# FINAL TRANSCRIPT

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# SFI - Q4 2007 iStar Financial Earnings Conference Call

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## CORPORATE PARTICIPANTS

**Andrew Backman**
*iStar Financial Inc. - SVP IR*

**Jay Sugarman**
*iStar Financial Inc. - Chairman, CEO*

**Katy Rice**
*iStar Financial Inc. - CFO*

## CONFERENCE CALL PARTICIPANTS

**Don Fandetti**
*Citigroup - Analyst*

**James Shanahan**
*Wachovia - Analyst*

**Susan Berliner**
*Bear Stearns - Analyst*

**David Fick**
*Stifel Nicolaus - Analyst*

**Michael Dimler**
*UBS - Analyst*

**Tayo Okusanya**
*UBS - Analyst*

**Douglas Harter**
*Credit Suisse - Analyst*

**Stephen Laws**
*Deutsche Bank - Analyst*

**Dean Choksi**
*Lehman Brothers - Analyst*

## PRESENTATION

**Operator**

Good morning and welcome to iStar Financial's fourth quarter and year-end 2007 earnings conference call. (OPERATOR INSTRUCTIONS). As a reminder, today's conference is being recorded. At this time with opening remarks and introductions, I would like to turn the conference over to iStar Financial's Senior Vice President of Investor Relations and Marketing, Mr. Andrew Backman. Please go ahead, sir.

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**Andrew Backman** - *iStar Financial Inc. - SVP IR*

Good morning to everyone. Thank you for joining us today to review iStar Financial's fourth quarter and year-end 2007 earnings. With me today are Jay Sugarman, Chairman and Chief Executive Officer; Jay Nydick, our President; Tim O'Connor, our Chief Operating Officer; and Katy Rice, our Chief Financial Officer.

This morning's call is being webcast on our website at istarfinancial.com in the Investor Relations section. There will be a replay of the call beginning at 12 PM Eastern time today. The dial-in for the replay is 1-800-475-6701 with the confirmation code of 909339.



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Before I turn the call over to Jay, I would like to remind everyone that statements in this earnings call which are not historical facts may be deemed forward-looking statements. Factors that could cause actual results to differ materially from iStar Financial's expectations are detailed in our SEC reports. Now I would like to turn the call over to iStar's Chairman and CEO, Jay Sugarman.

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

Welcome everybody. We have got a lot of information this morning to share with you, so let me quickly recap fourth quarter and full year results right up front. First, on the earnings front, our fourth quarter earnings included two unusual items, $135 million in non-cash impairments in our corporate loan invest portfolio and an increase loan loss provision of approximately $50 million higher than expected. Including those items, adjusted earnings per share were negative $0.29 in the fourth quarter and positive $2.72 per share for the year. Excluding the impairment, AEPS was $0.74 per diluted share and $3.75 per share for the full year. And actually excluding both items, AEPS was $1.13 per share and $4.14 per share for the full year. Katy will talk more about the economic scenario now embedded in our reserve and impairment decisions in just a minute.

Second, we funded $1.3 billion in new and existing investments and received over $500 million in repayments during the quarter, and for the full year funded $7.7 billion in new and existing investments and received $2.7 billion in repayments during the full year. We will share with you some detailed repayment information from the residential portfolio later in the call.

Third return on equity was obviously disappointing, impacted by those two items from above. The ROEs for the quarter and the year were -6.1% and positive 14.6%, respectively including those items. There were 15% and 19.6% excluding the impairments, and 23.3% and 21.4% for the quarter and year respectively, excluding both those items.

While the increases in first mortgages as a percentage of the portfolio and the Fremont acquisition bumped up overall leverage targets slightly, we still believe the portfolio is quite conservatively and appropriately leveraged relative to other finance industry metrics, and runrate return on equities are still quite good.

Fourth, on credit, we adjusted our overall macroeconomic view downward, resulting in more asset downgrades and increased reserves. We still believe the portfolio breaks down generally into approximately 15% great assets, 70% of the assets being just fine, and 15% of the assets with the potential for some level of principal loss. I will walk you through our view on reserves and discounts we have put in place to protect against those assets with issues, after Katy walks you through the earnings detail.

Lastly, on the strategic front we are moving forward on several fronts to position the Company to get out of the mud first and fastest, and make sure we are well-placed to take advantage of a market environment that should play to our strengths for years to come. We announced another strategic alliance, this time a $500 million JV with Lubert-Adler, a multibillion dollar private real estate investment fund, to expand our network of knowledge and to add a large equity investor's viewpoint on markets and asset types that look right for high-risk adjusted return lending.

We also announced a significant transaction in our TimberStar venture that will generate very strong returns for us and our partners. And we have begun utilizing the strength of our balance sheet to selectively access parts of the credit market available to us as a result of our diversified and unencumbered portfolio.

With that quick overview, let me turn it over to Katy. And then I am going to follow up with more detailed comments.

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**Katy Rice** - *iStar Financial Inc. - CFO*

Good morning everyone. As Jay mentioned, over the past few months we have been working on a number of initiatives to build liquidity and to position our firm for the new environment. We believe that the steps we are taking now will allow us to maintain our financial flexibility and begin to take advantage of certain opportunities we are starting to see in the market.



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As we discussed at our Investor Day back in December, our almost $16 billion of unencumbered assets will enable us to tap attractive sources of secured capital at a time when the unsecured debt markets remain disrupted. Before I give you an update on some of these initiatives, let me review the results for the quarter and for the year.

Our fourth quarter earnings clearly reflect the impact of the current credit environment on certain of our investments, as well as the continued stress in the overall market. Our adjusted earnings resulted in a loss this quarter of $36.6 million, or a loss of $0.29 per diluted common share.

Included in fourth quarter earnings were $135 million of non-cash charges associated with the impairment of two credits in our corporate loan and debt portfolio. Excluding the effect of the impairment for these two credits, adjusted earnings for the fourth quarter were $95.4 million or $0.74 per diluted common share.

Let me provide you with some background on the impairments. We took a non-cash impairment charge totaling $135 million on two credits, which are accounted for as held to maturity debt securities. Both credits are performing and continue to pay interest. The accounting for these securities does not allow loan loss provisions to be taken against them, but requires that the value be impaired based on a significant drop in market value for an extended or other than temporary period of time.

Our $1.8 billion corporate loan and debt portfolio has two primary types of investments -- $1.4 billion of what we call regular way loans that are accounted for as held for investment, and approximately $425 million of held to maturity debt securities in six diversified credits. Again, we can take loan loss reserves against our loans, but not on our debt securities.

Excluding the two credits that were impaired in the fourth quarter, the remaining four investments in the held to maturity bucket are currently trading close to our cost basis.

Our net investment income for the fourth quarter was $221 million, up over 80% from the fourth quarter of 2006. The year-over-year increase was due to growth in the overall loan portfolio, primarily due to the addition of the Fremont assets, as well as the amortization of $43 million of Fremont loan purchase discounts recognized in the quarter.

New commitments for the fourth quarter totaled $705 million in 15 separate transactions, $213 million of which was funded during the quarter. We also funded $1.1 billion of pre-existing commitments and received repayments of $505 million. This resulted in net asset growth of approximately $800 million for the quarter.

Our adjusted return on equity, excluding the non-cash impairments, was 15% this quarter, at the low end of our targeted range of 15 to 20%. Our net finance margin for the quarter, excluding the amortization of the Fremont loan purchase discount, was 3.16%.

With respect to our credit statistics for the quarter, again excluding the non-cash impairments, interest coverage was 1.6 times compared to 1.8 times last quarter. Our trailing 12 months fixed charge coverage ratio, as calculated in accordance with our covenants, was 1.7 times. Our coverage statistics were down this quarter primarily as a result of the $113 million loan loss provision we recorded versus a $62 million provision last quarter, an increase of $51 million quarter over quarter.

As many of you know who follow the Company, we undertake a comprehensive review of all 600 plus assets in the portfolio during our regular quarterly risk rating process. It is through this process that we determine whether any assets are impaired, and whether we need to increase our loan loss provision. This quarter we took a more conservative view with respect to current and near-term market conditions. So the quarter over quarter increase in our loan loss provision is based on the continued deterioration of market conditions and the impact we expect on our portfolio.

However, despite a more gloomy outlook, it is important to remember that the vast majority of our assets are performing as we expected, and our portfolio remains highly diversified by product, geographic area, loan structure, and origination vintage.



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At the end of the quarter our equity represented 23% of total capitalization. And our leverage, defined as debt to equity plus accumulated depreciation, depletion and loan loss reserves, was 3.4 times versus 3.3 times at the end of the third quarter. We expect to see slight variations in quarter over quarter leverage, but do not anticipate leverage increasing materially from these levels.

Now let's take a few minutes to talk about risk management and our overall credit quality. While the economy is placing strains on all lenders, we believe iStar is well positioned to manage through the current cycle. With nearly 140 people at the firm devoted to tracking, managing and understanding the risks associated with our portfolio, risk management remains a critical part of our overall strategy. While there are problems concentrated in parts of our loan portfolio, the issues are knowable and underwritable.

Based upon our risk rating review this quarter, 19.6% of our structured finance assets ranked 4 or higher this quarter. Of the assets that ranked 4 or higher, 78% are on our watchlist or on NPL status.

At the end of the fourth quarter 31 assets were on NPL status, representing $1.2 billion of gross book value, or 6.4% of total managed assets. In addition, 40 assets were on the watchlist and were performing, representing $1.6 billion of gross loans value. As a reminder, gross loan value represents iStar's book value plus Fremont's A-participation interest. Excluding Fremont's A-participation interest on the associated assets, NPLs were $719 million, and performing watchlist assets were $1.2 billion.

Loans on NPLs status and watchlist range in size from $1 million to $200 million, but are typically in that $35 million to $40 million range. The largest of our NPLs this quarter is a $200 million first mortgage on a well-located mixed-use site in midtown Manhattan. This loan was put on NPL status in the fourth quarter due to a maturity default. But as we hold the senior most tranche with an approximate 55% loan to value, we are comfortable that we will recover our entire principal amount, in addition to default interest and other fees.

As we have mentioned several times during past conference calls, we expect NPL and watchlist assets to increase somewhat over the coming quarters. Several of the assets on NPL and watchlist where higher risk transactions that were underwritten with higher return expectations. The majority of the Fremont assets that are on the NPL list are condominium conversions. We do expect to resolve several NPLs in the first quarter and will update you on our progress on the April earnings call.

With the addition of the $113 million in loan loss provisions this quarter, we now have $385 million of total loss coverage. Total loss coverage includes $218 million of on-balance sheet loan loss reserves and $167 million of remaining discount from the Fremont acquisition. Our loss coverage represents 3.6% of total loan assets. However, if you take the total loss coverage over 100% of our NPLs and 50% of our watchlist assets, we have 19% loss coverage on these assets. We believe that our loss coverage provides adequate protection against future loan losses.

During the fourth quarter we also took title to three properties, all of which were previously on NPL status. This resulted in a $19 million charge against asset specific reserves.

We are taking a long-term and thoughtful view to managing the issues in the portfolio. It is our policy to stop accruing interest on NPL assets. This obviously impacts our earnings. While we try to resolve issues and remove assets from our NPL list as soon as possible, our greater priority is to generate the highest return possible from these situations, even at the expense of a larger NPL list and lower near-term earnings.

We are prepared to enter into restructuring discussions, and in certain cases, to foreclose, if necessary, rather than simply extending defaulted loans, because we have the in-house capabilities to manage these assets. Our 140 asset managers, leasing experts and construction professionals have extensive local market knowledge, and currently manage our own portfolio of over 40 million square feet of commercial real estate across the country.



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With respect to our CDO portfolio there were no material changes in the credit metrics this quarter. At the end of the fourth quarter the portfolio included 407 office, industrial, entertainment, hotel and retail facilities, with over 40 million square feet of space leased to 121 different credits. The portfolio was 95.3% leased, with a weighted average lease term of 11.2 years.

Before turning to funding and Capital Markets initiatives, let me quickly review the year-end results. Adjusted earnings for the year ended December 31, 2007 were $348 million or $2.72 per diluted share. Excluding the $135 million of non-cash impairment charges, adjusted earnings were $480 million or $3.75 per diluted share, which was $0.25 below the low end of our guidance range.

Net investment income for the year was $694 million, and total revenue was a record $1.4 billion. Our impairment earnings were lower primarily due to the increases in our loan loss provision in the fourth quarter. As we mentioned earlier, we took a relatively conservative stance based on the continued deterioration of the market and the impact we expect it to have on our portfolio. If the increase from our third quarter to our fourth quarter loan loss provision was also excluded, adjusted earnings per share would have been $4.14, in line with our guidance.

However, the market has deteriorated somewhat more than we expected over the last quarter, and we believed it was prudent to increase our loan loss provision accordingly, or by $51 million more than we originally modeled for the fourth quarter.

Net asset growth for the year was $5 billion, including $5 billion of funding in 138 new financing commitments, $2.7 billion of additional funding, and $2.7 billion in repayments and asset sales. This compares to net asset growth of $2.5 billion for the fiscal year 2006. The increase was primarily due to the addition of the Fremont portfolio, as well as overall growth in our core portfolio.

Now let's turn to liquidity and our funding initiatives. We have been working on several initiatives to raise the most cost-effective capital available in the current and still very dislocated credit environment. The Company has multiple sources of capital and liquidity, including our cash flow from operations, our unsecured and our secured lines of credit, unsecured corporate debt, mortgage financings, secured term loans, preferred and common equity, and select asset sales if appropriate. All of these sources of capital we believe will provide sufficient liquidity to meet our short and long term funding needs.

More specifically let me give you an update on some of the financings and asset sales that we are pursuing. As we mentioned at our Investor Day in December, we are in the process of raising approximately $1 billion of mortgage financing that will be secured by a portion of our $3.3 billion CTL portfolio.

Over the past five years we have moved to an unsecured model, which we believe provides the greatest amount of balance sheet flexibility and efficiency. Today we have very little secured debt and almost $16 billion of unencumbered assets. However, in times when the unsecured markets are disrupted, we have found that the secured markets typically offer a more attractive cost of capital.

While clearly certain areas of the secured markets, such as the structured products arena, remain essentially shut down, the first mortgage market remains open, albeit at somewhat higher spreads and more conservative underwriting standards than in the recent past. Our high-quality diversified, single tenant CTL portfolio is both easy to underwrite and easy to understand, and provides an attractive pool of assets for first mortgage lenders. We are seeing significant interest in this financing thus far from multiple bidders, and anticipate closing sometime in the second quarter.

We are also in the process of raising an additional $100 million to $200 million of capital secured by corporate tenant lease assets in our AutoStar subsidiary.

We recognize the need to maintain significant levels of unencumbered assets. And taking into consideration all of the secured financing initiatives currently being pursued, we anticipate our percentage of secured debt as a percentage of total debt will remain at or below 15%. We still believe an unsecured investment-grade model offers the most flexibility and efficiency.



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As Jay mentioned, another step we have recently taken is to form a joint venture with Lubert-Adler to create a $500 million investment fund. Founded in 1997, Lubert-Adler is a real estate private equity firm with 30 investment professionals that have invested over the $15 billion since inception. This vehicle will primarily focus on investing in first mortgages greater than $75 million, and junior loans larger than $50 million. The vehicle will be comprised of a $125 million contribution from iStar and a $375 million contribution from Lubert-Adler. We have recently begun to review investment opportunities together on behalf of this new fund.

Finally, we also recently announced that TimberStar Southwest, a venture in which we are 47% partner, has signed a definitive agreement for the sale of its timber assets in the Texas, Louisiana and Arkansas regions. This sale was consistent with the venture strategy, which was to create compelling returns through value creation. Despite the relatively short holding period, the partners determined that the price we received was very attractive, and was enhanced by both the securitized debt we put in place at closing and the land and harvest optimization plan our team has executed over the past year.

We expected to receive approximately $400 million in net proceeds from the sale once completed in the second quarter. Based on our initial $185 million equity investment, we will receive a gain of approximately $215 million on the sale, representing a return of over 100% in just 15 months.

Let me take a moment now to talk about our sources and uses of funds for the year. At our Investor Day in December we walked through our expectations for our sources and uses of capital for the balance of 2007 and 2008. Since December, however, market conditions have continued to change at a rapid pace. Like others, we have seen some slippage in the repayments of our loans. At the same time, we are also seeing slippage in our unfunded commitment obligations, as some borrowers are either out of compliance with their loan agreements or are postponing, or even canceling, their projects as they reassess the economics in the current climate.

Let me provide you with a revised look at our sources and uses of capital for the balance of 2008 as we see it today. On the sources side we now expect to receive $4 billion from asset sales -- excuse me, from asset maturities and paydowns this year versus our expectation of $5 billion in early December.

In addition, we currently have $1 billion of capacity on our credit facility. We expect to receive approximately $400 million in net proceeds from the TimberStar Southwest sale. And we expect to raise approximately $1.2 billion of CTL mortgage financing, both from our core portfolio and our AutoStar portfolio. This brings our total funds available for the balance of the year to approximately $6.6 billion versus the $6.5 billion we outlined in December.

On the uses side, we now expect to fund $3 billion of unfunded commitments for the remainder of 2008 versus our expectation of $4.4 billion in December. In addition, we will repay approximately $600 million of senior notes and other debt that matures this year, as well as the remaining $1.3 billion of our interim credit facility used to finance the Fremont acquisition. This brings our total funding requirements for the balance of 2008 to $4.9 billion versus $6.5 billion in December.

The secured financing alternatives we are currently executing will provide additional sources of liquidity and cushion in 2008. And while we will not be perfectly matched quarter by quarter, we do not expect a need to raise significant incremental capital this year, assuming minimal net asset growth of the portfolio. We will, however, continue to assess the market and consider raising additional funds if market conditions improve or if the business requires it as we move forward in 2008.

Finally, I will conclude with a look at our earnings guidance. Given the uncertainty we continue to see in the market, it is still difficult to predict how the overall environment will shake out in 2008. We believe the only reasonable way to look at earnings guidance is to assume that the Capital Markets remain disrupted, and that as a result we have little or no balance sheet growth. We call this our "zero net asset growth scenario."



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Based upon this view, we now expect 2008 diluted AEPS of $3.50 to $4, and diluted GAAP earnings per share of $4 to $4.50. These numbers are below our previous guidance, but they take into consideration a more conservative outlook with respect to the overall market, and little or no net asset growth this year, both of which we believe are prudent.

With respect to our dividends, as you know, we increased our quarterly dividend in the fourth quarter to $0.87 per common share, or $3.48 per share on an annualized basis. We also issued a special dividend of $0.25 at the end of the year. This increase in special dividend was primarily the result of an increase of taxable income from the Fremont transaction. Although we anticipate some of the expected gain we received from the sale of our interest in TimberStar Southwest to be netted with realized losses in our loan portfolio in 2008, we believe that our dividend has a solid foundation and reasonable cushion, even at the lower end of our guidance range.

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

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

Katy talked about the more conservative outlook we have utilized in our projections and our reserve analysis. I think there is no question it is appropriate and reflects a very real chance of recession throughout 2008. However, it is also important to continue to watch the data in the real estate world very carefully, and not be entirely captive to headlines and one-off anecdotes.

And one statistic we track quite carefully obviously is condominium unit closings in our portfolio projects that have units available for sale. I think while the general consensus is that nothing is moving in that market, we think that is too general a statement and too draconian a view. With respect to our own portfolio, we track closings on a weekly basis across all projects we are invested in that are in a position to close on contracts. And I thought I would share those statistics with you for the past few months.

In October of 2007, 292 units closed, generating $147 million of sales proceeds. In November of 2007, 197 units closed with $89 million of sale proceeds. In December 243 units closed with $175 million of sale proceeds. In January 304 units closed with $209 million of sale proceeds. And in the first three weeks of February, 338 units have closed with $228 million of sale proceeds.

Now we are not telling you it is all rosy on the condo front, but we would caution extrapolating from some of the headlines out there. We believe borrowers will need to work very hard to help buyers access mortgage financing, to be realistic with respect to pricing, and to accept that the profit potential in many projects is gone, and now it is really about them recouping part of their equity.

Let's switch to the reserve and discount question. As I have said before, if you give us 20 points to work out a portfolio of messed up first mortgages, we think we can bring you out very close to whole. As Katy outlined, the reserves and Fremont discounts currently available in our portfolio add up to around 19% of the combined principal balance of the NPLs and 50% of the watchlist assets. In raw numbers that is around $380 million to fix or resolve $2 billion of assets that need work.

Based on what we know today, that might be a little short or a little extra, but it is not a lot short. With a few more data points coming in, it should be easier to start demonstrating that in coming quarters. And with the actual issues in many cases not likely to occur until 2009 or even 2010, we expect to have plenty of time to reserve appropriately for whatever the economic environment turns out to be.

One other note before we open it up for questions. I look back at the transcript of my closing comments from last year's fourth quarter call. We called the market irrational and said it had reached a point where it was no longer based on value and logic. And we said we looked forward to a return to more thoughtful and value-based markets and would position ourselves to be a leader in that environment.



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Given our viewpoint back then, we should have positioned ourselves better for the expected correction, but I do think we have gotten the value-based market we hoped for. I firmly believe we will emerge, as we did in 1993 and in 1999, as the leader in our field during what is shaping up as another extended period where very attractive lending will be possible.

So stay tuned, and let's open it up for questions.

## QUESTIONS AND ANSWERS

**Operator**

(OPERATOR INSTRUCTIONS). Don Fandetti, Citigroup.

**Don Fandetti** - *Citigroup - Analyst*

A question. CRE fundamentals and delinquencies remain pretty good, yet it seems like your portfolio is starting to really show some weakness. What do you attribute that to? Is it that you have a residential taint? And how do you expect to manage through that as the market gets tougher in theory?

**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

I guess two things. In terms of the parts of the portfolio, obviously as Katy mentioned, the condo conversion market, we took a pretty hard view pretty quickly and said, "If you are not prepared to put up money and protect your position, we are going to foreclose, period."

As Katy also said, in each case we have a choice. We can work out lower interest rates, provide more capital, waive some requirements. Our fundamental view over the last six months has become if we do not control the collateral, value is destroyed. So in cases where we are not seeing a response from a borrower that indicates a belief in either the return of value to their equity position or protection by the mezzanine lender of their position, we are going straight to, "Guys, if you do not believe, hand us the keys. And if you do not want to hand them politely, we are going to take them."

I think a lot of these situations we will recover full value. In some cases we will recover extra return through either default interest, extension fees. But I guess our view right now is let's get our hands on the collateral because we feel very comfortable we can maximize the value.

It is primarily in the residential related area. I think as we look at our loan to values we still feel pretty good about most of the book. So we set up $300 million against a bunch of assets we expected to have to work on, and we still feel really good, as you heard me say, that if you give us $0.20 on a deal that was a 0 to 80% loan to cost, and you give us a big basket of those to work with, we are going to get you out. And our returns and our profile have always -- have been premised on, we can lose up to $0.20. That is what we believe. I still think that number is the correct number. It might be little bit off; it is not a lot off.

I think the real estate market is weakening. I think we are trying to be proactive. I think where customers and sponsors show commitment, we should not have a problem. Where they do not, I think we are probably moving a little more aggressively perhaps than others to say, "We are not going to cut our interest rate. We are not going to waive a floor. We are not going to do the things that transfer value from our shareholders to your pocketbook, unless you show a very serious commitment in and of your own capital."

I feel like the credit markets' down shift here needed to be reflected in our numbers. We took a pretty harsh view across a wide range of assets and said, you know, that should be put on watchlist, because if this market continues with very, very limited



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liquidity, we are going to be in a conversation with that customer. It does not mean we are going to lose our money, it just means we are going to be in a hard conversation.

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**Don Fandetti** - *Citigroup - Analyst*

Katy, just to clarify, when you close the secured debt on the CTL portfolio you will be paying off the bridge prior to maturity, is that correct?

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**Katy Rice** - *iStar Financial Inc. - CFO*

Yes. Both the AutoStar, the CTL proceeds and obviously the timber sale will be happening in the second quarter. We will have plenty of liquidity to pay the bridge down.

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**Operator**

James Shanahan, Wachovia.

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**James Shanahan** - *Wachovia - Analyst*

First of all, with regards to the condo unit closings, Jay, thank you very much for providing that incremental disclosure. That was very helpful. Can you provide, however, a little bit of added context? And what I need is how do, for example, these strong loan closing, especially given what I would expect to have observed here are seasonal trends in January and February, how do those closings compare to the number of units in the portfolio that are available for sale? And what kind of actions do you take in terms of pricing or really any other potential added value to the buyer to incent them to act and to close on a condo?

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

We tried to come up with a statistic that would do exactly what you are asking. There is just no simple way to do it on a portfolio-wide basis. Obviously, new projects that reach the state of receiving their certificate of occupancy can be begin closing on contract. So we are in a position where we track those every week. And it is hard from week to week to give you a statistic that actually make sense, so we are giving you raw data.

There are probably somewhere between 7,500 and 10,000 units that we track inside our portfolio available for sale. We only need a fraction of those to close to get us out. But obviously the equity sponsors are trying not only to get their money back, pay off their mezzanine, but actually in many cases they still believe they have meaningful profits at stake. We do not control the pricing. It is really not our purview as a lender to tell people what to do. We may waive minimum release prices. We can work with borrowers to say, if you sell at this price we might be willing to do something for you.

But at this point we are just trying to encourage everyone that we think still has value in their project to understand that on a net present value basis they will do better in the long run from actually moving units with a customer who says, I want to close. I either need a little help in price or I need a little help in terms of getting financing. That is what they should be focused on rather than holding tight and saying, we are not going to move prices. Those sponsors who have actually done that are continuing to move units. We have seen that again throughout the portfolio. It is not concentrated in any one geographic location. We see it throughout the portfolio, that if you move markets to a market clearing price, people are seeing both traffic and they are seeing closings.

I think, again, we are fortunate that most of the projects, the new build projects, are quite good. They are good real estate. They are in good locations. In many cases, they are the best product in the market. And when you cut the price to be competitive



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with old product, or obsolete product, you start inducing people out of those projects into your projects. Now that price point typically is fine for us, and typically not so good for the equity, or in some cases even the mezz, and so that is not something we can force them to do until they reach a point where they actually have to ask us for a favor.

And then we are guiding them to, look, the markets are not likely to get better. If you move to a market price now here is how we are willing to play. But if you do not, guys, we are not going to sit here and take any sort of concession so you can try to make profits that we think are no longer available in the marketplace.

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**James Shanahan** - *Wachovia - Analyst*

Then a quick follow-up. Given the repayments and the fundings that have occurred in particularly the condo loans and investments, have there been any meaningful changes in the geographic diversification of the condo portfolio?

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

Not yet. I would think you may see a reduction in New York throughout this year. And even in South Florida we are still of the mind that enough units will close and both of those exposures will come down fairly materially this year. But as Katy said, we are being somewhat conservative. We have taken repays down probably about 25%, 20 to 25% from last year's viewpoint. I will tell you lower, certainly our minds, lower interest rates are helping. Expanded Fannie Mae eligibility will likely help a little bit. But this macro economic overlay is really the variable we are spending the most time trying to figure out, when does it stabilize, does it stabilize, and how do we play that both offensively and defensively.

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**Operator**

Susan Berliner, Bear Stearns.

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**Susan Berliner** - *Bear Stearns - Analyst*

I wanted to touch on two topics. One was if you can talk about the corporate loan and bond portfolio? And I guess it just looks like the loan sizes in that were a lot larger than you typically take in the loan portfolio. I guess, considering how it is done, and I know it is a little unfair because of what is going on in the market, are you reevaluating that kind of product type for investment?

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

Two good questions. On the first one, these are two of the larger positions. In one case it was meant to be a semi-controlled position. In the other case we wanted to be a larger player. We had actually looked in the capital stack of the transaction with a very high private institutional equity investor. They were looking to actually put a mezzanine piece in. We did extensive underwriting, decided that risk reward was not appropriate for us. Dropped down into a senior bank debt position thinking we were safe. Market has kind of caught one by the tail. The equity sponsor continues to believe in the story, continues to have a very significant investment. Junior continues to pay those notes. But it is right in the vortex of some of the crosscurrents that are touching the marketplace.

And while it is in our held for maturity bucket, which everybody should understand when we put something in held to maturity bucket, it is very, very difficult for us to exit until there is a credit event. We expected to be a long-term hold. At this point it is still a long-term hold. But when it trades at the kind of levels we have seen recently, we think it was appropriate, as we analyzed it recently, to take that one down.



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The other asset is a controlled position in asset we thought we knew quite a bit about. We still believe there is inherent value there. But again that one is right in the crosshairs of some of market dynamics -- some ugly market dynamics. And it is still paying and we are still going to be in the mix there. And certainly we hope to recover our collateral value. But again, appropriate to move that one down. Those are larger -- in fact, I think those are two of the largest exposures in that portfolio.

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**Susan Berliner** - *Bear Stearns - Analyst*

I guess the other question was, it seemed like you were talking about that one $200 million mix used asset on the NPL list, and you seemed pretty confident in that. And you guys also made note to resolving a bunch of NPLs in the quarter. I guess I am trying to figure out what can we expect for additional provisions this year?

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**Katy Rice** - *iStar Financial Inc. - CFO*

It is hard for us to predict. Obviously the provision is based on, again, the risk rating process that we undertake after the end of the quarter. And as you can see, while we are busy resolving a number of our NPL and Watch List assets, the Watch List is also up a bit. And so I think it is a little bit difficult for us to give you a good forecast on the potential provision.

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

I would say as just a characterization, the fourth quarter was unusual.

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**Operator**

David Fick, Stifel Nicolaus.

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**David Fick** - *Stifel Nicolaus - Analyst*

Just following up on that question, Katy, you, in your prepared comments, said that the issues are knowable and underwritable. Yet we have this big impairment issue this quarter. I know it is hard for you to look forward, but clearly things happen that you did not underwrite and did not know. I am just wondering how you would advise analysts and investors to look at your book value and the quality of its underwriting going forward?

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**Katy Rice** - *iStar Financial Inc. - CFO*

That is a good question. I think it is a little confusing in the corporate and loan and debt maturity -- held to maturity bucket. As we outlined, that bucket is not reservable and it is subject -- it is on the book at book value. And to the extent assets in that portfolio trade down significantly on a more than temporary basis, we are required to take an impairment based on the market trading. So that group of assets, as we outlined, is only about $423 million. We took an impairment on two of the six assets in that bucket. And I am sure you are well aware that the corporate debt market is being subjected to some fairly draconian trading levels at this point. I think at the end of the quarter we felt, although we are still relatively confident in both of these assets, that we needed to take this impairment based on the market price.

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

Just to chip in there a little bit. What is clear to us, and I hope it really is the punch line to Katy's comment about underwritable and knowable, these are non-structured products. These are not assumptions stuck into a model. If you are right, you are right and if you are wrong, you are wrong. You are not even making a real estate call, because you cannot go and look at the real



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estate, or you cannot go on looking at the operating business. Basically you have a structured security that has very volatile characteristics that are unknowable and un-underwritable.

We certainly have looked at a lot of opportunities in the current market dislocation that appear on the surface to be very attractive, but when we get inside they are unknowable and un-underwritable and really do not fit our profile. The things we are investing in and the things we hopefully are working on inside our own portfolio, we can come to a reasonable value conclusion and could probably defend that across a wide range of investors, and say, this is why this value is reasonable.

We are having a very hard time when we get shown some of the structured product stuff that somewhere in its mix it has a piece of real estate, but it is so layered or so convoluted in its return profile we cannot underwrite it, and we do not really know how to defend purchase price. There may be some great opportunities in that sector. That is why we continue to look. But right now we think the structured product world is not our strength. And weare very much focused on the existing portfolio and new opportunities, where we can bring the full resources of the firm to bear and actually come to a conclusion. Everybody around the table in every discipline, from asset management to construction to legal to real estate investment can look at each other and go, that makes sense. I understand that.

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**David Fick** - *Stifel Nicolaus - Analyst*

Can you help us out with why GAAP EPS guidance is higher than adjusted EPS? Typically it runs the other way?

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

Yes, as I said, and I think we have said this a couple of times in the past, we think embedded gains in the portfolio significantly outweigh some of the issues that obviously have a lot of attention. As you talked about, book value we continue to believe very strongly that we have a number of assets that are very much under book in terms of value. And on the downside we have lots of reserves for those that are on the other side. So we still feel very good about the overall book.

When you look at timber in particular as one of the asseta that, at least at this point we can actually demonstrate to you that dynamic. It is $185 million. That is from depletion down probably to about $150 million on our book. We are going to receive $400 million of proceeds. There is going to be a very large GAAP gain and a large economic gain there. And so we, from a GAAP perspective, are going to have a very large gain, but that is not something we will run through AEPS. It will only run through GAAP. But it clearly is a taxable gain, and so in terms of the dividend, as Katy mentioned, it creates an enormous cushion to protect that dividend in 2008. We do not want that to be lost on folks.

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**David Fick** - *Stifel Nicolaus - Analyst*

Last question. Clearly, a lot of external factors are affecting performance, but I am wondering if you can give us any guidance on how management compensation is being impacted by share performance and losses?

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

As you saw, G&A came down very materially in the fourth quarter. That was the reversal of some management bonus accruals. We continue to try to implement pay for performance structures that align shareholder interest with management's interest. We continue to have an enormous amount of our net worth in this Company. And I am going to continue to exercise option and buy shares at these levels. I believe that at a 16 dividend yield or 15 dividend yield, I think that dividend certainly for this year is very well protected. There is an extraordinary opportunity, and we are willing to make the bet with our Board and our comp committee that we will generate strong returns for shareholders over the next several years. And we will structure our compensation appropriately.



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**Operator**

Michael Dimler, UBS.

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**Michael Dimler** - *UBS - Analyst*

I am just kind of curious as to why your last dollar LTV rose during the quarter when it has been pretty steady all along? Can you talk a little bit about the dynamics of that?

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

It would be hard to not think real estate values are going to be impacted by a lack of liquidity throughout the entire credit markets. We certainly thought, even at the end of last year, that values were starting to slip by as much as 10 or 15 or even 20%. So we have a pretty good cushion in that we never mark our assets up internally to some of the valuations that we thought were inappropriate. So the LTV has inched up. I do not think it has moved up materially.

But I think we are cognizant as everybody should be that some of the valuation metrics that existed over the last two or three years are going to get notched down if liquidity does not come back to this market. And based on our view that we have notched the entire risk complex down based on the macroeconomic overlay, it is not surprising that LTVs are inching up.

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**Michael Dimler** - *UBS - Analyst*

And that is marked not necessarily to transactions but to your view of where they should be priced? Is that right?

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

Exactly. I think we have mentioned our historical experience, our marks are significantly below where things actually traded, or values upon which they were refinanced. I think that statistic which our asset managers track has been in the 20 to 25% range historically. As I said, we are probably eating up some of that margin as values in the more frothy sectors come back to earth. But we still think we mark things very appropriately.

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**Michael Dimler** - *UBS - Analyst*

Just as a follow-up, apart from condos, are you seeing any serious acceleration of deterioration in other property classes?

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

You know the equity side of the real estate market is very quiet right now. I think people are trying to find the new level. Some assets get done at prices that still shock us. We have not seen the big distress portfolio moves where you have seen real estate equity prices be readjusted materially. I think that will be a matter of both the overall market environment and liquidity. And there will come a point where there will be sellers who have to sell. There is plenty of equity money in this market. There is plenty of mezzanine money actually in the market. What is lacking, and this is unusual because it is the 180 degree flip side of history, is low-risk, low return money has disappeared.

So you have got high-risk, high-return money sitting on the sidelines waiting, but a lot of that money needs low-risk, low-return credit to actually make their play. And right now that is the piece of the market that has not come back. And that is the piece of the market we are watching very carefully, because it will be a driver of value, not just in our market but in lot of markets.



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**Operator**

Tayo Okusanya, UBS.

**Tayo Okusanya** - *UBS - Analyst*

I am just trying to do all my reconciliations of your actuals versus my projections. There is one thing I am -- I just need a little help with it -- it is the large other expense line that shows up in the numbers this quarter that has not been there historically. Could you just give us more detail in regards to what that is?

**Katy Rice** - *iStar Financial Inc. - CFO*

Sure. Other expense tail in this quarter is the $135 million impairment primarily. Plus there are also the gain or loss of the mark-to-market on our derivatives.

**Tayo Okusanya** - *UBS - Analyst*

That is the whole thing that goes --. It actually went through the P&L rather than going through retained earnings?

**Katy Rice** - *iStar Financial Inc. - CFO*

Yes.

**Operator**

Douglas Harter, Credit Suisse.

**Douglas Harter** - *Credit Suisse - Analyst*

I was just wondering if you could help reconcile the difference between the $4.4 billion of unfunded commitments that you gave at the Investor Day and the $3 billion that you were talking about today?

**Katy Rice** - *iStar Financial Inc. - CFO*

Sure. Some of them had been funded in the interim. But as we mentioned, there are a lot of projects that are either being delayed, postponed or canceled, particularly given the current economic environment and what people are viewing as it may be a time to hold on to those assets rather than proceed ahead, and kind of get a better feel for -- if it is a two-year construction period, when they really want to start that process.

**Douglas Harter** - *Credit Suisse - Analyst*

Then on the debt maturities and paydowns, I think you said the paydowns in the current quarter were like $500 million and you are expecting $4 billion for full year 2008. Is some of that seasonal or are you expecting a pick up in activity?



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**Katy Rice** - *iStar Financial Inc. - CFO*

In terms of paydowns for the remainder of 2008, it totals about $4 billion. That was versus $5 billion at the end of December, sort of at Investor Day. We received a lot of those paydowns. We also scrub those numbers. And as we have mentioned, one of the things that we have a little less confidence in is the repay schedule, given the current liquidity environment. We are having borrowers that are having -- they have good projects, great credit statistics on their projects, but they are having trouble right now finding sources of repayments.

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

I think it is fair to say the second half repayments are slightly higher than the first half repayments. So if you are looking for that trend, that is what it would be.

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**Douglas Harter** - *Credit Suisse - Analyst*

Is that contractual or is that some assuming that there is some improved liquidity in the market?

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**Katy Rice** - *iStar Financial Inc. - CFO*

No, this is not contractual per se. This is the list -- this is how we look at it as what we expect to get based on our knowledge and our discussion with borrowers that have 2008 maturities.

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**Douglas Harter** - *Credit Suisse - Analyst*

Your plan now obviously has more of a built-in cushion. Are you likely to run with that bigger cushion for the foreseeable future as opposed to deploying the assets -- deploying that excess sources?

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**Katy Rice** - *iStar Financial Inc. - CFO*

Right now, as Jay mentioned, we are not seeing tremendous amounts of transaction volume. There seems to be a bit of stoppage in both the equity and debt side of the real estate Capital Markets. We expect, and hope, that as the year continues we will see additional opportunities to put capital to work at what we think will be very attractive risk-adjusted returns. But right now we are just not seeing that level of activity, so it is a little hard to give you a view on that.

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**Operator**

Stephen Laws, Deutsche Bank.

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**Stephen Laws** - *Deutsche Bank - Analyst*

A couple of questions. I wanted to follow-up on the Fremont I guess unfunded commitment pipelined that I think you touched on earlier. You talked about it looks like a little over $500 million was funded during the quarter, yet the unfunded pipeline went down about $800 million. You are looking to fund about $1.8 billion of the $2.2 billion left. Can you talk about why you expect the fallout to decline on -- to decrease the pace there? And also talk about any property types or geographical regions where you are seeing a high percentage of fallout?

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**Katy Rice** - *iStar Financial Inc. - CFO*

There are a couple of things that impacts the additional funding. One is it tends to be pushed out from the timing perspective. And this is nothing more than construction frankly always takes longer than people originally think. So I think while a lot of those will be funded, they tend to lag what we originally think of as the schedule.

But the second thing, as I mentioned, again a lot of the early-stage projects, particularly in the Fremont portfolio, we have sponsors who are scratching their heads saying, I am not really sure I want to move forward, given what I am seeing in my market for this type of project. So many of them are coming, and we are working with them to say, we think that makes sense. Let's put the project on hold. And we are effectively canceling those commitments to fund.

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

I think those cancellations are front loaded. We know which ones are not moving forward. We would not expect that same percentage to drop out of the future projection.

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**Katy Rice** - *iStar Financial Inc. - CFO*

Right, every quarter.

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

People have missed benchmarks, which give us the ability to say, your project is not viable, or for them to say their project is not viable. A lot of that has already been sorted through the book. By the end of the year the Fremont forward commitments are actually at quite low numbers. So really 2008 will be the hump year. We will pretty much have very good visibility. And we think we already know the vast majority of the deals that just will never fund, or which will never hit the benchmark to cause us to fund. I would not project that forward as something that is going to keep repeating itself.

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**Stephen Laws** - *Deutsche Bank - Analyst*

Obviously, I guess it is a lot of the condo conversion, but any other property types or geographic concentrations we are seeing in that fallout abnormally high?

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

I cannot give you anything systemic that actually rises to level of here is a big trend. It is one-off projects, sympathetic with the overall market conditions in almost every major metro market. People are much more cautious in terms of being able to deliver presales. That is one precondition on the residential side, preleasing on the retail side, preleasing on the office side.

If you are not hitting numbers, most of these loans are predicated on very stiff milestones. And if you do not hit them, generally if you have a chance to stop the project, borrowers are stopping. And if they cannot, they are in a position where we are requiring them to put a lot more money in before we are willing to do something.

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**Stephen Laws** - *Deutsche Bank - Analyst*

I guess one quick question, if you could just touch on the integration of the Fremont salesforce? When the deal was completed you guys were looking to retain most of the salespeople in the various offices. How is that coming along with changing the culture there?



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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

We spent a lot of time on that in the last six months. It is unfortunate that we have not really been able to unleash what the combination of local market knowledge and some of the Capital Markets knowledge that we sitting in New York have. I think that is frustrating to everybody. But I think the systems, the processes, some of the dynamics that we needed to get in place are there now. And I certainly feel like we have a very strong organization with tremendous capabilities right now. It would be nice to have the capital to use that.

One of the reasons for the joint venture with Lubert-Adler was frankly those guys are on the ground investing equity capital out of their new funds. They, like us, see that the debt market is repricing much faster. They, like us, see that some of the more interesting areas are semi-distressed. And it takes a real on the ground presence to be able to underwrite and gain confidence that you are generating good or great risk-adjusted returns. And we think that is another case where one plus one can actually equal three.

We are excited by that. Obviously, we would like to get back in business investing a lot of our own capital, but first things first. When we do get out of the mud, we want to be running pretty quickly. We are going to keep everybody focused on existing assets, new asset opportunities and market trends, and when the door opens we will be ready to run through it.

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**Stephen Laws** - *Deutsche Bank - Analyst*

One final question. Just some detail on the guidance, new guidance of $3.50 to $4. I think you said during the prepared remarks it assumes zero net asset growth. Is it really the loss provision that is the key there from what is going to drive it from $3.50 to $4? What are the other main variables to the endpoints of that range?

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**Katy Rice** - *iStar Financial Inc. - CFO*

I think it is a number of things. It is the loss provision. Obviously, we mentioned that when we do put assets on NPL, we stop accruing the income, so that impacts income. I think we are also taking a harder look at the other income line item, which historically has been primarily comprised of prepayment penalties. Obviously in this environment we are expecting lower prepayment penalties on assets. So it is a couple of things.

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**Operator**

Dean Choksi, Lehman Brothers.

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**Dean Choksi** - *Lehman Brothers - Analyst*

Can you provide a little bit more color on the investment mandate for the private equity JV and the fee structure?

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

Sure. We are really targeting that to large transactions, so first mortgages over $75 million, junior positions over $50 million. We will be receiving a management fee and a small promote on capital those is actually deployed. I think that is probably secondary in our minds to really the ability to expand our network of knowledge with a firm that has tremendous relationships throughout the country. And we think it is at ground zero in a couple of the markets where we think there is going to be really interesting opportunities, both by geographic regions and asset types.



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I think we have had a lot of people actually approach us with capital. I think frankly some of them on more attractive economic terms to us to invest. We like this structure for the one plus one equals three network of knowledge angle, but it is also very short term. It is a six month duration investment period, so it is meant to be quick hitting. It has the ability to do some of the more semi-distressed stuff that we think might be more interesting early in the curve here. But it certainly does not preclude us from doing something in a different vein down the road.

We think this is the way to build our knowledge-base very quickly in a market that we think is going to change valuations relatively soon, if this market does not correct. We think Lubert-Adler is a great partner here to use their new fund that we have raised to get into the market in some really great risk-adjusted return opportunities that we see, and to just share the economics of those.

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**Operator**

James Shanahan, Wachovia.

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**James Shanahan** - *Wachovia - Analyst*

Just a quick question. There was some volatility on the revenue side associated with joint venture income. And I apologize if I missed that explanation, but the last time it spiked it had something to do with Ivy Hill. Can you comment on what led to that big joint venture income increase on a year-over-year and sequential quarter basis?

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**Katy Rice** - *iStar Financial Inc. - CFO*

The bulk of that increase was related to the an increase in management fees in our 47.5% interest in Oak Hill.

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**Operator**

Susan Berliner, Bear Stearns.

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**Susan Berliner** - *Bear Stearns - Analyst*

I just wanted to follow-up. I guess, Katy, on the sources and uses, one quick question. Do any of the loans -- or what percentage of the loans can be extended instead of being repaid?

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**Katy Rice** - *iStar Financial Inc. - CFO*

We do not track that exact statistic. But when we look at the forces from maturities and paydowns, again this is not necessarily the contractual date, this is an assumption that we and our asset management team scrub almost on a weekly basis to indicate when we actually expect. So that the borrower may have a maturity coming up, but we know that he is working on refinancing and will probably be a month late.

Instead of showing that at the maturity, we would show it at when we actually expect to receive the paydown. Or if we do not expect to receive the paydown, we would not include that. So we would obviously take into account any extensions, any as-of-right extensions that they have, and frankly assumed in this environment that they will extend.

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**Susan Berliner** - *Bear Stearns - Analyst*

Just in terms of looking at the sources and uses, the sources include the remaining on your bank line. And I know you mentioned asset sales as a possibility. I was wondering if you could elaborate a little bit on that, and also about potential for additional equity issuance?

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**Katy Rice** - *iStar Financial Inc. - CFO*

As we have already talked about, we are in the process of finalizing the sale of our TimberStar Southwest venture. We are also working on the sale, which will take a little longer and it has really just started the process, of our Northeastern timber assets.

With respect to equity issuance, I think we do not have any firm plans there. And based upon the current valuations, obviously that is not an attractive proposition. But it is early in the year, and I think we will have to keep you updated based on where we see the business headed.

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**Operator**

Tayo Okusanya, UBS.

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**Tayo Okusanya** - *UBS - Analyst*

Thanks for taking my follow-on question. Just a little bit of focus on the dividend. When I think about the dividend going forward I really should be thinking about the taxable earnings, right? Although even if provision levels go up going forward, if you guys are successful at working through any default, and you end up not having any charge-offs, then on a net net basis you are not seeing any impact to your taxable earnings, which should not impact the dividends, right?

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**Katy Rice** - *iStar Financial Inc. - CFO*

That is correct.

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**Tayo Okusanya** - *UBS - Analyst*

Or am I thinking about this -- should I be thinking about this differently?

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**Katy Rice** - *iStar Financial Inc. - CFO*

No, that is correct.

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**Tayo Okusanya** - *UBS - Analyst*

Great. Thank you.

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**Jay Sugarman** - *iStar Financial Inc. - Chairman, CEO*

Let me just follow-up on that question. I get asked often what are the priorities for the firm right now. I just want to make sure that everybody understands that from a credit prospective being an investment grade company is sacrosanct. We have worked



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tremendously hard over a ten-year period. We have unencumbered our balance sheet. We have kept low leverage relative to all the other finance metrics we have seen in the marketplace. That remains number one priority.

Two, that dividend is important to our shareholders. We think with the timber sale it is well-cushioned. At this point we fundamentally believe that the dividend is something that is critically important.

Then lastly I think our focus is on raising the capital to get busy. We have got a very large and talented organization that has proved over 15 years that it can make 15 to 20% returns on equity. We want to deploy that a market that we think is as good as it is going to be for many, many years. And I think that if we do those three things well this year, we are going to be very well-positioned going into '09, '10, and '11.

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**Andrew Backman** - *iStar Financial Inc. - SVP IR*

Thanks, Jay. And thanks everybody for joining us this morning. If you do have any additional questions on today's earnings release or the call, please feel free to contact me directly here in New York. Ken, will you please give the conference call replay instructions once again. Thank you everybody.

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**Operator**

Ladies and gentlemen, this conference will be available for replay after 12 PM today until March 13 at midnight. To access our playback service, you may dial 1-800-475-6701 and enter the access code of 909339. International participants may dial 320-365-3844 and entering the access code of 909339. That does conclude our conference for today. Thank you for your participation and using AT&T. You may now disconnect.

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