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PRESENTATION

Operator

Good morning. And welcome to iStar's Second Quarter 2021 Earnings Conference Call. (Operator Instructions) As a reminder, today's conference is being recorded.

At this time, for opening remarks and introduction, 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, and good morning, everyone. Thank you for joining us today to review iStar's second quarter 2021 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 results, and our call will refer to these slides, which can be found on our website at istar.com in the Investors section. There will be a replay of the call beginning at 1:00 p.m. Eastern Time today. The replay is accessible on our website or by dialing 1-866-207-1041 with the confirmation code of 2859281.

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. - Executive Chairman & CEO***

Thanks, Jason, and thank you all for joining us today. Second quarter saw continued progress on our stated strategy, which enabled us to increase the scale and value of our ground lease business and see that value more fully reflected in the shares of iStar.

During the quarter, the value of our investment in Safehold increased several hundred million dollars as Safehold's share price benefited from increasing origination activity and a growing recognition of its unique value-creating strategies. This, together with our progress at iStar in our legacy asset monetization and capital redeployment plans helped us highlight iStar's growing value for investors and helped our shares perform strongly during the quarter.

Our strategy to scale Safehold and streamline iStar also led us to begin exploring the market for our net lease portfolio and platform. And while this process is not likely to be completed before the end of the year, this has the potential to represent another meaningful step in our two-year plan seeking to maximize value for shareholders. We believe the market should find the long-term cash flows and strong track record of our net lease platform quite attractive, but we don't expect to have any further information to share until sometime in the fourth quarter.

Based on the positive momentum in our business, we increased our dividend another 14% during the quarter and continue to look for ways to attractively deploy capital internally, externally, and in our own capital structure. With further asset monetization since the end of the quarter, we should be in a strong position to continue making accretive capital decisions.

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

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

Thanks, Jay, and good morning, everyone. Let me begin on Slide 3. During the second quarter, we made steady progress on our three-pronged strategy, which we laid out at the beginning of the year. First and foremost, we continue to scale SAFE and expand the ground lease ecosystem, seeing solid investment activity while growing our suite of products. At the same time, we are working with the investment community to help the market understand the value of the SAFE enterprise as it scales. Second, we continue to maintain a strong balance sheet, so we have the financial strength and flexibility to execute on our strategy.

During the quarter, Fitch recognized the improvement and upgraded our credit rating to BB, while S&P upgraded their credit outlook to stable. And finally, we saw momentum on the monetization of our legacy assets, began a process to explore interest in our net lease portfolio and raised our common stock dividend by 14% to an annualized $0.50 per share, all with the intent to simplify the business and shrink the gap between our view of intrinsic value and where the stock has been trading. Slide 4 provides more detail on SAFE's performance.

Second quarter was a solid quarter for SAFE. We closed on $222 million of ground leases and grew unrealized capital appreciation by $374 million. Safehold also expanded its suite of offerings in Q2 with the launch of Ground Lease Plus, a new innovative product, which provides customers with ground lease capital earlier in the life cycle of an asset. I'll discuss more about our Ground Lease Plus activity in a moment.

Safehold utilized its recently awarded investment-grade ratings for its successful debut on secured bond offering, in which it issued $400 million of 2.8% senior notes due 2031. The market value of our investment in SAFE, based on the June 30 closing price of $78.50 per share increased to nearly $2.8 billion, bringing our unrealized gain to $1.7 billion. On Slide 5, we provide an update on our legacy assets.

During the quarter, we sold legacy assets for $34 million of proceeds, generating a $2.5 million gain. In addition, you can see highlighted on the slide in green that subsequent to quarter end, we sold legacy assets for an additional $167 million of proceeds, which should generate an approximate $30 million gain in the third quarter. Also, as Jay mentioned, during the second quarter, we announced that we engaged Eastdil to explore market interest in our net lease portfolio. We are in the very early stages of this process.

Slide 6 summarizes our investment activity for the quarter. iStar invested a total of $163 million during the second quarter. This included $25 million of open market SAFE share purchases, $7 million of CapEx on legacy assets, and $20 million or 1.1 million shares of iStar stock buybacks. The Board has approved our stock buyback authorization to $50 million as of today. Also during the quarter, we invested $111 million in loans, net lease, and Ground Lease Plus. For our first Ground Lease Plus transactions, iStar originated two ground leases totaling $84 million on adjacent pre-development land parcels in the CBD of Austin, Texas. These ground leases also contain an additional conditional funding obligation of $166 million, bringing the total to $250 million. I would like to take a moment to describe our new Ground Lease Plus concept in a bit more detail.

As we have continued to evolve the modern ground lease space, we recognize that while our customers would benefit from efficient ground lease capital solutions for their pre-development assets, those same assets generally do not meet Safehold's investment criteria. The Ground Lease [Plus] (added by company after the call) product was designed to fill that void. In the Ground Lease Plus investment, iStar enters into two arrangements. The first is the origination of the ground lease with a third-party ground tenant, our customer; and the second is a purchase agreement with Safehold to acquire that ground lease at a future date. The ground lease provides for an initial investment from iStar and an additional upside obligation to provide construction funds for the proposed development. That upside obligation is conditioned upon our customer achieving certain development milestones within a defined time frame, which we refer to as being "shovel-ready" for vertical construction. The achievement of those development milestones also serves to qualify the asset for Safehold's investment and trigger Safehold's obligation to purchase the ground lease from iStar.

Our Ground Lease Plus product further evidences iStar's commitment to the ground lease ecosystem, and we believe creates a win-win-win. First, iStar is able to generate an attractive risk-adjusted return through a combination of ground rent and a gain on selling the asset to Safehold; second, SAFE obtains a pipeline of high-quality ground leases that meets its investment criteria. And finally, and most importantly, our customers benefit from our efficient 99-year ground lease capital earlier in the life cycle of their assets.

Turning to Slide 7 shows the makeup of our portfolio. At the end of the second quarter, our total portfolio stood at $6.5 billion. We continue to monetize our real estate financing, which is down by a net $79 million during the quarter and now represents $460 million or 7% of our portfolio. And pro forma for the sales we completed subsequent to the end of the quarter, our legacy asset balance is approximately 8% of our portfolio. Slide 8 details our earnings result.

We reported a net loss for the quarter of $19.5 million or loss of $0.27 per share compared to a net loss of $23.3 million or a loss of $0.31 per share in the same period last year. Adjusted earnings were $12 million or $0.15 per share, an improvement from a loss of $2.9 million or $0.04 per share in the prior year period.

Lastly, slide 9 shows our book value per share and illustrates the value created through Safehold, but not recognized in our reported financial statement. Including SAFE's mark-to-market value as of June 30, our book value per share stood at $29.59 per share at the end of the quarter and at $34.37 per share when adjusted for depreciation, amortization, and the CECL allowance. While we are pleased to see the stock momentum year-to-date, we also recognize we still have work to do as we believe there remains a gap between where the stock is trading and intrinsic value.

In conclusion, this quarter represented encouraging progress on our strategy with solid investment activity and innovation at SAFE and continued legacy asset monetization.

And with that, let me turn it back to Jay.

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

Great. Thanks, Marcos. I think with that details, the backdrop, it sounds like we can just go ahead and open it up for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Jade Rahmani with KBW.

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

Can you talk to which legacy assets were sold in the quarter and post quarter end, as you disclosed? And where are you seeing the most traction there? What do you think the outlook is in terms of timing of monetization of those assets? Has that accelerated at all?

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

Yes, Jade, I think we've been working on pretty diligently trying to work through the short-term assets. A couple sold in the quarter; a couple sold post quarter. Actually, some of the ones that we've spent a lot of time and a lot of management resources getting prepared for sale. So we're delighted to see those go. We got small parcels of land, some operating properties. You see in the deck, one of the long-term -- larger long-term assets. So we're making good progress across all fronts on that. It's been a time-consuming process. So each one that sells is a good day for us. We still got more to go, but the team continues to work on those assets. Really, at the end of our two-year plan, we think Asbury and Magnolia Green are the only two relevant assets. Asbury had another good quarter. Magnolia had another good quarter. So now they're tracking. They just happen to be on a longer lead time monetization schedule. So I think you'll see us continue to move through those short-term assets in the next 18 months. And then we'll have done a lot of good work at Asbury and Magnolia to put those on the same track longer term.

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

And so what was the third -- you said that one of the larger long-term assets, there was some progress on. Was that Grand Vista? Or which asset was that --

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

Yes, yes.

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

So that's been sold?

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

Yes.

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

Okay. I guess in terms of looking at the valuation of the company overall, you guys talk a lot about that in terms of the UCA, and even looking at iStar's earlier days, I think, the proponent of the discounted dividend model, what do you think the right way is to value iStar today? And do you believe that the value of the legacy assets post COVID has increased?

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

Yes. Look, we think the markers we put out in the market, Jade, are relevant. But obviously, the driving force for the last couple of years has been our investment in this ground lease creation. We think there's enormous upside. And we're still early in that game. I think as Marcos noted, we've done very well so far, but we have very high aspirations for what that business can be. When we look around and see what the dominant companies in all the sectors in real estate size-wise are, we've got a lot of good opportunity and white space ahead of us. So our mandates are really to grow that business. That's going to create enormous value given our shareholding position and our management contract. And at the same time, maximize the value as we see opportunities arise in our legacy assets and our non-core assets. So I don't think post COVID per se or even pre COVID we would have said legacy assets are the main event. They're not. Our asset management teams have done a great job working through those, and we're fortunate in many cases to generate gains, but you've heard me say over the years, there'll be winners, there'll be losers. We'll get our money out, we'll redeploy it, and that's really the main event. And so we're much more pleased, frankly, by the success we're having on the ground lease ecosystem business because that's the real driver of the business going forward and the fuel coming out of some of the legacy assets just gives us even more runway to build that business. I think with net lease, it's a little bit different. We see our JV with our partner. The investment period runs out later this year. So this was a natural time in any event. But we're also seeing a very strong bid for the kind of assets and the track record we've built up. So there's a natural interest on our part in terms of maximizing value to just see where the market is. So that made sense some point along the curve anyway, but we're seeing a very attractive market developing potentially for the kind of assets we own. We've had some very good news on our largest net lease tenant, Bowlero. So all of those things came together to make it a pretty easy decision to at least explore what might be possible there. And then as you know, the loan book is sort of running off on its own. Continue to see our customers do their thing, make their assets worth more. And maybe that's the one area where the post-COVID rebound has made the financing markets a lot more liquid, and our customers are taking advantage of some of that low-priced capital. So we have seen some payoffs there that have really been the result of a reopening of the real estate finance markets.

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

And on the equity side, do you expect a sale this year to happen? Or is it still very early in the exploratory process? And if it did happen, a question I get a lot from investors, does that accelerate a potential combination with SAFE in 2022?

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

Yes. A lot of good questions in there. First, this is an exploration. We have not committed to do any specific course of action. So we'll just take it one piece at a time. We think the market will like what we're going to show them, but no decisions can be made until we see how that goes, whether it makes more sense to do things in total or in pieces or in some other structured fashion. So let's see how that plays out. And then we'll turn our attention to how do we use what we learned from that to help maximize value in the remaining period of our two-year plan. We think there's going to be lots of options on the table, lots of opportunities, both within iStar and with Safehold to do some smart capital allocation. We think there is opportunities internally, externally, and in our own capital structure, but we're going to take it one step at a time, Jade, right now. This is a lot of good things happening, and we're going to let them play out, so we get the best information back. And then you'll see us come to you guys with a very thoughtful plan on how that might impact what we're going to do architecturally between SAFE and Star. We've said SAFE needs to scale a little bit larger to really have that conversation in the right way.

We've put out a marker. It should have north of $5 billion of ground leases in terms of its scale. So all these things are moving down the field nicely, but can't rush one or the other. So we're letting them all develop as the market gives us opportunities. And we think the net lease piece is a big piece, but SAFE scaling is also a big piece.

Operator

Our next question comes from Matthew Howlett with B. Riley.

Matthew Philip Howlett ***B. Riley Securities, Inc., Research Division - Senior Analyst***

Jay, just on the priority on capital deployment and capital allocation. You have a lot -- with the ground lease plus program now kicking in, you're obviously repurchasing stock and then potentially, say, there could be more investments at SAFE in the back half of the year. How are you thinking about capital allocation in the back half of the year? What's -- what do you -- how do you prioritize it?

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

Yes, we always started with, let's build a really strong balance sheet. We know there are good things happening in the company. And the last thing we want to do is, in any way, jeopardize that corridor of opportunity. So we started with the premise of keep the balance sheet really strong. I think Marcos mentioned some of the things that we've been working on that have been recognized by the agencies. Two is to look across the portfolio of opportunities. And we're trying to focus on things that are go-forward businesses and deemphasize things that we think are non-core. We've reached peak Asbury sometime last year. So we're seeing capital come out of that. We'll see the same thing in Magnolia Green relatively soon. The loan book is providing capital. So as that money comes in, Matt, you're exactly right, we look across where is iStar trading; where is Safehold trading; where are different parts of the capital structure; and then we look at externally, what can we do to create value, where are the accretive opportunities. And clearly, right now, we keep reemphasizing this, the ground lease is a massive opportunity. We have done a good job basically creating this modern ground lease industry, but we think there are a lot more legs to that story. You heard about one of them, ground lease plus. There are others we are working on thinking about with customers to make us the best longest-term capital available in the marketplace when it comes to the land under buildings. And I think that story is not yet fully recognized and not yet fully played out. So you'll see us continue to commit capital there. We think there's a lot of upside to that. We think iStar's still undervalued. We think SAFE is still undervalued on many, many metrics that we look at. So lots of places to put capital, and I think all of them are good choices, but we'll be thoughtful each time we have to make that decision, where is the one that moves the ball the furthest, or what's going to have the biggest impact. Ground lease right now is -- the story has been for the last couple of years. Different parts of the ground lease ecosystem that we have been experimenting with may turn out to be really attractive for capital allocation. But right now, the focus is scale Safehold; streamline this iStar balance sheet so we have really simple, clear directions in terms of where we want to deploy capital and how we want to deploy it; and set us up for 2022, so we can continue this value maximization journey. We set out -- gave ourselves two years. Our Board gave us a mandate, in two years let's see the value you've been creating recognized. We're six, seven months into that. So far, so good, but we've got a lot more work to do and a lot more opportunities to finish that story.

Matthew Philip Howlett ***B. Riley Securities, Inc., Research Division - Senior Analyst***

Just a follow-up on the streamlining of iStar's balance sheet. Part of I think of it is paying down debt. When I think about the net lease sale, do I think of most unsecured debt going with the sale being paid down with cash? And then you have that convert coming up next year. I'm assuming those are the two items, I mean, do you get both that debt off the balance sheet? iStar could really look a lot different to a lot of people and close that gap, as you mentioned. Just talk about the cadence for debt pay downs heading into '22.

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

Yes. Look, I think you're on the right path in terms of debt secured by our net lease assets will need to be taken care of. And a transaction would certainly accelerate that part of the process. We're liquid. We're strong. I think you're going to see continued liquidity coming out of that legacy book. Any net lease transactions would only add to that liquidity. So we do think there'll be opportunities to streamline not only the asset side of the balance sheet, but the liability side. But it's a little premature to go down any of those thought processes just yet. We're certainly looking forward to coming back in the fourth quarter and having a little more clarity. But this is the right moment for us to continue to push on some of these levers and the net lease lever is a big one.

Operator

Our next question comes from Stephen Laws with Raymond James.

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

Jay, I wanted to follow-up on the use of capital question from earlier. On the buyback, more shares than we've seen in the last couple of quarters, and you also announced an increase in the authorization. Is that coincidental? Or just given the kind of widening gap, it seems like we should expect to see a higher level of repurchase if the stock stays where it is.

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

Yes. -- over the years, you've seen us be a thoughtful and consistent buyer at prices we thought made a lot of sense for the company. We're prudent about it. We want to keep a strong balance sheet. It's one of our key pillars. We think the 6 million shares has been a solid bite, not anything crazy. As we build liquidity, as we build balance sheet strength, as we pay down debt, certainly, that number can move around a little bit. But right now, we're on the same steady path we've been on for several years. And so I think until factors change, that's kind of the path we want to stay on.

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

Great. And on the ground lease plus, can you give us some insight into how we should think about modeling that? Is it going to be carried held for investment at iStar, held for sale since that should go up? And so will you accrete some income into forecasted sale price? Or is it going to be cash flow with a big gain on sales? And how should we think about modeling the growth in that grounds plus on the iStar balance sheet?

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

Yes. I think because of the Safehold potential purchase of that ground lease is conditioned on a number of events. You can't assume it's going to happen with 100% probability. So until those conditions are met, and there is a transaction triggered, I don't think you'll see anything other than the rent coming in from the underlying tenant. So yes, at the end, when the transaction happens, there will be a pickup to iStar. But all you'll see now is it owns a ground lease on a great piece of dirt, and it has a very strong tenant. He's got a lot of money at risk, working very hard to get it into a position where it fits Safehold's very high-quality building parameters. And once that happens, then you'll see the full economic impact flow through.

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

What's the typical time it's going to need to season to reach that point? Is that 12 months or 36 months? Or kind of how do we think about when those gains start, what year we should start to see those roll in from this first ground lease plus investments?

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

I think each ground lease plus transaction will be unique, but for modeling purposes, you can assume somewhere between 24 to 48 months.

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

Great. Last question, Jay. Can you touch on just Bowlero and how that investment's going here in reopening? I think there was some news earlier this month that they may look to go public through a SPAC, whether that has any impact on your investment? And if so, what is that?

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

Yes. It's certainly one of the -- one of several positive events that took place in our net lease portfolio over the first six months of the year. That is a business that we felt very comfortable with long-term, which snapped back. It has done so. The SPAC transaction is an added bonus. I think it gives a currency to continue their business plan. They are one of the top experiential companies out there now. And certainly, they're getting a benefit from that. But the bottom line for us is we've owned those assets for a long, long time, well over a decade. We know the real estate underlying the business is very strong. So as the markets are reopening, we're seeing the benefits of that. But I think more importantly, as part of our portfolio, it's a very long-term, very well-constructed net lease asset. And I think when people really dig in, they're going to like what they see there.

Operator

(Operator Instructions) We have a follow-up question from Jade Rahmani with KBW.

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

Just a broader macro question. Curious if your thoughts around the New York office market have changed at all. Are you looking at deals in the New York office market? Are you inclined to participate in such deals? What are your thoughts there?

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

Yes, Jade. I'll start with the premise of we love New York as a market. We focus, first and foremost, on locations, whether they are office or otherwise. So we continue to be long-term believers in New York. New leadership coming in. We'll see how that goes. We think the long-term dynamics of a city like New York are places we want to invest in. We can't predict short-term dynamics. Certainly, office continues to have a rough road ahead of it. We think vaccination in New York is still pretty good. But post Labor Day is when we'll start to see how companies really adjust to this new, effectively either hybrid or more flexible, workplace. We know from our experience. We've been back in the office for almost a year now. We are far more productive in the office, but we can afford to be flexible. So I think that's the bet we would make is that offices will adapt. Companies will adapt. But they'll still need high-quality space where people can congregate and be creative. But there'll be a flexibility attached to it. So near term, I think the top landlords will start to figure out how to accommodate the needs of the post-COVID era. For us, it's -- that's less relevant. If you have great land under buildings, we want to talk to you. We think we can unlock value for you far better than any other solution. So we wouldn't shy away from those kind of transactions, Jade, but it starts with you have great land.

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

And I think Vornado, probably a couple of quarters ago, maybe it was last quarter, talked about some potential to bifurcate the company to separate out their land through a ground lease REIT. You -- on the Safehold side, anticipate the potential for any M&A transactions? I know in iStar's genesis, there were some interesting M&A transactions that accelerated the company's growth. I think you guys bought Lazard's Mezzanine business at one point. Anything on the M&A side, do you think that might accelerate SAFE trajectory toward that $5 billion gross asset number you put out?

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

We always love talking to forward-thinking folks. We do think this is a way to unlock significant value for shareholders. It's a new business. It's a new way to think. It will take a forward thinker to really come over to that kind of thinking with their entire portfolio. But I think there are going to be opportunities to work with all kinds of building owners, private, public, institutional, international. You've heard us talk about this, Jade, we think one plus one equals more than two. And eventually, real estate markets will look a lot more like what we see in the corporate sale-leaseback world, where it just makes a ton more sense to separate the operating business, which all of these top operators are great at that. They constantly think about highest and best use, how can I meet the customers' needs. I think in that same letter, Vornado talked a lot about every asset's a hospitality asset. Every asset is trying to figure out what a customer wants and needs and meet that need. We love that kind of thinking because we're in the same business. And we think our customers, these building owners, we want to provide them with what they need, whether its ground lease plus or a modern ground lease that unlocks value. Everything we do is to expand this market as fast as possible. And I think you'll see, at some point, the forward-thinkers will go first, and then everybody else will follow. And that seems to be the dynamic we're on right now.

Operator

(Operator Instructions) Mr. Fooks, we have no further questions.

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

Okay. Thank you. If anyone should have additional questions on today's earnings release, please feel free to contact me directly. Tiffany, would you please give the conference call replay instructions again? Thanks.

Operator

Thank you. Ladies and gentlemen, this conference will be available for replay after 1:00 p.m. Eastern Time today through August 17 at midnight. You may access the executive replay system at any time by dialing 1-866-207-1041 and entering the access code 2859281.

Those numbers again are 1-866-207-1041 with the access code 2859281. That does conclude our conference for today. Thank you for your participation, and you may now disconnect.