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PRESENTATION

Operator

Good morning, and welcome to iStar's 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 and Marketing. Please go ahead, sir.

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

Thank you, John, and good morning, everyone. Thank you for joining us today to review iStar's third quarter 2019 earnings. With me today are Jay Sugarman, Chairman and Chief Executive Officer; and Marcos Alvarado, our President and Chief Investment Officer. This morning, we published an earnings presentation highlighting our third quarter results, and our call will refer to these slides, which can be found on our website at istar.com in the Investors section. There'll be a replay of the call beginning at 12:00 p.m. Eastern Time today, and the replay is accessible on our website or by dialing 1 (800) 475-6071 with the confirmation code of 472952.

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

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

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

Thanks, Jason. The third quarter was highlighted by strong growth in our core ground lease initiatives and continued progress in strengthening our balance sheet. Our shift earlier this year to focus on building a customer-friendly value-enhancing ground lease platform is beginning to bear fruit, And we've seen strong returns on our capital invested in shares of Safehold as well as the direct benefit of using the better price capital that a Safehold ground lease provides as part of our own SAFE/STAR transactions.

On the capital side, we continue to increase our Safehold position, primarily by acquiring an additional 6 million shares during Safehold's follow-on offering in August and now own a stake valued at over $900 million. Safehold posted record third quarter investment volume, closing $400 million in new transactions and is on track to close an even higher number in the fourth quarter, breaking through with several top-tier building owners and operators. We continue to believe the value of the Safehold business increases significantly as it scales and think its shares remain a compelling investment.

On the property acquisition side, we captured the benefits of the modern ground-lease structure as we acquired a $113 million leasehold position in a brand-new 300,000 square foot office building in one of the strongest submarkets in Austin. That building is leased on a long-term basis to a high-grade credit. The acquisition was jointly structured with Safehold under our SAFE/STAR program with iStar's investment gaining the financial benefits that come with a modern, efficient ground lease, higher cash-on-cash returns, higher expected IRRs, lower debt maturity risk. Demonstrating to us once again the properly structured ground leases are more capital-efficient and more cost-efficient and can increase value and lower overall risk for building owners across the country.

The capital for these investments continues to come mainly from loan repayments and certain net leased and legacy asset sales, and the ability to redeploy proceeds into SAFE's diversified portfolio of ground leases through additional investments in its shares or into direct investments through our SAFE/STAR program represents an attractive capital recycling opportunity and one that is upgrading the quality of our portfolio. At the same time, we've taken several strong steps forward with our balance sheet by replacing shorter-term debt with new longer maturities and opening up a sizable runway with no debt maturities. Better asset quality and a stronger balance sheet has led to some positive momentum with the rating agencies, and we look forward to making additional progress in the future.

On the earnings front, while our net lease and finance portfolios continue to generate solid returns, our legacy and development assets will remain a drag on earnings until they are sold, and the proceeds redeployed into the ground lease ecosystem. With sizable earnings already booked for the year, and our SAFE investment becoming increasingly profitable, we are redoubling our efforts to trade out of legacy assets and into higher quality, more strategic earning generators over the next 12 to 18 months.

And with that quick overview, let's have Marcos take you through the details. Marcos?

Marcos Alvarado ***iStar Inc. - President & CIO***

Thanks, Jay, and good morning, everyone. My remarks will refer to the slides from the earnings presentation posted on our website earlier this morning. Let me begin on Slide 3. I want to take a moment to reflect on the strategy we laid out at the beginning of the year and to measure our progress so far in 2019. As you'll recall, we set out to pave the new direction of growth and value creation for iStar by going all-in on the ground lease ecosystem at Safehold, while at the same time working to simplify and strengthen our balance sheet.

In the third quarter, we've continued to make significant strides on this strategy, which has driven year-to-date earnings of $4.26 per diluted share and adjusted earnings of $4.04 per diluted share. However, these results are exclusive of the unrealized gains embedded in our investment in Safehold shares, which currently have a market value of $347 million or more than $4 per diluted share in excess of our basis using yesterday's closing price.

I'll discuss more of the key achievements at Safehold in the third quarter shortly, as we're enthusiastic to see growth and customer adoption accelerate significantly. Additionally, this quarter, we also continued to enhance our credit profile by executing a $675 million bond refinancing, which extended our overall debt maturity profile, created a runway of no corporate debt maturities for the next 2.5 years and lowered our overall costs.

Flipping to Slide 4, More detail on this quarter's earnings. During the third quarter, iStar had a GAAP loss of $0.12 per share and adjusted income of $0.06 per share. Year-to-date, we have recorded $338 million of GAAP earnings or $4.26 per share and $320 million of adjusted income or $4.04 per share.

Moving to Slide 5. During the quarter, we invested a total of $381 million, which included $183 million of investments in SAFE. Our SAFE investment was made primarily in connection with SAFE's first follow-on equity offering at $28 per share, a 40% premium to the IPO price. In addition, we made a $168 million in investment fundings in our real estate finance and net lease businesses, the largest of which was the new SAFE/STAR net lease investment in Austin, Texas that Jay referenced. This investment is wholly owned and not part of our net lease joint venture. Separately, we also invested $30 million of CapEx this quarter versus $53 million in the second quarter. In Asbury Park, at the beginning of the third quarter, we began closing condo units at Asbury Ocean Club and began operations at the Asbury Ocean Club hotel, which has now moved from our land and development segment into operating properties. Asbury Ocean Club is setting a new standard for luxury living on the Jersey Shore, and we have been very pleased to date with the early reception of the project from the media, hotel guests and condo buyers.

As we continue to close on condo sales, we expect to see our book balance in Asbury Park decline. However, this balance may fluctuate slightly over the coming quarters due to the seasonal nature of the market, the final construction closeout and the timing of condo closings.

Turning to Slide 6. The substantial progress we've made this year in unlocking value within the portfolio has translated into meaningful growth in our equity value per share. Our common equity value per share has grown from $6.61 at the beginning of the year to $10 at the end of the quarter. On an adjusted basis, which primarily adds back accumulated depreciation and amortization, our equity value per share has grown from $11.15 at the start of the year to $13.75 at the end of the third quarter. However, these figures are based on the historical investment basis in SAFE and do not reflect the strong performance of the SAFE stock. Inclusive of the market value of our investment in SAFE, our common equity value per share was $14.19 per share, and our adjusted equity per share stood at $18.17. These figures are based on a diluted share count inclusive of the conversion of our $200 million of Series J convertible preferred, which are currently in the money with a conversion price of $12.22 per share.

On Slide 7, we highlight SAFE's performance during the quarter. Safehold hit several critical milestones this year, underscored by a strong third quarter with $1.3 billion of closed deals and signed contracts. These investments were matched with innovative financing structures that provide Safehold with a weighted average debt maturity profile of approximately 30 years. Pro forma for closing all these transactions, the portfolio has grown 7x since our IPO to $2.5 billion, and our unrealized capital appreciation account has grown 10x to $4.5 billion.

Safehold is originating trophy assets in major markets, including Manhattan with sophisticated institutional investors. As we continue to see adoption pick up, Safehold has also made meaningful progress exploring innovative new channels of growth with the launch of its SAFE swap program. The program works with customers to purchase and restructure outdated ground leases, stripping away archaic provisions in favor of the modern framework that unlocks significant value. As of today, Safehold has increased its market cap to approximately $1.4 billion.

On Slide 8, I'd like to walk through what was an important and value-enhancing capital markets transaction we announced during the quarter. We refinanced $675 million of notes that were maturing in 2020 and 2021 with $675 million of new unsecured notes due in 2024. As a result, we pushed out our weighted average debt maturity profile from 3.8 to 4.6 years and created 2.5 years of runway with no corporate debt maturities. In addition, we've reduced the weighted average coupon on those notes by 64 basis points. We also amended and extended and upsized our revolving credit facility, adding a new lender into the mix, giving us $350 million of total capacity and pushing out that maturity until September of 2022. We've continued to improve our credit profile by reducing cost, strengthening the balance sheet, monetizing legacy assets and ultimately recycling that capital from higher-risk assets in our portfolio into among the safest ground leases.

As the balance sheet continues to transform, S&P has recognized this progress and put iStar's credit ratings on a positive outlook.

With that, I'd like to conclude by saying that this quarter has continued to be part of a strong year for iStar, as we forge ahead on our strategic plan we laid out at the beginning of the year. With strong earnings and our ground lease strategy taking hold, we expect that we will continue to -- that we'll continue to be a driver of growth for iStar moving forward.

Lastly, the capital markets transactions we discussed continue to enhance our credit profile, strengthen our balance sheet and reduce risk. And while we were pleased to see these achievements are beginning to be recognized in the market, as the stock price has risen over 40% from the announcement of our strategic shift earlier this year, we still believe there's plenty of room to continue shrinking that gap between market value and intrinsic value.

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

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

Thanks, Marcos. So we've achieved a lot so far this year and the growing success of SAFE and the growing strength of iStar as its majority owner and manager, sets us up nicely going forward with a clear and unique business strategy, a solid balance sheet and a deep and committed team. We have a lot more work to do, but we're pleased with the progress so far and look forward to educating more of the market about what the new iStar is doing and why it is succeeding.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And first with the line of Stephen Laws with Raymond James.

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

I guess, first, I'd love to get a little more color on Asbury Park? It looks like CapEx declined sequentially $53 million to $30 million, seeing some press releases on a penthouse sale, and you commented, you are seeing good traction there. Can you maybe give us a little more color on remaining CapEx or CapEx expectation for Asbury for next year? And an idea of kind of what kind of sales proceeds you expect to see or kind of a net cash flow we should think about off the Asbury Park assets?

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

Sure. Think of Asbury Ocean Club as 3 separate components. The hotel, that capital expense is closed out. And the condominiums, which we'll probably see the closeout in the fourth quarter, a little bit maybe into the first quarter. And then the street-level retail, which will be in sort of white box condition. But as we bring tenants in, there'll be a little bit of CapEx associated with the TIs and leasing commissions there. So the majority of the capital is in the tower structure and in the hotel should be behind us by the end of the year. The rest of Asbury Park, we continue to see quite high levels of interest. So our expectation is we will not -- we have seen peak Asbury by the end of the year, and we'll see a CapEx offset by reduction in capital deployed elsewhere, particularly through the condo sales. We still, I think, are setting record-breaking numbers in terms of the price per foot we're achieving in the building. We're looking for about $50 million of proceeds by the end of the year. We've got a bunch of contracts going back and forth for additional proceeds, but those will be into 2020. So we do think the tipping point is about to be reached or actually has been reached where Asbury will become self-funding, and we call that sort of peak Asbury. But I think the goal there was to build the reputation of that marketplace out to a point where not only we, but other developers would come in and find the land that we have owned, attractive. And you'll see us starting to work to monetize those assets as opposed to build them out ourselves.

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

Great. And moving to some of the short-term legacy assets looks like about $380 million left. Are there any big concentrations in that? I know that the goal is to have those resolved by the end of next year. Any significant assets, where the sales may be chunky or any visibility into how you expect that to wind down over the next 14 months?

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

Yes. Our team is working really hard to move the very small ones, but even the largest ones are probably in that 25 to 30 range. Just -- as we've said before, these land development assets are typically multiple parcels, there are development processes, permitting processes. So even when we get them under hard contracts, they take a while to get closed. So we continue to give ourselves sort of a window to move out the ones that are already on the market, already under contract. I think the big 3, the Asbury, Magnolia Green and Grand Vista continue to be steady as she goes. Obviously, Asbury's hopefully reached the tipping point where it will become self-funding. Magnolia for all intents and purposes is self-funding. And Grand Vista has a -- this potential purchase right by the tenant in about 2 years. So those are the time frames for the longer live assets. The shorter live assets, I think you'll see progress almost every quarter. But as I have unfortunately had to say in the past, selling land assets is a laborious process. Our team is working diligently. And every dollar we get back from that, we can redeploy into simpler, more strategic earnings generators. And that's always a good day for us.

Steven Cole Delaney ***JMP Securities LLC, Research Division - MD, Director of Specialty Finance Research & Senior Research Analyst***

Appreciate that. And kind of to piggybacking on your last comment, can you maybe talk about, I guess, first, I haven't had a -- haven't seen the q. But did you repurchase any stock in STAR during the quarter? And then just in general, how do you view repurchasing STAR stock, which seems to be at over 30% discount this morning to the mark-to-market adjusted book value versus potential dividend increases? Or obviously, the investments in SAFE stock, I expect to continue. But can you talk about the thoughts on buying back STAR common stock.

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

Sure. Unfortunately, in the third quarter, we're only able to buy back a very, very small amount. That was a heavy capital markets quarter, a lot of blackout moments for us, unfortunately. We did get our board recently to authorize a buyback program up to $50 million again, so we are reloaded and ready. And obviously, if we can get out of the blackout periods, we think it's an attractive valuation to deploy capital into.

Operator

And next, we go to Jade Rahmani with KBW.

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

You mentioned doubling down on asset monetizations. And thinking about the real estate financed portfolio. On the one hand, it is the current earnings generator, but it seems to me covering the commercial real estate lenders, those kinds of yields are not available today in the market, and there's tons of spread compression, lending competition. So would you consider selling that portfolio, both portfolio sale to a debt fund that has aspirations to create a public mortgage REIT, take that capital and redeploy it into your now -- your core strategy?

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

So yes, I think the good news about that portfolio is it does have very high returns. The bad news is it has relatively short weighted average maturities. So we're actually seeing a really nice natural progression of capital coming back from that finance book. And as we have used for it in our other ground lease ecosystem areas, primarily SAFE, it's kind of working out nicely. The money shows up when we need it, but we have these earning assets until we need it. So I think trying to do something in holistic all at once doesn't really make sense for us. Those assets will come back over a relatively short period of time and provide a lot of liquidity to redeploy. So it's kind of happening naturally, I don't think we need to force it.

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

Okay. Just thinking about the profile of the company. If you look 2 to 3 years out, the real estate finance portfolio has paid off. Shorter duration legacy assets, hopefully, are monetized and SAFE continues to grow. And what kind of returns on equity do you think iStar could achieve in that scenario, I guess, both on a current cash return basis, such as the Austin deal that you talked about or total returns factoring in the value of the SAFE portfolio?

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

Sure. I mean, look, our viewpoint, and I touched on this in my comments, is the total return profile coming out of the SAFE ecosystem is not only great today, but as that business scales, we think the values will be recognized by the marketplace that we see and believe in every day, and our boards believe in. It's one of the reasons we continue to make that as our primary focus for our investment capital. And we don't think the value is simply in the cash flows we create. It's in the value we're creating throughout the portfolio. The fact that as we get bigger, our financing gets more efficient. So we think the ROEs of the underlying assets are attractive on a risk-adjusted basis. But because they're so far above the comparable benchmarks, the real value creation is understanding the delta between the risk and maturity profile of what we're creating and the risk and maturity profile of comparable financial instruments. And that return is exceptional. And so I think right now, we think the net lease business that we're creating are quite interesting. I think the Austin deal will probably double-digit cash on cash, certainly in the mid- to high teens for an overall IRR expectation. We would love to do those. High-quality assets, that one, I think, is leased to a single A, single A minus tenant for 14, 15 years, that's really good business in a competitive net lease world. And we think that value was unlocked by working with SAFE and creating a more efficient structure. But those are few and far between. The real driver of earnings, both enterprise value and actually alpha in the assets is going to be the ground lease business, the Safehold business. So when you ask what do we think we're going to earn, our goal has always been to earn mid- to high teens ROEs with relatively low risk. We don't think that's achievable in the finance market right now. We think only in very specific situations can we unlock in the net lease market, but we think we have a wide-open playing field in the ground lease world to create those kind of returns. So you'll see our capital go there. You'll see us continue to try to identify for the marketplace, the value components at SAFE, not only the cash flow components, but the enterprise value it's building and the network and portfolio effect value that its unrealized capital appreciation is aggregating. And we've got to do a better job of getting that recognized. iStar will not get the full benefit of what it's created until we are able to get the market to see those 3 separate components and value them fully. And we can tell you quite honestly, we're still in the first inning on that process.

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

That's helpful. On the 3 large development assets. Have you been approached by any equity partners about potential joint venture structures? Is that something you would consider? Are there any active dialogues taking place?

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

Nothing holistic on the other 3 very different profiles. We are getting approached quite a bit on individual parcels within Asbury Park. I'm sure you've seen the press in 10 years that city has gone from close to bankruptcy and off the radar to what somebody told me recently was one of the coolest small cities in America. So developers are taking notice of the price points that we've been able to achieve in that market. And I look forward to finding ways to either work together or actually outright monetizing some of those parcels in the coming year. Magnolia Green, unfortunately, is a master plan community, really a spectacular family environment, great amenities, but the price points are all over the map. So there's not one natural player to partner with. We have probably have 5 to 10 builders across all those price points and products. So that one, unfortunately, we're going to have to stay in and help just continue to feedlots into those different builders. We've been one of the, I don't know, highest market share lot providers over the last many years, but it's going to take a couple more years to really work through the last couple of phases of that project. And then maybe we can partner with somebody to take out the last whatever number of lots remain and the third piece is completely different. It represents a 5,500 acres that's currently being used as an autonomous vehicle testing facility. It, one day, will be a very valuable piece of land. But right now, its most value is what it's being used for. And given the tenant has buyout rights, we really can't do any future thinking about what that might be. I think the highest probability outcome is the tenant buys the parcel. But until we know that for sure, we're just collecting checks and waiting patiently.

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

On the Long Beach, I think there was a sale reported in the press, I'm wondering is that closed? And how the proceeds as compared to carrying value?

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

Sorry, Jade, I missed the first.

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

Just the Long Beach asset was reportedly sold? Or is -- I'm wondering if that closed and how proceeds would compare to carrying value?

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

Yes. Look, we have a long road to go there. That one is what I would tell you the permitting process, the government contingencies are still real. So we're still working through those, but we have -- we are engaged and certainly hope to bring that one to conclusion sometime in 2020. I'm not going to go out on a limb on that one. It's been here, it's way too long. The value, it's been a disappointing asset. We think it is a very valuable asset, but we will, again, just trying to get our money back. And if we get close to book, we're going to be happy.

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

Okay. I wanted to ask -- I get a lot of questions on a potential SAFE/STAR combination, something of that sort. And I know I've asked you before, and you've answered it, generally speaking. But do you think that iStar's equity base has to shrink in order for some kind of transaction to happen?

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

I hadn't really thought of it in that context. I mean, again, we've historically said, that is definitely something out there in the future that might make sense. And both boards independently will have to come to that decision. Our goal is to build an extremely valuable platform and for iStar shareholders, make their investment in both the shares and the management contract become very valuable assets. So that's still our goal. How that gets realized, whether that's in conjunction with the transaction with SAFE or with a third party yet to be determined. But our goal is to continue to deploy assets out of other asset classes into this. So at some point, iStar, and say, probably will have an interesting conversation.

Operator

(Operator Instructions) And we'll go back to Stephen Laws with Raymond James.

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

One follow-up question. It looks like your converts are now in the money. I know you've done some capital markets things recently with extending debt, but any thoughts on taking those out? Or how do you think about those now that they're in the money with other options you may have available?

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

Good question. We do think our cost of capital across all our preferred is quite high, given the balance sheet strengthening and the asset quality upgrading we've been doing. Those converts, as you point out, are in the money. We're trying to think of ways to not shrink our equity balance sheet, but also capture as much value as possible as we continue to make this transition to what we think is a really unique business. So I haven't had any direct conversations with holders there, continue to think internally what's the best way to refashion the balance sheet as this upgrading and transition takes place. And that's certainly some place we need to spend some time. We have an ability to call them, and that's certainly the ultimate power we have. But we also have a thoughtful long-term plan for how to capture value for all our constituents. So still working through it, but a good question, and one we're focused on.

Operator

And we have a question from Mike Levine with Wells Fargo.

Mike Levine ***Wells Fargo***

A nice job with SAFE. I guess, I'm just a little confused with the new incentive plan at SAFE. And I know there have been concerns in the past about G&A at STAR. Are you guys, in effect, being incentivized in both entities? And I guess that sort of ties into Jade's question again, I guess, because that's consolidating the organization.

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

Sure. Remember, the plans that iStar relate only to the shares that iStar owns in SAFE. And there's no obligation for iStar to own shares in SAFE. So from SAFE's independent director perspective, I don't think it would have been prudent to rely solely on a incentive program created to cover just shares owned by one particular owner. Albeit there is clearly economic value as we create value at SAFE that has not yet been recognized and iStar's plan does that, not just with SAFE shares, but all investments made in any particular 2-year window. So it's a co-mingled plan. It represents only a fraction of the total value at SAFE, albeit today, that's about 2/3. So the plan that was implemented in SAFE does not directly benefit employees unless 2 things happen. One, SAFE shares materially go up; and two, if they -- we can create value as we scale from what we call this unrealized capital appreciation account, which heretofor, we have not yet seen any analysts or, frankly, any shareholders give any value to. So it's a very specific, SAFE-centric incentive plan that only has value if shares rise materially, which, fortunately, they have certainly had a good run. And we create value in a way that, I guess, most people still seem pretty skeptical about, but that we believe. So it's just much more SAFE-centric what applies to all shareholders at SAFE, not just the shares owned by STAR. So we think they are certainly cognizant of each other's plans. But I think 2 independent boards have slightly different incentives and try to create a prudent incentive plan that met this particular needs of their companies. So sure, there's an overlap. We want SAFE to be extraordinarily successful for both shareholder basis. But I think the plans are structured quite differently and the incentive is a little bit different.

Operator

And Mr. Fooks, we have no further questions.

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

Great. Thank you. And if you should have any additional questions on today's earnings release, please feel free to contact me directly. John, would you please give the conference call with instruction once again?

Operator

And again, ladies and gentlemen, this replay starts today at 12:00 p.m. Eastern, will go until November 14 at midnight. You can access the replay at any time by dialing 1 (800) 475-6071, entering the access code 472952. That does conclude your conference for today. Thank you for your participation. You may now disconnect.