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STAR - Q1 2016 iStar Inc Earnings Call

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Jay Sugarman *iStar Inc. - Chairman & CEO*

David DiStaso *iStar Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Jade Rahmani *Keefe, Bruyette & Woods - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen and welcome to iStar's first quarter 2016 earnings conference call. (Operator Instructions). As a reminder, today's conference is being recorded. At this time for opening remarks and introductions, I would like to turn the conference over to Jason Fooks, Vice President of Investor Relations and Marketing. Please go ahead, sir.

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

Thank you, John and good morning, everyone. Thank you for joining us today to review iStar's first quarter 2016 earnings report. With me today are Jay Sugarman, Chairman and Chief Executive Officer and David DiStaso, our Chief Financial Officer.

This morning's call is being webcast on our website at istar.com in the investor section. There will be a replay of the call beginning at 12:30 PM Eastern time today. Dial-in for the replay is 1-800-475-6701 with the confirmation code of 391431.

Before I turn the call over to Jay, I'd like to remind everyone that statements in this earnings call, which are not historical facts, will be forward-looking. iStar's actual results may differ materially from these forward-looking statements and the risk factors that could cause these differences are detailed in our SEC reports and in our investor presentation posted on our website. iStar disclaims any intent or obligation to update these forward-looking statements except as expressly required by law. Now I'd like to turn the call over to iStar's Chairman and CEO, Jay Sugarman.

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

Thanks, Jason and thanks for joining us today. With the markets volatile at the beginning of the year, much of our first quarter activity was focused on laying the groundwork for the remainder of 2016. A combination of new investments, repayment of bonds and repurchase of stock should set us up for stronger quarters ahead when we begin to see monetization of several assets in the operating and land portfolios.

Work has continued on several fronts, including leasing in our retail and office properties, further development work on our California land assets and the summer opening of two highly-anticipated iStar properties in the hotel and entertainment sectors. These are important milestones necessary to begin realizing the value of these assets and should lead to profitable executions in later quarters.

On the balance sheet, we decided to deploy a portion of our large cash holdings to reduce debt and repurchase approximately 7% of our outstanding basic share count. We also completed several interesting investments on the finance side that redeployed capital coming in from repayments and various asset sales. And based on where we are today, we remain comfortable with our goal of increasing adjusted earnings per share by 50% this year.

With that quick overview, let me turn it over to Dave. Dave.

David DiStaso - *iStar Inc. - CFO*

Thanks, Jay and good morning, everyone. I'll begin by discussing our financial results for the first quarter of 2016 before moving on to investment activity and the performance of our business segments. Finally, I will finish with an update on recent capital markets activity and our outlook for the coming year.

For the quarter, our adjusted income allocable to common shareholders was $3 million or $0.04 per diluted common share compared to $9 million or $0.10 per diluted common share for the same quarter last year. The primary drivers for the year-over-year change included $11 million less income from sales of real estate as we've continued to reduce the balance of our condominium portfolio, partially offset by $6 million less in tax expense this quarter.

Our net income allocable to common shareholders for the quarter was a loss of $21 million compared to a loss of $23 million for the same period last year. In addition to the items I just discussed, net income benefited this quarter from a decrease in provisions and impairments and lower depreciation expense.

Now I will turn to investment activity in our real estate and loan portfolios. During the quarter, we funded a total of $148 million associated with new investments, prior financing commitments and ongoing development. We also generated $132 million of proceeds from repayments and sales within our portfolio. At the end of the first quarter, our portfolio totaled $5.1 billion.

Let me walk through a high-level summary of the performance of each of our business segments. Our $1.7 billion real estate finance portfolio continued to be a solid performer generating an 8.5% yield for the quarter. This resulted in $16 million of segment profit versus $18 million for the first quarter of last year. During the quarter, we invested $94 million and received $80 million of proceeds. At the end of the first quarter, we had $68 million of nonperforming loans and our total reserve for loan losses was $110 million, including $37 million of general reserves and $73 million of specific reserves.

Our $1.6 billion net lease portfolio generated a 7.9% yield for the quarter. Overall segment profit this quarter was $17 million compared to $16 million in the same quarter during the prior year. This portfolio was 97% leased with a weighted average remaining lease term of approximately 15 years. During the quarter, we sold net lease assets for $11 million and recorded $5 million in gains.

Next I will discuss our operating property portfolio. Our $703 million portfolio of operating properties, which are comprised of $571 million of commercial and $132 million of residential real estate, generated $2 million of segment profit this quarter versus $13 million for the same quarter last year. The difference is largely due to fewer condominium sales this quarter. Our expectation is for additional operating property sales over the next few quarters, which should generate additional segment profits.

The commercial properties included $141 million of stabilized commercial operating properties, which were 85% leased, resulting in an 8.5% yield for the quarter. The remaining $430 million of commercial operating properties are transitional real estate properties that were 66% leased and generated a 3.5% yield for the quarter.

That brings me to our land and development portfolio. At the end of the quarter, this portfolio totaled $1.1 billion comprised of 11 master plan communities, 13 infill land parcels and 6 waterfront land parcels. The portfolio generated revenues of $15 million offset by cost of sales of $12 million.

In addition, we earned $7 million from equity method investments within our land segment. This resulted in total gross margin from our land development portfolio of $10 million versus $4 million for the same quarter last year. Including allocated expenses and other carrying costs, segment loss was $9 million versus a loss of $12 million for the same quarter last year.

We have 7 land projects in production, 10 in development and 13 in the predevelopment phase. We invested $34 million into our land and development portfolio during the quarter. These investments are starting to demonstrate the tangible progress of our land development efforts. We look forward to further progress, which should result in increasing land development revenues during the year.

I will finish by providing an update on our capital markets activities and outlook for the year. This quarter, we repurchased 5.8 million shares of common stock for a total of $58 million at an average price of $9.94 per share. We continue to believe that our stock represents an attractive risk-adjusted return relative to other opportunities in the market.

On the debt side, during the quarter, we repaid $261 million of our 5.875% senior unsecured notes at maturity using available cash. In addition, during the quarter, we issued $275 million of 6.5% senior unsecured notes due July 2021. Some of the proceeds from our debt issuance were used during the first quarter to pay related financing costs and to partially repay our secured revolver. The majority of the proceeds from this offering were used subsequent to the end of the first quarter to fully repay $265 million of unsecured notes due July 2016. As a result, the $591 million of cash we had at March 31 represents the balance prior to the repayment of our July bonds. As of today, our cash position remains at $300 million.

Our weighted average cost of debt for the first quarter was 5.5%, in line with the first quarter of last year. And at the end of the quarter, our leverage was 2.2x times inside our targeted range of 2.0 - to 2.5x.

Next let me provide an update on expectations for the full year. As Jay mentioned, assuming market conditions remain relatively stable, for the full year, we expect to grow adjusted earnings by approximately 50% from last year. Much of the year-over-year growth will be driven by increased monetization of assets in our operating properties and land in development businesses. Accordingly, our adjusted income expectations are subject to change if our current assumptions about market conditions and the amount and timing of asset sales change.

Our remaining debt maturities for the year are two convertible bonds totaling $400 million, which mature in November. One of the key benefits of our unencumbered balance sheet is the financial flexibility that it affords us to generate liquidity and raise capital beyond the unsecured market. These include access to the secured debt markets, incremental asset sales, loan syndications or mortgages on individual assets. We are currently evaluating capital market strategies in order to address our remaining current year maturities. With that, let me turn it back to Jay. Jay.

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

Thanks, Dave. We've mentioned in the past the long lead times of some of our projects and how long they've taken to get on the path to value creation, let alone value realization. The two assets highlighted in today's press release are no exceptions, but highlight the growing capabilities of our Company, and we believe that Coney Island amphitheater and the adjacent park and Childs building restoration will become landmark assets and will accelerate development of the adjacent land held by iStar.

The same is true of the Asbury, a hotel with multiple venues to attract and entertain the growing list of trendsetters who want to spend time in Asbury Park. With almost a mile of oceanfront and waterfront land at Asbury Park to work with, we think we are positioned to deliver beautiful spaces for people to live and play in and to create long-term returns for our Company. So please go check them out both this summer. And with that, let's go ahead and open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Jade Rahmani, KBW.

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

Good morning and thanks for taking the questions. Wanted to get a sense for how you would characterize current market conditions in commercial real estate. For example, are you seeing banks curtail lending and do you think that this, in conjunction with what we've seen play out in CMBS this year, could lead to a liquidity crunch?

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

Yes, look, I think the markets are more stable than they were at the beginning of the year, but they've taken a step up in terms of spreads on the CMBS side and I'd say conservatism on the banking side. So we've seen a lot less fast money in some of the markets that last year were getting overrun with capital. But there's still plenty of capital in the real estate world. I'd say more aggressively in the high-profile markets and high-profile assets. Certainly less aggressively in secondary and tertiary markets and product types. So the market is a lot less frothy than it was last year, but it's very strong for good stable properties and maybe a little less strong for some of the stuff that might have gotten done last year at tight spreads or at cap rates that were a little bit surprising to us.

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

And at this point, do you read this as a reason to be cautious in investment activity going forward, or are you viewing this more as an opportunity at this point?

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

We play both sides of that. As a provider of capital, we've been a little bit cautious going into this year. We are starting to see some interesting opportunities. We were able to do some attractive stuff in New York City in the first quarter that we haven't seen in quite a while, so we were happy about that. But we are also a seller of assets, so we see the flipside of that, which is spreads are a little bit wider on some of the stuff we've seen in the past. So I would say the market is in a fair zone. I think there's opportunities for a Company like ours to play in that quite attractively, but certainly we are not seeing the same sort of close your eyes with abandon invested capital that we saw last year.

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

And in terms of 1Q investment activity, could you provide a little more specificity on what comprised loan originations? You alluded to New York City, but also maybe property type, structure, yield, leverage?

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

Yes, again, with the volatility we saw, we go to places we know well, so we worked primarily in New York City on a handful of assets. Some had really interesting risk-adjusted returns because of credit support we were able to negotiate. We did do a construction loan that we think is quite attractive in part of the Metropolitan market that we think is very interesting. It's probably the last interesting part of the hospitality sector that we see right now. Most of the hospitality sector right now is going through a bit of a shift, but we found some pockets there that we think are quite attractive.

We did a deal that we think is going to work out very well down in the West Chelsea area that really focuses more on the education sector. So again things that are a little bit more structured, a little bit less meat and potatoes where we think there's still quite a bit of capital, but all in a New York City market that we still quite like.

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

In terms of the 1Q volatility, did this impact the planned land sales or was it just on the commercial property side?

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

Yes, the land stuff really wasn't fully set up, so we didn't really see the impact on that. We will see those assets play out here over the next couple quarters. We did put a number of commercial properties on the market in the first quarter, but we are under no pressure, so we sort of skated until the market stabilized and then focused a little bit more on trying to see where values were.

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

And are those deals you think will be consummated this year?

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

Yes, I would expect a meaningful proportion of them to get done.

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

Regarding the land portfolio, are the land sales you anticipate for the year on transactions with terms already finalized, and can you say where these deals are coming from, whether it's projects currently in production or in development, or in predevelopment?

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

Just roughly let's call it $0.5 billion of stuff on the market between the land and the operating portfolios. Some of that will get done this year; some will get done next year. As I mentioned in my notes, California land assets were places where we had some pretty significant advancement on the entitlement side. Some of those are already under contract. We should see definitely some closings this year, and we will probably see some of it extend all the way into next year. That's places where we think we can extract more value by being more involved in the predevelopment process, rather than just turning it over to a buyer today and taking whatever discount they charge for doing that. We certainly have the in-house capabilities to take it all the way to the place where we can extract the fullest value.

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

And in terms of 2017, would you anticipate maintaining a similar aggregate level of sales, or has the work you've done the last couple of years led to the 2016 volumes you expect?

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

Yes, you've heard us talk long enough. We are hard-pressed to tie it down to individual quarters, but we think 2016 and 2017 are pretty meaty years in terms of realizations. I can't tell you exactly how the chips are going to fall timewise, but, yes, there's a good portion of stuff that will happen this year and next year. So I would expect a fairly continuous stream of stuff over the next six to eight quarters.

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

Thanks. And just lastly on the moderation in buyback activity that took place the second half of the first quarter, anything to attribute that to, and how do you view further share buybacks?

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

Yes, obviously, went into blackout, so that's part of the story, and we are, as you've seen, buyers of the stock when we think it's not appropriately valued, and we still have fairly significant availability under our current buyback program, so you would probably expect us to use that.

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

Thanks for taking my questions.

Operator

Mr. Fooks, we have no further questions.

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

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

Operator

Certainly. Ladies and gentlemen, the replay starts today at 12:30 PM Eastern time, will last until May 17 at midnight. You can access the replay at anytime by dialing 800-475-6701 and the access code is 391431. Again, that phone number, 800-475-6701, with the access code 391431. That does conclude your conference for today. Thank you for your participation. You may now disconnect.
