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Safehold Inc.

Fourth Quarter 2018 Earnings Call

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CONFERENCE CALL PARTICIPANTS

Anthony Paolone, *JP Morgan*

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Jade Rahmani, *KBW*

Joshua Dennerlein, *Bank of America Merrill Lynch*

John Massocca, *Ladenburg Thalmann*

PRESENTATION

Operator:

Good morning and welcome to Safehold's Fourth Quarter and Fiscal Year 2018 Earnings Conference Call. If you need assistance during today's call, please press star, zero. As a reminder, today's conference is being recorded.

At this time, for opening remarks and introductions, I would like to turn the conference over to Jason Fooks, Vice President of Investor Relations and Marketing. Please go ahead, sir.

Jason Fooks:

Good morning everyone, and thank you for joining us today on Safehold's Earnings Call. With me today are Jay Sugarman, Chairman and Chief Executive Officer; Andy Richardson, Chief Financial Officer, and Marcos Alvarado, President and Chief Investment Officer.

This morning we plan to walk through a presentation that details our results for the fourth quarter and fiscal year 2018. The corresponding presentation can be found on our website at our new website at safeholdinc.com, and by clicking on the Investor Relations link. There'll be a replay of this conference call beginning at 1:00 pm Eastern Time today. The dial-in for the replay is 800-585-8367 with a confirmation code of 4794594.

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

Now, with that, let's turn the call over to our Chairman and CEO, Jay Sugarman:. Jay?

Jay Sugarman:

Thanks, Jason. 2018 was an important year for our company. We grew our portfolio by almost 80%, we expanded into six new markets, and we accelerated our efforts to get our message out to the market. As pioneers in reinventing the ground lease sector, we continue to find attractive new markets to explore and multiple ways to deliver the benefits of our more efficient capital to our customers, whether they are acquiring properties, building properties or recapitalizing properties.

In 2019, our goal is simple and clear, to revolutionize real Estate ownership in this country. A modern ground lease that is tailored to be leasehold lender friendly and cap rate-neutral can increase the building owner's returns and reduce their maturity and interest rate risk. This is no longer a theory; it is proving a powerful competitive advantage in the marketplace and is leading to significant repeat customer business in the office and multi-family sectors and interest from across all property types.

Recognizing the importance of this moment, we are taking several steps to accelerate our progress. First, we're making clear our mission to revolutionize real estate ownership by giving our customers a new and better way to unlock the value of the land beneath their buildings. We are reaching out and explaining these benefits to everyone in our extensive network; that includes top brokers, a wide range of real estate financing sources, and specifically the owners, operators and developers of high quality real state around the country who have the most to gain from our innovative strategy.

Second, we are changing our name. We are now Safehold. It is what we are and what we do. While our previous name emphasized the very real benefits our business can deliver to shareholders, our new name better explains what we can do for our customers: create a safe and efficient way to unlock the value of their land and hold it quietly and securely while they execute the business plan for their building. The bottom line is, a well-structured, modern ground lease, what we call as Safehold gives property owners an opportunity to maximize the returns while reducing the risk.

We also have a new logo, graphically showing how we are breaking out of the box of limited conventional thinking by reinventing what ground leases are, and giving owners a more modern, more efficient way to capitalize their property.

Third, we are expanding our relationship with our largest shareholder and investment manager, iStar. We believe the combination of iStar's historical strength in finance and net lease together with our growing ground lease expertise can create a unique one-stop shop offering that will prove superior in many situations and help accelerate our growth. We have already seen this SAFE-Star combination create new opportunities to land attractive transactions.

We also closed another round of equity capital from iStar, giving us the firepower to expand our pipeline and our resources for pursuing deals. Raising $250 million at a premium to the screen demonstrated both sides' significant belief in the future growth prospects of Safehold, and a new management agreement better aligns incentives for reaching our aggressive growth targets. The capital support of iStar ensures we can scale while we continue to educate our future shareholder base of what we are building.

Each of the steps positions us to execute our strategy on a bigger scale across more markets and help more property owner's access our modern capital solution.

Fourth and finally, we are also expanding our outreach to the shareholder and lending communities. As Andy will outline, we continue to make progress highlighting our high-grade asset base and its superior credit metrics to lenders, and with the new accounting rules more actually portraying the lifetime economics of our income streams, we believe GAAP income will become a simple and far easier way to share our economic model with investors across a range of investment styles and disciplines, and help call attention to our significant growth rate.

As we've said before, we think this is a business that pays a very safe dividend, can grow earnings at high rates, and can capture long-term value in a unique way. It's our job to help others see what we see and all of these steps should help us do that.

Now, let me turn it over to Andy to go through the quarter and year-end results. Andy?

Andy Richardson:

Thank you, Jay, and good morning everyone. Let me continue with Slide 6. For the quarter, net income was $0.24 per share versus a loss of $0.07 for the fourth quarter last year. FFO was $0.36 per share versus $0.05 in the prior year period, and AFFO was $0.09 per share versus $0.06 in the prior year period. For the year, this brought net income to $0.64 per share, FFO to a $1.15 per share and AFFO to $0.63 per share. Because we formed the company midway through 2017, the full year-over-year comparison is not meaningful.

Our quarter was highlighted by strong quarter-over-quarter investment volume, and an investment of new equity capital from our manager received after year -end that provides us with runway for growth.

Let's turn to Slide 7, to discuss this quarter's investment activity.

For the quarter, we closed $178 million of new investments, growing our aggregate portfolio to $948 million, a 23% increase from the third quarter, and almost tripling in size since our IPO. You can see the key investment metrics on the safeholds we originated in Q4 toward the bottom half of the slide. We are earning a 5.6% effective yield with AAA-like credit metrics of 3.2 times coverage and a cost basis of 41% of the combined property value. These investments also included periodic CPI look backs to provide additional potential upside to our effective return.

Slide 8 describes this quarter's investments in some additional detail. Most noteworthy, we originated a safehold on 1111 Pennsylvania Avenue in Washington D.C., a trophy office building that is fully occupied by global law firm Morgan Lewis & Bockius. This $150 million investment represents the largest single asset in the portfolio and further demonstrates that Safehold can provide better capital to its customers on any scale. Washington D.C. continues to be a strong MSA for us with approximately $300 million of deals closed in the market to-date.

Our second investment for the quarter expanded Safehold's geographic footprint with our first deal in Nashville. We created a safehold underlying a 275-unit Class A multi-family building located in Novel Music Row, a vibrant submarket of Nashville, marking the second deal we have completed with this customer. We remain enthusiastic about our continued ability to penetrate the multi-family segment while continuing to expand into new core markets.

Moving to Slide 9, along with announcing SAFE's rebrand, we're also introducing the SAFE/STAR one-stop capital program that is a direct result of Safehold's aligned relationship with iStar. This platform combines iStar's 25 years of financing expertise and innovative thinking, along with Safehold's unique product, in order to provide our customers with a one-stop capital solution. With both companies operating in tandem, this powerful program delivers an efficient capital structure to customers seeking flexibility and simplicity.

An excellent example of the SAFE/STAR program is the deal we recently closed in Washington D.C., shown on the slide. Safehold provided the capital to create a new ground lease on the property and iStar provided the first mortgage leasehold loan. With this structure, we can deliver to customers an efficient capital solution with certainty and ease of having the whole envelope structured in one place, significantly expediting the pathway to closing.

Turning to Slide 10, as previously announced, on January 2nd, iStar made an additional $250 million equity investment in Safehold valued at a price equivalent to $20 per share, an attractive premium to the market price of our stock. This investment provides Safehold with fresh capital to pursue approximately $750 million of new deals, assuming our targeted 2:1 debt-to-equity ratio. The investment was structured as a purchase of 12.5 million limited partnership units that will be exchanged for common stock on a one-for-one basis subject to shareholder approval. iStar's ownership now represents approximately 65% of our total equity. However, it should be noted that iStar’s discretionary voting power will be capped at 41.9%.

In conjunction with this investment, our independent directors approved an amendment to the management agreement with iStar. The key changes to the agreement, which we believe creates increased alignment with our manager, are summarized on the slide.

Lastly, SAFE's Board approved iStar's request to increase its common stock ownership limitation to 43.9% from 41.9%, allowing it to make additional open market purchases of up to 366,000 shares.

Slides 12 and 13 show the diversification in our portfolio. Washington D.C. has now become our largest MSA and the map includes Safehold's expansion into Nashville.

In Slide 14, we have highlighted the portfolio of properties for which we own the ground lease. Our ground leases underlie nearly 7.2 million square feet of real estate, including over 2,800 hotel rooms and 2,600 multi-family units.

Slide 15 details key metrics of our portfolio. Annualized GAAP revenue, which takes into account straight line rent, totaled $70.6 million at the end of the fourth quarter. Net of depreciation and amortization, our portfolio yields 6.9% on a GAAP basis. Annual cash flow of the buildings sitting on top of our land covers our annual cash rent by 4.5 times, and our total cost basis represents about 35% of the combined property value which we believe to be compelling measures of safety in our investments. Comparatively, the average AAA loan-to-value in commercial mortgage backed securities is approximately 38% to 42%.

Slide 16 delivers an update on Value Bank. During the fourth quarter, Value Bank grew to $1.8 billion, representing a 15% increase from the third quarter and 65% from a year ago. As a reminder, Value Bank represents today's estimated market value of the buildings that we may receive in the future because typically embedded in our investments are reversionary rights of the buildings and improvements at the lease expiration.

Moving to Slide 18, I will review our debt and leverage. During the fourth quarter, we closed a 10-year $79 million non-recourse senior secured loan that was tailored to meet the unique attributes of our assets. The loan has an initial effective rate of 3.91% which increases 2% annually, in line with the rent bumps of the investment that collateralize it. The all-in effective rate is 4.25% and is interest-only for the entire 10-year term. It was collateralized by seven assets and represents a 60% advance rate against base investment basis in the collateral. In addition, it provides for asset addition and substitution flexibility.

In addition, we continue to have $227 million of long-term fixed rate debt in 2027, secured by our initial $340 million portfolio and $71 million of asset-specific debt against our Hollywood investments. We drew $96 million on a revolver during the quarter to fund investment activity, bringing the outstanding balance on our revolver to $170 million at December 31. The revolver was fully repaid after year-end using the proceeds from iStar's equity investment.

Slide 19 continues to outline the interest rate hedges sufficient to allow protected two times leverage on the existing portfolio.

Finally, on Slide 20, I would like to discuss how we will be reporting our metrics going forward. We expect that after the adoption of new lease accounting standards beginning January 1 of this year, nearly all of our newly originated safeholds will be classified as sales type leases rather than operating leases. These leases will be recorded on our balance sheet as a net investment in lease rather than as land. We will recognize income from these leases in a revenue line item called interest income from sales type leases. This amount will be computed similar to how an effective interest or effective yield is computed on a bond using contractual future cash flows and a residual value equal to our cost of the land. The difference between the effective yield, or what GAAP refers to as the rate implicit in the lease, and current period cash received is recorded as amortization which increases or decreases the net investment in lease balance sheet accounts.

We believe that the GAAP treatment of these leases under the new accounting standards captures many of the fixed income-like aspects of our business, such that AFFO and FFO will be of less utility as supplemental measures going forward. Already under GAAP, we use a similar method to record interest expense on our debt. Consequently, we believe the new GAAP yields recorded on our assets and debt obligations will be more comparable and that GAAP net income will be more indicative of our operating performance as a high-grade fixed income investment business.

In conclusion, we are encouraged and confident based on the progress we've made to-date, but as we rollout the new brand we are even more excited about the possibilities ahead.

With that, I'll turn it back to Jay.

Jay Sugarman:

Thanks, Andy. I know there's a lot there to unpack so we're just going to go ahead and open it up for questions. Operator?

Operator:

Thank you. Today's question and answer session will be conducted electronically. To ask a question, please press star, one at this time. We will take as many questions as time permits. Once again, please press star, one to ask a question. We will pause a moment to assemble the roster.

Your first question comes from Anthony Paolone with JPMorgan. Your line is open.

Anthony Paolone:

Thanks. Good morning. I guess we'll jump into some of this accounting because I think that's interesting. If we think about that effective yield is that I mean if your residual is the same as your base, is that effectively like the straight line yield that we've been accustomed to in the past? Is there much difference there?

Andy Richardson:

Yes, it's really more like a bond where we assume we do receive par back at the end, so we're not increasing the back end values at all. It's really capturing the cash flow stream, and assume your investment in and your principal receipt at the end out is the same number, so it really is very much like bond accounting.

Jay Sugarman:

Andy, did you say it was like an IRR?

Anthony Paolone:

Yes.

Jay Sugarman:

Yes, that's correct. That's exactly what it is.

Anthony Paolone:

Will you still be able to provide us like some sense of going in cash- on-cash and will the GAAP accounting loss to see what those cash numbers are, just to understand things like liquidity and dividend coverage and so forth?

Andy Richardson:

Yes, we will talk about cash yield as well, but again I think what we like about the effective interest effective yield is given the high quality of the assets, it's very much like a AAA bond that you can buy at a discount. The effective yield really does capture the true value but will also provide us a running cash yield as well.

Anthony Paolone:

Okay, so then going to a GAAP EPS type number, does that also mean there won't be any adjustments for non-cash compensation or the amortization of debt costs and so forth?

Andy Richardson:

We're going to make it really simple for you – no adjustments.

Anthony Paolone:

Okay, got it. Perhaps maybe on a more economic side, can you talk a little bit about the pipeline, cadence, deal flow maybe, to expect the next few quarters and returns on those?

Jay Sugarman:

Sure. I think our goal right now is as you heard throughout today's comments is to really accelerate the growth. In some respects, we're really through the beta phase of the business and we're now really in the execution phase. I think generically we have targets this year of about $750 million in new ground leases and up, so that's a good number to be thinking about as we try to work our way through these early quarters and then really build towards a much faster growth rate. Right now we feel like getting our message out into new markets, across the top 25 target markets is really critical, so we've got people in the field working on building those relationships, but we feel pretty good about what we see in the pipeline.

Right now, we are still having to educate in some of the new markets, but in markets we've already executed in we're starting to take calls from people who have seen what we're doing, have seen their peers, and competitors frankly, win deals by using the structure. We do think the pipeline feels pretty good in terms of the number of calls we're fielding and the number of places we're engaged.

Anthony Paolone:

Okay. Then just a last question, on the SAFE/STAR one-stop program, I know it's pretty customized per deal, but can you maybe give us a rough sketch as to what does that mean to a sponsor in terms of thinking about your total proceeds versus maybe going after more conventional financing, and also maybe what is the branded sort of carrier rate, if you will, if you were to combine the ground lease plus whatever financing package Star may provide again in comparison to something a bit more traditional?

Jay Sugarman:

Yes, I like the way you put that. It is a flexible structure, so what we're seeing is folks who are a little bit hedging on where interest rates are going, they like the fixed rate nature of the ground lease. They also are willing to work on the leasehold on a floating rate basis if they have a shorter term hold period. So, they can kind of custom tailor what they need for their business plan.

What we find interesting is we don't walk in and say, 'This is what we do.' We walk in and say, 'What is your business plan, and what are your financing alternatives? We think we can beat them.' We can either provide the same proceeds in a better structure, lower cost, less maturity risk, or in some cases we can provide more proceeds so they can generate higher returns on whatever capital plans they have.

Again, it's really a customer-centric business, which is the key. I don't think anybody ever thinks of the ground lease business as customer-centric. We're going to build a business that much like the other businesses we've built in our past at iStar that really respond to what the customers need and create a better alternative for them. Sometimes it will be lower cost capital, sometimes it will be lower cost and more proceeds, sometimes it will be more proceeds. But it gives them the ability to really match their capital needs in a way more efficient way than just taking down a single sort of conventional financing.

Anthony Paolone:

Okay. Thank you.

Operator:

Your next question comes from Collin Mings with Raymond James. Your line is open.

Collin Mings:

Thank you. Good morning guys.

Jay Sugarman:

Good morning.

Andy Richardson:

Good morning.

Collin Mings:

First, just going back to the announcement last month, can you just discuss in a bit more detail the trade-offs that the Board contemplated, taking more capital from iStar with making the management agreement more complicated and higher cost to safety?

Jay Sugarman:

Yes, I think it's a little bit of two independent decisions. One, from a capital standpoint it was attractively priced capital, obviously given where the public screen was and where our advisers thought you could do an execution in a more widely distributed fashion. We had a nice meeting of the minds; iStar believes strongly in the business and SAFE has a pipeline that represents what we think is a very attractive future business opportunity, so that piece of the trade made a lot of sense for both parties.

On the management agreement, we start with the fundamental premise of what do we want to achieve? What is the incentive we want to create? If scale is the critical factor and we fundamentally believe once we reach scale, people will start to see what we see, we wanted to create proper incentives to invest now, far beyond what the management fees themselves would justify, to create this future of a much bigger, much more scaled business. We would argue that the costs upfront here need to be viewed as investments and they need to be some prospect of over-investing early and seeing the returns later. So, we're spending a lot of time and effort upfront to make this business grow. We wanted to create a management agreement that is aligned with that scaling growth target. I actually think it's a better aligned management agreement.

It has no impact unless we scale. Once we can get the equity base of this company above $1.5 billion, there's really no change. It's really meant to help us do what we laid out this morning which is take this new, more efficient capital structure to the market, in as many places as we can as fast as we can and have all the resources available to us to do that, both capital resources and intellectual property resources.

Collin Mings:

Okay, that’s helpful color there. Then going back to Anthony's question, just on the deal pipeline, I may have missed it but I didn't see the pipeline spot that you included in prior quarters. Can you maybe put a finer point on kind of quantifying where the pipeline stands? Then maybe any sort of notable property mix shift since last quarter, just as you look at kind of what you're going through right now, either through LOI or some of level of negotiations?

Marcos Alvarado:

Sure. Hey, it's Marcos Alvarado:. In Q1 already we've closed four transactions totaling $62 million in safeholds. We have another approximately $160 million across three transactions—excuse me, $95 million that totals approximately $160 million that we expect to close in Q1, and the cumulative pipeline is approximately $300 million.

Collin Mings:

Okay, that’s helpful. Then just as far as the property type mix, any sort of bias? I know obviously there’s been momentum, if you will, with the Company with trying to do a little bit more on multi-family side, but just if you can kind of walk us through where that mix stands as you think about the pipeline now?

Marcos Alvarado:

It's consistent with our strategy of creating a diversified asset base in broader markets. One of the closings that already occurred is in a new top 25 market which we're excited about. There's a few office assets and a few multi-family assets and one hospitality asset.

Collin Mings:

Okay. Very helpful color. One last one and then I'll turn it over. Maybe just a little bit bigger picture, just as we think about today's announcement and accounting changes, and the decision to move away from communicating FFO or AFFO metrics. How do you think or how does the potential reception from the REIT community and just having kind of a different metrics, if you will, for this company factor into your thinking of kind of moving away from that decision?

Marcos Alvarado:

Well, in many respects we're a very different company than anything else in the sector, and so we fundamentally believe it's not only appropriate for our real estate followers to understand the business and what it does, but also much wider range growth, growth in income. The financial sector should all be paying attention because we think we offer a combination of very safe dividends, very high growth rate potential, very large market opportunity. We think the strategies and disciplines that will be attracted to that combination go well beyond just the REIT sector. That's our tax classification, but we do think there's a much wider audience that will be it attracted to those unique benefits.

We'll try to continue to communicate within the real estate community why this is so special. It's really unlike anything that we've seen, but also expand that well beyond just dedicated core real estate investors to a much wider audience that's looking for growth, that's looking for safety, that's looking for long-term capital appreciation. We continue to believe this is a unique opportunity for lots of different types of investors to really find something that we hear very often from shareholders that they're looking for.

Collin Mings:

Okay. I'll turn it over. I appreciate the thoughts there.

Operator:

Your next question comes from Jade Rahmani with KBW. Your line is open.

Jade Rahmani:

Thanks very much. In terms of the accounting change, does it effectively incorporate future anticipated rent growths and smooth it over time to calculate an effective yield?

Jay Sugarman:

Hey Jade, it only uses contractual growth that's built into the leases, so it would not include anything that is not estimable or contractually stipulated in the lease.

Jade Rahmani:

Okay. Will dividend policy be based on cash flow or GAAP earnings?

Andy Richardson:

Primarily cash. We think the economic model will support more flexibility than being 100% rigid to that metric, but right now you'll see it track cash.

Jade Rahmani:

Okay. What are your expectations for SAFE's dividend growth? Will it track and rent escalations that are contractual in the portfolio, and so it's reasonable to anticipate some growth in 2019?

Andy Richardson:

I would tell you it's not our core metric. Unfortunately, we're old bond guys and fixed income investors. If we can take our money and reinvest it in high rates of return, we think that if you're creating excess return on a credit quality that we think we are creating, we want to keep that money working and compounding at those high rates of return. Our metric is are we creating a lot of value above and beyond a market level for our credit exposure? As long as we do that, dividend growth will happen but it won't be our primary emphasis.

Jade Rahmani:

Okay. If cash is less than GAAP, will you finance the difference through leverage? Will that ultimately depress book value to the extent that dividends run ahead of cash?

Andy Richardson:

Yeah, as I said, I think cash will track—dividends will track cash, so we don't expect any material situation like you're outlining.

Jade Rahmani:

Okay. Looking at the balance sheet, there is some accumulated depreciation and I don't believe land is depreciated. What's the source of that?

Jay Sugarman:

That's primarily related to the hotel portfolio, the Park Hotel portfolio.

Andy Richardson:

We're actually own the overlying buildings and get that depreciation.

Jade Rahmani:

Okay. And finally, in your view why do you think SAFE's stock price didn't react more positively to iStar's investment at a material premium to where SAFE was then and is now trading?

Jay Sugarman:

Yes, right now we don't think the stock really has any information and it's trading de minimis volumes. We have a number of very large shareholders who have reached their limits just by our bylaws, and so we really view 2019 is the year we start telling our story and expanding the reach of the company into the shareholder community, into the lending communities. Right now we just don't think the stock actually reflects any of the information that some of our people who are following the company closely now understand.

Jade Rahmani:

Okay. Thanks very much for taking the questions.

Jay Sugarman:

Take care.

Operator:

Your next question comes from Joshua Dennerlein with Bank of America Merrill Lynch. Your line is open.

Joshua Dennerlein:

Hey, good morning guys.

Jay Sugarman:

Good morning.

Joshua Dennerlein:

I am just still trying to wrap my head around effective yield versus kind of the old way of using cap rate. It might be helpful—for 4Q deals that you've closed, it looks like there's a 5.6 effective yield. How would GAAP and cash cap rates compare to that effective yield?

Jay Sugarman:

If you think about it as you were buying a treasury bond that had a 5.6 effective yield, you know you're going to get that yield because it's AAA credit quality. If you're getting cash of 3.5%, 4% upfront and the rest of that yield over time that gets constantly reinvested at that rate, our view is if you can make excess returns to AAA level of credit risk and compound it continually, that's a really great place to be from a fixed income investor standpoint, from an equity investor standpoint. You're recreating that alpha every time you rollover a portion of that. So, that's really what's happening here. Think of it as the bond. Think of it as a AAA bond or a treasury bond. Part of it your return is paid in cash every year, and part of it is rolled over and compounds at that same rate going forward. If your cash yield Year 1 is 3.5% to 4% and you've got bumps of 2%, over time you're going to make a 5.5% effective yield. There's no if here because of the quality where we are sitting in the capital structure. It's not like an equity deal where you can't really predict whether you'll ever get that future accrued amount. Here we're still starting at, I think Andy said 35% LTV; you are going to get the amount. What's best about it is you're actually going to compound that at these high rates of return that we're creating that really are not replicable anywhere else in the market.

It's a little bit of a different mentality and it's one that comes naturally to us given our fixed income and lending backgrounds. We look at this as a way to create very attractive long-term returns, long-term compounding returns, and we think the cash-on-cash yields out of the box are attractive in and of themselves relative to the marketplace, but what was really driving the business is much more of this effective yield relative to other effective yields for similar credit quality instruments.

Joshua Dennerlein:

Okay. It assumes that you're taking the cash flows and reinvesting them at kind of the market rate or the internal rate?

Jay Sugarman:

No, if you think about if you get 4% of your 5.5% in cash, the other 1.5% is in effect going to compound. That's how effective interest is calculated. What is the constant return that will create the stream of income that we contractually have over the life of the instrument, assuming you receive par of the end and pay par at the beginning. That is standard bond math. Effective yield and effective interest is really what the accounts are now trying to create out of leads streams particularly long dated lead streams. They look at them and they try to understand the economic reality. We think that is the long-term economic reality.

Now, if we were at 90% of the capital structure 80% or 100% we would not use this methodology because those future cash flows are not assured. But when you start at a de facto AAA credit quality location in the capital structure, and as you build a diversified portfolio, these credit metrics are exactly what we've been doing our entire careers here, is trying to find long-duration non-callable cash flows that create above market returns, that create alpha every time you create them, and if you can let them run and compound and not have them get repaid on you, those are really good businesses. We've seen tremendous success in the last two decades when we've found those businesses.

We think Safehold has the ability because of its unique skill sets, because of the financial support and personnel support for iStar to really start telling this story, both for our customers about why this is a better, more efficient capital structure for them, and now for shareholders and, frankly, for lenders, why a diversified scaled of portfolio of these assets starts to look very much like some of the businesses we built in the past.

We tend not to look at any single individual deal as the way to think about our company. You have to think about as a growing, scaling business generating what we think are these attractive, risk adjusted returns and evaluate whether you think we can continually repeat that and build an ever0larger business. We certainly believe it, we believe iStar believes. We have repeat customers who I think believe it, but we now need to bring that message to the broader market.

Joshua Dennerlein:

Okay, thanks. Just so we're prepared for the 1Q release, what are you guys going to show? I'm assuming it will look very similar just Page 22, you'll kind of get rid of Page 23 of your presentation. I don't know, is there is anything else that we should kind of focus on so our models are ready for the new accounting change?

Andy Richardson:

I think that the pre January 1 amounts and presentation will stay exactly the same, and all the new deals will be recorded under the new accounting that we described earlier, which is the revenues will be recorded as interest income from sales type lease, which is effectively the IRR implicit in the lease cash flow stream, and the amount that we paid for the asset will be recorded as investment in lease on the balance sheet, and we will report straight net income.

Joshua Dennerlein:

Okay. All right, thank you. (Inaudible).

Operator:

Again, it is star, one to ask a question. Your next question comes from John Massocca with Ladenburg Thalmann. Your line is open.

Brandon Travis:

Good morning. This is a Brandon Travis on with John.

Jay Sugarman:

Good morning.

Brandon Travis:

On your purchase of your existing ground lease in San Antonio, can you discuss the terms of the transaction, and what made it an attractive asset?

Jay Sugarman:

We won't discuss the specific terms and the yields on it. The reason we like the transaction is it's on the Riverwalk in a central location; the coverage exceeds our metrics, and the cash yield we're getting exceeds the metrics in our portfolio, plus it got us into a market that we've not been in before.

Brandon Travis:

Okay, thanks. How big is the market for third-party ground lease acquisitions in non-top five MSAs?

Jay Sugarman:

You mean to say acquisition of existing ground leases, or the ability to create them in these markets?

Brandon Travis:

Existing ground leases.

Jay Sugarman:

Yes, there are more ground leases than you might think out there, but they don't trade very often. It will be a part of our business, but we don't think it's the driver of the business.

Brandon Travis:

Okay. That's helpful. Thank you.

Operator:

Your next question comes from Collin Mings with Raymond James. Your line is open.

Collin Mings:

Thanks, just a follow-up going back really the last question there. I recognize you don't want to provide maybe the specifics on the San Antonio deal, but just more broadly can you talk a little bit more about asset pricing, and then just benchmarking as you think about obviously there's been some moves in the interest rate environment just as far as benchmarking deals and kind of from a deal flow perspective where pricing stands?

Jay Sugarman:

Again, we're credit dependent. So depending on the market thing on the quality of the asset, depending on the capital structure, these numbers can bounce around. I think when we first gave metrics to the market, we gave a range and I think those ranges are still reasonable. We've seen coverage ratios that we still like to see in the 3- to 5 times range and depending on how good all those other factors are, initial cash yields have been in the—3.5 to 4 is kind of the centering number. The effective yields on those type of assets will be in the 5 to 6 range.

As Andy explained, I think our financing costs we think are in the 4.5-ish range for a diversified pool of assets. So, the metrics you'll see going forward from a GAAP income statement are driven by those inputs and they're still pretty consistent. We think there are opportunities to grow this business very fast. The rules are somewhat flexible in terms of there are markets we want to be in, and there are asset quality that are at the very high end, and so we have flexibility on both sides of that equation. Those metrics are still kind of the ones we want. We want to be in that 35—a third to 40% total value of the property. We think that's the appropriate optimal space that allows us to be leasehold lender friendly and cap rate neutral. We don't like to move above that and we don't like to move below 3 times coverage.

Other than that, we price against the market and try to create a better alternative for our customers. As the markets move for capitalizing real estate, we'll move with them.

Collin Mings:

Okay. Appreciate the detail there. It doesn't sound like that moves in the tenure one way or the other have really had an impact in terms of the pricing you're able to achieve. Is that a fair takeaway?

Andy Richardson:

I would say on a pipeline we try to be very disciplined and take a look at obviously the moves in treasuries. We have floors in our term sheets. We price off the treasury. It is deal dependant. If I take a look at the cash cap rates that we've closed already in Q1, I would say that they fall within the outline that Jay gave you. We're getting better pricing in what I would call outside of the top five markets, and you're getting pricing on the lower end of the range in the more core markets. But again, those cash cap rates we think are strong but these weighted average effective yields is what we're really focused on.

Collin Mings:

Understood. All right, very helpful. Thanks guys.

Operator:

Mr. Fooks, we have no further questions.

Jason Fooks:

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

Operator:

Certainly. To access the replay for today's call, you may dial 1-800-585-8367 or 1-855-859-2056 and enter passcode 4794594. Again, to access the replay for today's call you may dial 1-800-585-8367 or 1-855-859-2056 and enter the passcode 4794594. The replay will be available approximately two hours from now. Thank you and have a good day.