ISTAR FINANCIAL INC
Form 10-Q
November 07, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2008

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ______________ to ______________

Commission File No. 1-15371

iSTAR FINANCIAL INC.

(Exact name of registrant as specified in its charter)

Maryland	**95-6881527**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
1114 Avenue of the Americas, 39th Floor **New York, NY**	**10036**
(Address of principal executive offices)	(Zip code)

Registrant's telephone number, including area code: **(212) 930-9400**

Indicate by check mark whether the registrant: (i) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve months (or for such shorter period that the registrant was required to file such reports); and (ii) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ý	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No ý

As of October 31, 2008, there were 130,649,270 shares of common stock, $0.001/par value per share of iStar Financial Inc., ("Common Stock") outstanding.

iStar Financial Inc.

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PART 1. CONSOLIDATED FINANCIAL INFORMATION

Item I. Financial Statements

iStar Financial Inc.

Consolidated Balance Sheets

(In thousands, except per share data)

(unaudited)

	As of September 30, 2008	As of December 31, 2007
ASSETS		
Loans and other lending investments, net	$ 10,744,047	$ 10,949,354
Corporate tenant lease assets, net	3,143,697	3,309,866
Other investments	527,760	856,609
Other real estate owned	277,232	128,558
Assets held for sale	3,657	74,335
Cash and cash equivalents	779,472	104,507
Restricted cash	59,329	32,977
Accrued interest and operating lease income receivable	89,200	121,405
Deferred operating lease income receivable	114,748	102,135
Deferred expenses and other assets	180,648	125,274
Goodwill	4,186	43,278
Total assets	$ 15,923,976	$ 15,848,298
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Accounts payable, accrued expenses and other liabilities	$ 348,189	$ 495,311
Debt obligations	13,060,499	12,399,558
Total liabilities	13,408,688	12,894,869
Commitments and contingencies		
Minority interest in consolidated entities	61,206	53,948
Shareholders' equity:		
Series D Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 4,000 shares issued and outstanding at September 30, 2008 and December 31, 2007	4	4
Series E Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 5,600 shares issued and outstanding at September 30, 2008 and December 31, 2007	6	6
Series F Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 4,000 shares issued and outstanding at September 30, 2008 and December 31, 2007	4	4
Series G Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 3,200 shares issued and outstanding at September 30, 2008 and December 31, 2007	3	3
Series I Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 5,000 shares issued and outstanding at September 30, 2008 and December 31, 2007	5	5
High Performance Units	9,800	9,800

Common Stock, $0.001 par value, 200,000 shares authorized, 137,224 issued and 132,043 outstanding at September 30, 2008 and 136,340 issued and 133,929 outstanding at December 31, 2007	136	135
Options		1,392
Additional paid-in capital	3,724,109	3,700,086
Retained earnings (deficit)	(1,209,409)	(752,440)
Accumulated other comprehensive income (losses) (see Note 13)	6,658	(2,295)
Treasury stock (at cost)	(77,234)	(57,219)
Total shareholders' equity	2,454,082	2,899,481
Total liabilities and shareholders' equity	$ 15,923,976	$ 15,848,298

The accompanying notes are an integral part of the consolidated financial statements.

iStar Financial Inc.

Consolidated Statements of Operations

(In thousands, except per share data)

(unaudited)

	For the Three Months Ended September 30, 2008	For the Three Months Ended September 30, 2007	For the Nine Months Ended September 30, 2008	For the Nine Months Ended September 30, 2007
Revenue:				
Interest income	$ 237,006	$ 316,829	$ 748,460	$ 689,836
Operating lease income	81,440	81,859	242,008	237,975
Other income	22,922	19,271	88,707	84,855
Total revenue	341,368	417,959	1,079,175	1,012,666
Costs and expenses:				
Interest expense	168,040	173,376	499,131	441,095
Operating costs corporate tenant lease assets	5,647	7,746	15,583	21,555
Depreciation and amortization	24,827	23,244	73,973	63,061
General and administrative	37,736	51,246	124,516	128,178
Provision for loan losses	411,142	62,000	777,302	72,000
Impairment of goodwill			39,092	
Impairment of other assets	88,075		145,766	
Other expense	(972)	2,949	6,127	2,949
Total costs and expenses	734,495	320,561	1,681,490	728,838
Income (loss) before earnings from equity method investments, minority interest and other items	(393,127)	97,398	(602,315)	283,828
Gain on early extinguishment of debt	68,321		69,916	
Gain on sale of joint venture interest, net of minority interest			261,659	
Earnings from equity method investments	1,905	2,598	5,377	1,145
Minority interest in consolidated entities	502	(277)	1,069	302
Income (loss) from continuing operations	(322,399)	99,719	(264,294)	285,275
Income from discontinued operations	688	4,880	11,222	15,705
Gain from discontinued operations, net of minority interest	19,955	1,045	68,798	7,823
Net income (loss)	(301,756)	105,644	(184,274)	308,803
Preferred dividend requirements	(10,580)	(10,580)	(31,740)	(31,740)
Net income (loss) allocable to common shareholders and HPU holders(1)	$ (312,336)	$ 95,064	$ (216,014)	$ 277,063
Per common share data(2):				
Income (loss) from continuing operations per common share:				
Basic	$ (2.46)	$ 0.69	$ (2.16)	$ 1.96
Diluted	$ (2.46)	$ 0.68	$ (2.16)	$ 1.94
Net income (loss) per common share:				
Basic	$ (2.30)	$ 0.74	$ (1.58)	$ 2.14
Diluted	$ (2.30)	$ 0.73	$ (1.58)	$ 2.12
Weighted average number of common shares basic	133,199	126,488	133,955	126,644
Weighted average number of common shares diluted	133,199	127,508	133,955	127,782
Per HPU share data(2):				
Income (loss) from continuing operations per HPU share:				
Basic	$ (463.13)	$ 130.41	$ (412.19)	$ 370.54
Diluted	$ (463.13)	$ 129.47	$ (412.19)	$ 367.41
Net income (loss) per HPU share:				
Basic	$ (434.47)	$ 139.07	$ (301.53)	$ 404.87
Diluted	$ (434.47)	$ 138.07	$ (301.53)	$ 401.47

Weighted average number of HPU shares basic and diluted	15	15	15	15

Explanatory Notes:

(1) HPU holders are Company employees who purchased high performance common stock units under the Company's High Performance Unit Program (see Note 11).

(2) See Note 12 Earnings Per Share for additional information.

The accompanying notes are an integral part of the consolidated financial statements.

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iStar Financial Inc.
Consolidated Statements of Changes in Shareholders' Equity
For the nine months ended September 30, 2008
(In thousands)
(unaudited)

	Series D Preferred Stock	Series E Preferred Stock	Series F Preferred Stock	Series G Preferred Stock	Series I Preferred Stock	HPU's	Common Stock at Par	Options	Additional Paid-In Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (losses)	Treasury Stock	Total
Balance at December 31, 2007	$4	$6	$4	$3	$5	$ 9,800	$ 135	$ 1,392	$ 3,700,086	$(752,440)	$(2,295)	$ (57,219)	$ 2,899,481
Exercise of options								(1,392)	7,260				5,868
Dividends declared preferred										(31,740)			(31,740)
Dividends declared common										(236,052)			(236,052)
Dividends declared HPU										(4,903)			(4,903)
Repurchase of stock												(20,015)	(20,015)
Issuance of stock vested restricted stock units							1		15,013				15,014
Issuance of stock DRIP/stock purchase plan									1,750				1,750
Net loss for the period										(184,274)			(184,274)
Change in accumulated other comprehensive income (losses)											8,953		8,953
Balance at September 30, 2008	$4	$6	$4	$3	$5	$ 9,800	$ 136	$	$ 3,724,109	$ (1,209,409)	$ 6,658	$ (77,234)	$ 2,454,082

The accompanying notes are an integral part of the consolidated financial statements.

iStar Financial Inc.

Consolidated Statements of Cash Flows

(In thousands)

(unaudited)

	For the Nine Months Ended September 30, 2008	2007
Cash flows from operating activities:		
Net income (loss)	$ (184,274)	$ 308,803
Adjustments to reconcile net income to cash flows from operating activities:		
Minority interest in consolidated entities	(1,069)	(302)
Non-cash expense for stock-based compensation	17,262	12,300
Impairment of goodwill	39,092	
Impairment of other assets	145,766	
Shares withheld for employee taxes on stock based compensation arrangements	(3,379)	(3,053)
Depreciation, depletion and amortization	79,407	71,547
Amortization of deferred financing costs	28,520	19,091
Amortization of discounts/premiums, deferred interest and costs on lending investments	(155,511)	(142,680)
Discounts, loan fees and deferred interest received	23,974	46,697
Equity in earnings of unconsolidated entities	(5,377)	(6,390)
Distributions from operations of unconsolidated entities	41,132	35,655
Deferred operating lease income receivable	(14,242)	(17,153)
Gain from discontinued operations, net of minority interest	(68,798)	(7,823)
Gain on sale of joint venture interest, net of minority interest	(261,659)	
Gain on early extinguishment of debt	(69,916)	
Note receivable from investment redemption	(44,228)	
Provision for loan losses	777,302	72,000
Provision for deferred taxes	3,768	1,597
Other non-cash adjustments	(15,607)	769
Changes in assets and liabilities:		
Changes in accrued interest and operating lease income receivable	34,479	(25,327)
Changes in deferred expenses and other assets	(19,247)	8,019
Changes in accounts payable, accrued expenses and other liabilities	2,202	57,241
Cash flows from operating activities	349,597	430,991
Cash flows from investing activities:		
New investment originations	(13,609)	(2,732,281)
Add-on fundings under existing loan commitments	(2,635,428)	(1,819,407)
Repayments of and principal collections on loans	1,730,379	2,055,190
Purchase of securities		(28,815)
Cash paid for acquisition of Fremont CRE		(1,891,571)
Net proceeds from sales of discontinued operations	469,845	70,227
Net proceeds from sales of other real estate owned	91,707	
Net proceeds from sales of joint venture interest	416,970	
Proceeds from maturities or sales of securities	16,155	305,982
Contributions to unconsolidated entities	(28,445)	(56,506)
Distributions from unconsolidated entities	23,757	143,224
Capital improvements for build-to-suit facilities	(70,802)	(43,334)
Capital expenditures and improvements on corporate tenant lease assets	(17,942)	(21,526)
Other investing activities, net	(17,872)	(1,619)
Cash flows from investing activities	(35,285)	(4,020,436)
Cash flows from financing activities:		
Borrowings under revolving credit facilities	11,286,203	21,528,670
Repayments under revolving credit facilities	(10,402,382)	(20,322,709)
Borrowings under interim financing facility		1,900,000
Repayments under interim financing facility	(1,289,811)	

Borrowings under secured term loans	1,307,776	18,321
Repayments under secured term loans	(81,272)	(127,064)
Borrowings under unsecured notes	740,506	1,035,288
Repayments under unsecured notes	(812,189)	(200,000)
Contributions from minority interest partners	116	17,440
Distributions to minority interest partners	(9,215)	(3,339)
Changes in restricted cash held in connection with debt obligations	(31,415)	828
Payments for deferred financing costs/proceeds from hedge settlements, net	(27,736)	495
Common dividends paid	(269,827)	(210,394)
Preferred dividends paid	(31,740)	(31,740)
HPU dividends paid	(5,607)	(4,649)
HPUs redeemed	(11)	(82)
Purchase of treasury stock	(20,015)	(20,202)
Proceeds from exercise of options and issuance of DRIP/Stock purchase shares	7,272	4,675
Cash flows from financing activities	360,653	3,585,538
Changes in cash and cash equivalents	674,965	(3,907)
Cash and cash equivalents at beginning of period	104,507	105,951
Cash and cash equivalents at end of period	$ 779,472	$ 102,044

The accompanying notes are an integral part of the consolidated financial statements.

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iStar Financial Inc.

Notes to Consolidated Financial Statements

(unaudited)

Note 1 Business and Organization

Business iStar Financial Inc. (the "Company") is a leading publicly-traded finance company focused on the commercial real estate industry. The Company primarily provides custom-tailored financing to high-end private and corporate owners of real estate, including senior and mezzanine real estate debt, senior and mezzanine corporate capital, corporate net lease financing and equity. The Company, which is taxed as a real estate investment trust ("REIT"), seeks to deliver strong dividends and superior risk-adjusted returns on equity to shareholders by providing innovative and value-added financing solutions to its customers. The Company's two primary lines of business are lending and corporate tenant leasing.

The lending business is primarily comprised of senior and mezzanine real estate loans that typically range in size from $20 million to $150 million and have maturities generally ranging from three to ten years. These loans may be either fixed rate (based on the U.S. Treasury rate plus a spread) or variable rate (based on LIBOR plus a spread) and are structured to meet the specific financing needs of the borrowers. The Company also provides senior and subordinated capital to corporations, particularly those engaged in real estate or real estate related businesses. These financings may be either secured or unsecured, typically range in size from $20 million to $150 million and have maturities generally ranging from three to ten years. As part of the lending business, the Company also acquires whole loans, loan participations and debt securities which present attractive risk-reward opportunities.

The Company's corporate tenant leasing business provides capital to corporations and other owners who control facilities leased to single creditworthy customers. The Company's net leased assets are generally mission critical headquarters or distribution facilities that are subject to long-term leases with public companies, many of which are rated corporate credits, and many of which provide for most expenses at the facility to be paid by the corporate customer on a triple net lease basis. Corporate tenant lease ("CTL") transactions have initial terms generally ranging from 15 to 20 years and typically range in size from $20 million to $150 million.

The Company's primary sources of revenues are interest income, which is the interest that borrowers pay on loans, and operating lease income, which is the rent that corporate customers pay to lease our CTL properties. A smaller and more variable source of revenue is other income, which consists primarily of prepayment penalties and realized gains that occur when borrowers repay their loans before the maturity date. The Company primarily generates income through the "spread" or "margin," which is the difference between the revenues generated from loans and leases and interest expense and the cost of CTL operations. The Company generally seeks to match-fund our revenue generating assets with either fixed or floating rate debt of a similar maturity so that changes in interest rates or the shape of the yield curve will have a minimal impact on earnings.

Organization The Company began its business in 1993 through private investment funds. In 1998, the Company converted its organizational form to a Maryland corporation and the Company replaced its former dual class common share structure with a single class of common stock. The Company's common stock ("Common Stock") began trading on the New York Stock Exchange on November 4, 1999. Prior to this date, the Company's Common Stock was traded on the American Stock Exchange. Since that time, the Company has grown through the origination of new lending and leasing transactions, as well as through corporate acquisitions, including the acquisition of TriNet Corporate Realty Trust, Inc. in 1999, the acquisition of Falcon Financial Investment Trust, the acquisition of a significant non-controlling interest in Oak Hill Advisors, L.P. and affiliates in 2005, and the acquisition of the commercial real estate lending

iStar Financial Inc.

Notes to Consolidated Financial Statements (Continued)

(unaudited)

Note 1 Business and Organization (Continued)

business of Fremont Investment and Loan ("Fremont CRE"), a division of Fremont General Corporation, in 2007.

Note 2 Basis of Presentation

The accompanying unaudited Consolidated Financial Statements have been prepared in conformity with the instructions to Form 10-Q and Article 10-01 of Regulation S-X for interim financial statements. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles in the United States of America ("GAAP") for complete financial statements. These unaudited Consolidated Financial Statements and related Notes should be read in conjunction with the Consolidated Financial Statements and related Notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

The Consolidated Financial Statements include the accounts of the Company, its qualified REIT subsidiaries, its majority-owned and controlled partnerships and other entities that are consolidated under the provisions of FASB Interpretation No. 46R, "Consolidation of Variable Interest Entities," an interpretation of ARB 51 ("FIN 46R") (see Note 3). Certain investments in joint ventures or other entities which the Company does not control are accounted for under the equity method or the cost method (see Note 3 and Note 6 for further detail). All significant intercompany balances and transactions have been eliminated in consolidation.

In the opinion of management, the accompanying Consolidated Financial Statements contain all adjustments, consisting of normal recurring adjustments, necessary for a fair statement of the Company's consolidated financial position at September 30, 2008 and December 31, 2007, the results of its operations for the three and nine months ended September 30, 2008 and 2007, its changes in shareholders' equity for the nine months ended September 30, 2008 and its cash flows for the nine months ended September 30, 2008 and 2007. Such operating results may not be indicative of the expected results for any other interim periods or the entire year.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Certain prior year amounts have been reclassified in the Consolidated Financial Statements and the related notes to conform to the 2008 presentation.

Note 3 Summary of Significant Accounting Policies

Loans and other lending investments, net As described in Note 4, "Loans and other lending investments" includes the following investments: senior mortgages, subordinate mortgages, corporate/partnership loans and other lending investments-securities. Management considers nearly all of its loans and other lending investments to be held-for-investment or held-to-maturity, although a certain number of investments may be classified as held-for-sale or available-for-sale. Items classified as held-for-investment or held-to-maturity are reported at their outstanding unpaid principal balance, net of unamortized acquisition premiums or discounts and unamortized deferred loan costs or fees. These items also include accrued and paid-in-kind interest and accrued exit fees that the Company determines are probable of being collected.

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iStar Financial Inc.

Notes to Consolidated Financial Statements (Continued)

(unaudited)

Note 3 Summary of Significant Accounting Policies (Continued)

Items classified as available-for-sale are reported at fair value with unrealized gains and losses included in "Accumulated other comprehensive income (losses)" on the Company's Consolidated Balance Sheets and are not included on the Company's Consolidated Statements of Operations.

For debt securities held in "Loans and other lending investments," management evaluates whether the asset is other-than-temporarily impaired when the fair market value is below carrying value. The Company considers (1) the length of time and the extent to which fair value has been below carrying value, (2) the intent and ability of the Company to hold the security and (3) other market factors. If it is determined that an impairment exists that is other-than-temporary, the unrealized loss will be charged against earnings as an "Impairment of other assets" on the Company's Consolidated Statements of Operations.

Corporate tenant lease assets and depreciation CTL assets are generally recorded at cost less accumulated depreciation. Certain improvements and replacements are capitalized when they extend the useful life, increase capacity or improve the efficiency of the asset. Repairs and maintenance items are expensed as incurred. Depreciation is computed using the straight-line method of cost recovery over the shorter of estimated useful lives or 40 years for facilities, five years for furniture and equipment, the shorter of the remaining lease term or expected life for tenant improvements and the remaining useful life of the facility for facility improvements.

CTL assets to be disposed of are reported at the lower of their carrying amount or estimated fair value less costs to sell and are included in "Assets held for sale" on the Company's Consolidated Balance Sheets. The Company also periodically reviews long-lived assets to be held and used for an impairment in value whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable.

Regarding the Company's acquisition of facilities, purchase costs are allocated to the tangible and intangible assets and liabilities acquired based on their estimated fair values. The value of the tangible assets, consisting of land, buildings, building improvements and tenant improvements, is determined as if these assets are vacant, that is, at replacement cost. Intangible assets may include above-market or below-market value of leases, the value of in-place leases and the value of customer relationships and are recorded at their relative fair values.

The capitalized above-market (or below-market) lease value is amortized as a reduction of (or, increase to) operating lease income over the remaining non-cancelable term of each lease plus any renewal periods with fixed rental terms that are considered to be below-market. The Company generally engages in sale/leaseback transactions and typically executes leases with the occupant simultaneously with the purchase of the CTL asset at market-rate rents. Because of this, no above-market or below-market lease value is ascribed to these transactions. The value of customer relationship intangibles are amortized to expense over the initial and renewal terms of the leases, but no amortization period for intangible assets will exceed the remaining depreciable life of the building. In the event that a customer terminates its lease, the unamortized portion of each intangible asset, including market rate adjustments, lease origination costs, in-place lease values and customer relationship values, would be charged to expense.

Other real estate owned Other real estate owned ("OREO") consists of properties acquired by foreclosure or by deed-in-lieu of foreclosure in partial or total satisfaction of non-performing loans. OREO obtained in satisfaction of a loan is recorded at the lower of cost or estimated fair value less costs to sell at the date of transfer. The excess of the carrying value of the loan over the fair value of the property less

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iStar Financial Inc.

Notes to Consolidated Financial Statements (Continued)

(unaudited)

Note 3 Summary of Significant Accounting Policies (Continued)

estimated costs to sell is charged-off to the reserve for loan losses when title to the property is obtained. Any costs of holding the property are recorded in "Other expense" in the Company's Consolidated Statements of Operations. Significant property improvements may be capitalized to the extent that the carrying value of the property does not exceed the estimated fair value less costs to sell. The gain or loss on final disposition of an OREO is recorded in "Other expense" on the Company's Consolidated Statements of Operations, and is considered income/loss from continuing operations because it represents the final stage of the Company's loan collection process.

The Company also reviews the recoverability of an OREO's carrying value when circumstances indicate a possible impairment of the value of the property. If impairment exists due to the inability to recover the carrying value of a property, an impairment loss is recorded to the extent that the carrying value exceeds the estimated fair value of the property less cost to sell. These charges are recorded in "Impairment of other assets" on the Consolidated Statements of Operations in the period the determination is made.

Equity investments Purchased equity interests that are not publicly traded and/or do not have a readily determinable fair value are accounted for pursuant to the equity method of accounting if the Company's ownership position is large enough to significantly influence the operating and financial policies of an investee. This is generally presumed to exist when ownership interest is between 20% and 50% of a corporation, or greater than 5% of a limited partnership or limited liability company. The Company's share of earnings and losses in equity method investees is included in "Earnings from equity method investments" on the Consolidated Statements of Operations. When the Company's ownership position is too small to provide such influence, the cost method is used to account for the equity interest.

For investments accounted for using the cost or equity method of accounting, management evaluates information such as budgets, business plans, and financial statements of the investee in addition to quoted market prices, if any, in determining whether an other-than-temporary decline in value exists. Factors indicative of an other-than-temporary decline in value include, but are not limited to, recurring operating losses and credit defaults. For any investments in which the estimated fair value is less than its carrying value, management will consider whether the impairment of that investment is other-than-temporary and record impairment charges as necessary.

Timber and timberlands Timber and timberlands, including logging roads, are stated at cost less accumulated depletion for timber harvested and accumulated road amortization. The Company capitalizes timber and timberland purchases and reforestation costs and other costs associated with the planting and growing of timber, such as site preparation, growing or purchases of seedlings, planting, silviculture, herbicide application and the thinning of tree stands to improve growth. The cost of timber and timberlands typically is allocated between the timber and the land acquired, based on estimated relative fair values.

Timber carrying costs, such as real estate taxes, insect and wildlife control and timberland management fees, are expensed as incurred. Net carrying value of the timber and timberlands is used to compute the gain or loss in connection with timberland sales. Timber and timberlands are included in "Other investments" on the Company's Consolidated Balance Sheets (see Note 6 for further detail).

Capitalized interest and project costs The Company capitalizes pre-construction costs essential to the development of property, development costs, construction costs, real estate taxes, insurance and interest costs incurred during the construction periods for qualified build-to-suit projects for corporate tenants.

iStar Financial Inc.

Notes to Consolidated Financial Statements (Continued)

(unaudited)

Note 3 Summary of Significant Accounting Policies (Continued)

The Company ceases cost capitalization when the property is held available for occupancy upon substantial completion of tenant improvements, but no later than one year from the completion of major construction activity.

Cash and cash equivalents Cash and cash equivalents include cash held in banks or invested in money market accounts with original maturity terms of less than 90 days.

Restricted cash Restricted cash represents amounts required to be maintained in escrow under certain of the Company's debt obligations, leasing and derivative transactions.

Variable interest entities In accordance with FIN 46R, the Company identifies entities for which control is achieved through means other than through voting rights (a "variable interest entity" or "VIE"), and determines when and which business enterprise, if any, should consolidate the VIE. In addition, the Company discloses information pertaining to such entities wherein the Company is the primary beneficiary or other entities wherein the Company has a significant variable interest.

During 2007, the Company closed on a €100 million commitment in Moor Park Real Estate Partners II, L.P. Incorporated ("Moor Park"). Moor Park is a third-party managed fund that was created to make investments in European real estate as a 33% investor along-side a sister fund. The Company determined that Moor Park is a VIE and that the Company is the primary beneficiary. As such, the Company consolidates this entity for financial statement purposes. As of September 30, 2008, Moor Park had $45.1 million of total assets, $1.9 million in debt and $1.4 million of minority interest. The investments held by this entity are presented in "Other investments" on the Company's Consolidated Balance Sheets as of September 30, 2008.

During 2006, the Company made an investment in Madison Deutsche Andau Holdings, LP ("Madison DA"). Madison DA was created to invest in mortgage loans secured by real estate in Europe. The Company determined that Madison DA is a VIE and that the Company is the primary beneficiary. As such, the Company consolidates Madison DA for financial statement purposes. As of September 30, 2008, Madison DA had $64.2 million of total assets, no debt and $9.7 million of minority interest. The investments held by this entity are presented in "Loans and other lending investments" on the Company's Consolidated Balance Sheets.

Identified intangible assets and goodwill Upon the acquisition of a business, the Company records intangible assets acquired at their estimated fair values separate and apart from goodwill. The Company determines whether such intangible assets have finite or indefinite lives. As of September 30, 2008, all such intangible assets acquired by the Company have finite lives. The Company amortizes finite lived intangible assets based on the period over which the assets are expected to contribute directly or indirectly to the future cash flows of the business acquired. The Company reviews finite lived intangible assets for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. The Company recognizes impairment loss on finite lived intangible assets if the carrying amount of an intangible asset is not recoverable and its carrying amount exceeds its estimated fair value.

The excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired (including identified intangible assets) and liabilities assumed is recorded as goodwill. Goodwill is not amortized but is tested for impairment on an annual basis, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is done at a level of reporting referred to as a reporting unit. If the fair value of the reporting unit is less than its carrying value, an

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Note 3 Summary of Significant Accounting Policies (Continued)

impairment loss is recorded to the extent that the fair value of the goodwill within the reporting unit is less than its carrying value.

Fair values for goodwill and other finite lived intangible assets are determined using the market approach, income approach or cost approach, as appropriate.

Due to an overall deterioration in market conditions within the commercial real estate lending environment the Company determined that it was necessary to evaluate goodwill for impairment as of June 30, 2008. The Company estimated the fair value of its real estate lending reporting unit using a market-based valuation. The fair value of the assets and liabilities were then allocated to the reporting unit based on an analysis of discounted cash flows. As a result of this analysis, the Company recorded a non-cash impairment charge of $39.1 million during the second quarter of 2008 to reduce the carrying value of goodwill within the real estate lending reporting unit to zero. As of September 30, 2008, the remaining $4.2 million of goodwill relates to our corporate tenant leasing reporting unit.

During the nine months ended September 30, 2008, the Company recorded a non-cash charge of $12.5 million to reduce the carrying value of certain intangible assets, related to the Fremont CRE acquisition, based on their revised fair values. This charge was recorded to "Impairment of other assets" on the Company's Consolidated Statements of Operations.

As of September 30, 2008 and December 31, 2007, respectively, the Company had $72.5 million and $98.6 million of unamortized finite lived intangible assets primarily related to the acquisition of new CTL facilities. The total amortization expense for these intangible assets was $3.2 million and $3.8 million for the three months ended September 30, 2008 and 2007, respectively. The total amortization expense for these intangible assets was $10.8 million and $7.7 million for the nine months ended September 30, 2008 and 2007, respectively.

Revenue recognition The Company's revenue recognition policies are as follows:

Loans and other lending investments: Interest income on loans and other lending investments is recognized on an accrual basis using the interest method.

On occasion, the Company may acquire loans at premiums or discounts based on the credit characteristics of such loans. Deferred costs or fees, discounts and premiums are typically amortized over the contractual term of the loan using the interest method. Exit fees are also deferred and recognized over the lives of the related loans as a yield adjustment, if management believes it is probable that such amounts will be received. If loans with premiums, discounts, loan origination or exit fees are prepaid, the Company immediately recognizes the unamortized portion as a decrease or increase in the prepayment gain or loss which is included in "Other income" on the Company's Consolidated Statements of Operations.

The Company considers a loan to be non-performing and places loans on non-accrual status at such time as: (1) management determines the borrower is incapable of, or has ceased efforts toward, curing the cause of an impairment; (2) the loan becomes 90 days delinquent; or (3) the loan has a maturity default. While on non-accrual status, loans are either accounted for on a cash basis, in which interest income is recognized only upon actual receipt, or on a cost-recovery basis, in which all receipts reduce loan carrying value, based on the Company's judgment as to collectability of principal.

A small number of the Company's loans provide for accrual of interest at specified rates that differ from current payment terms. Interest is recognized on such loans at the accrual rate subject to

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Notes to Consolidated Financial Statements (Continued)

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Note 3 Summary of Significant Accounting Policies (Continued)

management's determination that accrued interest and outstanding principal are ultimately collectible, based on the underlying collateral and operations of the borrower.

Prepayment penalties or yield maintenance payments from borrowers are recognized as additional income when received. Certain of the Company's loan investments provide for additional interest based on the borrower's operating cash flow or appreciation of the underlying collateral. Such amounts are considered contingent interest and are reflected as income only upon certainty of collection.

Leasing investments: Operating lease revenue is recognized on the straight-line method of accounting from the later of the date of the origination of the lease or the date of acquisition of the facility subject to existing leases. Accordingly, contractual lease payment increases are recognized evenly over the term of the lease. The cumulative difference between lease revenue recognized under this method and contractual lease payment terms is recorded as "Deferred operating lease income receivable" on the Company's Consolidated Balance Sheets.

Reserve for loan losses The reserve for loan losses is a valuation allowance that reflects management's estimate of loan losses inherent in the loan portfolio as of the balance sheet date. The reserve for loan losses includes a formula-based component and an asset-specific component. The reserve is increased through the "Provision for loan losses" on the Company's Consolidated Statements of Operations and is decreased by charge-offs when losses are confirmed through the receipt of assets such as cash in a pre-foreclosure sale or via ownership control of the underlying collateral in full satisfaction of the loan upon foreclosure or when significant collection efforts have ceased.

The formula-based reserve component covers performing loans and provisions for loan losses are recorded when (i) available information as of each balance sheet date indicates that it is probable a loss has occurred in the portfolio and (ii) the amount of the loss can be reasonably estimated in accordance with SFAS No. 5, "Accounting for Contingencies" ("SFAS 5"). Required reserve balances for the performing loan portfolio are derived from estimated probabilities of principal loss and loss given default severities assigned to the portfolio during the Company's quarterly internal risk rating assessment. Probabilities of principal loss and severity factors are based on industry and/or internal experience and may be adjusted for significant factors that, based on the Company's judgment, impact the collectability of the loans as of the balance sheet date.

The asset-specific component relates to reserves for losses on loans considered impaired and measured pursuant to Statement of Financial Accounting Standards No. 114, "Accounting by Creditors for Impairments of a Loan (an amendment of FASB Statement No. 5 and 15)," ("SFAS 114"). In accordance with SFAS 114, the Company considers a loan to be impaired when, based upon current information and events, it believes that it is probable that the Company will be unable to collect all amounts due under the contractual terms of the loan agreement. A reserve is established when the present value of payments expected to be received, observable market prices, or the estimated fair value of the collateral (for loans that are dependent on the collateral for repayment) of an impaired loan is lower than the carrying value of that loan. A loan is also considered impaired in accordance with SFAS 114 if its terms are modified in a troubled debt restructuring ("TDR"). Each of our non-performing loans ("NPL") and TDR loans are considered impaired and are evaluated individually to determine required asset-specific reserves.

Allowance for doubtful accounts The Company has established policies that require a reserve on the Company's accrued operating lease income receivable balances and on the deferred operating lease income receivable balances. The reserve covers asset specific problems (e.g., tenant bankruptcy) as they arise, as well as a portfolio reserve based on management's evaluation of the credit risks associated with these receivables.

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Note 3 Summary of Significant Accounting Policies (Continued)

Derivative instruments and hedging activity The Company recognizes derivatives as either assets or liabilities on the Company's Consolidated Balance Sheets at fair value. If certain conditions are met, a derivative may be specifically designated as a hedge of the exposure to changes in the fair value of a recognized asset or liability or a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability.

For fair value hedges, changes in the fair value of the derivative, along with changes in the fair value of the respective hedged item are reported in earnings in "Other expense" on the Company's Consolidated Statements of Operations. The effective portion of the change in fair value of a derivative that is designated as a cash flow hedge is reported in "Accumulated other comprehensive income (losses)" on the Company's Consolidated Balance Sheets and the ineffective portion of a change in fair value of a cash flow hedge is reported in "Other expense" on the Company's Consolidated Statements of Operations. The net interest receivable or payable on the interest rate swaps is accrued and recognized as an adj