

ISTAR FINANCIAL INC  
Form 10-Q  
May 09, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2008

OR

**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

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**iSTAR FINANCIAL INC.**

(Exact name of registrant as specified in its charter)

**Maryland**

(State or other jurisdiction of incorporation or organization)

**95-6881527**

(I.R.S. Employer Identification Number)

**1114 Avenue of the Americas, 39<sup>th</sup> Floor**

**New York, NY**

(Address of principal executive offices)

**10036**

(Zip code)

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

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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  No

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 the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

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As of April 30, 2008, there were 134,406,695 shares of common stock, \$0.001/par value per share of iStar Financial Inc., ("Common Stock") outstanding.

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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 March 31, 2008	As of December 31, 2007
	<u>                    </u>	<u>                    </u>
<b>ASSETS</b>		
Loans and other lending investments, net	\$ 10,878,095	\$ 10,949,354
Corporate tenant lease assets, net	3,328,210	3,309,866
Other investments	956,887	856,609
Other real estate owned	284,134	128,558
Assets held for sale	79,163	74,335
Cash and cash equivalents	119,404	104,507
Restricted cash	34,135	32,977
Accrued interest and operating lease income receivable	125,097	141,405
Deferred operating lease income receivable	107,245	102,135
Deferred expenses and other assets	156,647	105,274
Goodwill	43,278	43,278
	<u>                    </u>	<u>                    </u>
Total assets	\$ 16,112,295	\$ 15,848,298
	<u>                    </u>	<u>                    </u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Liabilities:		
Accounts payable, accrued expenses and other liabilities	\$ 639,910	\$ 495,311
Debt obligations	12,566,913	12,399,558
	<u>                    </u>	<u>                    </u>
Total liabilities	13,206,823	12,894,869
	<u>                    </u>	<u>                    </u>
Commitments and contingencies		
Minority interest in consolidated entities	53,730	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 March 31, 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 March 31, 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 March 31, 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 March 31, 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 March 31, 2008 and December 31, 2007	5	5
High Performance Units	9,800	9,800
Common Stock, \$0.001 par value, 200,000 shares authorized, 136,917 issued and 134,406 outstanding at March 31, 2008 and 136,340 issued and 133,929 outstanding at December 31, 2007	136	135
Options		1,392
Additional paid-in capital	3,709,895	3,700,086

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	As of March 31, 2008	As of December 31, 2007
	<u>                    </u>	<u>                    </u>
Retained earnings (deficit)	(795,123)	(752,440)
Accumulated other comprehensive income (losses) (see Note 13)	(14,227)	(2,295)
Treasury stock (at cost)	(58,761)	(57,219)
	<u>                    </u>	<u>                    </u>
Total shareholders' equity	2,851,742	2,899,481
	<u>                    </u>	<u>                    </u>
Total liabilities and shareholders' equity	\$ 16,112,295	\$ 15,848,298
	<u>                    </u>	<u>                    </u>

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 March 31,	
	2008	2007
<b>Revenue:</b>		
Interest income	\$ 276,100	\$ 180,860
Operating lease income	86,439	75,942
Other income	59,890	28,472
<b>Total revenue</b>	<b>422,429</b>	<b>285,274</b>
<b>Costs and expenses:</b>		
Interest expense	168,215	128,527
Operating costs - corporate tenant lease assets	5,363	6,461
Depreciation and amortization	25,931	19,921
General and administrative	42,809	37,550
Provision for loan losses	89,500	5,000
Other expense	3,800	
<b>Total costs and expenses</b>	<b>335,618</b>	<b>197,459</b>
Income before losses from equity method investments, minority interest and other items	86,811	87,815
Losses from equity method investments	(2,598)	(1,351)
Minority interest in consolidated entities	(204)	564
Income from continuing operations	84,009	87,028
Income from discontinued operations	324	5,653
Gain from discontinued operations, net	2,056	1,415
Net income	86,389	94,096
Preferred dividend requirements	(10,580)	(10,580)
Net income allocable to common shareholders and HPU holders(1)	\$ 75,809	\$ 83,516
<b>Per common share data(2):</b>		
Income from continuing operations per common share:		
Basic	\$ 0.54	\$ 0.59
Diluted	\$ 0.54	\$ 0.59
Net income per common share:		
Basic	\$ 0.55	\$ 0.64
Diluted	\$ 0.55	\$ 0.64
Weighted average number of common shares - basic	134,262	126,693
Weighted average number of common shares - diluted	134,862	127,867
<b>Per HPU share data(2):</b>		
Income from continuing operations per HPU share:		
Basic	\$ 101.26	\$ 111.66
Diluted	\$ 100.93	\$ 110.66

**For the  
Three Months Ended  
March 31,**

Net income per HPU share:			
Basic	\$	104.60	\$ 122.00
Diluted	\$	104.20	\$ 120.93
Weighted average number of HPU shares basic		15	15
Weighted average number of HPU shares diluted		15	15

**Explanatory Notes:**

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- (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.

**iStar Financial Inc.**  
**Consolidated Statements of Changes in Shareholders' Equity**  
(In thousands)  
(unaudited)

	Series D Preferred Stock	Series E Preferred Stock	Series F Preferred Stock	Series G Preferred Stock	Series I Preferred Stock	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)	6,615					5,223
Dividends declared preferred									(10,580)				(10,580)
Dividends declared common									(116,040)				(116,040)
Dividends declared HPU									(2,452)				(2,452)
Repurchase of stock											(1,542)		(1,542)
Issuance of stock vested restricted stock units							1	2,688					2,689
Issuance of stock DRIP/stock purchase plan								506					506
Net income for the period									86,389				86,389
Change in accumulated other comprehensive income (losses)										(11,932)			(11,932)
Balance at March 31, 2008	\$ 4	\$ 6	\$ 4	\$ 3	\$ 5	\$ 9,800	\$ 136	\$ 3,709,895	\$ (795,123)	\$ (14,227)	\$ (58,761)	\$ 2,851,742	

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 Three Months Ended March 31,	
	2008	2007
<b>Cash flows from operating activities:</b>		
Net income	\$ 86,389	\$ 94,096
<b>Adjustments to reconcile net income to cash flows from operating activities:</b>		
Minority interest in consolidated entities	204	(564)
Non-cash expense for stock-based compensation	4,609	4,652
Shares withheld for employee taxes on stock based compensation arrangements	(2,548)	(2,988)
Depreciation, depletion and amortization	28,009	21,977
Amortization of deferred financing costs	7,949	6,126
Amortization of discounts/premiums, deferred interest and costs on lending investments	(66,962)	(18,508)
Discounts, loan fees and deferred interest received	9,247	11,726
Equity in losses of unconsolidated entities	2,598	139
Distributions from operations of unconsolidated entities	21,450	15,050
Deferred operating lease income receivable	(4,977)	(5,301)
Gain from discontinued operations, net	(2,056)	(1,415)
Provision for loan losses	89,500	5,000
Provision for deferred taxes	1,291	737
Other non-cash adjustments	1,492	(2,562)
Note receivable from investment redemption	(44,228)	
<b>Changes in assets and liabilities:</b>		
Changes in accrued interest and operating lease income receivable	16,308	(8,652)
Changes in deferred expenses and other assets	(20,198)	6,113
Changes in accounts payable, accrued expenses and other liabilities	(30,346)	(16,724)
<b>Cash flows from operating activities</b>	<b>97,731</b>	<b>108,902</b>
<b>Cash flows from investing activities:</b>		
New investment originations	(10,953)	(1,031,564)
Add-on fundings under existing loan commitments	(962,424)	(350,276)
Net proceeds from sales of corporate tenant lease assets	8,203	34,844
Repayments of and principal collections on loans	897,411	255,284
Proceeds from maturities or sales of securities	878	59,643
Contributions to unconsolidated entities	(17,520)	(9,561)
Distributions from unconsolidated entities	4,211	7,474
Capital expenditures and improvements on corporate tenant lease assets	(47,845)	(18,076)
Other investing activities, net	(3,551)	(2,840)
<b>Cash flows from investing activities</b>	<b>(131,590)</b>	<b>(1,055,072)</b>
<b>Cash flows from financing activities:</b>		
Borrowings under revolving credit facilities	4,392,360	5,954,196
Repayments under revolving credit facilities	(4,035,232)	(5,771,000)
Borrowings under secured term loans	355,108	7,066
Repayments under secured term loans	(41,499)	(53,475)
Borrowings under unsecured notes		1,035,000
Repayments under unsecured notes	(570,000)	(200,000)
Contributions from minority interest partners	63	
Distributions to minority interest partners	(484)	(319)
Changes in restricted cash held in connection with debt obligations	8	355
Payments for deferred financing costs/proceeds from hedge settlements, net	(11,195)	4,993

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	<b>For the Three Months Ended March 31,</b>	
Common dividends paid	(33,551)	
Preferred dividends paid	(10,580)	(10,580)
HPU dividends paid	(704)	
HPUs issued/(redeemed)	(11)	
Purchase of treasury stock	(1,542)	
Proceeds from exercise of options and issuance of DRIP/Stock purchase shares	6,015	856
Cash flows from financing activities	48,756	967,092
Changes in cash and cash equivalents	14,897	20,922
Cash and cash equivalents at beginning of period	104,507	105,951
Cash and cash equivalents at end of period	\$ 119,404	\$ 126,873

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

**iStar Financial Inc.**

**Notes to Consolidated Financial Statements**

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

**iStar Financial Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**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). 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 March 31, 2008 and December 31, 2007, and the results of its operations and its cash flows for the three months ended March 31, 2008 and 2007, and its changes in shareholders' equity for the three months ended March 31, 2008. 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 small 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. 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.

**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

iStar Financial Inc.

Notes to Consolidated Financial Statements (Continued)

**Note 3 Summary of Significant Accounting Policies (Continued)**

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 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, 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 estimated 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 estimated costs to sell is charged-off to the reserve for loan losses. Any decline in the estimated fair value of OREO that occurs after the initial transfer from the loan portfolio and 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 does not exceed the estimated fair value. 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.

**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 our ownership position is large enough to significantly influence the operating and financial policies of an investee. This is generally presumed to exist when we own between 20% and 50% of a corporation, or when we own greater than 5% of a limited partnership or limited liability company. Our share of earnings and losses in equity method investees is included in "Earnings (loss) from equity method investments" on

iStar Financial Inc.

Notes to Consolidated Financial Statements (Continued)

Note 3 Summary of Significant Accounting Policies (Continued)

the Consolidated Statements of Operations. If our 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 of our investments in which the estimated fair value is less than its carrying value, we consider whether the impairment of that investment is other-than-temporary.

**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).

**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. 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. Capitalized interest was approximately \$4.0 million and \$0.6 million for the three months ended March 31, 2008 and 2007, respectively.

**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 March 31, 2008, Moor Park had

**iStar Financial Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**Note 3 Summary of Significant Accounting Policies (Continued)**

\$49.6 million of total assets, no 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 March 31, 2008.

During 2006, the Company made an investment in TN NRDC, LLC ("TN"). TN was created to invest in a strategic real estate related opportunity in Canada. The Company determined that TN is a VIE and that the Company is the primary beneficiary. As such, the Company consolidates TN for financial statement purposes. As of March 31, 2008, TN had \$101.6 million of total assets, no debt and \$5.1 million of minority interest. The cost method investment held by this entity is presented in "Other investments" on the Company's Consolidated Balance Sheets.

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 March 31, 2008, Madison DA had \$72.5 million of total assets, no debt and \$11.1 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 March 31, 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 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.

As of March 31, 2008 and December 31, 2007, respectively, the Company had \$94.7 million and \$98.6 million of unamortized finite lived intangible assets primarily related to the acquisition of new CTL facilities and the acquisitions of Fremont CRE, Falcon Financial Investment Trust ("Falcon Financial") and certain partnership interests in AutoStar Realty Operating Partnership, L.P. ("AutoStar"). The total amortization expense for these intangible assets was \$3.8 million and \$1.9 million for the three months ended March 31, 2008 and 2007, respectively.

iStar Financial Inc.

Notes to Consolidated Financial Statements (Continued)

**Note 3 Summary of Significant Accounting Policies (Continued)**

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

*Loans and other lending investments:* Interest income on loans and other lending investments held-for-investment and held-to-maturity 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 the 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 judgement as to collectibility 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 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 incurred 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 the underlying collateral in full satisfaction of the loan upon foreclosure.

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 probabilities of principal loss and loss given default estimates



iStar Financial Inc.

Notes to Consolidated Financial Statements (Continued)

Note 3 Summary of Significant Accounting Policies (Continued)

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 collectibility 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 loan agreement on a timely basis. 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 solely dependent on the collateral for repayment) of an impaired loan is lower than the carrying value of that loan. Each of our non-performing loans or NPLs 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., bankruptcy) as they arise, as well as a portfolio reserve based on management's evaluation of the credit risks associated with these receivables.

**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 adjustment to "Interest expense" on the Company's Consolidated Statements of Operations.

Derivatives, such as foreign currency hedges, that are not designated as fair value or cash flow hedges are considered economic hedges, with changes in fair value reported in current earnings in "Other income" on the Company's Consolidated Statements of Operations. The Company does not enter into derivatives for trading purposes.

The Company formally documents all hedging relationships at inception, including its risk management objective and strategy for undertaking the hedge transaction. The hedge instrument and the hedged item are designated at the execution of the hedge instrument or upon re-designation during the life of the hedge. Hedge effectiveness is assessed and measured under identical time periods and depending on the hedging strategy, the Company uses the hypothetical derivative method and statistical regression to assess effectiveness, and the hypothetical derivative method to measure ineffectiveness. In addition, the

iStar Financial Inc.

Notes to Consolidated Financial Statements (Continued)

Note 3 Summary of Significant Accounting Policies (Continued)

Company does not exclude any component of the derivative's gain or loss in the assessment of effectiveness.

**Stock-based compensation** The Company measures compensation costs for restricted stock awards as of the date of grant and expenses such amounts against earnings, either at the grant date (if no vesting period exists) or ratably over the respective vesting/service period.

The Company follows the fair-value method of accounting for options issued to employees or directors. Accordingly, the Company recognizes a charge equal to the fair value of these options at the date of grant multiplied by the number of options issued. This charge is amortized over the related remaining vesting terms to individuals as additional compensation.

**Disposal of long-lived assets** The results of operations from CTL assets sold or held for sale in the current and prior periods are classified as "Income from discontinued operations" on the Company's Consolidated Statements of Operations even though such income was actually recognized by the Company prior to the asset sale. Gains from the sale of CTL assets are classified as "Gain from discontinued operations, net" on the Company's Consolidated Statements of Operations.

**Depletion** Depletion relates to the Company's investment in timberland assets. Assumptions and estimates are used in the recording of depletion. An annual depletion rate for each timberland investment is established by dividing book cost of timber by estimated standing merchantable inventory. Changes in the assumptions and/or estimations used in these calculations may affect the Company's results, in particular depletion costs. Factors that can impact timber volume include weather changes, losses due to natural causes, differences in actual versus estimated growth rates and changes in the age when timber is considered merchantable.

**Income taxes** The Company is subject to federal income taxation at corporate rates on its "REIT taxable income;" however, the Company is allowed a deduction for the amount of dividends paid to its shareholders, thereby subjecting the distributed net income of the Company to taxation at the shareholder level only. In addition, the Company is allowed several other deductions in computing its "REIT taxable income," including non-cash items such as depreciation expense. These deductions allow the Company to shelter a portion of its operating cash flow from its dividend payout requirement under federal tax laws. The Company intends to operate in a manner consistent with and to elect to be treated as a REIT for tax purposes.

The Company can participate in certain activities from which it was previously precluded in order to maintain its qualification as a REIT, as long as these activities are conducted in entities which elect to be treated as taxable subsidiaries under the Code, subject to certain limitations. As such, the Company, through its taxable REIT subsidiaries ("TRSs"), is engaged in various real estate related opportunities, including but not limited to: (1) managing corporate credit-oriented investment strategies; (2) certain activities related to the purchase and sale of timber and timberlands; and (3) servicing certain loan portfolios. The Company will consider other investments through TRS entities if suitable opportunities arise. The Company's TRS entities are not consolidated for federal income tax purposes and are taxed as corporations. For financial reporting purposes, current and deferred taxes are provided for in the portion of earnings recognized by the Company with respect to its interest in TRS entities and are included in "General and administrative" on the Company's Consolidated Statements of Operations. The Company also recognizes interest expense and penalties related to uncertain tax positions, if any, as income tax expense, included in "General and administrative" on the Company's Consolidated Statements of

**iStar Financial Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**Note 3 Summary of Significant Accounting Policies (Continued)**

Operations. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, as well as operating loss and tax credit carryforwards. The tax effects of our temporary differences and carryforwards are recorded as deferred tax assets and deferred tax liabilities, included in "Deferred expenses and other assets" and "Accounts payable, accrued expenses and other liabilities", respectively, on the Company's Consolidated Balance Sheets. Such amounts are not material to the Company's Consolidated Financial Statements. Accordingly, except for the Company's taxable REIT subsidiaries, no current or deferred federal taxes are provided for in the Consolidated Financial Statements.

**Earnings per common share** In accordance with Emerging Issues Task Force 03-6, ("EITF 03-6"), "Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings Per Share," the Company presents both basic and diluted earnings per share ("EPS") for common shareholders and High Performance Unit ("HPU") holders (see Note 11). EITF 03-6 must be utilized in calculating earnings per share by a company that has issued securities other than common stock that contractually entitles the holder to participate in dividends and earnings of the company when, and if, the company declares dividends on its common stock. Vested HPU shares are entitled to dividends of the Company when dividends are declared. Basic earnings per share ("Basic EPS") for the Company's Common Stock and HPU shares are computed by dividing net income allocable to common shareholders and HPU holders by the weighted average number of shares of Common Stock and HPU shares outstanding for the period, respectively. Diluted earnings per share ("Diluted EPS") would be computed similarly, however, it reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, where such exercise or conversion would result in a lower earnings per share amount.

As of March 31, 2008 the conditions for conversion related to the Company's \$800 million convertible senior floating rate notes due 2012 ("Convertible Notes") have not been met. If the conditions for conversion are met, the Company may choose to pay in cash and/or Common Stock; however, if this occurs, the Company has the intent and ability to settle this debt in cash. Accordingly, there was no impact on the Company's diluted earnings per share for any of the periods presented.

iStar Financial Inc.

Notes to Consolidated Financial Statements (Continued)

Note 3 Summary of Significant Accounting Policies (Continued)

New accounting standards

In March 2008, the FASB issued Statement No. 161, "Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133" ("SFAS No. 161"). The Statement requires companies to provide enhanced disclosures regarding derivative instruments and hedging activities. It requires companies to better convey the purpose of derivative use in terms of the risks that such company is intending to manage. Disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect a company's financial position, financial performance, and cash flows are required. This Statement retains the same scope as SFAS No. 133 and is effective for fiscal years and interim periods beginning after November 15, 2008. The Company will adopt SFAS No. 161 on January 1, 2009, as required, and management is still evaluating the impact on the Company's Consolidated Financial Statements.

In February 2008, the FASB issued a FASB Staff Position ("FSP") on Accounting for Transfers of Financial Assets and Repurchase Financing Transactions "FSP FAS 140-3." This FSP addresses the issue of whether or not these transactions should be viewed as two separate transactions or as one "linked" transaction. The FSP includes a "rebuttable presumption" that presumes linkage of the two transactions unless the presumption can be overcome by meeting certain criteria. The FSP will be effective for fiscal years beginning after November 15, 2008 and will apply only to original transfers made after that date; early adoption will not be allowed. The Company is currently evaluating the impact, if any, the adoption of this interpretation will have on the Company's Consolidated Financial Statements.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations" ("SFAS 141(R)"). SFAS 141(R) expands the definition of transactions and events that qualify as business combinations; requires that the acquired assets and liabilities, including contingencies, be recorded at the fair value determined on the acquisition date and changes thereafter reflected in revenue, not goodwill; changes the recognition timing for restructuring costs; and requires acquisition costs to be expensed as incurred. Adoption of SFAS 141(R) is required for combinations after December 15, 2008. Early adoption and retroactive application of SFAS 141(R) to fiscal years preceding the effective date are not permitted. The Company will adopt SFAS 141(R) as required, and management is still evaluating the impact on the Company's Consolidated Financial Statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements" ("SFAS 160"). SFAS 160 re-characterizes minority interests in consolidated subsidiaries as non-controlling interests and requires the classification of minority interests as a component of equity. Under SFAS 160, a change in control will be measured at fair value, with any gain or loss recognized in earnings. The effective date for SFAS 160 is for annual periods beginning on or after December 15, 2008. Early adoption and retroactive application of SFAS 160 to fiscal years preceding the effective date are not permitted. The Company will adopt SFAS 160 on January 1, 2009, as required, and management is still evaluating the impact on the Company's Consolidated Financial Statements.

In February 2007, the FASB released Statement of Financial Accounting Standards No. 159 ("SFAS No. 159"), "The Fair Value Option for Financial Assets and Liabilities Including an Amendment of FASB Statement No. 115." SFAS No. 159 permits entities to choose to measure certain financial assets and liabilities at fair value and is effective for the first fiscal year beginning after November 15, 2007. The Company adopted SFAS No. 159 on January 1, 2008, as required, but did not elect to apply the fair value

**iStar Financial Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**Note 3 Summary of Significant Accounting Policies (Continued)**

option to any of its financial assets or liabilities. As such, the adoption of SFAS No. 159 did not have an impact on the Company's Consolidated Financial Statements

In September 2006, the FASB released Statement of Financial Accounting Standards No. 157 ("SFAS No. 157"), "Fair Value Measurements." This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 clarifies the exchange price notion in the fair value definition to mean the price that would be received to sell the asset or paid to transfer the liability (an exit price), not the price that would be paid to acquire the asset or received to assume the liability (an entry price). This statement also clarifies that market participant assumptions should include assumptions about risk, should include assumptions about the effect of a restriction on the sale or use of an asset and should reflect its nonperformance risk (the risk that the obligation will not be fulfilled). Nonperformance risk should include the reporting entity's credit risk.

In February 2008, the FASB issued FASB Staff Position 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13" ("FSP 157-1") and FSP 157-2, "Effective Date of FASB Statement No. 157" ("FSP 157-2"). FSP 157-1 amends SFAS No. 157 to remove certain leasing transactions from its scope. FSP 157-2 provides a one-year deferral of the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. These nonfinancial items include assets and liabilities such as reporting units measured at fair value in a goodwill impairment test and nonfinancial assets acquired and liabilities assumed in a business combination. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and was adopted by the Company, as it applies to its financial instruments, effective January 1, 2008. The adoption of SFAS No. 157 as it relates to financial instruments did not have a significant impact on the Company's Consolidated Financial Statements. See Note 15 Fair Value of Financial Instruments for additional details. The Company will adopt the provisions of SFAS No. 157 as it relates to its non-financial assets and non-financial liabilities effective January 1, 2009, and the Company does not expect it to have a significant the impact on its Consolidated Financial Statements.

**iStar Financial Inc.**  
**Notes to Consolidated Financial Statements (Continued)**

**Note 4 Loans and Other Lending Investments**

The following is a summary description of the Company's loans and other lending investments (\$ in thousands)(1):

Type of Investment	Underlying Property Type	# of Borrowers In Class	Principal Balances Outstanding	Carrying Value as of		Effective Maturity Dates	Contractual Interest Payment Rates(2)	Contractual Interest Accrual Rates(2)
				March 31, 2008	December 31, 2007			
Senior Mortgages(3)(4)(5)(6)	Office/Residential/Retail/Industrial, R&D/Mixed Use/Hotel/Land/Entertainment, Leisure/Other	336	\$ 8,679,436	\$ 8,542,477	\$ 8,356,716	2008 to 2026	Fixed: 6.5% to 20% Variable: LIBOR + 1.75% to LIBOR + 8.5%	Fixed: 6.5% to 20% Variable: LIBOR + 1.75% to LIBOR + 8.5%
Subordinate Mortgages(3)(4)(5)(6)	Office/Residential/Retail/Mixed Use/Hotel/Land/Entertainment, Leisure/Other	24	627,755	623,151	649,794	2008 to 2018	Fixed: 5% to 10.5% Variable: LIBOR + 2.75% to LIBOR + 8.3%	Fixed: 7.32% to 25% Variable: LIBOR + 2.75% to LIBOR + 10%
Corporate/Partnership Loans(3)(4)(5)(6)	Office/Residential/Retail/Industrial, R&D/Mixed Use/Hotel/Land/Other	47	1,535,145	1,518,225	1,712,941	2008 to 2046	Fixed: 4.5% to 17.5% Variable: LIBOR + 2% to LIBOR + 7.84%	Fixed: 8.5% to 17.5% Variable: LIBOR + 2% to LIBOR + 14%
Total Loans				10,683,853	10,719,451			
Reserve for Loan Losses				(252,884)	(217,910)			
Total Loans, net				10,430,969	10,501,541			
Other Lending Investments Securities(3)	Retail/Industrial, R&D/Entertainment, Leisure/Other	8	480,886	447,126	447,813	2012 to 2023	Fixed: 6% to 9.25% Variable: LIBOR + 5.63%	Fixed: 6% to 9.25% Variable: LIBOR + 5.63%
Total Loans and Other Lending Investments, net				\$ 10,878,095	\$ 10,949,354			

**Explanatory Notes:**

- (1) Details (other than carrying values) are for loans outstanding as of March 31, 2008.
- (2) Substantially all variable-rate loans are based on either 30-day LIBOR and reprice monthly or six-month LIBOR and reprice semi-annually. The 30-day LIBOR and six-month LIBOR on March 31, 2008 was 2.7% and 2.6%, respectively. As of March 31, 2008, nine loans with a combined carrying value of \$394.6 million have a stated accrual rate that exceeds the stated pay rate.
- (3)

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Certain loans require fixed payments of principal resulting in partial principal amortization over the term of the loan with the remaining principal due at maturity.

- (4) As of March 31, 2008, 30 loans with a combined carrying value of \$796.9 million are on non-accrual status. As of December 31, 2007, 31 loans with a combined carrying value of \$719.4 million were on non-accrual status.
- (5) As of March 31, 2008, three loans with a combined carrying value of \$75.5 million have stated accrual rates of up to 25%, however, no interest is due until their scheduled maturities ranging from 2009 to 2012. One Corporate/Partnership loan, with a carrying value of \$60.5 million, has a stated accrual rate of 12.7% and no interest is due until its scheduled maturity in 2046.
- (6) As of March 31, 2008, includes foreign denominated loans with combined carrying values of approximately £169.7 million, €174.1 million, CAD 46.0 million and SEK 121.7 million. Amounts in table have been converted to U.S. dollars based on exchange rates in effect at March 31, 2008.

## iStar Financial Inc.

## Notes to Consolidated Financial Statements (Continued)

## Note 4 Loans and Other Lending Investments (Continued)

During the three months ended March 31, 2008 and 2007, respectively, the Company originated or acquired an aggregate of approximately \$9.0 million and \$1.00 billion in loans and other lending investments, funded \$962.4 million and \$350.3 million under existing loan commitments, and received principal repayments of \$1.39 billion and \$314.9 million.

As of March 31, 2008, the Company had 232 loans with unfunded commitments totaling \$4.68 billion, of which \$828.0 million was discretionary and \$3.86 billion was non-discretionary.

As of March 31, 2008, \$959.3 million of loans and other lending investments were pledged as collateral on two of our secured term loans (see Note 8).

**Reserve for loan losses** Changes in the Company's reserve for loan losses were as follows (in thousands):

<b>Reserve for loan losses, December 31, 2006</b>	\$ 52,201
Provision for loan losses	185,000
Charge-offs	(19,291)
	<hr/>
<b>Reserve for loan losses, December 31, 2007</b>	217,910
Provision for loan losses	89,500
Charge-offs	(54,526)
	<hr/>
<b>Reserve for loan losses, March 31, 2008</b>	<b>\$ 252,884</b>
	<hr/>

As of March 31, 2008, the Company identified loans with a carrying value of \$758.3 million and a gross loan value of \$957.0 million that were impaired in accordance with SFAS 114 (see Note 3 Reserve for loan losses). Gross loan value represents the Company's carrying value of a loan and the portion of the loan that is owned by Fremont through the loan participation agreement. It represents what the carrying value of the loan would have been if the loan participation had not occurred. Under the terms of the participation, Fremont will receive 70% of all loan principal payments, including principal that the Company has funded. Therefore, the Company is in the first loss position. As such, the Company believes that presentation of the total recorded investment is more relevant than a presentation of the Company's carrying value when assessing the Company's risk of loss on the loans in the Fremont CRE Portfolio. The Company assessed each of the loans for impairment and determined that loans with a gross loan value of \$396.1 million required specific reserves totaling \$89.9 million and that the remaining loans with a gross loan value of \$560.9 million did not require any specific reserves. All impaired loans are included on the Company's non-performing loan list and are on non-accrual status as of March 31, 2008. The \$89.9 million of SFAS 114 specific reserves is included in the total reserve for loan losses of \$252.9 million and the remainder of the balance represents SFAS 5 reserves. The average carrying value of impaired loans were approximately \$983.1 million and \$69.7 million during the three months ended March 31, 2008 and 2007, respectively. The Company recorded cash payments of \$1.9 million from impaired loans in "Interest income" on the Company's Consolidated Statements of Operations for the three months ended March 31, 2008.

During the three months ended March 31, 2008, the Company received title to properties in satisfaction of three senior mortgage loans, with cumulative carrying values of \$191.6 million, for which those properties had served as collateral. During the three months ended March 31, 2008, the Company recorded charge-offs totaling \$36.5 million that related to these loans. The amounts charged-off represent the difference between the Company's carrying values in the loans and the respective estimated fair values



iStar Financial Inc.

Notes to Consolidated Financial Statements (Continued)

Note 4 Loans and Other Lending Investments (Continued)

of the net assets received through foreclosure or in lieu of payment. The Company recorded the estimated fair values of the net assets received in respect to the three loans in "Other real estate owned" on the Company's Consolidated Balance Sheets, as the Company plans to sell these properties. In addition, the Company charged-off \$14.7 million related to a loan that was reclassified as an equity investment. The loan had a carrying value of \$84.1 million prior to the charge-off.

During the three months ended March 31, 2008, the Company sold loans with a total cumulative carrying value of \$157.8 million for which it recorded a net realized gain of \$0.9 million. Gains and losses on sales of loans are reported in "Other income" on the the Company's Consolidated Statements of Operations.

**Securities** As of March 31, 2008, the carrying value of Other Lending Investment-Securities includes \$423.0 million of held-to-maturity securities with an aggregate fair value of \$394.7 million and gross unrealized gains of \$5.1 million and losses of \$33.4 million. As of March 31, 2008, the aggregate fair value of securities with unrealized losses was \$304.7 million and none of the securities had been in a continuous unrealized loss position for 12 months or longer. The carrying value also includes \$20.0 million of available-for-sale securities recorded at fair value for which a cumulative unrealized loss of \$4.3 million is recorded in "Accumulated other comprehensive income (losses)" on the Company's Consolidated Balance Sheets. Included in Other Lending Investments-Securities are \$236.0 million of held-to-maturity securities that mature in one to five years, \$187.0 million of held-to-maturity securities that mature in five to ten years and \$20.0 million of available-for-sale securities that mature in five to ten years.

**SOP 03-3 loans** AICPA Statement of Position 03-3 ("SOP 03-3") prescribes the accounting treatment for acquired loans with evidence of credit deterioration for which it is probable, at acquisition, that all contractually required payments will not be received. As of March 31, 2008 and December 31, 2007, the Company had SOP 03-3 loans with a cumulative principal balance of \$244.3 million and \$273.6 million, respectively, and a cumulative carrying value of \$203.1 million and \$231.8 million, respectively. As of March 31, 2008, SOP 03-3 loans with a cumulative carrying value of \$90.6 million are on non-accrual status and the Company is recognizing interest on the cash basis of accounting or applying cash using the cost recovery method. In addition, as of March 31, 2008, the Company had SOP 03-3 loans with a carrying value of \$112.5 million for which the Company did not have a reasonable expectation about the timing and amount of cash flows expected to be collected and is recognized income using the cash basis of accounting. The majority of the Company's SOP 03-3 loans were acquired in the acquisition of Fremont CRE.

**Other real estate owned** "Other real estate owned" on the Company's Consolidated Balance Sheets includes real estate assets received through foreclosure or by deed-in-lieu of foreclosure on certain non-performing loans in the Company's loan portfolio. During the three months ended March 31, 2008, the Company recorded properties with a combined estimated fair value of \$155.1 million into OREO. Prior to the Company taking title to these assets, they had served as collateral on three non-performing loans. The Company recorded \$2.4 million of net expense in "Other expense" on the Company's Consolidated Statements of Operations related to holding costs for these properties.

**Fremont CRE participation** On July 2, 2007, the Company completed the sale of a \$4.20 billion participation interest in the \$6.27 billion Fremont CRE portfolio. Under the terms of the participation, the Company pays 70% of all principal collected from the Fremont CRE portfolio, including principal collected from amounts funded on the loans subsequent to the acquisition of the portfolio, until the participation is fully repaid. As of March 31, 2008, the Company had unfunded loan commitments of

## iStar Financial Inc.

## Notes to Consolidated Financial Statements (Continued)

## Note 4 Loans and Other Lending Investments (Continued)

\$1.51 billion related to the Fremont CRE portfolio. The Fremont CRE participation pays floating interest at LIBOR + 1.50%.

Changes in the outstanding Fremont loan portfolio participation balance were as follows (in thousands):

<b>Loan participation, December 31, 2007</b>	\$ 2,980,238
Principal repayments(1)	(575,380)
	<hr/>
<b>Loan participation, March 31, 2008</b>	<b>\$ 2,404,858</b>
	<hr/>

**Explanatory Note:**

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(1)

Includes \$275.5 million of principal repayments received by the Company that have not yet been remitted to Fremont and are reflected as a payable in "Accounts payable, accrued expenses and other liabilities" on the Company's Consolidated Balance Sheets.

## Note 5 Corporate Tenant Lease Assets

During the three months ended March 31, 2008 and 2007, the Company acquired an aggregate of approximately \$2.0 million and \$20.1 million in CTL assets, respectively and disposed of CTL assets for net proceeds of approximately \$8.2 million and \$34.8 million, respectively resulting in gains of \$2.1 million and \$1.4 million, respectively. In addition, in March 2007, the Company received title to property with a fair value of \$156.8 million that served as collateral for a senior mortgage loan. The Company allocated \$120.4 million of this fair value to CTL assets and the remainder was allocated to CTL intangibles.

The Company's investments in CTL assets, at cost, were as follows (in thousands):

	<b>As of March 31, 2008</b>	<b>As of December 31, 2007</b>
	<hr/>	<hr/>
Facilities and improvements	\$ 3,032,162	\$ 2,996,386
Land and land improvements	729,572	730,495
Less: accumulated depreciation	(433,524)	(417,015)
	<hr/>	<hr/>
Corporate tenant lease assets, net	<b>\$ 3,328,210</b>	<b>\$ 3,309,866</b>
	<hr/>	<hr/>

Under certain leases, the Company is entitled to receive additional participating lease payments to the extent gross revenues of the corporate customer exceed a base amount. The Company earned approximately \$1.4 million in additional participating lease payments on such leases during the three months ended March 31, 2008 and none during the three months ended March 31, 2007. In addition, the Company also receives reimbursements from customers for certain facility operating expenses including common area costs, insurance and real estate taxes. Customer expense reimbursements for the three months ended March 31, 2008 and 2007 were approximately \$9.4 million and \$6.7 million, respectively, and are included as a reduction of "Operating costs corporate tenant lease assets" on the Company's Consolidated Statements of Operations.

The Company is subject to expansion option agreements with three existing customers which could require the Company to fund and to construct up to 171,000 square feet of additional adjacent space on which the Company would receive additional operating lease income under the terms of the option agreements. Upon exercise of such expansion option agreements, the corporate customers would be



## iStar Financial Inc.

## Notes to Consolidated Financial Statements (Continued)

## Note 5 Corporate Tenant Lease Assets (Continued)

required to simultaneously extend their existing lease terms for additional periods ranging from six to ten years. Additionally, the Company has an obligation, through February 28, 2009, to consider an existing customer's pending proposal to acquire and construct up to seven additional sites similar to those already included in the customer's lease agreement, which could require funding by the Company of up to \$200 million. Upon completion of each site, the Company would receive additional operating lease income under the terms of the existing lease agreement and extend the lease for a period of 25 years.

Certain CTL assets are subject to mortgage liens. As of March 31, 2008, 31 CTL assets were encumbered with 12 mortgages with a cumulative outstanding balance of approximately \$367.5 million. As of December 31, 2007, 27 CTL assets were encumbered with 11 mortgages with a cumulative outstanding balance of \$316.8 million. As of March 31, 2008, the mortgages' balances ranged in amount from approximately \$5.6 million to \$121.4 million and had maturity dates ranging from 12 months to 18.7 years. As of March 31, 2008, 11 of the loans had fixed interest rates ranging from 6.4% to 8.4% and one variable rate loan had a rate of LIBOR + 1.65% (see Note 8 for further detail).

As of March 31, 2008, the Company had \$49.8 million of non-discretionary unfunded commitments related to six CTL investments. These commitments generally fall into two categories: (1) pre-approved capital improvement projects; and (2) new or additional construction costs. Upon completion of the improvements or construction, the Company will receive additional operating lease income from the customers. In addition, the Company had \$12.2 million of non-discretionary unfunded commitments related to 14 existing customers in the form of tenant improvements which were negotiated between the Company and the customers at the commencement of the leases.

As of March 31, 2008, there were three CTL assets with an aggregate book value of \$79.2 million classified as "Assets held for sale" on the Company's Consolidated Balance Sheets.

The Company capitalized \$4.0 million and \$0.6 million of interest on build-to-suit CTL assets during the three months ended March 31, 2008 and March 31, 2007, respectively.

## Note 6 Other Investments

Other investments consist of the following items (in thousands):

	As of March 31, 2008	As of December 31, 2007
Equity method investments	\$ 472,203	\$ 482,170
Cost method investments	246,313	173,788
Timber and timberlands, net(1)	125,765	129,600
CTL intangibles, net(2)	67,644	69,912
Note receivable	44,228	
Marketable securities	734	1,139
Other investments	\$ 956,887	\$ 856,609

## Explanatory Notes:

- (1) Accumulated depletion on timber and timberlands was \$16.1 million and \$14.1 million as of March 31, 2008 and December 31, 2007, respectively.
- (2) Accumulated amortization on CTL intangibles was \$17.8 million and \$15.5 million as of March 31, 2008 and December 31, 2007, respectively.



## iStar Financial Inc.

## Notes to Consolidated Financial Statements (Continued)

## Note 6 Other Investments (Continued)

**Equity method investments** As of March 31, 2008, the Company owned 47.5% interests in Oak Hill Advisors, L.P., Oak Hill Credit Alpha MGP, LLC, Oak Hill Credit Opportunities MGP, LLC, OHA Finance MGP, LLC, OHA Capital Solutions MGP, LLC and OHA Strategic Credit Fund, LLC, and 48.1% interests in OHSF GP Partners II, LLC and OHSF GP Partners (Investors), LLC, (collectively, "Oak Hill"). Oak Hill engages in investment and asset management services. The Company has determined that all of these entities are variable interest entities and that an external member is the primary beneficiary. As such, the Company accounts for these ventures under the equity method. Upon acquisition of the original interests in Oak Hill there was a difference between the Company's book value of the equity investments and the underlying equity in the net assets of Oak Hill of approximately \$200.2 million. The Company allocated this value to identifiable intangible assets of approximately \$81.8 million and goodwill of \$118.4 million. The unamortized balance related to intangible assets for these investments was approximately \$56.9 million and \$58.4 million as of March 31, 2008 and December 31, 2007, respectively. The Company's carrying value in Oak Hill was \$183.5 million and \$199.6 million at March 31, 2008 and December 31, 2007, respectively, and the Company recognized equity in earnings from these entities of \$5.1 million and \$4.1 million for the three months ended March 31, 2008 and 2007, respectively.

As of March 31, 2008, the Company owned a 46.7% interest in TimberStar Southwest Holdco LLC ("TimberStar Southwest"), through its majority owned subsidiary TimberStar Operating Partnership, L.P. ("TimberStar"). TimberStar Southwest was created to acquire and manage a diversified portfolio of timberlands located in Texas, Louisiana and Arkansas. The Company accounts for this investment under the equity method due to the venture's external partners having certain participating rights giving them shared control. Upon acquisition, there was a \$1.0 million difference between the Company's book value of the equity investment and the underlying equity in the net assets of the entity, which the Company allocated to identifiable intangible assets. As of March 31, 2008 and December 31, 2007, the unamortized balance was \$0.9 million. The Company's carrying value in the venture was \$140.9 million and \$145.4 million at March 31, 2008 and December 31, 2007, respectively. The Company recognized equity in losses from the investment of (\$2.7) million and (\$3.8) million for the three months ended March 31, 2008 and 2007, respectively. The Company's share of depletion, depreciation and amortization expense from the entity was \$6.7 million and \$9.2 million for the three months ended March 31, 2008 and 2007, respectively, and consists primarily of depletion from the harvesting and sale of timber. On April 1, 2008, the Company closed on the sale of the TimberStar Southwest joint venture (see Note 17).

As of March 31, 2008, the Company owned a 29.52% interest in Madison International Real Estate Fund II, LP, a 32.92% interest in Madison International Real Estate Fund III, LP, a 29.52% interest in Madison GP1 Investors, LP (collectively, the "Madison Funds"). The Madison Funds invest in illiquid ownership positions of entities that own real estate assets. The Company's carrying value in the Madison Funds was \$48.2 million and \$38.0 million at March 31, 2008 and December 31, 2007, respectively, and the Company recognized equity in losses from these investments of (\$2.6) million and (\$0.4) million for the three months ended March 31, 2008 and 2007, respectively.

The Company also had investments in 16 and 15 additional entities that were accounted for under the equity method as of March 31, 2008 and December 31, 2007, respectively. The Company's ownership in these entities ranged from 0.83% to 50.0% as of March 31, 2008 and the Company's carrying value in these investments was \$99.5 million and \$99.2 million as of March 31, 2008 and December 31, 2007, respectively. The Company recognized cumulative net equity in losses of (\$0.9) million for the three months ended March 31, 2008 and equity in earnings of \$1.6 million for the three months ended March 31, 2007.

## iStar Financial Inc.

## Notes to Consolidated Financial Statements (Continued)

## Note 6 Other Investments (Continued)

The following table presents the summarized financial information of the Company's equity method investments (in thousands):

	For the Three Months Ended March 31,	
	2008	2007
<b>Income Statement</b>		
Revenues	\$ 182,724	\$ 129,804
Costs and expenses	\$ 148,904	\$ 116,925
Net income (loss)	\$ (1,384)	\$ 43,281

As of March 31, 2008, the Company had \$93.5 million of non-discretionary unfunded commitments related to eight equity method investments.

**Cost method investments** The Company had investments in 18 separate real estate related funds or other strategic investment opportunities within niche markets that are accounted for under the cost method and had cumulative carrying values of \$246.3 million and \$173.8 million as of March 31, 2008 and December 31, 2007, respectively. As of March 31, 2008, the Company had \$163.8 million of non-discretionary unfunded commitments related to three cost method investments. During the three months ended March 31, 2008, the Company reclassified a loan with a net carrying value of \$69.4 million from "Loans and other lending investments, net" to "Other investments" on the Company's Consolidated Balance Sheets, as a cost method investment.

During the three months ended March 31, 2008, the Company redeemed its interest in a profits participation that was originally received as part of a prior lending investment and carried as a cost method investment prior to redemption. As a result of the transaction, the Company recorded a note receivable of \$44.2 million and an equal amount of income in "Other income" in the Company's Consolidated Statements of Operations.

## iStar Financial Inc.

## Notes to Consolidated Financial Statements (Continued)

## Note 7 Other Assets and Other Liabilities

Deferred expenses and other assets consist of the following items (in thousands):

	As of March 31, 2008	As of December 31, 2007
Derivative assets	\$ 47,593	\$ 17,929
Intangible assets, net(1)	27,025	28,733
Deferred financing fees, net(2)	22,947	14,017
Corporate furniture, fixtures and equipment, net(3)	15,765	14,302
Leasing costs, net(4)	15,179	15,764
Other assets	28,138	14,529
	<b>156,647</b>	<b>105,274</b>

## Explanatory Notes:

- (1) Accumulated amortization on intangible assets was \$7.7 million and \$6.0 million as of March 31, 2008 and December 31, 2007, respectively.
- (2) Accumulated amortization on deferred financing fees was \$29.8 million and \$27.6 million as of March 31, 2008 and December 31, 2007, respectively.
- (3) Accumulated depreciation on corporate furniture, fixture and equipment was \$5.3 million and \$4.8 million as of March 31, 2008 and December 31, 2007, respectively.
- (4) Accumulated amortization on leasing costs was \$7.9 million and \$8.4 million as of March 31, 2008 and December 31, 2007, respectively.

Accounts payable, accrued expenses and other liabilities consist of the following items (in thousands):

	As of March 31, 2008	As of December 31, 2007
Fremont participation payable (see Note 4)	\$286,606	\$209,570
Dividends payable	118,715	34,868
Accrued interest payable	96,113	103,080
Unearned operating lease income	22,053	12,345
Accrued expenses	21,052	62,199
Security deposits from customers	19,776	19,849
Derivative liabilities	19,137	6,621
Other liabilities	56,458	46,779
	<b>639,910</b>	<b>495,311</b>



## iStar Financial Inc.

## Notes to Consolidated Financial Statements (Continued)

## Note 8 Debt Obligations

As of March 31, 2008 and December 31, 2007, the Company has debt obligations under various arrangements with financial institutions as follows (in thousands):

	Maximum Amount Available	Carrying Value as of		Stated Interest Rates(1)	Scheduled Maturity Date(1)
		March 31, 2008	December 31, 2007		
<b>Secured revolving credit facility:</b>					
Line of credit	\$ 500,000	\$ 244,718	\$	LIBOR + 1%-2%(2)	September 2009(3)
<b>Unsecured revolving credit facilities:</b>					
Line of credit(4)	2,220,000	1,988,203	1,485,286	LIBOR + 0.525%(5)	June 2011
Line of credit(6)	1,200,000	834,184	1,195,888	LIBOR + 0.525%(5)	June 2012
Total revolving credit facilities	\$ 3,920,000	3,067,105	2,681,174		
Interim financing facility		1,289,811	1,289,811	LIBOR + 0.50%	June 2008
<b>Secured term loans:</b>					
Collateralized by CTL assets		121,386	122,690	7.44%	April 2009
Collateralized by CTL assets		246,140	194,061	LIBOR + 1.65% and 6.4%-8.4%	Various through 2026
Collateralized by investments in corporate debt		300,000		LIBOR + 2.5%	March 2009
Collateralized by investments in corporate bonds		54,221	91,388	LIBOR + 1.65%	April 2008
Total secured term loans		721,747	408,139		
Debt premium		5,408	5,543		
Total secured term loans		727,155	413,682		
<b>Unsecured notes:</b>					
LIBOR + 0.34% Senior Notes		500,000	500,000	LIBOR + 0.34%	September 2009
LIBOR + 0.35% Senior Notes		500,000	500,000	LIBOR + 0.35%	March 2010
LIBOR + 0.39% Senior Notes			385,000	LIBOR + 0.39%	March 2008
LIBOR + 0.50% Senior Notes		800,000	800,000	LIBOR + 0.50%	October 2012
LIBOR + 0.55% Senior Notes		225,000	225,000	LIBOR + 0.55%	March 2009
4.875% Senior Notes		350,000	350,000	4.875%	January 2009
5.125% Senior Notes		250,000	250,000	5.125%	April 2011
5.15% Senior Notes		700,000	700,000	5.15%	March 2012
5.375% Senior Notes		250,000	250,000	5.375%	April 2010
5.5% Senior Notes		300,000	300,000	5.5%	June 2012
5.65% Senior Notes		500,000	500,000	5.65%	September 2011
5.7% Senior Notes		367,022	367,022	5.7%	March 2014
5.8% Senior Notes		250,000	250,000	5.8%	March 2011
5.85% Senior Notes		250,000	250,000	5.85%	March 2017
5.875% Senior Notes		500,000	500,000	5.875%	March 2016
5.95% Senior Notes		889,669	889,669	5.95%	October 2013
6% Senior Notes		350,000	350,000	6%	December 2010
6.05% Senior Notes		250,000	250,000	6.05%	April 2015
6.5% Senior Notes		150,000	150,000	6.5%	December 2013
7% Senior Notes			185,000	7%	March 2008
8.75% Notes		50,331	50,331	8.75%	August 2008
Total unsecured notes		7,432,022	8,002,022		
Debt discount		(95,955)	(102,168)		
Fair value adjustment to hedged items (see Note 10)		48,729	16,999		

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Carrying Value as of

Total unsecured notes	7,384,796	7,916,853		
Other debt obligations	100,000	100,000	LIBOR + 1.5%	October 2035
Debt discount				