822</u>	<u>264,797</u>	<u>128,096</u>
Costs and Expenses:			
Interest expense	173,891	91,184	44,697
Operating costs-corporate tenant lease assets	12,809	2,246	—
Depreciation and amortization	34,514	10,340	4,287
General and administrative	25,706	6,269	2,583
Provision for possible credit losses	6,500	4,750	2,750
Stock option compensation expense	2,864	412	5,985
Advisory fees	—	16,193	7,837
Costs incurred in acquiring external advisor	—	94,476	—
Total costs and expenses	<u>256,284</u>	<u>225,870</u>	<u>68,139</u>
Net income before minority interest, gain on sale of corporate tenant lease assets and extraordinary loss	215,538	38,927	59,957
Minority interest in consolidated entities	(195)	(41)	(54)
Gain on sale of corporate tenant lease assets	2,948	—	—
Net income before extraordinary loss	218,291	38,886	59,903
Extraordinary loss on early extinguishments of debt	(705)	—	—
Net income	\$ 217,586	\$ 38,886	\$ 59,903
Preferred dividend requirements	(36,908)	(23,843)	(944)
Net income allocable to common shareholders	<u>\$ 180,678</u>	<u>\$ 15,043</u>	<u>\$ 58,959</u>
Basic earnings per common share ⁽¹⁾	\$ 2.11	\$ 0.25	\$ 1.40
Diluted earnings per common share ⁽¹⁾	\$ 2.10	\$ 0.25	\$ 1.36

* Reclassified to conform to 2000 presentation.

Explanatory Notes:

(1) Net income per basic common share excludes 1% of net income allocable to the Company's class B shares prior to November 4, 1999. These shares were exchanged for Common Stock in connection with the TriNet Acquisition and related transactions on November 4, 1999. As a result, the Company now has a single class of Common Stock outstanding.

The accompanying notes are an integral part of the financial statements.

Consolidated Statements of Cash Flows

	For the Year ended December 31,		
	2000	1999*	1998*
	(in thousands)		
Cash Flows from Operating Activities:			
Net income	\$ 217,586	\$ 38,886	\$ 59,903
Adjustments to reconcile net income to cash flows provided by operating activities:			
Minority interest	195	41	54
Non-cash expense for options issued to Advisor	1,700	412	5,985
Non-cash expense for Advisor Transaction	—	94,476	—
Equity in earnings of unconsolidated joint ventures and subsidiaries	(4,753)	(234)	(96)
Depreciation and amortization	47,402	15,932	7,662
Amortization of discounts/premiums and deferred interest	(27,059)	(25,493)	(17,750)
Distributions from operating joint venture	4,511	470	—
Deferred operating lease income adjustments	(9,130)	(1,597)	—
Realized (gain)/loss on sale of securities	233	(11)	—
Gain on sale of corporate tenant lease assets	(2,948)	—	—
Extraordinary loss on early extinguishment of debt	705	—	—
Provision for possible credit losses	6,500	4,750	2,750
Changes in Assets and Liabilities:			
(Increase) decrease in restricted cash	(10,246)	2,924	(5,699)
Increase in accrued interest and operating lease income receivable	(3,761)	(3,089)	(5,613)
Decrease in deferred expenses and other assets	(26,764)	(1,212)	(902)
Increase (decrease) in accounts payable, accrued expenses and other liabilities	(1,702)	(3,706)	8,621
Cash flows provided by operating activities	<u>192,469</u>	<u>122,549</u>	<u>54,915</u>
Cash Flows from Investing Activities:			
Net cash outflow for the Recapitalization Transactions (Note 3)	—	—	(334,964)
Net cash outflow for TriNet Acquisition (Note 3)	—	(23,723)	—
Proceeds from sale of corporate tenant lease assets	146,265	—	—
New investment originations/acquisitions	(849,618)	(640,757)	(975,670)
Principal fundings on existing loan commitments	(56,039)	(45,916)	(16,500)
Investment in iStar Operating, Inc.	(3,443)	—	(426)
Proceeds from sale of investment securities	30	—	—
Repayments of and principal collections from loans and other investments	584,452	520,768	103,926
Investments (in) and advances to unconsolidated joint ventures	(24,047)	(377)	(47,675)
Distributions from unconsolidated joint ventures	34,759	47,365	—
Other capital expenditures on real estate subject to operating leases	(9,011)	(1,271)	—
Cash flows used in investing activities	<u>(176,652)</u>	<u>(143,911)</u>	<u>(1,271,309)</u>
Cash Flows from Financing Activities:			
Net borrowings (repayments) under revolving credit facilities	(183,837)	168,592	640,945
Borrowings under term loans	90,000	39,234	368,683
Repayments under term loans	(300,799)	—	—
Borrowings under repurchase agreements	65,067	(7,331)	46,091
Repayments under repurchase agreements	(31,564)	—	—
Mortgage note repayments	—	(150)	—
Borrowings under bond offerings	863,254	—	—
Repayments under bond offerings	(274,919)	—	—
Common dividends paid	(202,397)	(90,076)	(38,638)
Preferred dividends paid	(36,576)	(20,524)	—
Minority interest	(164)	—	—
Extraordinary loss on early extinguishment of debt	(317)	—	—
Payment for deferred financing costs	(21,048)	(4,593)	(11,615)
Proceeds from issuance of class B shares	—	—	1,534
Costs incurred in reorganization	—	—	(480)
Purchase of treasury stock	(302)	(40,439)	—
Proceeds from exercise of options	6,129	947	285
Proceeds from issuance of preferred stock and warrants	—	—	219,403
Cash flows (used in) provided by financing activities	<u>(27,473)</u>	<u>45,660</u>	<u>\$1,226,208</u>
Increase (decrease) in cash and cash equivalents	(11,656)	24,298	9,814
Cash and cash equivalents at beginning of period	34,408	10,110	296
Cash and cash equivalents at end of period	<u>\$ 22,752</u>	<u>\$ 34,408</u>	<u>\$ 10,110</u>
Supplemental Disclosure of Cash Flow Information:			
Cash paid during the period for interest	<u>\$ 142,145</u>	<u>\$ 85,835</u>	<u>\$ 38,006</u>

* Reclassified to conform to 2000 presentation.

The accompanying notes are an integral part of the financial statements.

Consolidated Statement of Changes in Shareholders' Equity

	Series A Preferred Stock	Series B Preferred Stock	Series C Preferred Stock	Series D Preferred Stock
Balance at January 1, 1998	\$ —	\$ —	\$ —	\$ —
Recapitalization Transactions	—	—	—	—
Issuance of options to Advisor	—	—	—	—
Effects of reorganization ⁽¹⁾	—	—	—	—
Exercise of options	—	—	—	—
Issuance of preferred shares and warrants	44	—	—	—
Dividends declared-preferred	—	—	—	—
Dividends declared-common	—	—	—	—
Net Income for the period	—	—	—	—
Change in accumulated other comprehensive income	—	—	—	—
Balance at December 31, 1998*	\$ 44	\$ —	\$ —	\$ —
Exercise of options	—	—	—	—
Dividends declared-preferred	—	—	—	—
Dividends declared-common	—	—	—	—
Effects of Incorporation Merger	(40)	—	—	—
Acquisition of TriNet	—	2	1	4
Issuance of shares of Common Stock through conversion of joint venture partners interest	—	—	—	—
Advisor Transaction	—	—	—	—
Special stock dividend	—	—	—	—
Purchase of treasury stock	—	—	—	—
Net income for the period	—	—	—	—
Change in accumulated other comprehensive income	—	—	—	—
Balance at December 31, 1999	\$ 4	\$ 2	\$ 1	\$ 4
Exercise of options	—	—	—	—
Dividends declared-preferred	—	—	—	—
Dividends declared-common	—	—	—	—
Acquisition of ACRE Partners	—	—	—	—
Restricted stock units issued to employees in lieu of cash bonuses	—	—	—	—
Restricted stock units granted to employees	—	—	—	—
Issuance of stock through DRIP plan	—	—	—	—
Purchase of treasury stock	—	—	—	—
Net income for the period	—	—	—	—
Change in accumulated other comprehensive income	—	—	—	—
Balance at December 31, 2000	\$ 4	\$ 2	\$ 1	\$ 4

* Reclassified to conform to 2000 presentation.

Explanatory Note:

(1) As adjusted for one-for-six reverse stock split effective June 19, 1998.

The accompanying notes are an integral part of the financial statements.

Common Stock at Par	Common Stock at par		Warrants and Options	Additional Paid-in Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income	Treasury Stock	Total
	Class A	Class B						
	(in thousands)							
\$ –	\$ 7,550	\$ 38	\$ –	\$ –	\$ (1,075)	\$(162)	\$ –	\$ 6,351
–	306,796	1,534	–	432,084	–	–	–	740,414
–	–	–	5,985	–	–	–	–	5,985
–	(261,956)	(1,310)	–	262,786	–	–	–	(480)
–	18	–	(270)	537	–	–	–	285
–	–	–	13,189	206,170	–	–	–	219,403
–	–	–	–	15	(944)	–	–	(929)
–	–	–	–	–	(60,343)	–	–	(60,343)
–	–	–	–	–	59,903	–	–	59,903
–	–	–	–	–	–	139	–	139
\$ –	\$ 52,408	\$ 262	\$18,904	\$ 901,592	\$ (2,459)	\$ (23)	\$ –	\$ 970,728
–	63	–	(969)	1,853	–	–	–	947
–	–	–	–	330	(25,149)	–	–	(24,819)
–	–	–	–	–	(116,813)	–	–	(116,813)
53	(52,471)	(262)	–	52,720	–	–	–	–
29	–	–	–	868,933	–	–	–	868,969
–	–	–	–	6,226	–	–	–	6,226
4	–	–	–	97,862	–	–	–	97,866
1	–	–	–	24,456	(24,457)	–	–	–
(2)	–	–	–	–	–	–	(40,439)	(40,441)
–	–	–	–	–	38,886	–	–	38,886
–	–	–	–	–	–	(206)	–	(206)
\$85	\$ –	\$ –	\$17,935	\$1,953,972	\$(129,992)	\$(229)	\$(40,439)	\$1,801,343
–	–	–	(992)	7,089	–	–	–	6,097
–	–	–	–	330	(36,906)	–	–	(36,576)
–	–	–	–	–	(205,477)	–	–	(205,477)
–	–	–	–	3,637	–	–	–	3,637
–	–	–	–	1,125	–	–	–	1,125
–	–	–	–	212	–	–	–	212
–	–	–	–	31	–	–	–	31
–	–	–	–	–	–	–	(302)	(302)
–	–	–	–	–	217,586	–	–	217,586
–	–	–	–	–	–	209	–	209
\$85	\$ –	\$ –	\$16,943	\$1,966,396	\$(154,789)	\$ (20)	\$(40,741)	\$1,787,885

Notes to Consolidated Financial Statements

Note I – Organization and Business

Organization – iStar Financial Inc.⁽¹⁾ (the “Company”) began its business in 1993 through private investment funds formed to capitalize on inefficiencies in the real estate finance market. In March 1998, these funds contributed their approximately \$1.1 billion of assets to the Company’s predecessor, Starwood Financial Trust, in exchange for a controlling interest in that company. Since that time, the Company has grown by originating new lending and leasing transactions, as well as through corporate acquisitions. Specifically, in September 1998, the Company acquired the loan origination and servicing business of a major insurance company, and in December 1998, the Company acquired the mortgage and mezzanine loan portfolio of its largest private competitor. Additionally, in November 1999, the Company acquired TriNet Corporate Realty Trust, Inc. (“TriNet”), which was then the largest publicly traded company specializing in the net leasing of corporate office and industrial facilities (the “TriNet Acquisition”). The TriNet Acquisition was structured as a stock-for-stock merger of TriNet with a subsidiary of the Company. Concurrent with the TriNet Acquisition, the Company also acquired its external advisor (the “Advisor Transaction”) in exchange for shares of common stock of the Company (“Common Stock”) and converted its organizational form to a Maryland corporation (the “Incorporation Merger”). As part of the conversion to a Maryland corporation, the Company replaced its dual class common share structure with a single class of Common Stock. The Company’s Common Stock began trading on the New York Stock Exchange under the symbol “SFI” in November 1999.

During 1993 through 1997, the Company did not qualify as a real estate investment trust (“REIT”) under the Internal Revenue Code of 1986, as amended (the “Code”). However, pursuant to a closing agreement with the Internal Revenue Service (the “IRS”) obtained in March 1998, the Company was eligible and elected to be taxed as a REIT for the taxable year beginning January 1, 1998.

Business – The Company is the leading publicly traded finance company focused on the commercial real estate industry. The Company provides structured financing to private and corporate owners of real estate nationwide, including senior and junior mortgage debt, corporate mezzanine and subordinated capital, and corporate net lease financing. The Company, which has elected to be taxed as a real estate investment trust (“REIT”), seeks to deliver superior risk-adjusted returns on equity for shareholders by providing innovative and value-added financing solutions to its customers.

The Company has implemented its investment strategy by: (1) focusing on the origination of large, highly structured mortgage, corporate and lease financings where customers require flexible financial solutions, and avoiding commodity businesses in which there is significant direct competition from other providers of capital; (2) developing direct relationships with borrowers and corporate tenants as opposed to sourcing transactions through intermediaries; (3) adding value beyond simply providing capital by offering borrowers and corporate tenants specific lending expertise, flexibility, certainty and continuing relationships beyond the closing of a particular financing transaction; and (4) taking advantage of market anomalies in the real estate financing markets when the Company believes credit is mispriced by other providers of capital, such as the spread between lease yields and the yields on corporate tenants’ underlying credit obligations.

The Company intends to continue to emphasize a mix of portfolio financing transactions to create built-in diversification and single-asset financings for properties with strong, long-term competitive market positions.

Explanatory Note

(1) As more fully discussed in Note 4, on November 4, 1999, the Company changed its form and became a corporation under Maryland law and changed its name from Starwood Financial Trust to Starwood Financial Inc. Further, effective April 30, 2000, the registrant changed its name to iStar Financial Inc.

Note 2 – Basis of Presentation

The accompanying audited Consolidated Financial Statements have been prepared in conformity with generally accepted accounting principles ("GAAP") for complete financial statements. The Consolidated Financial Statements include the accounts of the Company, its qualified REIT subsidiaries, and its majority-owned and controlled partnerships. Certain third-party mortgage servicing operations are conducted through iStar Operating, Inc. ("iStar Operating"), a taxable corporation which is not consolidated with the Company for financial reporting or income tax purposes. The Company owns all of the non-voting preferred stock and a 95% economic interest in iStar Operating, which is accounted for under the equity method for financial reporting purposes. The Company does not own any of the outstanding voting stock of iStar Operating. In addition, the Company has an investment in TriNet Management Operating Company, Inc. ("TMOC"), a taxable noncontrolled subsidiary of the Company, which is also accounted for under the equity method. Further, certain other investments in partnerships or joint ventures which the Company does not control are also accounted for under the equity method. All significant intercompany balances and transactions have been eliminated in consolidation.

In the opinion of management, the accompanying Consolidated Financial Statements contain all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the Company's consolidated financial position at December 31, 2000 and December 31, 1999 and the results of its operations, changes in shareholders' equity and its cash flows for the years ended December 31, 2000, 1999 and 1998. Such operating results are not necessarily indicative of the results that may be expected for any other interim periods or the entire year.

Note 3 – Summary of Significant Accounting Policies

Loans and other lending investments, net – As described in Note 5, "Loans and Other Lending Investments," includes the following investments: senior mortgages, subordinate mortgages, corporate/partnership loans/unsecured notes, loan participations and other lending investments. In general, management considers its investments in this category as held-to-maturity and, accordingly, reflects such items at amortized historical cost.

Real estate subject to operating leases and depreciation – Real estate subject to operating leases is generally recorded at cost. Certain improvements and replacements are capitalized when they extend the useful life, increase capacity or improve the efficiency of the asset. Repairs and maintenance items are expensed as incurred. The Company capitalizes interest costs incurred during the land development or construction period on qualified development projects, including investments in joint ventures accounted for under the equity method. Depreciation is computed using the straight line method of cost recovery over estimated useful lives of 40.0 years for buildings, five years for furniture and equipment, the shorter of the remaining lease term or expected life for tenant improvements, and the remaining life of the building for building improvements.

Real estate assets to be disposed of are reported at the lower of their carrying amount or fair value less costs to sell. The Company also periodically reviews long-lived assets to be held and used for an impairment in value whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. In management's opinion, real estate assets to be held and used are not carried at amounts in excess of their estimated recoverable amounts.

Capitalized interest – The Company capitalizes interest costs incurred during the land development or construction period on qualified development projects, including investments in joint ventures accounted for under the equity method. Interest capitalized was approximately \$513,000 and \$377,000 during the years ended December 31, 2000 and 1999, respectively.

Cash and cash equivalents – Cash and cash equivalents include cash held in banks or invested in money market funds with original maturity terms of less than 90 days.

Restricted cash – Restricted cash represents amounts required to be maintained in escrow under certain of the Company's debt obligations and leasing cost obligations.

Non-cash activity – During the year ended December 31, 1998, the Company had significant non-cash activity including: (1) conversion of units in APMT Limited Partnership (shown as "minority interest" in the consolidated financial statements) to class A shares of the Company (see Note 4); (2) issuance of options to Starwood Financial Advisors, L.L.C. (the "Advisor") to acquire class A shares of the Company (see Note 11); and (3) issuance of new class A shares in exchange for a portion of the acquisition of loans and related investments as part of the Recapitalization Transactions (see Note 4).

The cash portion of the Recapitalization Transactions is summarized as follows (in thousands):

Acquisition of loans and other investments	\$(1,061,006)
Acquired accrued interest and operating lease income receivable	(7,451)
Conversion of minority interest	(5,387)
Par value of class A shares issued	306,796
Additional paid in capital on class A shares issued	432,084
Net cash outflow for the recapitalization transactions	<u>\$ (334,964)</u>

During 1999, the Company acquired TriNet (see Note 4). The following is a summary of the effects of this transaction on the Company's consolidated financial position (in thousands):

	<u>Acquisition of TriNet</u>
Fair value of:	
Assets acquired	\$(1,589,714)
Liabilities assumed	676,936
Minority interest	2,524
Stock issued	<u>875,195</u>
Cash paid	(35,059)
Less cash acquired	<u>11,336</u>
Net cash outflow for TriNet Acquisition	<u>\$ (23,723)</u>

There was no non-cash activity during the year ended December 31, 2000.

Marketable securities – From time to time, the Company invests excess working capital in short-term marketable securities such as those issued by the Government National Mortgage Association ("GNMA"), Federal National Mortgage Association ("FNMA"), and Federal Home Loan Mortgage Corporation ("FHLMC"). Although the Company generally intends to hold such investments for investment purposes, it may, from time to time, sell any of its investments in these securities as part of its management of liquidity. Accordingly, the Company considers such investments as "available-for-sale" and reflects such investments at fair market value with changes in fair market value reflected as a component of shareholders' equity.

Repurchase agreements – The Company may enter into sales of securities or loans under agreements to repurchase the same security or loan. The amounts borrowed under repurchase agreements are carried on the balance sheet as part of debt obligations at the amount advanced plus accrued interest. Interest incurred on the repurchase agreements is reported as interest expense.

Revenue recognition – The Company's revenue recognition policies are as follows:

Loans and other lending investments: The Company generally intends to hold all of its loans and other lending investments to maturity. Accordingly, it reflects all of these investments at amortized cost less allowance for loan losses, acquisition premiums or discounts, deferred loan fees and undisbursed loan funds. On occasion, the Company may acquire loans at either premiums or discounts based on the credit characteristics of such loans. These premiums or discounts are recognized as yield adjustments over the lives of the related loans. If loans that were acquired at a premium or discount are prepaid, the Company immediately recognizes the unamortized premium or discount as a decrease or increase in the prepayment gain or loss, respectively. Loan origination or exit fees, as well as direct loan origination costs, are also deferred and recognized over the lives of the related loans as a yield adjustment. Interest income is recognized using the effective interest method applied on a loan-by-loan basis.

Certain of the Company's loans provide for accrual of interest at specified rates which differ from current payment terms. Interest is recognized on such loans at the accrual rate subject to management's determination that accrued interest and outstanding principal are ultimately collectible, based on the underlying collateral and operations of the borrower.

Prepayment penalties or yield maintenance payments from borrowers are recognized as additional income when received. Certain of the Company's loan investments provide for additional interest based on the borrower's operating cash flow or appreciation of the underlying collateral. Such amounts are considered contingent interest and are reflected as income only upon certainty of collection.

Leasing investments: Operating lease revenue is recognized on the straight-line method of accounting from the later of the date of the origination of the lease or the date of acquisition of the facility subject to existing leases. Accordingly, contractual lease payment increases are recognized evenly over the term of the lease. The cumulative difference between lease revenue recognized under this method and contractual lease payment terms is recorded as a deferred operating lease income receivable on the balance sheet.

Provision for possible credit losses – The Company's accounting policies require that an allowance for estimated credit losses be maintained at a level that management, based upon an evaluation of known and inherent risks in the portfolio, considers adequate to provide for possible credit losses. Specific valuation allowances are established for impaired loans in the amount by which the carrying value, before allowance for estimated losses, exceeds the fair value of collateral less disposition costs on an individual loan basis. Management considers a loan to be impaired when, based upon current information and events, it believes that it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement on a timely basis. Management measures these impaired loans at the fair value of the loans' underlying collateral less estimated disposition costs. Impaired loans may be left on accrual status during the period the Company is pursuing repayment of the loan; however, these loans are placed on non-accrual status at such time that the loans either: (1) become 90 days delinquent; or (2) management determines the borrower is incapable of, or has ceased efforts toward, curing the cause of the impairment. While on non-accrual status, interest income is recognized only upon actual receipt. Impairment losses are recognized as direct write-downs of the related loan with a corresponding charge to the provision for possible credit losses. Charge-offs occur when loans, or a portion thereof, are considered uncollectible and of such little value that further pursuit of collection is not warranted. Management also provides a portfolio reserve based upon its periodic evaluation and analysis of the portfolio, historical and industry loss experience, economic conditions and trends, collateral values and quality, and other relevant factors.

Income taxes – The Company did not qualify as a REIT from 1993 through 1997; however, it did not incur any material tax liabilities as a result of its operations. See Note 10 to the Consolidated Financial Statements for more information.

As confirmed in a closing agreement with the IRS obtained in March 1998, the Company was eligible and has elected to be taxed as a REIT for its tax year beginning January 1, 1998. As a REIT, the Company is subject to federal income taxation at corporate rates on its REIT taxable income; however, the Company is allowed a deduction for the amount of dividends paid to its shareholders, thereby subjecting the distributed net income of the Company to taxation at the shareholder level only. iStar Operating and TMOOC are not consolidated for federal income tax purposes and are taxed as corporations. For financial reporting purposes, current and deferred taxes are provided for in the portion of earnings recognized by the Company with respect to its interest in iStar Operating and TMOOC.

Net income allocable to common shares – Net income allocable to common shares excludes 1% of net income allocable to the class B shares prior to November 4, 1999. The class A and class B shares were exchanged for Common Stock in connection with the TriNet Acquisition, as more fully described in Note 4.

Earnings (loss) per common shares – In accordance with the Statement of Financial Accounting Standards No. 128 ("FASB No. 128"), the Company presents both basic and diluted earnings per share ("EPS"). Basic earnings per share ("Basic EPS") excludes dilution and is computed by dividing net income available to common shareholders by the weighted average number of shares outstanding for the period. Diluted earnings per share ("Diluted EPS") reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, where such exercise or conversion would result in a lower earnings per share amount.

Use of estimates – The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

New accounting standards – In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). On June 23, 1999, the FASB voted to defer the effectiveness of SFAS No. 133 for one year. SFAS No. 133 is now effective for fiscal years beginning after June 15, 2000, but earlier application is permitted as of the beginning of any fiscal quarter subsequent to June 15, 1998. SFAS No. 133 establishes accounting and reporting standards for derivative financial instruments and hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as: (1) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment; (2) a hedge of the exposure to variable cash flows of a forecasted transaction; or (3) in certain circumstances, a hedge of a foreign currency exposure. The Company adopted this pronouncement, as amended by Statement of Financial Accounting Standards No. 137 "Accounting for Derivative Instruments and Hedging Activities – deferral of the Effective Date of FASB Statement No. 133" and Statement of Financial Accounting Standards No. 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities – an Amendment of FASB Statement No. 133," on January 1, 2001. Because the Company has primarily used derivatives as cash flow hedges of interest rate risk only, the adoption of SFAS No. 133 did not have a material financial impact on the financial position and results of operations of the Company. However, should the Company change its current use of such derivatives (see Note 9), the adoption of SFAS No. 133 could have a more significant effect on the Company prospectively.

In December 1999, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 101 ("SAB 101"), Revenue Recognition in Financial Statements." In June 2000, the SEC staff amended SAB 101 to provide registrants with additional time to implement SAB 101. The Company adopted SAB 101, as required, in the fourth quarter of fiscal 2000. The adoption of SAB 101 did not have a material financial impact on the financial position or the results of operations of the Company.

In March 2000, the FASB issued FASB Interpretation No. 44 ("FIN 44"), "Accounting for Certain Transactions Involving Stock Compensation." The Company was required to adopt FIN 44 effective July 1, 2000 with respect to certain provisions applicable to new awards, exchanges of awards in a business combination, modifications to outstanding awards, and changes in grantee status that occur on or after that date. FIN 44 addresses practice issues related to the application of Accounting Practice Bulletin Opinion No. 25, "Accounting for Stock Issued to Employees." The initial adoption of FIN 44 by the Company did not have a material impact on its consolidated financial position or results of operations.

Note 4 – Capital Transactions

Prior transactions with affiliates – Through a series of transactions beginning in November 1993 and through March 18, 1998, the date of the Recapitalization Transactions described in the following section, Starwood Mezzanine Investors, L.P. (“Starwood Mezzanine”) and certain other affiliates (collectively, the “Starwood Investors”) had acquired controlling interests in the Company represented by an aggregate of 874,016 class A shares, or 69.46% of the then total class A shares outstanding, and 629,167 class B shares, representing 100% of the then total class B shares outstanding. Together, the class A and class B shares held by the Starwood Investors represented 79.64% of the voting interests of the Company.

During the quarter ended March 31, 1998, the Company consummated certain transactions and entered into agreements which significantly recapitalized and expanded its capital resources, as well as modified future operations, including those described herein below in “Recapitalization Transactions” and “Advisor Agreement.”

Recapitalization Transactions – As more fully discussed above, pursuant to a series of transactions beginning in March 1994 and including the exercise of the class A and class B warrants in January 1997, the Starwood Investors acquired joint ownership of 69.46% and 100% of the outstanding class A shares and class B shares of the Company, respectively, through which they controlled approximately 79.64% of the voting interests in the Company as of December 31, 1997. Prior to the consummation of these transactions on March 18, 1998 (collectively, the “Recapitalization Transactions”), Starwood Mezzanine also owned 761,491 units which represented the remaining 91.95% of APMT Limited Partnership not held by the Company. Those units were convertible into cash, an additional 761,491 class A shares of the Company, or a combination of the two, as determined by the Company.

On March 18, 1998, each outstanding unit held by Starwood Mezzanine was exchanged for one class A share of the Company and, concurrently, the partnership was liquidated through a distribution of its net assets to the Company, its then sole partner.

Simultaneously, Starwood Mezzanine contributed various real estate loan investments to the Company in exchange for 9,191,333 class A shares and \$25.5 million in cash, as adjusted. Starwood Opportunity Fund IV, L.P. (“SOF IV”), one of the Starwood Investors, contributed loans and other lending investments, \$17.9 million in cash and certain letters of intent in exchange for 41,179,133 class A shares of the Company and a cash payment of \$324.3 million. Concurrently, the holders of the class B shares who were affiliates of the Starwood Investors acquired 25,565,979 additional class B shares sufficient to maintain existing voting preferences pursuant to the Company’s Amended and Restated Declaration of Trust. Immediately after these transactions, the Starwood Investors owned approximately 99.27% of the outstanding class A shares of the Company and 100% of the class B shares. Assets acquired from Starwood Mezzanine were reflected using step acquisition accounting at predecessor basis adjusted to fair value to the extent of post-transaction, third-party ownership. Assets acquired from SOF IV were reflected at their fair market value.

Advisory Agreement – In connection with the Recapitalization Transactions, the Company and its former external advisor (the “Advisor”), an affiliate of the Starwood Investors, entered into an Advisory Agreement (the “Advisory Agreement”) pursuant to which the Advisor managed the affairs of the Company, subject to the Company’s purpose and investment policy, the investment restrictions and the directives of the Board of Directors.

The Company paid the Advisor a quarterly base management fee of 0.3125% (1.25% per annum) of the “Book Equity Value” of the Company. “Book Equity Value” was generally defined as the excess of the book value of the assets of the Company over all liabilities of the Company.

In addition, the Company paid the Advisor a quarterly incentive fee of 5.00% of the Company’s “Adjusted Net Income” during each quarter that the Adjusted Net Income for such quarter (restated and annualized as a rate of return on the Company’s Book Equity Value for such quarter) equaled or exceeded the “Benchmark BB Rate.” “Adjusted Net Income” was generally defined as the Company’s gross income less the Company’s expenses for the applicable quarter (including the base fee for such quarter but not the incentive fee for such quarter). The Advisor was also reimbursed for certain expenses it incurred on behalf of the Company.

Prior to the transactions described below through which, among other things, the Company became internally-managed, the Company was dependent on the services of the Advisor and its officers and employees for the successful execution of its business strategy.

1999 Transactions – On November 3, 1999, consistent with previously announced terms, the Company's shareholders approved a series of transactions including: (1) the acquisition, through a merger, of TriNet; (2) the acquisition, through a merger and a contribution of interests, of 100% of the ownership interests in the Advisor; and (3) the change in form, through a merger, of the Company's organization to a Maryland corporation. TriNet shareholders also approved the TriNet Acquisition on November 3, 1999. These transactions were consummated on November 4, 1999. As part of these transactions, the Company also replaced its dual class common share structure with a single class of Common Stock.

TriNet Acquisition – TriNet merged with and into a subsidiary of the Company, with TriNet surviving as a wholly-owned subsidiary of the Company (the "Leasing Subsidiary"). In the TriNet Acquisition, each share of TriNet common stock was converted into 1.15 shares of Common Stock, resulting in an aggregate issuance of 28.9 million shares of Common Stock. Each share of TriNet Series A, Series B and Series C Cumulative Redeemable Preferred Stock was converted into a share of Series B, Series C or Series D (respectively) Cumulative Redeemable Preferred Stock of the Company. The Company's preferred stock issued to the former TriNet preferred shareholders has substantially the same terms as the TriNet preferred stock, except that the new Series B, C and D preferred stock has additional voting rights not associated with the TriNet preferred stock. The holders of the Company's Series A preferred stock retained the same rights and preferences as existed prior to the TriNet Acquisition.

The TriNet Acquisition was accounted for as a purchase. Because the Company's stock prior to the transaction was largely held by the Starwood Investors, and, as a result, the stock was not widely traded relative to the amount of shares outstanding, the pro forma financial information presented below was prepared utilizing a stock price of \$28.14 per TriNet share, which was the average stock price of TriNet during the five-day period before and after the TriNet Acquisition was agreed to and announced.

Advisor Transaction – Contemporaneously with the consummation of the TriNet Acquisition, the Company acquired 100% of the interests in the Advisor in exchange for total consideration of four million shares of Common Stock. For accounting purposes, the Advisor Transaction was not considered the acquisition of a "business" in applying Accounting Principles Board Opinion No. 16, "Business Combinations" and, therefore, the market value of the Common Stock issued in excess of the fair value of the net tangible assets acquired of approximately \$94.5 million was charged to operating income as a non-recurring, non-cash item in the fourth quarter of 1999, rather than capitalized as goodwill.

Incorporation Merger – Prior to the consummation of the TriNet Acquisition and the Advisor Transaction, the Company changed its form from a Maryland trust to a Maryland corporation in the Incorporation Merger, which technically involved a merger of the Company with a wholly-owned subsidiary formed solely to effect such merger. In the Incorporation Merger, the class B shares were converted into shares of Common Stock on a 49-for-one basis (the same ratio at which class B shares were previously convertible into class A shares), and the class A shares were converted into shares of Common Stock on a one-for-one basis. As a result, the Company no longer has multiple classes of common shares. The Incorporation Merger was treated as a transfer of assets and liabilities under common control. Accordingly, the assets and liabilities transferred from the Maryland trust to the Maryland corporation were reflected at their predecessor basis and no gain or loss was recognized.

The Company declared and paid a special dividend of one million shares of its Common Stock payable pro rata to all holders of record of its Common Stock following completion of the Incorporation Merger, but prior to the effective time of the TriNet Acquisition and the Advisor Transaction.

Pro Forma Information – The summary unaudited pro forma consolidated statements of operations for the years ended December 31, 1999 and 1998 are presented as if the following transactions, consummated in November 1999, had occurred on January 1, 1998: (1) the TriNet Acquisition; (2) the Advisor Transaction; and (3) the borrowings necessary to consummate the aforementioned transactions, and as if the following transactions consummated in March 1998 had occurred on January 1, 1998: (1) the Recapitalization Transactions; (2) the exchange of each outstanding unit in the APMT Limited Partnership held by holders other than the Company for one class A share; (3) the liquidation and termination of the partnership; and (4) the borrowings necessary to consummate the aforementioned transactions. The unaudited pro forma information is based upon the historical consolidated results of operations of the Company and TriNet for the years ended December 31, 1999 and 1998, after giving effect to the events described above.

Pro Forma Consolidated Statements of Operations

	For the Year Ended December 31,	
	1999	1998
	<i>(in thousands, except per share data)</i>	
Revenue:		
Interest income	\$218,359	\$140,261
Operating lease income	186,776	169,196
Other income	21,000	9,776
Total revenue	<u>426,135</u>	<u>319,233</u>
Expenses:		
Interest expense	135,795	99,138
Operating costs-corporate tenant lease assets	12,601	7,651
Depreciation and amortization	36,423	35,053
General and administrative	21,716	20,770
Provision for possible credit losses	4,750	2,750
Stock option compensation expense	2,474	5,985
Total costs and expenses	<u>213,759</u>	<u>171,347</u>
Income before minority interest	\$212,376	\$147,886
Minority interest	(164)	(128)
Net income	<u>\$212,212</u>	<u>\$147,758</u>
Preferred dividend requirements	<u>(36,906)</u>	<u>(16,622)</u>
Net income allocable to common shareholders	<u>\$175,306</u>	<u>\$131,136</u>
Basic earnings per share:		
Basic earnings per common share	<u>\$ 2.01</u>	<u>\$ 1.50</u>
Weighted average number of common shares outstanding	<u>87,073</u>	<u>87,193</u>

Investments and dispositions are assumed to have taken place as of January 1, 1998; however, loan originations and acquisitions are not reflected in these pro forma numbers until the actual origination or acquisition date by the Company. The pro forma information above excludes the charge of approximately \$94.5 million taken by the Company in fiscal 1999 to reflect the costs incurred in acquiring the Advisor as such charge is non-recurring. The pro forma information also excludes certain non-recurring historical charges recorded by TriNet of \$3.4 million in 1999 for a provision for a real estate write-down and \$3.0 million in 1998 for a special charge for an expected reduction in TriNet's investment activity. General and administrative costs represent estimated expense levels as an internally-managed Company.

The pro forma financial information is not necessarily indicative of what the consolidated results of operations of the Company would have been as of and for the periods indicated, nor does it purport to represent the results of operations for future periods.

Note 5 – Loans and Other Lending Investments

The following is a summary description of the Company's loans and other lending investments (in thousands):

Type of Investment	Underlying Property Type ⁽¹⁾	# of Borrowers in Class ⁽¹⁾	Original Commitment Amount ⁽¹⁾	Principal Balances Outstanding ⁽¹⁾	Carrying Value As at December 31,	
					2000	1999
Senior Mortgages ⁽⁵⁾	Office/Hotel/Mixed Use/ Apartment/Retail/Resort	21	\$1,337,717	\$1,232,307	\$1,210,992	\$1,039,052
Subordinated Mortgages	Office/Hotel/Mixed Use	13	372,136	340,088	325,558	464,105
Corporate Loans/Partnership Loans/Unsecured Notes	Office/Hotel/ Residential/Apartment	14	413,946	401,795	398,978	309,768
Loan Participations	Office/Retail	3	127,497	111,388	111,251	128,105
Other Lending Investments	Resort/Office/Mixed Use/ Residential/Homebuilder	N/A	N/A	N/A	192,404	69,976
Gross Carrying Value					\$2,239,183	\$2,011,006
Provision for Possible Credit Losses					(14,000)	(7,500)
Total, Net					<u>\$2,225,183</u>	<u>\$2,003,506</u>

Type of Investment	Effective Maturity Dates	Contractual Interest Payment Rates ⁽²⁾	Contractual Interest Accrual Rates ⁽³⁾	Principal Amortization	Participation Features
Senior Mortgages ⁽⁵⁾	2001 to 2019	Fixed: 6.13% to 20.00% Variable: LIBOR + 1.50% to 6.00%	Fixed: 6.13% to 24.00% Variable: LIBOR + 1.50% to 6.00%	Yes ⁽⁴⁾	Yes ⁽³⁾
Subordinated Mortgages	2002 to 2007	Fixed: 7.00% to 15.25% Variable: LIBOR + 5.80%	Fixed: 10.07% to 17.00% Variable: LIBOR + 5.80%	Yes ⁽⁴⁾	Yes ⁽³⁾
Corporate Loans/Partnership Loans/Unsecured Notes	2001 to 2008	Fixed: 6.13% to 14.50% Variable: LIBOR + 2.78% to 7.50%	Fixed: 6.13% to 17.50% Variable: LIBOR + 2.78% to 7.50%	Yes	Yes ⁽³⁾
Loan Participations	2003 to 2005	Fixed: 10.00% to 13.60% Variable: LIBOR + 4.50%	Fixed: 13.60% to 14.00% Variable: LIBOR + 4.50%	No	Yes ⁽³⁾
Other Lending Investments	2002 and 2013	Fixed: 6.75% to 12.75%	Fixed: 6.75% to 12.75%	No	No

Explanatory Notes:

(1) Amounts and details are for loans outstanding as of December 31, 2000.

(2) Substantially all variable-rate loans are based on 30-day LIBOR and reprice monthly. The 30-day LIBOR rate on December 29, 2000 was 6.56%.

(3) Under some of these loans, the lender receives additional payments representing additional interest from participation in available cash flow from operations of the property and the proceeds, in excess of a base amount, arising from a sale or refinancing of the property.

(4) The loans require fixed payments of principal and interest resulting in partial principal amortization over the term of the loan with the remaining principal due at maturity. In addition, one of the loans permits additional annual prepayments of principal of up to \$1.3 million without penalty at the borrower's option.

(5) The unfunded commitment amount on one of the Company's construction loans, included in senior mortgages, was \$16.2 million as of December 31, 1999. As of December 31, 2000, the construction loan was fully funded.

During the years ended December 31, 2000 and 1999, respectively, the Company and its affiliated ventures originated or acquired an aggregate of approximately \$721.2 million and \$663.4 million in loans and other lending investments, funded \$56.0 million and \$46.4 million under existing loan commitments and received principal repayments of \$584.5 million and \$561.9 million.

As of December 31, 2000, the Company had nine loans with unfunded commitments. The total unfunded commitment amount was approximately \$151.1 million, of which \$83.5 million was discretionary (i.e., at the Company's option) and \$67.6 million was non-discretionary.

The Company's loans and other lending investments are predominantly pledged as collateral under either the iStar Asset Receivables secured notes, the secured revolving facilities or secured term loans (see Note 7).

The Company has reflected provisions for possible credit losses of approximately \$6.5 million, \$4.8 million and \$2.8 million in its results of operations during the years ended December 31, 2000, 1999 and 1998, respectively. These provisions represent portfolio reserves based on management's evaluation of general market conditions, the Company's internal risk management policies and credit risk ratings system, industry loss experience, the likelihood of delinquencies or defaults, and the underlying collateral. No direct impairment reserves on specific loans were considered necessary. Management may transfer reserves between general and specific reserves as considered necessary.

Note 6 – Real Estate Subject to Operating Leases

During 2000, the Company acquired one corporate tenant lease facility for a purchase price of \$22.8 million and exercised an option to purchase another facility for \$16.4 million by funding an additional \$474,000 on an existing convertible mortgage loan. Construction was completed on five facilities under development in one of the Company's joint venture partnerships for a total development cost of \$65.2 million. In addition, the TN-CP joint venture acquired one facility for a purchase price of \$36.8 million. The Company also purchased 78.4 acres of land for approximately \$80.7 million subject to a 20-year ground lease to a corporate customer, with the first year of operating lease payments equal to a return on cost of approximately 11.6%. In addition, the Company purchased 32.4 acres of land for approximately \$2.3 million on which it is constructing a build-to-suit distribution facility for a corporate customer under a 15-year net lease.

The Company's investments in real estate subject to operating leases, at cost, were as follows (in thousands):

	December 31,	
	2000	1999
Buildings and improvements	\$1,294,572	\$1,390,933
Land and land improvements	344,490	277,872
Less: accumulated depreciation	(46,975)	(14,627)
	1,592,087	1,654,178
Investments in unconsolidated joint ventures	78,082	60,106
Real estate subject to operating leases, net	<u>\$1,670,169</u>	<u>\$1,714,284</u>

The Company's net lease facilities are leased to customers with initial term expiration dates from 2001 to 2020. Future operating lease payments under non-cancelable leases, excluding customer reimbursements of expenses, in effect at December 31, 2000, are approximately as follows (in thousands):

Year:	Amount
2001	\$ 176,429
2002	172,811
2003	164,401
2004	146,279
2005	127,867
Thereafter	751,177
	<u>\$1,538,964</u>

Under certain leases, the Company receives additional participating lease payments to the extent gross revenues of the tenant exceed a base amount. The Company earned \$0.6 million and \$0.5 million of such additional participating lease payments in the years ended December 31, 2000 and 1999, respectively. In addition, the Company also receives reimbursements from tenants for certain facility operating expenses.

At December 31, 2000, the Company had investments in five joint ventures: (1) TriNet Sunnyvale Partners L.P. ("Sunnyvale"), whose external partners are John D. O'Donnell, Trustee, John W. Hopkins, and Donald S. Grant; (2) Corporate Technology Associates LLC ("CTC I"), whose external member is Corporate Technology Centre Partners LLC; (3) Sierra Land Ventures ("Sierra"), whose external joint venture partner is Sierra-LC Land, Ltd.; (4) TriNet Milpitas Associates, LLC ("Milpitas"), whose external member is The Prudential Insurance Company of America; and (5) ACRE Simon, L.L.C. ("ACRE"), whose external partner is William E. Simon & Sons Realty Investments, L.L.C. These ventures were formed for the purpose of operating, acquiring and in certain cases, developing corporate tenant lease facilities. At December 31, 2000, all facilities held by CTC II and TN-CP had been sold. The Company previously had an equity investment in CTC II which was sold for approximately \$66.0 million in September, 2000. In connection with this sale, the note receivable from the venture was modified to mature on December 31, 2001. The note receivable and related accrued interest are included in Loans and Other Lending Investments at December 31, 2000.

Through the TriNet Acquisition, the Company also acquired a 50% interest in W9/TriNet Poydras LLC ("Poydras"). Effective November 22, 1999, the joint venture partners, who are affiliates of Whitehall Street Real Estate Limited Partnership, IX and The Goldman Sachs Group L.P. (the "Whitehall Group"), elected to exercise their right under the partnership agreement, which was accelerated as a result of the TriNet Acquisition, to exchange all of their membership units for 350,746 shares of Common Stock of the Company and a \$767,000 distribution of available cash. As a consequence, Poydras is now wholly owned and is reflected on a consolidated basis in these financial statements.

At December 31, 2000, the ventures comprised 23 net leased facilities, three of which were under development (these three facilities became fully operational with lease payments commencing as of January 2001). Additionally, 17.7 acres of land are held for sale. The Company's combined investment in these joint ventures at December 31, 2000 was \$78.1 million. The joint ventures' purchase price for the 23 facilities owned at December 31, 2000 was \$295.7 million. The purchase price of the land held for sale was \$6.8 million. In the aggregate, the joint ventures had total assets of \$366.8 million and total liabilities of \$267.8 million as of December 31, 2000, and net income of \$7.1 million for the year ended December 31, 2000. The Company accounts for these investments under the equity method because the Company's joint venture partners have certain participating rights which limit the Company's control. The Company's investments in and advances to unconsolidated joint ventures, its percentage ownership interests, its respective income and the Company's pro rata share of its ventures' third-party debt as of December 31, 2000 are presented below (in thousands):

Unconsolidated Joint Venture	Ownership %	Equity Investment	Note Receivable	Accrued Interest Receivable	Total Investment	Joint Venture Income	Interest Income	Pro Rata Share of Third-Party Debt
Operating:								
Sunnyvale	44.7%	\$12,772	\$ -	\$ -	\$ 12,772	\$1,163	\$ -	\$ 10,728
CTC I	50.0%	32,440	-	-	32,440	1,053	-	43,789
CTC II	50.0%	-	24,874	6,222	31,096	(755)	5,371	-
Milpitas	50.0%	24,289	-	-	24,289	2,941	-	40,641
TN-CP	50.0%	-	-	-	-	397	-	-
ACRE Simon	20.0%	5,099	-	-	5,099	42	-	6,009
Development:								
Sierra	50.0%	3,482	-	-	3,482	217	-	724
Total		<u>\$78,082</u>	<u>\$24,874</u>	<u>\$6,222</u>	<u>\$109,178</u>	<u>\$5,058</u>	<u>\$5,371</u>	<u>\$101,891</u>

Effective September 29, 2000, iStar Sunnyvale Partners, LP entered into an interest rate cap agreement with Bear Stearns Financial Products, limiting the venture's exposure to interest rate movements on its \$24.0 million LIBOR-based mortgage loan to an interest rate cap of 9.0% through November 9, 2003.

Currently, the limited partners of the Sunnyvale partnership have the option to convert their partnership interest into cash; however, the Company may elect to deliver 297,728 shares of Common Stock in lieu of

cash. Additionally, commencing in February 2002, subject to acceleration under certain circumstances, partnership units held by certain partners of Milpitas may be converted into 984,476 shares of Common Stock.

Income generated from the above joint venture investments is included in Operating Lease Income in the Consolidated Statements of Operations.

Note 7 – Debt Obligations

As of December 31, 2000 and 1999, the Company has debt obligations under various arrangements with financial institutions as follows (in thousands):

	Maximum Amount Available	Carrying Value as of		Stated Interest Rates	Scheduled Maturity Date
		December 31, 2000	December 31, 1999		
Secured revolving credit facilities:					
Line of credit	\$ 700,000 ⁽¹⁾	\$ 284,371	\$ 592,984	LIBOR + 1.75% – 2.25% ⁽¹⁾	March 2005 ⁽¹⁾
Line of credit	500,000	307,978	169,952	LIBOR + 1.50% – 1.75% ⁽²⁾	August 2002 ⁽²⁾
Unsecured revolving credit facilities:					
Line of credit	350,000	173,450	186,700	LIBOR + 1.55%	May 2001 ⁽³⁾
Line of credit	100,000	–	–	LIBOR + 2.25%	January 2002
Total revolving credit facilities	<u>\$1,650,000</u>	<u>765,799</u>	<u>949,636</u>		
Secured term loans:					
Secured by real estate					
under operating leases		150,678	153,618	7.44%	March 2009
Secured by senior and subordinate					
mortgage investments		–	109,398	LIBOR + 1.00%	August 2000 ⁽⁴⁾
Secured by senior mortgage investment		–	90,902	LIBOR + 1.00%	August 2000 ⁽⁴⁾
Secured by corporate lending investments		60,000	–	LIBOR + 2.50%	June 2003 ⁽⁵⁾
Secured by real estate under					
operating leases ⁽⁶⁾		77,860	78,610	LIBOR + 1.38%	June 2001
Secured by real estate under					
operating leases		60,471	73,279	Fixed: 6.00% – 11.38%	⁽⁷⁾
Secured by senior mortgage investment		–	54,000	Variable: LIBOR + 1.75% ⁽⁸⁾	November 2000
Total term loans		<u>349,009</u>	<u>559,807</u>		
Debt premiums (discounts)		<u>51</u>	<u>(521)</u>		
Total secured term loans		<u>349,060</u>	<u>559,286</u>		
iStar Asset Receivables secured notes:					
Class A		207,114	–	LIBOR + 0.30%	August 2003 ⁽⁹⁾
Class B		94,055	–	LIBOR + 0.50%	October 2003 ⁽⁹⁾
Class C		105,813	–	LIBOR + 1.00%	January 2004 ⁽⁹⁾
Class D		52,906	–	LIBOR + 1.45%	June 2004 ⁽⁹⁾
Class E		123,447	–	LIBOR + 2.75%	January 2005 ⁽⁹⁾
Class F		5,000	–	LIBOR + 3.15%	January 2005 ⁽⁹⁾
Total iStar Asset Receivables					
secured notes		<u>588,335</u>	<u>–</u>		
Unsecured notes:⁽¹⁰⁾					
6.75% Dealer					
Remarketable Securities ⁽¹¹⁾		125,000	125,000	6.75%	March 2013
7.30% Notes		100,000	100,000	7.30%	May 2001
7.70% Notes		100,000	100,000	7.70%	July 2017
7.95% Notes		50,000	50,000	7.95%	May 2006
Total unsecured notes		<u>375,000</u>	<u>375,000</u>		
Less: debt discount ⁽¹²⁾		<u>(18,490)</u>	<u>(21,481)</u>		
Total unsecured notes		<u>356,510</u>	<u>353,519</u>		
Other debt obligations		<u>72,263</u>	<u>38,763</u>	Various	Various
Total debt obligations		<u>\$2,131,967</u>	<u>\$1,901,204</u>		

Explanatory Notes:

(1) On December 28, 2000, the Company expanded the facility to \$700.0 million, increased the range of collateral eligible for inclusion in the facility, increased pricing to LIBOR + 1.75% to 2.25%, and extended its final maturity to March 2005 (including an option to extend for an additional year).

Explanatory Notes (cont.):

- (2) On February 4, 2000, the Company extended the term of its \$500.0 million facility to August 2002 and increased pricing under the facility to LIBOR + 1.50% to 1.75%.
- (3) Subsequent to year end, the Company extended the maturity of this credit facility to May 2002.
- (4) On May 17, 2000, the Company repaid these secured term loan obligations.
- (5) The Company has a one-year extension option in June 2003.
- (6) The Company provides a guarantee for 25% of the principal balance outstanding.
- (7) These mortgage loans mature at various dates through 2010.
- (8) On November 30, 2000, the Company repaid this secured loan obligation.
- (9) Principal payments on these bonds are a function of the principal repayments on loan assets which collateralize these obligations. The dates indicated above represent the expected date on which the final payment would occur for such class based on the assumptions that the loans which collateralize the obligations are not voluntarily prepaid, the loans are paid on their effective maturity dates and no extensions of the effective maturity dates of any of the loans are granted. The final maturity date for the underlying indenture on classes A, B, C, D, E and F is September 25, 2022.
- (10) The notes are callable by the Company at any time for an amount equal to the total of principal outstanding, accrued interest and the applicable make-whole prepayment premium.
- (11) Subject to mandatory tender on March 1, 2003, to either the dealer or the Leasing Subsidiary. The initial coupon of 6.75% applies to first five-year term through the mandatory tender date. If tendered to the dealer, the notes must be remarketed. The rates reset upon remarketing.
- (12) These obligations were assumed as part of the TriNet Acquisition. As part of the accounting for the purchase, these fixed rate obligations were considered to have stated interest rates which were below the then prevailing market rates at which the Leasing Subsidiary could issue new debt obligations and, accordingly, the Company ascribed a market discount to each obligation. Such discounts will be amortized as an adjustment to interest expense using the effective interest method over the related term of the obligations. As adjusted, the effective annual interest rates on these obligations were 8.81%, 8.75%, 9.51% and 9.04%, for the 6.75% Dealer Remarketable Securities, 7.30% Notes, 7.70% Notes and 7.95% Notes, respectively.

Availability of amounts under the secured revolving credit facilities are based on percentage borrowing base calculations.

Certain of the Leasing Subsidiary's debt obligations contain financial covenants pertaining to the subsidiary. Such obligations also establish restrictions on certain intercompany transactions between the Leasing Subsidiary and other Company affiliates. Further, such obligations also provide for a limit on distributions from the Leasing Subsidiary at 85% of cash flow from operations on a rolling four-quarter basis.

On January 31, 2000, the Company closed a new unsecured revolving credit facility. The facility is led by a major commercial bank, which committed \$50.0 million of the facility amount. On July 7, 2000, the Company increased the facility amount to \$100.0 million through syndication. The new facility has a two-year primary term and a one-year extension, at the Company's option, and bears interest at LIBOR plus 2.25%.

On February 4, 2000, the Company extended the term of its existing \$500.0 million secured credit facility. The Company extended the original August 2000 maturity date to August 2002, through a one-year extension to the facility's draw period and an additional one-year "term out" period during which outstanding principal amortizes 25% per quarter. In connection with the extension, the Company and the facility lender also expanded the range of assets that the lender would accept as collateral under the facility. In exchange for the extension and expansion, the Company agreed to increase the facility's interest rate from LIBOR plus 1.25% to 1.50%, to a revised rate of LIBOR plus 1.50% to 1.75%, depending upon certain conditions.

On May 17, 2000, the Company closed the inaugural offering under its proprietary matched funding program, iStar Asset Receivables ("STARS"), Series 2000-1. In the initial transaction, a wholly-owned subsidiary of the Company issued \$896.5 million of investment grade bonds secured by the subsidiary's assets, which had an aggregate outstanding principal balance of approximately \$1.2 billion at inception. Principal payments received on the assets will be utilized to repay the most senior class of the bonds then outstanding. The maturity of the bonds match funds the maturity of the underlying assets financed under the program. The Company initially purchased the class F bonds at a par value of \$38.2 million, which the Company financed with a \$27.8 million repurchase agreement maturing in May 2001, which has a balance of \$24.2 million at December 31, 2000 and is included in other debt obligations in the preceding table. On July 17, 2000, the Company sold, at par, \$5.0 million of the class F bonds to an institutional investor. For accounting purposes, these transactions were treated as secured financings.

On June 20, 2000, the Company closed a \$60.0 million term loan secured by a corporate lending investment it originated in the first quarter of 2000. The new loan replaced a \$30.0 million interim facility, and effectively match funds the expected weighted average maturity of the underlying corporate loan asset. The loan has a three-year primary term and a one-year extension, at the Company's option, and bears interest at LIBOR plus 2.50%.

On December 28, 2000, the Company expanded its existing \$675.0 million secured warehouse facility to \$700.0 million. The Company extended the original March 2001 maturity date to March 2005, including a one-year "term-out" extension option to the facility's maturity during which the interest rate spread will increase 25 basis points, no additional draws under the facility will be permitted, and the outstanding principal must amortize 25% per quarter. In connection with the extension, the Company and the facility lender also increased the range of collateral eligible for inclusion in the facility. Also in connection with the extension, the Company agreed to increase the facility's interest rate from LIBOR plus 1.50% to a revised rate of LIBOR plus 1.75% to 2.25%, depending upon certain conditions.

See also Note 17 – Subsequent Events for information on a new \$700.0 million secured revolving credit facility entered into on January 11, 2001 and the extension of the Company's \$350.0 million unsecured revolving credit facility.

During the year ended December 31, 2000, the Company incurred an extraordinary loss of approximately \$0.7 million as a result of the early retirement of certain secured debt obligations of its Leasing Subsidiary.

Future expected/scheduled maturities of outstanding long-term debt obligations are as follows (in thousands):

Year:	Amount
2001 ⁽¹⁾	\$ 280,917
2002 ⁽²⁾	496,420
2003	361,169
2004	158,719
2005 ⁽³⁾	416,557
Thereafter	436,624
Total principal maturities	2,150,406
Net unamortized debt (discounts)/premiums	(18,439)
Total debt obligations	<u>\$2,131,967</u>

Explanatory Notes:

(1) Includes the 1994 mortgage loan balance of \$36.3 million which had an original maturity date in 2004 and was repaid on March 1, 2001.

(2) Reflects the one-year extension on the \$350.0 million unsecured revolving credit facility to mature in 2002.

(3) Assumes exercise of one-year extension option on secured revolving facility.

Note 8 – Shareholders' Equity

Prior to November 4, 1999, the Company was authorized to issue 105.0 million shares, representing 70.0 million class A shares and 35.0 million class B shares, with a par value of \$1.00 and \$0.01 per share, respectively. Class B shares were required to be issued by the Company in an amount equal to one half of the number of class A shares outstanding. Class A and class B shares were each entitled to one vote per share with respect to the election of directors and other matters. Pursuant to the Declaration of Trust, the class B shares were convertible at the option of the class B shareholders into class A shares on the basis of 49 class B shares for one class A share. However, the holder of class B shares had agreed with the Company that it would not convert the class B shares into class A shares without the approval of a majority of directors that were not affiliated with such holder. All distributions of cash were made 99% to the holders of class A shares and 1% to the holders of class B shares.

On December 15, 1998, for an aggregate purchase price of \$220.0 million, the Company issued 4.4 million shares of Series A Preferred Stock and warrants to acquire 6.1 million common shares of Common Stock, as adjusted for dilution, at \$34.35 per share. The warrants are exercisable on or after December 15, 1999 at a price of \$34.35 per share and expire on December 15, 2005. The proceeds were allocated between the two securities issued based on estimated relative fair values.

As more fully described in Note 4, the Company consummated a series of transactions on November 4, 1999 in which its class A and class B shares were exchanged into a single class of Common Stock. The Company's charter now provides for the issuance of up to 200.0 million shares of Common Stock, par value \$0.001 per share, and 30.0 million shares of preferred stock. As part of these transactions, the Company adopted articles supplementary creating four series of preferred stock designated as 9.5% Series A Cumulative Redeemable Preferred Stock, consisting of 4.4 million shares, 9.375% Series B Cumulative Redeemable Preferred Stock, consisting of 2.3 million shares, 9.20% Series C Cumulative Redeemable Preferred Stock, consisting of approximately 1.5 million shares, and 8.0% Series D Cumulative Redeemable Preferred Stock, consisting of 4.6 million shares. The Series B, C and D Cumulative Redeemable Preferred Stock were issued in the TriNet Acquisition in exchange for similar issuances of TriNet stock then outstanding. The Series A, B, C and D Cumulative Redeemable Preferred Stock are redeemable without premium at the option of the Company at their respective liquidation preferences beginning on December 15, 2003, June 15, 2001, August 15, 2001 and October 8, 2002, respectively.

Stock Repurchase Program: The Board of Directors approved, and the Company has implemented, a stock repurchase program under which the Company is authorized to repurchase up to 5.0 million shares of its Common Stock from time to time, primarily using proceeds from the disposition of assets and excess cash flow from operations, but also using borrowings under its credit facilities if the Company determines that it is advantageous to do so. As of December 31, 2000 and December 31, 1999, the Company had repurchased approximately 2.3 million shares at an aggregate cost of approximately \$40.7 million and \$40.4 million, respectively.

Note 9 – Risk Management and Use of Financial Instruments

Risk management – In the normal course of its on-going business operations, the Company encounters economic risk. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or different bases, than its interest-earning assets. Credit risk is the risk of default on the Company's loan assets that results from a property's, borrower's or tenant's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of loans due to changes in interest rates or other market factors, including the rate of prepayments of principal and the value of the collateral underlying loans and the valuation of corporate tenant lease facilities held by the Company.

Use of derivative financial instruments – The Company's use of derivative financial instruments is primarily limited to the utilization of interest rate agreements or other instruments to manage interest rate exposure. The principal objective of such arrangements is to minimize the risks and/or costs associated with the Company's operating and financial structure as well as to hedge specific anticipated transactions. The counterparties to these contractual arrangements are major financial institutions with which the Company and its affiliates may also have other financial relationships. The Company is potentially exposed to credit loss in the event of nonperformance by these counterparties. However, because of their high credit ratings, the Company does not anticipate that any of the counterparties will fail to meet their obligations.

The Company has entered into LIBOR interest rate caps struck at 9.00%, 7.50% and 7.50% in notional amounts of \$300.0 million, \$40.4 million and \$38.3 million, respectively, which expire in March 2001, January 2001 and June 2001, respectively. In addition, in connection with the TriNet Acquisition, the Company acquired LIBOR interest rate caps currently struck at 7.75%, 7.75% and 7.50% in notional amounts of \$75.0 million, \$35.0 million and \$75.0 million, respectively, which expire in December 2004, December 2004 and August 2001, respectively. In connection with the closing of STARS, Series 2000-1 in May 2000, the Company entered into a LIBOR interest rate cap struck at 10.00% in the notional amount of \$312.0 million, and simultaneously sold a LIBOR interest rate cap with the same terms. Since these instruments do not reduce the Company's net interest rate risk exposure, they do not qualify as hedges and changes in their respective values are charged to earnings. As the significant terms of these arrangements are substantially the same, the effects of a revaluation of these two instruments are expected to substantially offset one another. At December 31, 2000 and 1999, the net fair value of the Company's interest rate caps were \$0.4 million and \$2.2 million, respectively.

The Company has entered into LIBOR interest rate swaps struck at 5.714%, 7.055%, and 7.058% in notional amounts of \$92.0 million, \$125.0 million and \$125.0 million, respectively, which expire in March 2001, June 2003 and June 2003, respectively. These swaps effectively fix the interest rate on a portion of the Company's floating-rate term loan obligations. In connection with the TriNet Acquisition, the Company acquired an interest rate swap which, together with certain existing interest rate cap agreements, effectively fix the interest rate on \$75.0 million of the Leasing Subsidiary's LIBOR-based borrowings at 5.58% plus the applicable margin through December 1, 2004. Management expects that it will have aggregate LIBOR-based borrowings at the Leasing Subsidiary in excess of the notional amount for the duration of the swap. The actual borrowing cost to the Company with respect to indebtedness covered by the swap will depend upon the applicable margin over LIBOR for such indebtedness, which will be determined by the terms of the relevant debt instruments. In June 2000, an interest rate swap with a notional amount of approximately \$112.0 million matured. At December 31, 2000 and 1999, the fair value (liability) of the Company's interest rate swaps were (\$7.7) million and \$3.4 million, respectively.

During the year ended December 31, 1999, the Company settled an aggregate notional amount of approximately \$63.0 million that was outstanding under certain hedging agreements which the Company had entered into in order to hedge the potential effects of interest rate movements on anticipated fixed-rate borrowings. The settlement of such agreements resulted in a receipt of approximately \$0.6 million which had been deferred pending completion of the planned fixed-rate financing transaction. Subsequently, the transaction was modified and was actually consummated as a variable-rate financing transaction. As a result, the previously deferred receipt no longer qualified for hedge accounting treatment and the \$0.6 million was recognized as a gain included in other income in the consolidated statement of operations for the year ended December 31, 2000 in connection with the closing of STARS, Series 2000-1.

During the year ended December 31, 1999, the Company refinanced its \$125.0 million term loan maturing March 15, 1999 with a \$155.4 million term loan maturing March 5, 2009. The new term loan bears interest at 7.44% per annum, payable monthly, and amortizes over an approximately 22-year schedule. The new term loan represented forecasted transactions for which the Company had previously entered into U.S. Treasury-based hedging transactions. The net \$3.4 million cost of the settlement of such hedges has been deferred and is being amortized as an increase to the effective financing cost of the new term loan over its effective ten-year term.

Credit risk concentrations – Concentrations of credit risks arise when a number of borrowers or tenants related to the Company's investments are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations, including those to the Company, to be similarly affected by changes in economic conditions. The Company regularly monitors various segments of its portfolio to assess potential concentrations of credit risks. Management believes the current credit risk portfolio is reasonably well diversified and does not contain any unusual concentration of credit risks.

Substantially all of the Company's real estate subject to operating leases (including those held by joint ventures) and loans and other lending investments, are collateralized by facilities located in the United States, with significant concentrations (i.e., greater than 10%) as of December 31, 2000 in California (23.7%) and Texas (14.7%). As of December 31, 2000, the Company's investments also contain significant concentrations in the following asset/collateral types: office (48.5%) and hotel/resorts (20.2%).

The Company underwrites the credit of prospective borrowers and tenants and often requires them to provide some form of credit support such as corporate guarantees or letters of credit. Although the Company's loans and other lending investments and corporate tenant lease assets are geographically diverse and the borrowers and tenants operate in a variety of industries, to the extent the Company has a significant concentration of interest or operating lease revenues from any single borrower or tenant, the inability of that borrower or tenant to make its payment could have an adverse effect on the Company. As of December 31, 2000, the Company's five largest borrowers or tenants collectively accounted for approximately 18.6% of the Company's aggregate annualized interest and operating lease revenue.

Note 10 – Income Taxes

Although originally formed to qualify as a REIT under the Code for the purpose of making and acquiring various types of mortgage and other loans, during 1993 through 1997, the Company failed to qualify as a REIT. As confirmed by a closing agreement with the Internal Revenue Service (the "IRS") obtained in March 1998, the Company was eligible, elected to be taxed as a REIT and qualified for REIT status for the tax years commencing on January 1, 1998. The Company did not incur any material tax liabilities as a result of its operations during such years.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and income tax purposes, as well as operating loss and tax credit carry forwards. A valuation allowance is recorded if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred income tax asset will not be realized. Given the limited nature of the Company's operations and assets and liabilities from 1993 through 1997, the only deferred tax assets are net operating loss carry forwards ("NOLs") of approximately \$4.0 million, which arose during such periods. Since the Company has elected to be treated as a REIT for its tax years beginning January 1, 1998, the NOLs will expire unutilized. Accordingly, no net deferred tax asset value, after consideration of a 100% valuation allowance, has been reflected in these financial statements as of December 31, 2000 and 1999, nor has any net tax provision for the fiscal years ended December 31, 2000, 1999 or 1998.

Note 11 – Stock Option Plans and Employee Benefits

The Company's 1996 Long-Term Incentive Plan (the "Plan") is designed to provide incentive compensation for officers, other key employees and directors of the Company. The Plan provides for awards of stock options and restricted stock and other performance awards. The maximum number of shares of Common Stock available for awards under the Plan is 9% of the outstanding shares of Common Stock, calculated on a fully diluted basis, from time to time; provided that the number of shares of Common Stock reserved for grants of options designated as incentive stock options is 5.0 million, subject to certain antidilution provisions in the Plan. All awards under the Plan, other than automatic awards to non-employee directors, are at the discretion of the Board or a committee of the Board. At December 31, 2000, a total of approximately 7.7 million shares of Common Stock were available for awards under the Plan, of which options to purchase approximately 4.7 million shares of Common Stock were outstanding and approximately 56,000 shares of restricted stock were outstanding.

Concurrently with the Recapitalization Transactions, the Company issued approximately 2.5 million (as adjusted) fully vested and immediately exercisable options to purchase class A shares at \$14.72 per share (as adjusted) to the Advisor with a term of ten years. The Advisor granted a portion of these options to its employees and the remainder were allocated to an affiliate. Upon consummation of the Advisor Transaction, these individuals became employees of the Company. In general, the grants to these employees provided for scheduled vesting over a predefined service period of three to five years and, under certain conditions, provide for accelerated vesting. These options expire on March 15, 2008.

In connection with the TriNet Acquisition, outstanding options to purchase TriNet stock under TriNet's stock option plans were converted into options to purchase shares of Common Stock on substantially the same terms, except that both the exercise price and number of shares issuable upon exercise of the TriNet options were adjusted to give effect to the merger exchange ratio of 1.15 shares of Common Stock for each share of TriNet common stock. In addition, options held by the former directors of TriNet and certain executive officers became fully vested as a result of the transaction. Such options were converted into options to purchase shares of Common Stock on substantially the same terms, as adjusted for the merger exchange ratio.

Also, as a result of the TriNet Acquisition, TriNet terminated its dividend equivalent rights program. The program called for immediate vesting and cash redemption of all dividend equivalent rights upon a change of control of 50% or more of the voting common stock. Concurrent with the TriNet Acquisition, all dividend equivalent rights were vested and amounts due to former TriNet employees of approximately \$8.3 million were paid by the Company. Such payments were included as part of the purchase price paid by the Company to acquire TriNet for financial reporting purposes.

Changes in options outstanding during each of fiscal 1998, 1999 and 2000 are as follows:

	Number of Shares Non-Employee			Average Strike Price
	Employees	Directors	Other	
Options outstanding, December 31, 1997	–	1,333	–	\$13.32
Granted in 1998	–	9,996	2,402,476	\$ –
Exercised in 1998	–	(687)	(18,000)	\$15.00
Forfeited in 1998	–	(646)	–	\$15.00
Options outstanding, December 31, 1998	–	9,996	2,384,476	\$15.00
Granted in 1999	–	4,998	–	\$57.50
Exercised in 1999	–	–	(68,233)	\$15.00
Forfeited in 1999	(23,690)	–	(4,166)	\$24.94
Assumed in TriNet Acquisition	1,321,322	131,100	–	\$25.62
Reclassification for Advisor Transaction ⁽¹⁾	1,447,083	–	(1,447,083)	\$15.00
Adjustment for dilution	33,537	285	16,169	\$14.72
Options outstanding, December 31, 1999	2,778,252	146,379	881,163	\$19.03
Granted in 2000	1,852,059	80,000	80,000	\$17.34
Exercised in 2000	(412,734)	–	–	\$15.67
Forfeited in 2000	(682,005)	–	–	\$25.47
Options outstanding, December 31, 2000	<u>3,535,572</u>	<u>226,379</u>	<u>961,163</u>	\$18.97

Explanatory Note:

(1) Represents the reclassification of stock options originally granted to the Advisor and regranted to its employees who became employees of the Company upon consummation of the Advisor Transaction (see Note 4).

The following table summarizes information concerning outstanding and exercisable options as of December 31, 2000:

	Options Outstanding			Options Exercisable	
	Options Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Currently Exercisable	Weighted Average Exercise Price
Exercise Price Range:					
\$14.72–\$15.00 ⁽¹⁾	1,992,668	7.20	\$14.73	947,168	\$14.72
\$16.69–\$16.88	1,212,109	8.09	\$16.86	81,533	\$16.88
\$17.38–\$17.56	550,000	9.21	\$17.39	–	\$ –
\$19.50–\$19.69	6,250	9.39	\$19.54	–	\$ –
\$20.63–\$21.44	258,050	6.87	\$21.01	100,050	\$21.13
\$22.44–\$22.45	54,500	3.82	\$22.44	34,500	\$22.45
\$23.32–\$23.64	130,842	2.12	\$23.46	101,351	\$23.41
\$24.13–\$24.57	173,650	3.63	\$24.31	173,650	\$24.31
\$25.22–\$26.09	34,500	3.40	\$25.74	34,500	\$25.74
\$26.30–\$26.85	108,100	2.95	\$26.74	108,100	\$26.74
\$28.26–\$28.54	67,113	1.97	\$28.37	60,842	\$28.36
\$30.33	119,888	1.60	\$30.33	99,769	\$30.33
\$33.15–\$33.70	10,350	1.97	\$33.39	8,913	\$33.43
\$55.39	5,094	8.42	\$55.39	1,698	\$55.39
	<u>4,723,114</u>	<u>7.18</u>	<u>\$17.65</u>	<u>1,752,074</u>	<u>\$19.25</u>

Explanatory Note:

(1) Includes approximately 764,000 options which were granted, on a fully exercisable basis, in connection with the Recapitalization Transactions to Starwood Capital Group, and were subsequently regranted by that entity to its employees subject to vesting requirements. As a result of those vesting requirements, less than 2,000 of these options are currently exercisable by the beneficial owners. In the event that these employees forfeit such options, they revert to Starwood Capital Group, who may regrant them at its discretion.

The Company has elected to use the intrinsic method for accounting for options issued to employees or directors, as allowed under Statement of Financial Accounting Standards No. 123 "Accounting for Stock Based Compensation" ("SFAS No. 123") and, accordingly, recognizes no compensation charge in connection with these options to the extent that the options exercise price equals or exceeds the quoted price of the Company's common shares at the date of grant or measurement date. In connection with the Advisor Transaction, as part of the computation of the one-time charge to earnings, the Company calculated a deferred compensation charge of approximately \$5.1 million. This deferred charge represents the difference of the closing sales price of the shares of Common Stock on the date of the Advisor Transaction of \$20.25 over the strike price of the options of \$14.72 per share (as adjusted) for the unvested portion of the options granted to former employees of the Advisor who are now employees of the Company. This deferred charge will be amortized over the related remaining vesting terms to the individual employees as additional compensation expense.

In connection with the original grant of options in March 1998 to the Advisor, the Company utilized the option value method as required by SFAS No. 123. An independent financial advisory firm estimated the value of these options at date of grant to be approximately \$2.40 per share using a Black-Scholes valuation model. In the absence of comparable historical market information for the Company, the advisory firm utilized assumptions consistent with activity of a comparable peer group of companies, including an estimated option life of five years, a 27.5% volatility rate and an estimated annual dividend rate of 8.5%. The resulting charge to earnings was calculated as the number of options allocated to the Advisor multiplied by the estimated value at consummation. A charge of approximately \$6.0 million was reflected in the Company's first quarter 1998 financial results for this original grant.

Had the Company's compensation costs been determined using the fair value method of accounting for stock options issued under the Plan to employees and directors prescribed by SFAS No. 123, the Company's net income and earnings per share for the fiscal years ended December 31, 2000 and 1999 would have been reduced on a pro forma basis by approximately \$275,000 and \$141,000, respectively. This would not have significantly impacted earnings per share. As the Company had no employees prior to the consummation of the Advisor Transaction, no pro forma adjustment is necessary to reflect in the results of operations for fiscal 1998 as if the option value were utilized.

For the above SFAS No. 123 calculation, the Company utilized the following assumptions: a 26.8% volatility rate (historical volatility for the Company's Common Stock at December 31, 2000), a risk free rate of 5.3% and an estimated annual dividend rate of 13.5%.

Future charges may be taken to the extent of additional option grants, which are at the discretion of the Board of Directors.

During the year ended December 31, 2000, the Company granted 76,585 restricted stock units ("RSU's") to new employees. The RSU's vest over a three-year period, with the exception of 12,500 RSU's, which were immediately vested on the date of grant. The RSU's are valued at the date of grant and are reflected as compensation expense over the vesting period.

On July 28, 2000, the Company granted to its employees profits interests in a wholly-owned subsidiary of the Company called iStar Venture Direct Holdings, LLC. iStar Venture Direct Holdings, LLC has invested \$2.4 million in the aggregate in the preferred stock of three real estate-related technology companies. The profits interests have a three-year vesting schedules, and are subject to forfeiture in the event of termination of employment for cause or a voluntary resignation.

Effective November 4, 1999, the Company implemented a savings and retirement plan (the "401 (k) Plan"), which is a voluntary, defined contribution plan. All employees are eligible to participate in the 401 (k) Plan following completion of six months of continuous service with the Company. Each participant may contribute on a pretax basis between 2% and 15% of such participant's compensation. At the discretion of the Board of Directors, the Company may make matching contributions on the participant's behalf up to 50% of the first 10% of the participant's annual contribution. The Company made contributions of approximately \$320,000 to the 401 (k) Plan for the year ended December 31, 2000.

Note 12 – Earnings Per Share

Prior to November 4, 1999, Basic EPS was computed based on the income allocable to class A shares (net income reduced by accrued dividends on preferred shares and by 1% allocated to class B shares), divided by the weighted average number of class A shares outstanding during the period. Diluted EPS was based on the net earnings allocable to class A shares plus dividends on class B shares which were convertible into class A shares, divided by the weighted average number of class A shares and dilutive potential

class A shares that were outstanding during the period. Dilutive potential class A shares included the class B shares, which were convertible into class A shares at a rate of 49 class B shares for one class A share, and potentially dilutive options to purchase class A shares issued to the Advisor and the Company's directors and warrants to acquire class A shares.

As more fully described in Note 4, in the Incorporation Merger, the class A shares and class B shares were converted into shares of Common Stock and, as a result, the Company no longer has multiple classes of common shares. Basic and diluted earnings per share are based upon the following weighted average shares outstanding during the years ended December 31, 2000, 1999 and 1998, respectively:

	Year Ended December 31,		
	2000	1999	1998
		(in thousands)	
Weighted average common shares outstanding for basic earnings per common share	85,441	57,749	41,607
Add effect of assumed shares issued under treasury stock method for stock options and restricted stock units	710	1,500	1,311
Add effects of conversion of class B shares (49-for-one)	–	450	445
Add effects of assumed warrants exercised under treasury stock method for stock options	–	694	97
Weighted average common shares outstanding for diluted earnings per common share	<u>86,151</u>	<u>60,393</u>	<u>43,460</u>

As previously indicated, effective June 19, 1998, the Company consummated a one-for-six reverse stock split for its shares. Historical earnings per share have been retroactively restated to reflect the reverse split for comparative purposes.

Note 13 – Comprehensive Income

In June 1997, the FASB issued Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS No. 130") effective for fiscal years beginning after December 15, 1997. The statement changes the reporting of certain items currently reported as changes in the shareholders' equity section of the balance sheet and establishes standards for the reporting and display of comprehensive income and its components in a full set of general-purpose financial statements. SFAS No. 130 requires that all components of comprehensive income shall be reported in the financial statements in the period in which they are recognized. Furthermore, a total amount for comprehensive income shall be displayed in the financial statements. The Company has adopted this standard effective January 1, 1998. Total comprehensive income was \$217.8 million, \$38.7 million and \$59.9 million for the years ended December 31, 2000, 1999 and 1998 respectively. The primary component of comprehensive income other than net income was the change in value of certain investments in marketable securities classified as available-for-sale. Upon adoption of SFAS 133/SFAS 137 effective January 1, 2001 (see Note 3), other comprehensive income will also be affected by the mark-to-market on the effective portion of hedge instruments.

Note 14 – Dividends

In order to maintain its election to qualify as a REIT, the Company must distribute, at a minimum, an amount equal to 95% of its taxable income and must distribute 100% of its taxable income to avoid paying corporate federal income taxes. The distribution rate was modified to 90% by the REIT Modernization Act beginning in fiscal 2001. Accordingly, the Company anticipates it will distribute all of its taxable income to its shareholders. Because taxable income differs from cash flow from operations due to non-cash revenues or expenses, in certain circumstances, the Company may be required to borrow to make sufficient dividend payments to meet this anticipated dividend threshold.

On November 4, 1999, the class A shares were converted into shares of Common Stock on a one-for-one basis. Total dividends declared by the Company aggregated \$116.1 million, or \$1.86 per common share, for the year ended December 31, 1999. For the year ended December 31, 2000, total dividends declared by the Company aggregated \$205.5 million, or \$2.40 per common share. The Company also declared dividends aggregating \$20.9 million, \$4.7 million, \$3.0 million and \$8.0 million, respectively, on its Series A, B, C and D preferred stock, respectively, for the year ended December 31, 2000.

In November 1999, the Company declared and paid a dividend of a total of one million shares of Common Stock pro rata to all holders of record of Common Stock as of the close of business on November 3, 1999.

The Series A preferred stock has a liquidation preference of \$50.00 per share and carries an initial dividend yield of 9.50% per annum. The dividend rate on the preferred shares will increase to 9.75% on December 15, 2005, to 10.00% on December 15, 2006 and to 10.25% on December 15, 2007 and thereafter. Dividends on the Series A preferred shares are payable quarterly in arrears and are cumulative.

Holders of shares of the Series B preferred stock are entitled to receive, when and as declared by the Board of Directors, out of funds legally available for the payment of dividends, cumulative preferential cash dividends at the rate of 9.375% per annum of the \$25.00 liquidation preference, equivalent to a fixed annual rate of \$2.34 per share. Dividends are cumulative from the date of original issue and are payable quarterly in arrears on or before the 15th day of each March, June, September and December or, if not a business day, the next succeeding business day. Any dividend payable on the Series B preferred stock for any partial dividend period will be computed on the basis of a 360-day year consisting of twelve 30-day months. Dividends will be payable to holders of record as of the close of business on the first day of the calendar month in which the applicable dividend payment date falls or on another date designated by the Board of Directors of the Company for the payment of dividends that is not more than 30 nor less than ten days prior to the dividend payment date.

Holders of shares of the Series C preferred stock are entitled to receive, when and as declared by the Board of Directors, out of funds legally available for the payment of dividends, cumulative preferential cash dividends at the rate of 9.20% of the \$25.00 liquidation preference per year, equivalent to a fixed annual rate of \$2.30 per share.

Holders of shares of the Series D preferred stock are entitled to receive, when and as declared by the Board of Directors, out of funds legally available for the payment of dividends, cumulative preferential cash dividends at the rate of 8.00% of the \$25.00 liquidation preference per year, equivalent to a fixed annual rate of \$2.00 per share.

The exact amount of future quarterly dividends to common shareholders will be determined by the Board of Directors based on the Company's actual and expected operations for the fiscal year and the Company's overall liquidity position.

Note 15 – Fair Values of Financial Instruments

SFAS No. 107, "Disclosures About Fair Value of Financial Instruments" ("SFAS No. 107"), requires the disclosure of the estimated fair values of financial instruments. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Quoted market prices, if available, are utilized as estimates of the fair values of financial instruments. Because no quoted market prices exist for a significant part of the Company's financial instruments, the fair values of such instruments have been derived based on management's assumptions, the amount and timing of future cash flows and estimated discount rates. The estimation methods for individual classifications of financial instruments are described more fully below. Different assumptions could significantly affect these estimates. Accordingly, the net realizable values could be materially different from the estimates presented below. The provisions of SFAS No. 107 do not require the disclosure of the fair value of non-financial instruments, including intangible assets or the Company's real estate assets under operating leases.

In addition, the estimates are only indicative of the value of individual financial instruments and should not be considered an indication of the fair value of the Company as an operating business.

Short-term financial instruments – The carrying values of short-term financial instruments including cash and cash equivalents and short-term investments approximate the fair values of these instruments. These financial instruments generally expose the Company to limited credit risk and have no stated maturities, or have an average maturity of less than 90 days and carry interest rates which approximate market.

Loans and other lending investments – For the Company's interests in loans and other lending investments, the fair values were estimated by discounting the future contractual cash flows (excluding participation interests in the sale or refinancing proceeds of the underlying collateral) using estimated current market rates at which similar loans would be made to borrowers with similar credit ratings for the same remaining maturities.

Marketable securities – Securities held for investment, securities available for sale, loans held for sale, trading account instruments, long-term debt and trust preferred securities traded actively in the secondary market have been valued using quoted market prices.

Other financial instruments – The carrying value of other financial instruments including, restricted cash, accrued interest receivable, accounts payable, accrued expenses and other liabilities approximate the fair values of the instruments.

Debt obligations – A substantial portion of the Company's existing debt obligations bear interest at fixed margins over LIBOR. Such margins may be higher or lower than those at which the Company could currently replace the related financing arrangements. Other obligations of the Company bear interest at fixed rates, which may differ from prevailing market interest rates. As a result, the fair values of the Company's debt obligations were estimated by discounting current debt balances from December 31, 2000 or 1999 to maturity using estimated current market rates at which the Company could enter into similar financing arrangements.

Interest rate protection agreements – The fair value of interest rate protection agreements such as interest rate caps, floors, collars and swaps used for hedging purposes (see Note 9) is the estimated amount the Company would receive or pay to terminate these agreements at the reporting date, taking into account current interest rates and current creditworthiness of the respective counterparties.

The book and fair values of financial instruments as of December 31, 2000 and 1999 were (in thousands):

	2000		1999	
	Book Value	Fair Value	Book Value	Fair Value
Financial assets:				
Loans and other lending investments	\$2,239,183	\$2,333,112	\$2,011,006	\$2,031,065
Marketable securities	41	41	4,344	4,344
Allowance for credit losses	(14,000)	(14,000)	(7,500)	(7,500)
Financial liabilities:				
Debt obligations	2,131,967	2,135,574	1,901,204	1,885,797
Interest rate protection agreements	2,495	(7,261)	3,139	5,556

Note 16 – Segment Reporting

Statement of Financial Accounting Standard No. 131 ("SFAS No. 131") establishes standards for the way the public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected financial information about operating segments in interim financial reports issued to shareholders.

The Company has two reportable segments: Real Estate Lending and Corporate Tenant Leasing. The Company does not have substantial foreign operations. The accounting policies of the segments are the same as those described in Note 3. The Company has no single customer that accounts for 10% or more of revenues (see Note 9 for other information regarding concentrations of credit risk).

The Company evaluates performance based on the following financial measures for each segment:

	Real Estate Lending	Corporate Tenant Leasing ⁽¹⁾	Corporate/ Other ⁽²⁾	Company Total
	(in thousands)			
2000:				
Total revenues: ⁽³⁾	\$ 279,680	\$ 191,821	\$ 321	\$ 471,822
Total operating and interest expense: ⁽⁴⁾	115,906	111,808	28,570	256,284
Net operating income before minority interests: ⁽⁵⁾	163,774	80,013	(28,249)	215,538
Total long-lived assets: ⁽⁶⁾	2,225,183	1,670,169	N/A	3,895,352
Total assets:	2,225,183	1,670,169	139,423	4,034,775
1999:				
Total revenues: ⁽³⁾	209,848	42,186	12,763	264,797
Total operating and interest expense: ⁽⁴⁾	70,778	36,749	118,343	225,870
Net operating income before minority interests: ⁽⁵⁾	139,070	5,437	(105,580)	38,927
Total long-lived assets: ⁽⁶⁾	2,003,506	1,714,284	N/A	3,717,790
Total assets:	2,003,506	1,714,284	95,762	3,813,552
1998:				
Total revenues: ⁽³⁾	112,914	12,378	2,804	128,096
Total operating and interest expense: ⁽⁴⁾	36,998	12,554	18,587	68,139
Net operating income before minority interests: ⁽⁵⁾	75,916	(176)	(15,783)	59,957
Total long-lived assets: ⁽⁶⁾	1,823,761	189,942	N/A	2,013,703
Total assets:	1,823,761	189,942	45,913	2,059,616

Explanatory Notes:

- (1) Includes the Company's pre-existing Corporate Tenant Leasing investments since March 18, 1998 and the Corporate Tenant Leasing business acquired in the TriNet Acquisition since November 4, 1999.
- (2) Corporate and Other represents all corporate-level items, including general and administrative expenses and any intercompany eliminations necessary to reconcile to the consolidated Company totals. This caption also includes the Company's servicing business, which is not considered a material separate segment. In addition, as more fully discussed in Note 4, Corporate and Other for the year ended December 31, 1999 includes a non-recurring charge, non-cash of approximately \$94.5 million relating to the Advisor Transaction.
- (3) Total revenues represents all revenues earned during the period from the assets in each segment. Revenue from the Real Estate Lending business primarily represents interest income and revenue from the Corporate Tenant Leasing business primarily represents operating lease income.
- (4) Total operating and interest expense represents provision for possible credit losses for the Real Estate Lending business and operating costs on corporate tenant lease assets for the Corporate Tenant Leasing business, as well as interest expense specifically related to each segment. General and administrative expense, advisory fees (prior to November 4, 1999) and stock option compensation expense is included in Corporate and Other for all periods. Depreciation and amortization of \$34,514, \$10,340 and \$4,287 in 2000, 1999 and 1998, respectively, are included in the amounts presented above.
- (5) Net operating income before minority interests represents net operating income before minority interest, gain on sale of corporate tenant lease assets and extraordinary loss as defined in note (3) above, less total operating and interest expense, as defined in note (4) above.
- (6) Total long-lived assets is comprised of Loans and Other Lending Investments, net and Real Estate Subject to Operating Leases, net, for each respective segment.

Note 17 – Subsequent Events

On January 11, 2001 the Company closed a new \$700.0 million secured revolving credit facility which is led by a major commercial bank. The new facility has a three-year primary term and one-year “term-out” extension option, and bears interest at LIBOR plus 1.40% to 2.15%, depending upon the collateral contributed to the borrowing base. The new facility accepts a broad range of structured finance assets and has a final maturity of January 2005. In addition, subsequent to year end, the Company extended the maturity of its \$350.0 million unsecured revolving credit facility to May 2002.

Note 18 – Quarterly Financial Information (Unaudited)

The following table sets forth the selected quarterly financial data for the Company (in thousands, except per share amounts).

	Quarter Ended			
	December 31,	September 30,	June 30,	March 31,
2000:				
Revenue	\$122,337	\$120,683	\$117,914	\$110,888
Net income	56,177	55,591	53,829	51,989
Net income allocable to common shares	46,950	46,364	44,602	42,762
Net income per common share	\$ 0.55	\$ 0.54	\$ 0.52	\$ 0.50
Weighted average common shares outstanding – basic	85,731	85,662	85,281	85,087
1999:				
Revenue	\$ 89,483	\$ 60,635	\$ 59,255	\$ 55,424
Net income (loss) ⁽¹⁾	(50,485)	31,271	29,883	28,217
Net income (loss) allocable to common shares ⁽²⁾	(58,405)	25,963	24,575	22,909
Net income (loss) per common shares	\$ (0.80)	\$ 0.49	\$ 0.46	\$ 0.43
Weighted average common shares outstanding – basic	73,427	52,471	52,471	52,447

Explanatory Notes:

(1) As more fully discussed in Note 4, the quarter ended December 31, 1999 includes a non-recurring, non cash charge of approximately \$94.5 million relating to the Advisor Transaction. Excluding such charge, net income for the quarter would have been approximately \$44.0 million and net income per common share for the quarter would have been \$0.49.

(2) On November 4, 1999, through the Incorporation Merger, the class B shares were effectively converted into shares of Common Stock on a 49-for-one basis and the class A shares were converted into shares of Common Stock on a one-for-one basis.

Common Stock Price and Dividends

The high and low sales prices per share of Common Stock are set forth below for the periods indicated.

	Quarterly Period Ended	
	High	Low
1999:		
March 31, 1999	\$63	\$42½
June 30, 1999	\$66½	\$31⅝
September 30, 1999	\$76	\$27⅞
December 31, 1999	\$27⅝	\$16⅞
2000:		
March 31, 2000	\$18¾	\$16⅞
June 30, 2000	\$20⅝	\$17⅞
September 30, 2000	\$22⅞	\$20¼
December 31, 2000	\$21¾	\$19⅞

On March 15, 2001, the closing sale price of the Common Stock as reported by the New York Stock Exchange was \$24.01. The Company had approximately 1,267 holders of record of Common Stock as of March 15, 2001.

On June 12, 1998, the Frank Russell Company announced that the Company would be included in the Russell 1000 and Russell 3000 equity indices. From the time of the Company's inclusion in the Russell indices through the time of the announcement that the Company had agreed to acquire TriNet, the reported stock price of the Company was highly volatile, and its trading volume was relatively low due to the very limited number of shares available for trading at that time. Specifically, the Company believes that index funds that were required to mirror the Russell indices' performance purchased a large number of shares of the Company's Common Stock available in the public float. Those purchases, combined with the limited availability of the shares at that time, resulted in a dramatic increase in the "market" price for the common stock shortly after the June 12 announcement.

The following table sets forth the dividends paid or declared by the Company on its Common Stock:

	Stockholder Record Date	Dividend/ Share
1999:		
March 31, 1999	April 15, 1999	\$0.42
June 30, 1999	July 15, 1999	\$0.43
September 30, 1999	October 15, 1999	\$0.44
December 31, 1999	December 31, 1999	\$0.57 ⁽¹⁾
2000:		
March 31, 2000	April 14, 2000	\$0.60
June 30, 2000	July 17, 2000	\$0.60
September 30, 2000	October 16, 2000	\$0.60
December 31, 2000	December 29, 2000	\$0.60 ⁽²⁾

Explanatory Notes:

(1) A portion of this quarterly dividend (approximately \$0.47 per share) was treated as income to shareholders of record in 1999, and the remainder was treated as 2000 income.

(2) A portion of this quarterly dividend (approximately \$0.5976 per share) was treated as income to stockholders of record in 2000, and the remainder will be treated as 2001 income.

Directors

Jay Sugarman (3)
Chairman and Chief Executive Officer,
iStar Financial Inc.

Willis Andersen, Jr. (1)
Principal, REIT Consulting Services

Jeffrey G. Dishner (3)
Managing Director,
Starwood Capital Group

Jonathan D. Eilian
Senior Managing Director,
Starwood Capital Group

Madison F. Grose (4)
Senior Managing Director,
Starwood Capital Group

Spencer B. Haber (3)
Executive Vice President – Finance
and Chief Financial Officer,
iStar Financial Inc.

Robert W. Holman, Jr.
Managing Director,
Pebble Beach Institute

Robin Josephs (1)(2)
President, Ropasada, LLC

Merrick R. Kleeman
Senior Managing Director,
Starwood Capital Group

H. Cabot Lodge
Executive Vice President – Investments
iStar Financial Inc.

William M. Matthes (2)
Managing Partner, Behrman Capital

John G. McDonald (2)
Professor of Finance, Stanford University
Graduate School of Business

Michael G. Medzigian (1)(2)
President and Chief Executive Officer,
Lazard Freres Real Estate Investors, LLC

Stephen B. Oresman (4)
President, Saltash, Ltd.

George R. Puskar (3)
Former Chairman, Lend Lease
Real Estate Investments

Barry S. Sternlicht (3)
Chairman and Chief Executive Officer,
Starwood Hotels and Resorts

Kneeland C. Youngblood (1)(4)
Managing Partner,
Pharos Capital Group, LLC

- (1) Audit Committee
- (2) Compensation Committee
- (3) Investment Committee
- (4) Nominating Committee

Officers

Jay Sugarman
Chairman and Chief Executive Officer

Spencer B. Haber
Executive Vice President – Finance
and Chief Financial Officer

Timothy J. O'Connor
Executive Vice President and
Chief Operating Officer

Nina B. Matis
Executive Vice President and
General Counsel

Barbara Rubin
President – iStar Asset Services

Executive Vice Presidents – Investments:

Jeffrey R. Digel
R. Michael Dorsch
Barclay G. Jones
H. Cabot Lodge
Diane Olmstead

Senior Vice Presidents:

Steven R. Blomquist
Jeffrey N. Brown
Roger M. Cozzi
Geoffrey M. Dugan
Andrew C. Richardson
Steven B. Sinnott
Elizabeth B. Smith

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Employees

At December 31, 2000, the Company had
116 full-time employees.

Independent Auditors

PricewaterhouseCoopers LLP
New York, NY

Registrar and Transfer Agent

EquiServe Trust Company, N.A.
525 Washington Boulevard
Jersey City, NJ 07310
(800) 756-8200

Dividend Reinvestment Plan

Registered shareholders may reinvest dividends
through the Company's dividend reinvestment
plan. For more information, please call the
Transfer Agent or the Company at the numbers
listed above.

Annual Meeting of Shareholders

May 17, 2001, 9 a.m. EST
Sheraton New York Hotel and Towers
811 Seventh Avenue
New York, NY 10019

Investor Information Services

For help with questions about the Company, and
to receive additional corporate information,
please contact:

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