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# Safehold Inc.

## Second Quarter 2019 Earnings Call

## July 26, 2019

## C O R P O R A T E P A R T I C I P A N T S

**Jason Fooks,** *Senior Vice President, Investor Relations*

**Jay Sugarman,** *Chief Executive Officer & Chairman*

**Marcos Alvarado,** *President & CIO*

## C O N F E R E N C E C A L L P A R T I C I P A N T S

**Anthony Paolone,** *JPMorgan Chase & Co.*

**Richard Anderson,** *SMBC Nikko Securities*

**Marnie Georges,** *Raymond James*

**Jade Rahmani,** *Keefe, Bruyette, & Woods*

**John Massocca,** *Ladenburg Thalmann & Co.*

## P R E S E N T A T I O N

**Operator:**

Good morning, and welcome to Safehold's Second Quarter 2019 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, Senior Vice President of Investor Relations and Marketing. Please go ahead, sir.

**Jason Fooks**

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

This morning, we plan to walk through a presentation of details of our second quarter 2019 results. Presentation can be found on our website at safeholdings.com, and by clicking on the Investor Relations link.

There will be a replay of the conference call beginning at 12 p.m. Eastern Time today, and the dial-in for the replay is 1 (800) 585-8367 with a confirmation code of 9345669.

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 would cause these differences are detailed in our SEC reports. Safehold disclaims any intent or obligation to update these forward-looking statements, except as expressly required by law.

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

**Jay Sugarman:**

Thanks, Jason. We continue to make excellent progress during the second quarter, setting us up for a strong second half of the year. Core metrics advanced, with revenue up 70% year-over-year, earnings per share up over 80% year-over-year, and the quality of our pipeline continuing to increase. Our message is clear and simple: the Safehold ground lease enables building owners to be more capital efficient and more cost efficient, enabling them to achieve higher returns with lower risk.

Making a very large industry more efficient and delivering a better customer experience and better customer results has been a consistent theme for some of the biggest and most successful companies in the country, and we believe we can join their ranks by delivering a nationally scaled, professionally managed platform that focuses on reinventing the ground lease industry and meeting the needs of today's real estate owners in a way never done before.

Based on what we've seen over the first half of the year, we feel confident the message is breaking through, and as a result, we are raising our investment guidance to $1 billion for 2019, a 33% increase from our guidance at the beginning of the year.

We hope to keep expanding to all the top 30 markets in the country and look forward to locking down many of the deals in our pipeline to demonstrate the range of our capabilities. While we're very focused on growing the investment side of our business, we are also importantly continuing to refine our capabilities on the capital side of the business; raising more efficient debt to fund our portfolio and expanding the number and type of equity investors that we think will be attracted to what we're building.

We believe a combination of principal safety, premium asset returns, and a sizable capital gains potential embedded in our stock; will prove attractive to a wide range of investors well beyond the real estate world, and we've begun planning to share with them our story as it reaches scale.

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

**Marcos Alvarado:**

Thank you, Jay, and good morning, everyone.

Let me start with Slide 4. Second quarter of 2019 was highlighted by strong year-over-year earnings growth of 237% as Safehold continues to gain traction with customers and penetrate a significant market opportunity. As Jay mentioned, we're raising our investment target from $750 million to $1 billion. Additionally, we've continued to improve the right side of our balance sheet, as we've recently closed on several assets financings that have meaningfully extended our debt maturity profile along with increasing the commitments on our revolving credit facility by $100 million.

Slide 5 summarizes our earnings results. Revenues for the second quarter of this year jumped to $20 million, a 70% increase from the same period last year, while quarterly earnings per share grew 88%.

At the end of the quarter, our aggregate portfolio stood at $1.1 billion, and the unrealized capital appreciation in our own residual portfolio, representing the value of the bricks and mortar sitting on top of our land, grew to $2.2 billion; a 60% increase from the same period last year.

Slide 6 is a review of our investment activity. During the second quarter, we signed up five new Safeholds totaling $186 million, of which $43 million closed during the quarter. The balance is signed, committed and expected to close in the coming weeks. You could see the key investment metrics on these transactions on the bottom half of the slide, which are consistent with our strategy of creating AAA equivalent risk. These assets have a 5.7% effective yield with a 3.6 times coverage and a weighted average gross book value representing 39% of combined property value.

Moving to Slide 7, we illustrate the growth of our pipeline. As we continue to gain momentum, our pipeline is growing nicely. We're encouraged by the deal flow we're seeing as we expand into new markets, reaching new high-quality customers and educating them on the Safehold value proposition. This growth in our pipeline has given us the confidence to increase our full-year investment target by $250 million to $1 billion, assuming the economic conditions remain consistent with today. You can see some of the key metrics associated with our pipeline on this slide that are consistent with our existing portfolio.

Slide 8 provides a summary of our debt. We continue to improve the right side of our balance sheet to help facilitate the scale of Safehold. During the second quarter and subsequent to quarter end, we closed $287 million of long-term debt, across five separate nonrecourse financings, customized to the unique characteristics of our Safehold. The combined weighted averages of the financings this quarter have an initial cash interest rate of 3.1% and a 4.2% interest rate over the term of the debt, which has a weighted average maturity of 38 years.

As it stands today, we have approximately $600 million of debt outstanding. Based on our recent activity, we have extended our weighted average debt maturity from 7 years at the end of last quarter, to 23 years; giving us a clear runway with no mortgage maturities for 8 years. Presently, our debt has a 3.5% weighted average cash interest rate and a weighted average interest rate of 4.1% over the term of the debt. Leverage stands at one times debt-to-equity. Subsequent to the quarter-end, we expanded our bank group and upsized our revolver capacity by $100 million to $450 million, to supplement the growth of our franchise. Our revolver is currently undrawn.

Moving to Slide 9. During the second quarter, the unrealized capital appreciation in our own residual portfolio grew to $2.2 billion, increasing nearly five-fold since our IPO in June of 2017. As a reminder, this metric represents today's estimated market value of the buildings on top of our land.

In conclusion, it was a strong quarter, underscored by solid earnings, a larger pipeline, continued market penetration and an improved capital structure that should allow us to continue to scale the franchise. We're certainly pleased to see the stock performance over the last few months, as we believe investors are starting to recognize the opportunity and growing momentum. That being said, we believe we are only in the early stages of what we are building at Safehold. We will continue to educate a broad range of investors about the compelling combination of excess returns and growth embedded in our Company.

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

**Jay Sugarman:**

Thanks, Marcos. Let me just finish with a few finishing comments. We continue to believe we're at the beginning of an extraordinary opportunity to help modernize real estate ownership in this country. Our teams have been hard at work expanding our footprint and helping make Safehold the go-to name wherever a value-enhancing ground lease is needed. We look forward to telling our story and explain how our making the pie bigger approach can create compelling returns for our customers and for our shareholders.

Okay, Operator, let's go ahead and open it up for questions.

**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 from JPMorgan. Your line is open.

**Anthony Paolone:**

Thank you and good morning. Just a couple of questions on the deal volume and deal activity. First, the billion dollars that you've moved guidance up to, do you think that's money that's actually spent this year, or do you think that will be commitments as well?

**Jay Sugarman:**

Yes. I think, Anthony, we've said in the past, we can't control the timing. In fact, we've had a couple of customers ask us to delay closings well beyond when we actually had a deal signed, sealed and delivered. So, we're comfortable saying we will close and fund a billion this year based on what we see in the pipeline today.

**Anthony Paolone:**

Okay. And these delays in terms of—is it just timing, because the customer wants to just push it off a couple of months? Or, for instance, the volume that you did $186 million a quarter, is that commitments that could take several quarters before the capital is actually put out the door?

**Jay Sugarman:**

Yes. No, two relatively idiosyncratic reasons, but it saved our customers money to just delay them slightly and we're in a customer business, so we were happy to accommodate them.

**Anthony Paolone:**

All right. Then how are yields holding up, given what's happened to interest rates the last several months?

**Jay Sugarman:**

It's a great question. Again, I think our goal is to deliver better returns with lower risk to our customers. We think there's a lot of cost efficiency and a lot of capital efficiency, that gives us a pricing umbrella inside where alternative financing is available to our customers. So, we've seen a little bit of tightening in overall financing markets, but probably not as dramatic as you've seen in sort of base rates. We'll see where the market goes, but I think we continue to be a better alternative in lots of situations in our core kind of 3.5% starting rate, starting yield number, so we haven't seen a lot of erosion in that yet.

**Anthony Paolone:**

Okay. With the larger pipeline that's emerging, and stock has done well, how are you thinking about funding between equity and also having your capacity to get your target leverage level? Then the additional element I would love to hear about, is just how to think about iStar, just consistent purchases of the equity and where that goes over time?

**Jay Sugarman:**

Yes. Look, I think we started the year with sufficient capital to meet our original guidance. After that it's all pretty much pipeline driven, how fast the deals are closing, what's the amount of volume. We do think, and you heard both Marcos and I mention that scale is critical for our business. So, we're a little less focused on exactly how things come in quarter-by-quarter, but we're very focused on reaching scale.

So, at least at this point, it'll be driven by the closing of transaction-. We continue to believe the stock represents compelling value, and certainly are sensitive to that; but our end game here is to reach scale, to be the dominant player in what is a really revolutionary idea. So, we'll see how the pipeline plays out and that'll dictates some of our capital decisions.

In terms of iStar, desire is to continue acquiring as much of Safehold as it can at these prices, that is something that iStar's Board came to the conclusion, this was one of the most attractive businesses it'd seen. It made the large investment in January, and so long as the stock doesn't reflect what we think is full value, they continue to be an interested acquirer of shares. So, it's a relatively small amount in the open market, but they do have the right to participate up to their pro rata share of any future capital raises. So that will be the means through which it probably acquires significant amount in the future.

**Anthony Paolone:**

Okay. Then just last question, more detail on the G&A popped up from 1Q to 2Q, can you just comment on what that number is likely to be around as a sort of run rate go forward figure?

**Jay Sugarman:**

Yes. Just in terms of the jump there, at our annual meeting, our Board members do receive a share grant that we expense in the quarter. So that's not a recurring item. You will see that every year around our annual meeting.

Run rate, I think, you're going to start to see it stabilize. We think as we scale, we get real economies of scale, so we don't see G&A dramatically scaling with the business. But where it's been and on an annual basis, it's probably a good starting point.

**Anthony Paolone:**

So, the 1Q number is probably a little bit more of the base line, and 2Q just if that happens once a year kind of thing?

**Jay Sugarman:**

Yes. But we will be—we do make the Director grants every year, so that should factor that in. It's a one-time event just spread it over four quarters, so you could add a quarter of that for the first quarter. We do have legal costs as we've continued to do R&D around the actual structures we're using. Again, as we get bigger, we think a lot of those costs becomes smaller and smaller. There is still a little bit of innovation cost that we're incurring, things that we're still learning how to do better, make more efficient. But I think if you look at a run rate over the last 12 months, that's probably a better way to think about it than any individual quarter annualized.

**Anthony Paolone:**

Okay. Great. Thank you.

**Operator:**

Your next question comes from Rich Anderson from SMBC. Your line is open.

**Richard Anderson:**

Thanks, good morning everyone. So, on the financings, the $287 million—what was the range when you said 38 years on average? How high did you get at the top end of that range?

**Marcos Alvarado:**

Fifty years.

**Richard Anderson:**

Okay. Is that sufficient in your mind or could you see yourself going even higher if the opportunity presented itself?

**Marcos Alvarado:**

The way we think about our financing is the cash flow yields at the maturity are so high, so whether it was 30 years of duration or 50 years of duration, we don't think we have any real refinance risk. So that was an opportunistic execution for longer duration financing.

**Richard Anderson:**

Okay. In terms of the escalators, 55% are fixed with inflation adjustments, call it, 60% total fixed bumps. Do you see that percentage of fixed bump mass going higher as a percentage of the total over time?

**Marcos Alvarado:**

We do. All of our newly created Safeholds have a relatively consistent structure of a 2% annual bump. So as we continue to scale our business with new originations and new Safeholds that will become a bigger piece of the portfolio.

**Richard Anderson:**

Maybe one for Jay here. Are there opportunities out there where you are purchasing an existing ground lease that is, let's call it, sketchy in its structure? Some sort of landmark to market, that creates some problems for the leasehold, that you can buy and restructure on behalf of the leasehold and thereby really make your point. Drive your point home about how Safehold is attempting to sort of re-engineer this industry in, kind of, where—right where the rubber meets the road. Is that something that's out there as a possibility in terms of the pipeline?

**Jay Sugarman:**

Yes. I think that's excellent insight, Rich. We have done that already on a smaller deal and we think it's a tool that will become something we can use more often going forward as people start to understand the differences between these archaic ground leases and how inefficient they are in the modern capital markets versus what Safehold is doing. So, it's definitely a tool in our toolbox. We've only been able to deploy it a little bit so far, but we definitely see opportunities to do it on a bigger scale.

**Marcos Alvarado:**

Okay. Great. Rich, the reverse inquiry from existing leasehold owners to us about exactly what you're talking about has dramatically ticked up over the last 6 months.

**Richard Anderson:**

Good sign. When do you—when are you willing to accept an effective yield or cap rate or a coverage ratio that's below what one might think of as your kind of target? So coverage for the deals in the second quarter was below 4—I think 3.6%, not making a big deal out of that, but what is it about the deals that were announced that allowed you to accept a rent coverage that was somewhat below your target?

**Jay Sugarman:**

Yes. I mean, it's a little bit idiosyncratic as you might have suspect, the variables are quality, location, PPV percentage. We're taking all those factors into account and trying to make all of these become very attractive investments that UI and iStar and our shareholders all like to own. But it's hard to tell you exactly what circumstances drive each individual pricing decision. But I can tell you, when we close a deal, we feel like we have created a lot of value for shareholders, so that's the most consistent theme I can give you.

But certainly, higher quality gateway markets, we're going to be a lot more thoughtful about how to craft that deal, and if it requires us to go a little higher in the CPV calculation or a little low in coverage; that's going to be fine depending on the other qualitative factors. We also have some assets that, clearly, we think have the potential to continue to grow their revenue streams, there may be repositioning opportunities. So, we're looking at that entire set of variables, and ultimately the conclusion has to be, when we close this deal, we think we've made significant value for shareholders the day we close. That's really driving the business right now, more than a set of rules that, again, in a customer-focused business; we do have core return parameters, but there are a lot of other factors in real estate, as you know, and we've got a lot of experts in the field making those real-time judgments.

**Richard Anderson:**

Okay. Then last quick question, why did book equity decline second quarter versus first quarter?

**Jay Sugarman:**

I'll take a look at it. But I think, again, we did have some one-time cost in the second quarter. I'd have to look further, Rich. Apologies.

**Richard Anderson:**

Not a big deal. It's something I noticed here. Okay thanks, Jay. That's all from me.

**Operator:**

Your next question comes from Marnie Georges from Raymond James. Your line is open.

**Marnie Georges:**

Thanks. Good morning. First question for me, how should we be thinking about the type of different assets that you'll be targeting in the pipeline on a go-forward, the multifamily versus the office in industrial, for example. Just how are you thinking about that?

**Marcos Alvarado:**

This past quarter we closed our first student housing deal, which we're excited about. When I look at the pipeline, it is consistent with the portfolio that exists today. A lot of office, a lot of multifamily, we sprinkled in a few student housing transactions, as well and a hotel transaction. So generally consistent with the existing pipeline. I will tell you, the quality of the assets and the quality of our customers, has improved in the pipeline, which is exciting for us as a franchise.

**Marnie Georges:**

Awesome. That's good to hear. Then just looking at MSAs, was there anything specific driving the decision to go into the Oregon market this quarter? Are there any specific MSAs that you would be targeting in the near term or any of that you're looking to deepen your presence within?

**Marcos Alvarado:**

Yes. Portland is a fantastic growth market. We're able to get our first deal done in Portland. We actually as a franchise, have some lending experience in that market, so we'll look to continue to grow in Portland. As Jay mentioned, we have a target of getting into the 30 major MSAs. A few more to tick off.

**Marnie Georges:**

Definitely. Then one more for me, just other income this quarter came in a little higher than we've been expecting, was there anything too that or anything on a go-forward that we should be aware of?

**Jay Sugarman:**

I wouldn't think so, but maybe some anomalies in there. But there shouldn't be major changes in there.

**Marnie Georges:**

Great. Thanks so much. I'll turn it back over.

**Operator:**

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

**Jade Rahmani:**

Thanks very much. I wanted to ask specific question about the portfolio. The Park Hotel's assets, how soon would be reasonable to expect conversations to commence between SAFE and the Park Hotel about a potential renegotiation?

**Jay Sugarman:**

Hey Jade. We're delighted with the performance of the portfolio but have not heard from the tenant. They do have a renewal right, which will extend them out to 2035. Until it's on their radar, it's not really something we can push and drive. But we're very happy with the performance of that asset.

**Jade Rahmani:**

In terms of the economics that the Company is currently receiving from those assets, is it just some base level of rent right now of, I think, approximately $13 million annualized, and if the negotiation was not successful, let's say, the entire amount of NLI that those properties generate?

**Jay Sugarman:**

Yes. Look, those properties are making somewhere in the $30 million to $40 million range, and our rent is, I think, $10 million base and the rest is a small percentage rent was about $3 million/$3.5 million last year. So, there's significant delta between what the properties make and what we get paid. That usually creates an opportunity to have a conversation with the tenant, but it'll happen on the tenant's timetable. Each year, as we get closer to the maturity, we'll start taking a very hard look at the alternatives available to them, and frankly to us.

**Jade Rahmani:**

Okay. In terms of the pipeline, can you give us a sense for the average transaction size, just given the originations that have been completed so far, I would assume that there is potentially some large outsized transactions in there?

**Jay Sugarman:**

Yes. Look, we haven't been shy about targeting some of the bigger cities and some of the bigger assets. Again, they tend to be the ones that take much longer to get done. But we've definitely made progress on that front. And as Marcos said, we're penetrating some new product pipes, like student housing, that'll have lower balances, multifamily typically has been somewhat smaller. But it feels good, at least after the first six months of the year, good enough for us to want to raise our guidance. So, you can tell we're feeling positive that we're making progress on those fronts.

**Jade Rahmani:**

Just on the refinancing's that you completed this quarter, what kinds of lenders participated in those? Were those foreign banks, insurance companies or some other lending type?

**Jay Sugarman:**

We're exploring. As I said, we're trying to make the right side of balance sheet as efficient as possible as well, so we're exploring conversations with a wide range of lenders. I think the light (phon) company world is certainly one that understands the product, so that's been a good place to go. But we will continue to probe a wide range of providers of capital because we think this ultra-SAFE credit profile is one that's attractive to a lot of people.

**Jade Rahmani:**

Just last question, can you specify what the going-in cap rate is on the $186 million of deals that you put under contract this quarter?

**Jay Sugarman:**

Yes. I mean, you know our model is mid-3 year-1 yield, mid-5s return on asset, effectively IRRs. They were all pretty consistent with that.

**Jade Rahmani:**

Thank you.

**Operator:**

Again, to ask a question please press star, one.

Your next question comes from John Massocca from Ladenburg Thalmann. Your line is open.

**John Massocca:**

Good morning.

**Jay Sugarman:**

Hey, good morning.

**John Massocca:**

Can you provide some additional color on the acquisitions closed or brought under PSA in the quarter? You gave some detail earlier on property type and transaction size, but maybe with regards to location beyond the Portland transaction? And also, kind of specifically, how are these acquisitions being sourced, or how many are Safe ground leases versus maybe purchased existing ground leases?

**Marcos Alvarado:**

They're all Safehold's, so newly created. As we mentioned, student housing asset. First asset in Portland. There's a brand-new multifamily in the Orlando market, office building in the New York City MSA, and an office building in Austin, Texas. So, all great markets, great quality assets.

**John Massocca:**

Very helpful. Then maybe can you give us some additional color on trends with regards to rent coverage in the existing portfolio that was, kind of, in place at the beginning of the quarter? It seems like the overall coverage declined a little bit by, kind of, 0.2 turns. Some of that probably was the initial acquisitions you made, but was there anything that was going on in the existing portfolio?

**Marcos Alvarado:**

The existing portfolio is performing consistent with our expectations. It was the new acquisitions that were slightly lower coverage, that pulled that down.

**John Massocca:**

I always kind of mentioned it too because the number of assets for the over 5x coverage came down by 8%. It seemed like bigger than what could be explained by the two transactions? Is there anything, kind of, in the super, kind of, high-coverage range that had, kind of, its underlying income covering your rent, come down a little bit?

**Marcos Alvarado:**

No. But we'll double check.

**John Massocca:**

That's it for me. Thank you very much.

**Operator:**

Mr. Fooks, we have no other questions.

**Jason Fooks**

Okay. Great. So, if anyone else should have any additional questions on today's earnings release, please feel free to contact me directly. Jacqueline, would you please give the conference call replay instructions once again?

**Operator:**

Thank you for participating in today's Safehold's Second Quarter 2019 Earnings Conference Call. This call will be available for replay beginning at 1 pm Eastern Standard time today through 11:59 pm Eastern Standard time on August 9, 2019. The conference ID number for the replay is 9345669. Again, the conference ID number for the replay is 9345669, and the number to dial in for the replay is 1 (800) 585-8367.

This concludes today's conference call. You may now disconnect.