24-Oct-2019

Safehold Inc. (SAFE)

Q3 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to Safehold Third Quarter 2019 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, Senior Vice President of Investor Relations & Marketing. Please go ahead sir.

Jason Fooks
Senior Vice President-Investor Relations & Marketing, Safehold Inc.

Good morning, everyone, and thank you for joining us today for Safehold's earnings call. With me today are Jay Sugarman, Chairman and Chief Executive Officer; and Marcos Alvarado, President and Chief Investment Officer.

This morning, we plan to walk through a presentation that details our third quarter 2019 results. The presentation can be found on our website at safeholdinc.com and by clicking on the Investor Relations link. There'll be a replay of this conference call beginning at 12:00 PM Eastern Time today and the dial-in for the replay is 1-800-585-8367 with the confirmation code of 6795893.

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 may be forward-looking. Our actual results may differ materially from these forward-looking statements, and the risk factors that cause these differences are detailed in our SEC reports. Safehold disclaims any intent or obligation to update these forward-looking statements except as expressly required by law.

Now with that, I'd like to turn the call over to our Chairman and CEO, Jay Sugarman. Jay?

Jay Sugarman

Chairman & Chief Executive Officer, Safehold Inc.

Thanks Jason. As you saw in our earnings deck this morning this was an outstanding quarter for Safehold with record investment volumes and growing engagement with high quality building owners. We introduced our new SAFE x SWAP program to bring our modern ground lease capital solution to more customers and with the deals we've already announced that are under contract we set the table for a fourth quarter that is shaping up to be even more impressive and another record breaking quarter in terms of investment activity. For customers, our message remains clear and simple. A Safehold ground lease enables building owners to be more capital efficient and more cost efficient, enabling them to achieve higher returns with lower maturity risk.

For investors, this quarter was also a dramatic step forward. As we've said before our goal is to make this very large commercial real estate industry more efficient, provide a better mousetrap and a better user experience to customers and deliver strong shareholder returns as we scale the business. That has been a consistent theme for many of the biggest and most successful companies in the country and we believe we are delivering on this promise through our innovative nationally skilled platform that is seeing accelerating growth and demonstrating that the value of a diversified portfolio of modern ground leases is far more than just the value of any individual ground lease.

With several high-profile deals now under contract, we are once again raising our investment guidance for the year to an estimated $1.5 billion, this is well above our guidance of $750 million at the beginning of the year, and the increased guidance of $1 billion announced last quarter.

We're also continuing to make significant progress on the capital side of the business. Our capital markets team has created a long dated funding strategy that locks in attractive financing rates custom tailored to our asset cash flows and captures the benefits of match funding. Our weighted average debt maturity is now 25 years and we expect it to reach 30 years in the near future.

Our equity investor outreach also continues to grow and our team has begun highlighting Safehold's unique position in the market combining very strong growth metrics, and a very safe investment strategy to generate an intrinsic value that we believe is well above today's share price.

With a successful $265 million equity raise in August, our market cap now well above $1 billion and trading volume and shares increasing significantly, we are confident more investors will find the above benefits to be quite appealing.

With all of that, let me turn it over to Marcos to go through the quarter in more detail. Marcos?

Marcos Alvarado

President & Chief Investment Officer, Safehold Inc.

Thank you, Jay, and good morning, everyone. Jay highlighted many of the significant milestones we've achieved this quarter. So let's begin on slide 5 to drill down into some of the details. Revenues for the third quarter grew to $22.3 million, nearly doubling from the same period last year while net income grew to $5.4 million, a 170% increase year-over-year. These results were driven largely from the substantial growth in our portfolio. Earnings per share for the third quarter were $0.15 representing a 36% growth from the same period last year. Of note, third quarter earnings included a $2 million charge associated with the prepayment of short-term financing which was replaced with 50-year financing as well as approximately $800,000 of joint venture costs associated with the 425 Park Avenue transaction which is expected to close in the fourth quarter.

The refinancing allowed us to pull out $50 million of incremental proceeds to deploy into new investments highlighting the value embedded in our assets. Excluding these charges, earnings this quarter would have been $0.23 per share and $0.72 per share year-to-date. Additionally, per share results were impacted by the timing of our $265 million equity offering which was not fully invested at the end of the quarter.

Slide 6 highlights our significant investment activity over the quarter. We signed in closed a total of $1.3 billion of new ground leases, a record quarter demonstrating the increased market adoption as customers continue to recognize the benefits of our solution. You can see the key investment metrics on these transactions on the bottom half of the slide. Some of the ground leases we acquired this quarter contained archaic provisions like fair market value resets. Because fair market value resets are un-notable, GAAP attributes no value to them.

However, these fair market value resets can be extremely valuable to SAFE, our underwriting is based on the assumption that land value grows 2% annually when attributing value to fair market value resets using this assumption the investments have an effective yield of 5.3%, rent coverage and the percentage of combined property value are 4.2x and 36% respectively consistent with our strategy of creating low risk cash flows.

On slide 7, we feature four large ground leases we recently announced as Safehold breaks into a new tier of asset quality with an established institutional customer base. These four assets which include ground leases under 425 Park Avenue and 135 West 50th Street in midtown Manhattan 195 Broadway in downtown Manhattan, and the Alohilani Beach Resort represent trophy assets in key markets totaling approximately $1.1 billion in assets net of our joint venture interest in 425 Park Avenue. After announcing these three large Manhattan transactions we have seen a nice pickup in reverse inquiry from Global institutions interested in learning how Safehold can help structure value and enhancing capital solutions.

Turning to slide 8, I'd like to walk through the Alohilani transaction in more detail and how it led to the creation of our SAFE x SWAP program which should fuel further growth. As some background, the Alohilani resort is located along Waikiki Beach in a well-located strip of beachfront hotels in Honolulu, Hawaii. The program is centered around customers who are subject to existing archaic ground leases that are either on the market for sale or which the customer has an option to buy. In this case the customer reached out to see if they could create a better, more modern structure for them in connection with the ground lease becoming available for sale.

We partnered with our customer and were able to purchase the ground lease, and simultaneously swap out uncertain and ambiguous provisions for a transparent Safehold lease with known fixed economics. The creation of this program illustrates how Safehold is continuously finding innovative ways to deliver better capital, creating value for our customers, and unlocking new avenues of growth for shareholders.

Moving to slide 9, we illustrate our portfolio growth. As we have noted in each recent earnings call, our portfolio continues to grow rapidly. Pro forma for the $934 million of transactions expected to close in the fourth quarter, our portfolio stands at just $2.5 billion which represents 7x growth since we went public.

Last quarter we updated our 2019 investment target from $750 million to $1 billion and as Jay mentioned, we expect to exceed that in the fourth quarter.

Safehold's platform now spans across 24 markets across the US including our expansion into Austin, Texas and Honolulu this quarter. Each day our investments team continues to make significant strides in educating the marketplace and growing our brands footprint.

Slide 10 shows a snapshot of our current capital structure. In the third quarter Safehold's follow on equity offering generated an additional $265 million in equity capital to support the funding of new deals creating $845 million of total book equity at quarter end. We currently have approximately $775 million of outstanding debt inclusive of our financing under Alohilani that closed subsequent to the end of the quarter.

During the quarter we refinanced short-term debt with a new 50 year financing that included our custom tailored structure. As I previously mentioned, we were able to pull out an additional $50 million of equity through the debt origination, which when levered 2:1 provided an incremental $150 million of purchasing power.

This financing transaction demonstrates our continuous improvement on the liability side of our balance sheet along with the value embedded in our portfolio. Today, our weighted average cost of debt is 4%. And while we fundamentally believe that the more important metrics are the effective yield of our ground leases versus the effective interest rate of our debt, our separate debt structures mean we currently pay a cash rate of 3.4% versus the cash rate on our ground leases of 4%. Our recent financings have extended our weighted average debt maturity to 25 years, substantially reducing interest rate risk. We've also wound up and rate-locked long-term financings for all of our announced deals.

As a result we currently have sufficient capital to close all of the pro forma deals through the year end, and our timing for raising additional capital will be largely predicated on how our pipeline shapes up. Separately based on the commitments we have received, we expect to amend, and extend, and expand our revolver capacity in the fourth quarter to $525 million from $350 million with the addition of two new banks to further fuel our growth.

Moving to slide 11, I'd like to take a moment to explain in a little more detail the separate components of value in our ground lease portfolio. The first component of value is the bond-like cash flow our portfolio generates, which includes all of the rent payments over the life of the lease as well as the cost basis on par. Secondly we track the unrealized capital appreciation or UCA, which represents the value of the bricks-and-mortar on top of our land based on the reversionary right at the end of the ground lease. Pro forma for the deals we've announced. UCA stands at approximately $4.5 billion which is more than 10 times where we stood when we went public.

As disclosed in our 2018 proxy, the company created a wholly owned subsidiary called CARET to house this second component. While we believe this represents a substantial store value for shareholders. The stock price has not yet attributed much if any value to UCA. Accordingly the board introduced a shareholder approved management incentive plan last year with the goal of aligning management with shareholders in order to deliver both significant stock price appreciation, and to crystallize the value of UCA. Under this plan management can earn up to 15% of UCA based on achieving share price hurdles ranging from $25 to $35 per share. These hurdles represented approximately 45% to 90% appreciation above where the stock price was trading when the awards were granted.

Based on the share price appreciation through the end of the quarter, management has vested 7.5% of UCA, a portion of which remains subject to forfeiture based on time-based service conditions. Safehold shareholders continue to own all of the remaining UCA that management has not earned. And while we are pleased with the gains in our share price we have much work to do in order to unlock and crystallize this substantial store of value for our shareholders.

In conclusion, this was a breakthrough quarter for Safehold. On the investments end we achieved record originations, accelerated our portfolio growth, we're unlocking new opportunities with SAFE x SWAP and have attracted adoption from large scale world-class customers seeking a better way to unlock the value of their land beneath their buildings.

On the liability side, we are breaking through with longer debt maturities that are accretive on a cash-on-cash and effective yield basis. And with investors we successfully completed our first follow on equity offering and the stock continues to be one of the top performing REITs here today. Looking ahead we anticipate the fourth quarter to be strong as we close these announced deals, and continue our mission of revolutionizing the way real estate should be owned.

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

Jay Sugarman

Chairman & Chief Executive Officer, Safehold Inc.

Thanks, Marcos, and just a few couple final comments from me. There's a lot of misinformation out in the world regarding ground leases. The old archaic ground lease business has almost no relation to what Safehold is doing. We continue to educate the market and are pleased with our progress to date.

Likewise we're continuing to educate the market on how to best value the business we are building while our business is unique, the investment ideas at its core are time tested and proven, and the intrinsic value calculation for the cash flows from a diversified ground lease portfolio is relatively straightforward and demonstrates quite powerfully the value we are creating for shareholders.

What's also exciting is the potential capital appreciation we are banking for shareholders, every time we add an asset to our portfolio. This portfolio effect is one that will come into greater focus as we scale. But as Marcos pointed out, we're committed to figuring out how to capture and crystallize this value so it can be reflected in the share price. If we can do that successfully we think shareholders will be very happy.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. Today's question-and-answer session will be conducted electronically. [Operator Instructions] Your first question comes the line of [ph] Zach Silverman from Bruzo (00:15:46). Your line is open.

Q

Hi. Thanks guys. Can you give us some more color on the SAFE x SWAP Program, I mean specifically you mentioned the fair market value reset and what kind of other language do you guys look for to replace and how does the rent-bound structure compared to a originated ground lease?

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

Right [ph] Zach (00:16:12). So a couple of things starting from the biggest issue obviously fair market value resets create probably the most difficulty for modern financial markets and future buyers to get their hands around, so that's an easy one. But anything that was created or written 30 years, 40 years, 50 years ago probably doesn't fit in the modern insurance markets. So casualty and condemnation type provisions, there's just a whole litany of modernization that needs to take place in ground leases. So what SAFE x SWAP can do as not only fix some of the bigger or obvious issues but a lot of the more subtle and nuanced issues that we as a lender and we as a buyer and seller of real estate realize are holding back the potential of this better capital solution. So it's not just one or two things, there's a whole bunch of them. But our legal team works with lenders and buyers and sellers every day and we're continually improving some of the ground lease provisions that we think we can make fit very naturally and very easily in today's markets.

Marcos Alvarado
President & Chief Investment Officer, Safehold Inc.

A

As it relates to the economics, what we seek to create is consistent with our portfolio, so 5.5% ROAs and 99-year duration assets.

Q

Okay. Great. And switching gears. I guess after the Honolulu deal it's about 13.4%, 14% of your NOI, how do you guys think about this market when you eventually reach your critical mass?

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

Sorry, which market, the...

Q

Honolulu sorry.

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

Honolulu, okay. Yeah, look, I think a couple of things you know from a real estate perspective it continues to be one of the strongest hospitality markets in the country constrained supply, very high occupancy rates. We're seeing great elevation as more and more properties are going through the same thing that Alohilani did it which is really meeting the needs of the customers of today and tomorrow. So, we think it's one of the stronger hospitality markets from a supply demand standpoint. And the long – long-term we've done a lot of studies on its ability to be protected in any sort of climate change outcomes, and we're comfortable that there are sufficient long-term protections in place.

Marcos Alvarado
President & Chief Investment Officer, Safehold Inc.

A

And on a pro forma basis the transaction should be closer to 7.5% of our net income at fourth quarter.

Q

Okay. Great. And after three or so years of operations and being in the ground lease market do you notice an influx of competitors or do you see any momentum in terms of potential clients approaching you to execute a ground lease with you guys?

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

Look on the competition front this is not an easy business to launch. We spent significant time and candidly a lot of capital and a lot of money to figure out how to launch it to spend the time to educate the market to understand those nuances those subtleties to work with dozens and dozens of institutional lenders to understand their particular needs and nuances. So we have not yet today seen anyone really begin to focus and certainly no one on a nationally scaled type platform. Individual ground leases that do come up for sale which represent part of our business, we do see some competition. But again it tends to be one off and it tends not to even sort of be thinking about it as a business and looking at it as simply a one off investment. What we are setting out to do is demonstrate the difference between the value of a single asset and the value of a business that can actually deliver this capital on a de novo basis to all building owners. And I think it's just a fundamentally different mindset that we have not yet seen any competitive alternatives really show up.

Q

That's it. Thanks guys.

Operator: Your next question comes from the line of Collin Mings from Raymond James. Your line is open.

Collin Mings
Analyst, Raymond James & Associates, Inc.

Q

Hey good morning. Good morning.

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

Good morning.

Collin Mings
Analyst, Raymond James & Associates, Inc.

Q

First question for me just as far as asset pricing I mean just given the 10 years [indiscernible] (00:20:54) since this summer how does that impact the negotiations on potential deals. I know in the past you've highlighted, you got about 3.5% at as the typical starting yield, but just as you're working on transactions right now, do you see [indiscernible] (00:21:05) of that actually be below that in the current pipeline.

Marcos Alvarado
President & Chief Investment Officer, Safehold Inc.

A

No I think that 3.5% benchmark that Jay has laid out in the past is consistent with what we're achieving today. Our primary competition is the refinancing market and ultimately the cost of our liabilities has dropped somewhat as well. So we maybe selectively will drop below 3.5% for the right high quality asset, but we've been pretty consistent with that.

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

Yeah I think if you look at our basic construct it was can we create 5.5% always and fund them on a long term basis at 4.5% so we create a 100 basis point spread and lever 2:1, that simple math for us was really compelling given the AAA nature of the cash flows we're creating. What we've seen is an opportunity to actually do better than that on our debt side, and we do try to pass on some of the value we're creating as we scale the portfolio, and get the economies of scale on the debt side in the form of attractive financing for them.

So as Marcos said, as long as we're beating that 100 basis point benchmark and creating a better alternative to their fee financing solutions, we're able to attract some of these high quality customers with what we think is just a better mousetrap.

Collin Mings
Analyst, Raymond James & Associates, Inc.

Q

Got it. Also as it relates to deal flow and potential future activity just given maybe the success of 425 Park with that JV at the close in the fourth quarter, are you seeing very many other opportunities on the JV side moving forward?

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

Look we don't want to give any of the deals we're doing away. So the nature of 425 is just such a large asset that we felt it was prudent for shareholders and for our portfolio diversification to bring in one of our longstanding partners and give them a look. And I think the quality of the asset speaks for itself and the fact that they've invested several hundred million dollars side by side with us, is certainly a validation. But we didn't need that validation, we know these ground leases are very, very valuable, and so I don't think you'll see us do that unless transactions are very, very large or create some level of concentration that we'd prefer prudently to just pare back. So, it's not a core part of the business but it's certainly nice to know we have co-investors who are very, very interested in participating with us.

Collin Mings
Analyst, Raymond James & Associates, Inc.
Q

Okay. And then moving to just the kind of the capital front, just in the prepared remarks if I understood them correctly, you believe you have the capacity to close on the roughly $900 million of properties under PSA is that correct?

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.
A

Correct.

Collin Mings
Analyst, Raymond James & Associates, Inc.
Q

Okay. And then just maybe in context of that just maybe remind us of your leverage targets, any sort of potential capacity that you would see beyond what's under PSA just given your current cap structure?

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.
A

Yeah. Look I think when we did the raise in August and raised our guidance, we felt comfortable with continuing to accelerate the machine, and we put enough capital away to do that as the team is out and building the 2020 pipeline, obviously at some point we're going to want to prefund that. So, it's going to be a little bit data dependent, a little bit pipeline dependent. But I think the punch line for us is, keep the team going as fast as they can. We think they're creating enormous value by doing smart deals with really smart customers. And so we don't want to ever slow them down. So, we'll figure out an appropriate time to make sure that we have the capital to fund our 2020 plan as well.

Collin Mings
Analyst, Raymond James & Associates, Inc.
Q

Okay. I appreciate that, Jay. I'll turn it over.

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.
A

Thanks.

Operator: The next question comes from the line of Rich Anderson from SMBC. Your line is open.

Richard Anderson
Analyst, SMBC Nikko Securities America, Inc.
Q

Thanks. Good morning, everyone. Hey, so on the – on the fair market value situation where you estimated 2% growth in the land, and then in reference to the SWAP program is why would you not or do you plan to change the structure of those inherited fair market value situations like you did in Hawaii?

Marcos Alvarado
President & Chief Investment Officer, Safehold Inc.
A

You're way ahead of us. So, yeah, the four large transactions on the page 2 were new originations completely de novo ground leases to...

Richard Anderson
Analyst, SMBC Nikko Securities America, Inc.

Q

Right.

Marcos Alvarado
President & Chief Investment Officer, Safehold Inc.

A

... certainly have the potential, have the potential to be SAFE x SWAPs, one was really our first large scale SAFE x SWAP, but it definitely set the template for doing it again. We have a – an interested customer for 25 Park in creating optimal maximal value for themselves and certainly a SAFE x SWAP could make a lot of sense there, but we can't really have the conversation till we're deeper into the closing process.

Richard Anderson
Analyst, SMBC Nikko Securities America, Inc.

Q

Okay. Fair enough. Thanks very much for that. So you mentioned getting some reverse inquiries now you're getting more high profile deals done particularly in Manhattan. Are any REITs coming to you or public companies?

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

I would say the REITs are somewhat more selective given their leverage targets. So it has been more on the private fund side, so large global institutions core opportunistic fund vehicles.

Richard Anderson
Analyst, SMBC Nikko Securities America, Inc.

Q

Okay. Okay. The effective yield absent the fair market value situation is below 5% for the for the activity in the quarter, obviously below your target, is that just a function of the scale of these deals and you expect – you're not kind of resetting your effective yield math on a go-forward basis or are you?

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

No, that's just the function of the large transaction that has the fair market value reset.

Richard Anderson
Analyst, SMBC Nikko Securities America, Inc.

Q

Okay.

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

So the way we think about it internally is it – it's really a 5.3% on those new acquisitions, new originations not a 4.9%.

Richard Anderson
Analyst, SMBC Nikko Securities America, Inc.

Q

Okay, last from me. On the LTIP program, just I know you're trying to unlock the value, and get it into the stock of the unrealized capital appreciation. But are you saying just incentivizing management vis-à-vis the UCA is the kind of the dotted line between the stock price and the unrealized capital appreciation or is it more about that program that I'm missing in terms of why you guys getting paid will create more stock price appreciation. I'm not being tongue in cheek I just want to make sure I understand the mindset.

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

Yeah look I think Marcos laid out in his comments that we don't think we're getting or our shareholders are getting any benefit right now from the value we think is being created. A lot of people again you probably heard us talk about this the value of a single residual 99 years in the future is not the proper way to think about the value of UCA, but we're going to have to convince the market and show them results that enable us to crystallize that value. That is probably one of the biggest structural incentives that we have for shareholders to generate the most value.

It's our job every day to try to figure out how to do that. And we think we've made an enormous amount of progress. But the first and foremost it was make the shareholders win and that a combination of both the share price targets that were mentioned which were 50% to 100% above where the stock was trading. But also this opportunity to capture the second component of value in a way frankly we don't think the market understands. And to create a directly aligned incentive that would say if you can turn that into a very meaningful number, the incentive pool will be 15% of whatever you can turn it into, if it's zero then the incentive pool is also zero. But if it turns into something really valuable for shareholders you can participate in that value creation. We think that kind of aligning structure was very well thought out by the Independent Directors with a very specific target incentive tied to share price performance and really revolutionizing how people think about the value that can be created through these ground lease and ground lease future ownership positions.

So it's a big task ahead of us. We do think the results that you see are beginning to give people some sense of why we think shareholders have an enormous store of value that most, if not all are kind of looking past because the cash flow component is so compelling here you don't really have to value the ownership residual positions, but trust us, we are going to focus very hard on helping people understand what we believe, and we don't think these are [indiscernible] (00:31:04). If they are, we failed ourselves and we failed shareholders. But if we succeed, boy, will shareholders win.

Richard Anderson
Analyst, SMBC Nikko Securities America, Inc.

Q

Okay. All right. Thanks very much. That's all for me.

Operator: Your next question comes from the line of Nikita Bely from JPMorgan. Your line is open.

Nikita Bely
Analyst, JPMorgan Securities LLC

Q

Good morning guys. Can you talk about what drove the $1.1 million of other income in this quarter? And is that recurring?

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

Let's take other income, we had a lot of cash sitting on the balance sheet from the raise, so you're actually starting to see some descent with interest rates in the LIBOR in the 2% range, we actually made some interest income there, and I think that's probably the bulk of the change.

Nikita Bely
Analyst, JPMorgan Securities LLC

Q

What's – so the interest rate that you're getting on the cash balances [indiscernible] (00:31:53)?

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

I'm looking around the room 2% is my guess but I don't know.

Nikita Bely
Analyst, JPMorgan Securities LLC

Q

Okay. Got it. And I want to understand a little bit about the depth of the market for the growth linked debt that matches your lease cash flows. Can you talk a little bit about it?

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

Yeah. Look, we think our capital markets team continues to create really innovative bespoke structures with a range of capital providers. Right now, all domestic, we've not yet reached out to either the Asian markets or the European markets where we think we'll get the same kind of reception. Remember we are offering long-term call protected high quality cash flows that really in our minds represent almost AAA risk. And so to have inflation protected cash flow streams because they actually increase over time to have that AAA safety at 65% of our basis, which we think represents AAA safety.

This is a pretty interesting instrument for a lot of long dated capital providers whether that's insurance companies or pension funds or pick your long dated provider. Right now I think the goal has been to work all the kinks out and what we've seen in the last couple of quarters is an expanding roster of people interested in having this conversation understanding what we're building again not just looking at single assets and going, is this, is this all we're doing. But understanding we're building a revolutionary new way to think about capitalizing real estate and I think that is starting to draw those conversations in from more and more people.

So, I know, Brett's really pleased with the number of conversations he has going, the number of transactions we've closed with different providers, but we're still early stages as we get bigger as we scale, I think you'll see us go well beyond what we're talking – the group we're talking to today.

Nikita Bely
Analyst, JPMorgan Securities LLC

Q

Yeah. Yeah. And on this type of debt, I mean what are sort of the current terms, in terms of the duration, LTV, maybe if you could comment on the [indiscernible] (00:34:19) spreads, and then the average spreads to US Treasury that you've done right now?

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

Yeah. Look I think you'll see as we come out of the fourth quarter and this next series of financings, a statistically significant sort of set of new and real time financing. So I think you'll get a really good sense of that. But as we mentioned in this quarter our average maturity right now is 25 years, it's headed to 30 years. When we closed those deals we'll give you some specific metrics at the end of the fourth quarter. We are increasing the average maturity of the new financings, so most of them will be over 30 years, you'll see cash costs in year one be as much as 50 basis points to 100 basis points lower than the overall cost of the debt.

Those are the kind of metrics that I can share with you and in terms of LTV against the value of being in the building and the land together they're going to represent 20% to 25% maybe a little higher as we get more scaled and more diversified. That represents about 2:1 leverage against our zero percent to 35% position. So that math all sort of works together to create a very low LTV for our lenders, a long term financing strategy that should eventually be 30 years plus, a all-in cost of debt that we try to make sure is 100 basis points inside our all-in return on our asset, and a customized cash flow structure that matches our assets by starting at year one cost, and then slowly increasing.

Nikita Bely
Analyst, JPMorgan Securities LLC

Q

All right, got it. Got it. And then I could put one more in on the recent deals that you've done are there any material changes that you see in the next 5 years to 10 years in terms of your rent bump schedules. Like is there anything happening differently in the out years versus some of the other stuff that you've done.

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

No. It's consistent on the newly created Safehold product is 2% annual bumps.

Nikita Bely
Analyst, JPMorgan Securities LLC

Q

Okay.

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

Yeah. And I think we should and I think we should point out that when we talk about our ROAs and our yields to maturity, we don't include the CPI look back bumps that we have in a lot of our transactions so if CPI was actually greater than 2% in those outer years, we're understating all the numbers we're giving you. On the asset side, our financings do not have that provision. So just we don't want to try to guess, and we don't try to estimate what that might be worth, just want to point out that we're not calculating the benefit of our CPI lookbacks in any of the numbers we're sharing on the assets.

Nikita Bely
Analyst, JPMorgan Securities LLC

Q

So it's 2% at a minimum, and then if there's significant inflation in the out years you will also tuck on top of that?

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

Yeah, correct.

Marcos Alvarado
President & Chief Investment Officer, Safehold Inc.

A

We will cap it so it doesn't create uncertainty or ambiguity that causes problems. But we do have a nice pickup if inflation were to be higher.

Nikita Bely
Analyst, JPMorgan Securities LLC

Q

Got it. Thank you.

Operator: Your next question comes from the line of John Massocca from Ladenburg Thalmann. Your line is open.

John J. Massocca
Analyst, Ladenburg Thalmann & Co., Inc. (Broker)

Q

Good morning.

Marcos Alvarado
President & Chief Investment Officer, Safehold Inc.

A

Hey.

John J. Massocca
Analyst, Ladenburg Thalmann & Co., Inc. (Broker)

Q

So with regards to the joint venture on 425 Park, is there any color you can give on the structure at this time? I mean this – is it going to be a pure 55:45 split or is there some kind of promote structure to you guys? Any color there would be helpful.

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

It's a pure 55:45 split.

John J. Massocca
Analyst, Ladenburg Thalmann & Co., Inc. (Broker)

Q

Okay. Perfect. And then with the CARET program what will be the nominal impact of that today and how should that impact G&A going forward?

Marcos Alvarado
President & Chief Investment Officer, Safehold Inc.

A

There's no impact, there's no cost. So it is a pure incentive plan that says if you can – if you can create value for shareholders you can participate. I think when we created the program, there was a de minimis charge that probably flowing through, but it was quite small and it's over, I forget how many years, four years I think. So it's as we grow it's going to be just a de minimis number and I assure our guys can give you the actual numbers.

John J. Massocca
Analyst, Ladenburg Thalmann & Co., Inc. (Broker)

Q

Okay. That's fine. And then, one last one with the kind of – I think you highlighted the New York transactions and the Honolulu transaction. But can you maybe give some more color on some of the smaller transactions, Austin, I think being the only one you closed, but there's also some of the prior press releases mention of a potential deal in Phoenix, just the relative size of those and maybe what kind of percentage of future deal flow do you expect is going to be kind of smaller one off deals and what percentage is going to be some of these bigger kind of central business district type transactions?

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

Yeah. We're probably – because we have such success with some of these Manhattan deals, we probably are giving short shrift to the rest of the third quarter transactions we're really excited by. Austin as a market we really like both near-term and long-term. The transaction there is in a very dynamic market, the new up and coming tech location for most of the Fortune 10 companies that are moving into Austin. So that's a brand new building with a 15 year single A credit in there, across from a lot of developments. So we probably should make you guys aware that the rest of the deals we're doing are also ones we're quite excited by. The Arizona deals with a new customer we're really excited to be in business with in a great location, again another new asset, this is a student housing asset, that's a business that I think there's opportunity in in markets, you're seeing it every day.

Marcos Alvarado
President & Chief Investment Officer, Safehold Inc.

A

Yeah. Just to echo what Jay said, the Austin asset is brand new.

The student housing asset sits on ASU's campus brand new asset. We did a large office building in New York MSA as well this quarter. We also did a smaller student housing deal in Riverside, California, high quality as well. So the quality of the assets and the quality of the customers, although they're smaller than the large transactions, that's the same strategy.

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

So, we do – we do try to try to think about the businesses sort of a gateway city, trophy assets but the flow business is equally important, and the teams are out there constantly mining, and again this business is really built on this customer proposition of. We're making the pie bigger. We're making returns better. We're lowering risk and that's a proposition we can take a lot of different places.

John J. Massocca
Analyst, Ladenburg Thalmann & Co., Inc. (Broker)

Q

Understood. That's it from me. Thank you very much.

Operator: [Operator Instructions] Your next question comes from the line of Jade Rahmani from KBW. Your line is open.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Thanks very much. I wanted to see if you could comment as to whether SAFE would require additional common equity to execute the deals currently under contract?

Marcos Alvarado
President & Chief Investment Officer, Safehold Inc.

A

No.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay.

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.
A

Yeah. I think, we answered earlier Jade, the pipeline is really going to dictate when we need capital, and how much we need, and we're just beginning to put together all our 2020 plan, and we're thoughtful about how to fund that plan in 2019. We feel comfortable if we put that capital in place.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Okay. Have you seen any compression in the market with respect to ground leases. And a follow-up to that is it reasonable to assume lower yields on some of the trophy assets that you've been entering into?

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.
A

Yeah. It's interesting. The two de novo assets we did are right down the middle. I think the kind of ROAs in the 5.4% range. The SAFE x SWAP assets again customers are coming in with an existing cost structure. So, we don't have quite as much flexibility. We try to reach the same ROA targets, but we try to get there in a slightly different way. Just so we don't change the rent structure overnight and in any dramatic fashion. But again the business is really about creating these 100 basis points to 125 basis points spread to our debt. And I look to our capital markets team as much as to the third-party financing world to understand where values are, and what we need to achieve to make our shareholders what we think are enormously excess returns for the risk we're taking.

So, we can move on a trophy asset in terms of our ROA targets if Brett and the team tell us that they think the financing will also be commensurately tighter. So, that's really the driver. But I would tell you on the two non-SAFE x SWAP type assets that we just created they were right sort of down the middle of our core targets.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.
Q

And with respect to the New York office deals completed or under contract. With respect to the underlying tenancies can you comment as to whether there is WeWork or co-working exposure, and if that was part of the lease up strategy that the underlying sponsors had in mind?

Marcos Alvarado
President & Chief Investment Officer, Safehold Inc.
A

There is no WeWork exposure in those transactions. But again, I think it's important to understand where we sit in the capital stack, at 35% of value whether there's co-working or not, we feel very secure. Our basis per foot in this New York asset is below land value.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Okay. And then turning to the financing of the company, good to see the duration of the liability structure continue to extend. You're covering a variety of finance companies, duration gap is definitely something I've always been watchful of, how do you get comfortable with that duration gap between the lease maturity profile and your debt maturity profile, considering we could be through multiple interest rate cycles, and then in term, granted the ground lease, rents are going to continue to increase?

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

Yeah. Look we run a lot of sensitivities around where match funding is most efficient and we think that 30 year eliminates a lot of the interest rate risk. Our typical models run the refinancing profiles at hundreds of basis points above today's rates. The impact on the value creation is really quite small after 30 years. So you can stress that pretty hard and you're not really impacting the value we're creating for shareholders. So I would tell you, run the numbers, happy to share with you our sensitivities, but if you can get your weighted average maturity out to 30 years, the NPV that you will run off our cash flows using almost any consistent refinancing assumptions, conservative refinancing assumptions, that's not really the risk factor. I think it's the companies that take short term debt or take risk in the very near term or intermediate term where that can be a real problem. If we can move our liability structure out to 30 years we do not have that problem.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. And just also wanted to ask about the CARET. Does iStar's actual investment in SAFE purchases of SAFE stock as well as ownership interest in the company qualify under iStar's iPIP program the iStar long term incentive program.

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

iStar. If we make investments of iStar's capital it goes into an iStar program. CARET and the stock price incentives at Safehold are different. They were created by Safehold's board.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. But iStar's capital investments into SAFE's stock would qualify for the iStar iPIP. Assuming a positive return above the minimum target.

Jay Sugarman
Chairman & Chief Executive Officer, Safehold Inc.

A

Correct.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. And then lastly you know given that the growth in SAFE's market capitalization and your bullish outlook for the business, at what size point for safe's common equity market cap would some kind of internalization recombination transaction make sense do you think or is it really a function of iStar's legacy assets being run off and that dynamic playing out.

Marcos Alvarado
President & Chief Investment Officer, Safehold Inc.

A

Yeah, let's be clear what the mission here is, it's to revolutionize the $7 trillion industry, we think that will create by far the most value for shareholders across Safehold and iStar. So they are very aligned at this point in trying to figure out how to build a big powerful market changing business.

So we haven't spent a ton of time worrying about how to change the architecture today that is succeeding, and what we've said in the past is there will come a time where we think that conversation could take place. It's not taking place today. And you're right that iStar would have to really see a lot of legacy assets be eliminated and a lot more capital market flexibility before that would be something that would make any economic sense. But Jay and I would continue to focus on is the business that we are building is dramatically undervalued in our minds.

Everything else is around the edges. Nothing else matters. If we scale this business and people understand the intrinsic values, that is where the pot of gold for shareholders lies, and that's our mission critical focus. Let's say iStar and SAFE, and I think this quarter represented for us a really breakthrough quarter, on ideas that we've had and expressed that people said can you really do it, can you really generate the results. I hope you'd look at the results of this quarter, next quarter and determine whether you think that's taking place.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Well, thanks very much for taking the questions.

Operator: There are no further questions at this time. I turn the call back over to the presenters.

Jason Fooks
Senior Vice President-Investor Relations & Marketing, Safehold Inc.

Great. Thank you, everyone. Thanks for your participation. If you should have any additional questions on today's earnings release. Please feel free to contact me directly. Can you give the conference call replay instructions once again? Thanks.

Operator: As a reminder, the recording for this call will be available at 12:00 PM Eastern Standard Time. Please dial in 800-585-8367 and use conference ID 6795893 to listen. This recording will be available until November 7.