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## Q4 2021 iStar Inc Earnings Call

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## CORPORATE PARTICIPANTS

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**Jay S. Sugarman** *iStar Inc. - Executive Chairman & CEO*
**Marcos Alvarado** *iStar Inc. - President & CIO*

## CONFERENCE CALL PARTICIPANTS

**Jade Joseph Rahmani** *Keefe, Bruyette, & Woods, Inc., Research Division - Director*
**Matthew Philip Howlett** *B. Riley Securities, Inc., Research Division - Senior Research Analyst*
**Nathan Daniel Crossett** *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*
**Stephen Albert Laws** *Raymond James & Associates, Inc., Research Division - Research Analyst*

## PRESENTATION

**Operator**

Ladies and gentlemen, thank you for standing by. Good morning, and welcome to iStar's Fourth Quarter and Fiscal Year 2021 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.

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

Thank you, and good morning, everyone. Thank you for joining us today to review iStar's fourth quarter and fiscal year 2021 earnings. With me today are Jay Sugarman, Chairman and Chief Executive Officer; Marcos Alvarado, President and Chief Investment Officer; and Brett Asnas, our Chief Financial 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'll be a replay of the call beginning at 2:30 p.m. Eastern Time today. The replay is accessible on our website or by dialing 1 (866) 207-1041 with the confirmation code of 3597852.

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?

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

Thanks, Jason. Thanks to everyone for joining us today. iStar's fourth quarter was once again highlighted by progress on the plan we laid out at the beginning of last year. Excellent growth at Safehold and in the modern ground lease industry we created and ongoing success in monetizing nonground lease assets helped us deliver strong earnings results in the fourth quarter and for all of 2021.

GAAP net income of $0.11 per share and adjusted EPS of $0.87 per share in the fourth quarter helped drive full year GAAP earnings to $1.15 per share and adjusted EPS to $3.12 per share. The expected closing later this quarter of our recently announced agreement to sell our net lease platform sets us up nicely to deliver strong results again in 2022.

During the quarter, we continued to move out of noncore assets and redeploy the proceeds into our growing Ground Lease businesses. Monetized assets generated $140 million of capital with approximately half being redeployed either in the Safehold via share purchases or into ground lease adjacent business lines -- Ground Leases Plus and SAFEXSTAR leasehold loans where iStar can earn solid returns and help expand the market for ground leases. Capital freed up from the closing of the net lease sale should enable us to continue the strategy even as the pool of legacy assets becomes much smaller.

Progress at iStar was mirrored by strong progress at Safehold during the fourth quarter as well. Safehold added a record number of ground leases to its portfolio and recorded strong earnings growth, powering a 29% year-over-year increase in quarterly EPS. Other highlights of Safehold since the end of the year includes successfully placing its first 30-year unsecured bonds with several top-tier fixed income accounts and closing its first private offering of CARET units with top-tier venture capital, family office and sovereign wealth fund. While the market may not yet understand the importance of these milestones, we were very pleased both by the number of high-quality investors participating in both offerings and the execution of these key strategic initiatives well ahead of schedule.

As the year progresses, we'll highlight the value to iStar from the unique potential from CARET and the demonstrated principal safety, attractive growth rates and the inherent inflation protection built into SAFE's cash flow streams. And we remain confident the market will come to recognize the value of these key benefits over time.

With that, let me turn it over to Marcos to go into some more detail. Marcos?

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

Thanks, Jay, and good morning, everyone. Before we jump into the details, let me first say that we're excited to announce Brett Asnas' promotion to Chief Financial Officer. Many of you already know Brett since he's been with the company for a dozen years, most recently as our Head of Capital Markets. Brett and his team's innovation and execution have enabled us to strengthen the balance sheet at iStar and scale Safehold, and we are excited to see him build upon that success.

In addition, we promoted Theresa Ulyatt to Chief People Officer, reflecting the significant contributions she and her team have made in helping shape and drive a winning culture. iStar is a highly entrepreneurial business, and our people are our most important asset. Theresa has been pushing on key initiatives to maximize our firm's engagement so that we can deliver not just for our customers and shareholders, but also for our employees.

With that, let me begin on Slide 3. 2021 was a very strong year for iStar. We have made meaningful progress on our strategy of continuing to scale the ground lease ecosystem, simplifying the business through the monetization of non-core assets and strengthening our balance sheet. The goal being to shrink the gap between our view of the intrinsic value of the portfolio and where the stock had been trading, and ultimately, to focus on the growing ground lease ecosystem. We've continued to scale Safehold which originated $1.5 billion of ground leases over the past year, growing the portfolio by 48% to approximately $4.8 billion at year-end.

In addition, we also sold $483 million of non-core assets during 2021, including $140 million in the fourth quarter for a total annual net gain of $114 million. And subsequent to the end of the year, we signed a definitive agreement to sell our net lease portfolio and expect to realize a significant gain once that transaction closes. And while we still have work to do, we're pleased to see that the market has recognized this progress on our strategy with total shareholder returns for iStar of 78% for 2021.

Slide 4 details our earnings for the quarter and the year. Gains remain a material driver of our earnings. For the fourth quarter, iStar reported net income of $7.1 million or $0.11 per share. On an adjusted basis, we earned $68.9 million or $0.87 per share. And for the full year, we reported net income of $109 million or $1.51 per share, and on an adjusted basis, we earned $244.9 million or $3.12 per share. As a result of the definitive agreement we previously announced to sell our net lease portfolio, we moved all the assets and liabilities related to our net lease transaction to held for sale and the earnings associated with those assets show up on the P&L as discontinued operations.

Let me discuss the net lease transaction in a little more detail on Slide 5. We signed an agreement with Carlyle's Global Credit platform to sell our net lease portfolio for $3.07 billion, which is expected to close on or before March 29. After associated fees and expenses, we expect iStar's common shareholders to recognize an approximately $525 million positive net impact to net income and common equity, and approximately a $250 million positive impact in adjusted common equity. We recognized a net $40 million of expenses associated with the transaction in the fourth quarter. The offsetting balance of $565 million and $290 million, respectively, are expected to flow through our first quarter financials.

After distributions to our partners and repayment of our secured indebtedness, including prepayment fees and other transaction costs, the sale is expected to generate approximately $1.1 billion of net proceeds. In this earnings presentation on Slides 9 and 19, we have presented our portfolio and capital structure pro forma for this transaction.

Slide 6 provides more details on Safehold's performance. The fourth quarter was also very strong for SAFE. We closed on a record 17 ground leases totaling $777 million. Based on Safehold's closing price yesterday and our ownership at the end of the year, the market value of our investment in Safehold was $2.2 billion, totaling a $1 billion unrealized gain. Importantly, Safehold recently announced a transaction to sell 1.37% of authorized CARET units to a consortium of strategic investors for $21 million, implying a total CARET unit valuation of $1.75 billion. This initial CARET sale is a key first step and an important milestone in helping to unlock a full component of value within the portfolio. And we're excited to team up with this group of investors who can help Safehold realize on its full potential.

In connection with the sale, Safehold is obligated to seek to provide a public market listing of CARET within the next 2 years. If Safehold is unable to achieve a public market liquidity event at a value in excess of the investors basis, the investors would have the option to redeem their CARET units at their original purchase price.

On Slide 7, we provide an update on our legacy assets. During the fourth quarter, we sold legacy assets for $42 million of proceeds generating $34 million of gains, which has enabled us to continue to shrink and simplify the portfolio. Over the full year, our legacy portfolio has been reduced by 40% and now stands at $436 million. This is comprised of 11 short-term assets totaling $99 million with an average gross book value of $9 million per asset. We do not intend to make material additional investments in our short-term assets and our strategy is to monetize them in an orderly fashion. The 2 long-term legacy assets are Asbury Park, which has a gross book value of $229 million; and Magnolia Green, which has a gross book value of $108 million. While we continue to make progress selling Condos and Asbury Park and lot sales in Magnolia Green, there is no current plan to monetize these assets outright.

Slide 8 summarizes our investment activity for the quarter. iStar invested a total of $122 million during the fourth quarter. This included $43 million in Safehold through open market purchases; $40 million of portfolio investments, primarily through our new Ground Lease Plus opportunity as well as repurchasing approximately 1.2 million shares of iStar stock for $31 million at an average price of $24.68 per share.

Slide 9 shows the makeup of our portfolio. At the end of the year, our total portfolio stood at approximately $5.8 billion based on SAFE's market value as of February 23. You can see that we have highlighted the portion of the net lease portfolio, which is being sold to Carlyle. Pro forma for the net lease transaction, we have $192 million of net lease assets, which remain in our portfolio. $104 million of those assets are related to the ground lease ecosystem. And the remaining $88 million are comprised of 2 assets. One which is already sold during the first quarter and the other we presently have under a binding purchase and sale contract.

We continue to see repayments in our loan portfolio, which now stands at $386 million. In addition, during the quarter, we sold our strategic investment in Lineage Logistics for $98 million at a written-up basis, which reduced our total strategic investment balance down to $18 million at year-end. We ended the quarter with $340 million of cash on hand.

Lastly, Slide 10 shows our book value per share and illustrates the value created through Safehold, but not recognized in our reported financial statements. Including SAFE's mark-to-market value as of December 31, our book value per share stood at $19.58 at the end of the quarter and at $23.97 when adjusted for depreciation, amortization and the CECL allowance. Pro forma for the net lease transaction, those metrics are $26.82 per share and $27.69 per share, respectively. While we're pleased to have shrunk the value gap between today's market value and where we see intrinsic value, we also recognize that we still have work to do.

In conclusion, iStar has made significant progress on our strategy throughout 2021, continuing to simplify our business, reducing legacy assets and strengthening our balance sheet. Additionally, Safehold has seen strong investment momentum bringing its portfolio to nearly $5 billion. And the recent sale of CARET units was the first important step in continuing to unlock the value of the SAFE platform.

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

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

Thanks, Marcos. Obviously, the net lease sale will be a major event, will generate sizable earnings and liquidity for iStar. And once that closes, our focus will be even more intent on building the ground -- modern ground lease industry and executing ground lease-related investments. Just to reiterate, our 2022 goals are straightforward. We want to continue scaling the ground lease ecosystem and really see the full value realized for iStar shareholders while continuing to simplify and strengthen our balance sheet along the way.

Okay. Operator, let's go ahead and open up the line.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) And our first question is from Nate Crossett with Berenberg.

**Nathan Daniel Crossett** ***Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst***

Just a couple of general questions, I guess. I was wondering if you could just give an update on the Ground Lease Plus program. What does the kind of pipeline looks like for that right now? Where are you seeing the most opportunities?

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

Nate, it's Marcos. As you know, we've -- from the Safehold earnings call, the Ground Lease Plus program has been lucrative for both companies. It's led to 6 forward transactions for SAFE and 4 investments for STAR. The team is extremely proactive on starting to market and push the product with our customers. And so we're optimistic about the growth prospects in '22 for Ground Lease Plus.

**Nathan Daniel Crossett** ***Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst***

Okay. And maybe just kind of a follow-up from the SAFE call just on pricing. I think on that call, you kind of mentioned that the pricing outlook for this year was similar to what we've seen the last maybe 6 months. And I'm just curious if you can maybe speak to your guys' ability to push price just with funding costs going up? Like what kind of leverage do you have in that respect?

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

Nate, I think we still like that structure we've talked about in the past, trying to generate ROEs 100 basis points over our average cost of funds, I think we've got about a 23-, 24-year weighted average life. So that's a metric we continue to focus on. Obviously, if the world events change the dynamic in the rates market and financing costs change across the board for customers, we can be responsive to that. It too early to tell exactly where things are going to shake out here given the volatility. But certainly, we continue to compete against the broader financing markets. And if those markets widen, it certainly does give us some opportunities to be consistent with our policy.

**Operator**

And next, we have a question from Stephen Laws with Raymond James.

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

Marcos, first, I appreciate the details on the assets you ran through Asbury, Magnolia Green and the remaining net lease. Can you touch on the real estate finance book? I know about half of that is shorter duration, first mortgage, the other half, maybe some longer duration NPLs and other such. Can you talk about the outlook there? And any plans to dispose of those assets?

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

Thanks, Stephen. Yes, it's -- as we've mentioned, the portfolio is winding down nicely, and we continue to make investments in the leasehold loan and ground lease ecosystem and recycling those proceeds. So as you pointed out, most of the balance is first mortgages. There's about $190 million with a very short duration less than a year. And then there's about $13 million of mezzanine sub debt, which is actually associated with something in the ground lease ecosystem. And as we reported in the past, there's one NPL associated with the retail entertainment assets -- overall duration is pretty short.

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

Okay. Great. Appreciate the color on that. And Jay, looking at the large amount of cash, can you talk about your plans for that as the corporate debt more stock repurchases or investments in SAFE? How do you plan to allocate the $1 billion plus of cash?

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

Yes. We wanted to have a lot of liquidity coming into this year, Stephen. Again, we're looking to close the net lease sale by the end of the first quarter, which will give us a good launching pad for the rest of the year. I think there are going to be opportunities in the ground lease space, where we can use that capital. But we also think it who's -- iStar to continue to simplify the story, clean up the balance sheet where appropriate. So we're not in a lot of rush to spend the money until that transaction closes, but I think we'll stick to the sort of the core pillars of our strategy. We see a lot more opportunity coming in the ground lease space. I think volatility actually in some ways will help that business continue to prove its value to the customer base we target. And then I think with iStar's balance sheet, I think there are places whereas we transition from higher-risk assets to lower risk assets, perhaps that cost of capital is no longer appropriate. So we'll be looking at ways to use that capital profitably for shareholders, but we haven't made those decisions yet.

**Operator**

And next, we have a question from Jade Rahmani with KBW.

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

I had a follow-up to Steve's question. Typically in merger situations or internalizations between managed entities and the related manager affiliate, we see that oftentimes the -- externally advised company buys out the management contract, either in the form of cash or shares. This situation is very different where iStar owns around 65% of SAFE, and we'll be sitting on substantial cash position. Is that a scenario under which iStar entertains acquiring the 35% of SAFE that it doesn't currently own? Or more likely should we anticipate the [access] liquidity to be used to pay down debt, simplify the company thereby paving the way for a more traditional merger of equals type combination?

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

Jade, look, I think you know both boards have strong independent director representation. We said before, we think once SAFE reaches scale, the independent directors of Safehold will certainly want to take a look at the external management structure. We would assume iStar continues to want to unlock the maximum value at Safehold. So we think there can be a constructive conversation. It's just too early to -- there's been no conversations between the company. We're not going to speculate on who does what to whom and how. But I think, again, the principle here is there's been a great architecture in place. Strong independent directors can look and decide whether there's union better one and both parties would benefit if they get it right.

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

And in terms of the triggering point, I believe it's fair to say that the reason investors and analysts are talking about this is it's a story that the management team has been putting out there of a potential combination. What would be the triggering point or event that causes such a transaction to be contemplated? Is it yourselves as management in both iStar and SAFE deciding that this is the right time, and thereby, that would send motion the chain of events or something else?

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

Yes. We -- as management, our job is to figure out how to create the most value possible, and that's what we'll continue to do and share those business strategies with both boards. So it's too early to tell exactly how they will factor in everything we told and we believe in, Jade. So ultimately, as the independent directors will take control of that thought process. It can't really come from us.

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

Okay. Beyond the first quarter, substantial gain anticipated, should we anticipate the rest of 2022 to be around a breakeven year from an earnings perspective, just looking at the income statement and removing the operating lease income, the real estate expenses and interest expense associated with that, it's somewhere around breakeven reasonable?

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

Yes. Look, I think obviously, the net lease sale is going to generate some substantial gains. But net of that, how we deploy the capital, how quickly we deploy the capital will drive the ultimate answer. We think there's attractive returns to be had in some of these ground lease adjacent businesses. We think there's some things in terms of our cost of capital that should change as we transition from higher beta assets to lower beta assets and that process is going to be a transition. So I can't give you an exact answer this early in the year, but we certainly have a business plan that is going to take advantage of those opportunities.

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

I wanted to ask about what you're seeing in terms of competition on the ground lease side and also how the cost of capital in that business might be changing? A REIT I cover by the name of NexPoint originated to convert to a ground lease private REIT, and they [cited] an estimated yield on this convert of 9%. So not the equity return that the private REIT is looking to achieve but some piece of the capital structure. So I suppose the question would be, have you seen any changes in the competitive dynamic playing out? Was this perhaps a situation that SAFE looked at? I'm sure it was. And have you seen any changes in cost of capital in the ground lease space?

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

Jade, I don't think the competitive dynamic has changed at all quarter-over-quarter or year-over-year. Our primary competition is still the regular-way finance market. And so long as we're providing more efficient capital solutions than that efficient marketplace, I think we're going to get our fair share. There have been some nascent pop-ups. I think the one you're citing is one of them. We think that's a good thing for the overall market. They're sort of doing marketing and branding for us, unlocking new customers. And as we sit with our position as the most experienced group with the best cost of capital. The only unsecured borrower, we can tailor these flexible solutions and ultimately drive value for our customers. So I like the competitive dynamic today.

**Operator**

And our next question is from Matthew Howlett with B. Riley.

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

Can I ask a question about dividends and there's an NOL at STAR but clearly, the sale is going to generate a very big cash flow gain. Can you just talk a little bit about expectations on dividends for 2022?

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

Yes. I think at this point, we will have a chance through the net lease sale to utilize a lot of our NOLs, which is a good thing. If there's incremental taxable gains above that, there could be a possibility of something later in the year. Again, a little bit too early to say. But certainly, it's something I think we'll be looking at throughout the year just in terms of how fast we're deploying capital and some of the other taxable impacts from some of the other transactions in the book.

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

How about the NOL currently?

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

Reaching around $600 million at the end of the year. I don't have a final number for you, but I think we've got it in our K. So...

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

Got you. Okay. And then just on subject of taxable gains. I mean the land sales are coming down much higher than I would have thought. You've said in the past, there'll be some winners and some losers and sort of do assumed book on the remaining assets. Should we look at that differently now, particularly with the appreciation in home and presumably Asbury Park and Magnolia and the short-term assets you have left?

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

Yes. Again, we think it's getting down to a small enough number, plus or minus, but we're still not going to add it to the pile or take away from the pile. We think it's sort of a rounding error. Yes, there's some good things going in the market. But as we saw this thing, we're not projecting perfect outcomes in all of our assets. So I think we'll stick with what we think is the previous position, which is we're going to be able to monetize those and deploy them into a lot more attractive assets. But I wouldn't count on a large gain that could change the equation.

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

Got you. And then -- last question, I just want to ask one more time on use of capital with the proceeds. I mean, you're buying back stock, you're obviously buying back SAFE shares in the open market. You did [bold] and obviously, you could pay down some debt. Just talk about what -- how do you prioritize those 3? Do you look at SAFE as being still great investment? Would you put more capital into it if it asked for it? And clearly, you still intend to buy more STAR accelerating maybe the share repurchase program once the proceeds come in? And then maybe just one more thing on the debt. What corporate debt in terms of make-whole premiums? What steps down that you could pay off what doesn't yield maintenance require it?

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

Yes. I think you've touched on an important point, which is a lot of our debt outstanding unsecured bonds have pretty full yield maintenance. So not a lot of benefit to paying them down early. Of the [26s], we'll have a step down in their prepay later in the year, I think it's in August. So that might be something where we can lower our cost of capital. We'll look at all parts of the capital structure as we always do whether that includes equity on both companies and other parts of STAR's capital structure. I think we got to get the deal closed first. That's been our first priority. I think we're in good shape on that. But -- once you see sort of that capital sit on the balance sheet, we're going to be thoughtful with it. Things that add enterprise value probably have more value to us. Things that just [retire] cost structures are interesting, and we have reauthorized the $50 million buyback at STAR. So we certainly have the capacity -- we'll have the capacity to focus on undervalued opportunities in our own capital structures.

**Operator**

And Mr. Fooks, we have no further questions.

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

Okay. Great. Well, thank you. If you should have any additional questions on today's earnings release, please feel free to contact me directly. Leah, would you please give the conference call replay instructions once again? Thanks.

**Operator**

Certainly. Ladies and gentlemen, starting at 2:30 p.m. Eastern Time today through March 10 at midnight, you may access the replay service at any time by dialing 1 (866) 207-1041 and use the access code 3597842. And that does conclude your conference for today. Thank you for your participation and for using AT&T Teleconference service. You may now disconnect.