ISTAR FINANCIAL INC
Form 10-Q
August 10, 2009

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# 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 June 30, 2009**

**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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o 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.

| Large accelerated filer ý | Accelerated filer o | Non-accelerated filer o<br>(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 July 31, 2009, there were 99,651,865 shares of common stock, $0.001 par value per share of iStar Financial Inc., ("Common Stock") outstanding.

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**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 June 30, 2009 | As of December 31, 2008, As Adjusted(1) |
|---|---|---|
| **ASSETS** | | |
| Loans and other lending investments, net | $ 9,578,241 | $ 10,586,644 |
| Corporate tenant lease assets, net | 2,992,286 | 3,044,811 |
| Other investments | 391,292 | 447,318 |
| Other real estate owned | 382,570 | 242,505 |
| Cash and cash equivalents | 417,352 | 496,537 |
| Restricted cash | 34,406 | 155,965 |
| Accrued interest and operating lease income receivable, net | 66,611 | 87,151 |
| Deferred operating lease income receivable | 118,062 | 116,793 |
| Deferred expenses and other assets, net | 137,774 | 119,024 |
| Total assets | $ 14,118,594 | $ 15,296,748 |
| **LIABILITIES AND EQUITY** | | |
| Liabilities: | | |
| Accounts payable, accrued expenses and other liabilities | $ 230,491 | $ 354,492 |
| Debt obligations, net | 11,826,503 | 12,486,404 |
| Total liabilities | 12,056,994 | 12,840,896 |
| Commitments and contingencies | | |
| Redeemable noncontrolling interests | 7,447 | 9,190 |
| Equity: | | |
| iStar Financial Inc. shareholders' equity: | | |
| Series D Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 4,000 shares issued and outstanding at June 30, 2009 and December 31, 2008 | 4 | 4 |
| Series E Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 5,600 shares issued and outstanding at June 30, 2009 and December 31, 2008 | 6 | 6 |
| Series F Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 4,000 shares issued and outstanding at June 30, 2009 and December 31, 2008 | 4 | 4 |
| Series G Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 3,200 shares issued and outstanding at June 30, 2009 and December 31, 2008 | 3 | 3 |
| Series I Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 5,000 shares issued and outstanding at June 30, 2009 and December 31, 2008 | 5 | 5 |
| High Performance Units | 9,800 | 9,800 |

| | | |
|---|---|---|
| Common Stock, $0.001 par value, 200,000 shares authorized, 137,832 issued and 99,618 outstanding at June 30, 2009 and 137,352 issued and 105,457 outstanding at December 31, 2008 | 138 | 137 |
| Additional paid-in capital | 3,781,697 | 3,768,772 |
| Retained earnings (deficit) | (1,628,971) | (1,240,280) |
| Accumulated other comprehensive income (see Note 13) | 4,381 | 1,707 |
| Treasury stock, at cost, $0.001 par value, 38,214 shares at June 30, 2009 and 31,895 shares at December 31, 2008 | (137,883) | (121,159) |
| Total iStar Financial Inc. shareholders' equity | 2,029,184 | 2,418,999 |
| Noncontrolling interests | 24,969 | 27,663 |
| Total equity | 2,054,153 | 2,446,662 |
| Total liabilities and equity | $ 14,118,594 | $ 15,296,748 |

**Explanatory Note:**

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(1) On January 1, 2009, the Company adopted the provisions of FSP APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (including Partial Cash Settlement)" and SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements an amendment of ARB No. 51." Both new standards require retroactive application for prior periods presented. See Notes 3 and 8 for further details.

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

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**iStar Financial Inc.**

**Consolidated Statements of Operations**

**(In thousands, except per share data)**

**(unaudited)**

| | For the Three Months Ended June 30, 2009 | For the Three Months Ended June 30, 2008, As Adjusted(1) | For the Six Months Ended June 30, 2009 | For the Six Months Ended June 30, 2008, As Adjusted(1) |
|---|---|---|---|---|
| **Revenue:** | | | | |
| Interest income | $ 142,181 | $ 235,354 | $ 319,408 | $ 511,453 |
| Operating lease income | 76,835 | 77,295 | 155,485 | 155,495 |
| Other income | 5,560 | 7,760 | 8,073 | 65,785 |
| Total revenue | 224,576 | 320,409 | 482,966 | 732,733 |
| **Costs and expenses:** | | | | |
| Interest expense | 127,186 | 164,470 | 258,351 | 334,250 |
| Operating costs corporate tenant lease assets | 5,615 | 4,546 | 12,161 | 9,613 |
| Depreciation and amortization | 24,825 | 24,025 | 48,477 | 47,887 |
| General and administrative | 38,421 | 44,004 | 77,810 | 86,780 |
| Provision for loan losses | 435,016 | 276,660 | 693,112 | 366,160 |
| Impairment of other assets | 24,817 | 57,692 | 45,962 | 57,692 |
| Impairment of goodwill | | 39,092 | 4,186 | 39,092 |
| Other expense | 53,310 | 1,704 | 60,308 | 5,504 |
| Total costs and expenses | 709,190 | 612,193 | 1,200,367 | 946,978 |
| Income (loss) before earnings (loss) from equity method investments and other items | (484,614) | (291,784) | (717,401) | (214,245) |
| Gain on early extinguishment of debt | 200,879 | | 355,256 | |
| Gain on sale of joint venture interest | | 280,219 | | 280,219 |
| Earnings (loss) from equity method investments | 1,864 | 6,070 | (18,636) | 3,473 |
| Income (loss) from continuing operations | (281,871) | (5,495) | (380,781) | 69,447 |
| Income (loss) from discontinued operations | (102) | 5,994 | 119 | 14,025 |
| Gain from discontinued operations | | 50,476 | 11,617 | 52,532 |
| Net income (loss) | (281,973) | 50,975 | (369,045) | 136,004 |
| Net loss attributable to noncontrolling interests | 271 | 771 | 1,514 | 567 |
| Gain on sale of joint venture interest attributable to noncontrolling interests | | (18,560) | | (18,560) |
| Gain from discontinued operations attributable to noncontrolling interests | | (3,689) | | (3,689) |
| Net income (loss) attributable to iStar Financial Inc. | (281,702) | 29,497 | (367,531) | 114,322 |
| Preferred dividend requirements | (10,580) | (10,580) | (21,160) | (21,160) |
| Net income (loss) attributable to iStar Financial Inc. and allocable to common shareholders, HPU holders and Participating Security holders(2)(3)(4) | $ (292,282) | $ 18,917 | $ (388,691) | $ 93,162 |
| **Per common share data(4):** | | | | |
| Income (loss) attributable to iStar Financial Inc. from continuing operations: | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Basic | $ | (2.85) | $ | (0.24) | $ | (3.79) | $ | 0.21 |
| Diluted | $ | (2.85) | $ | (0.24) | $ | (3.79) | $ | 0.22 |
| Net income (loss) attributable to iStar Financial Inc.: | | | | | | | | |
| Basic | $ | (2.85) | $ | 0.14 | $ | (3.68) | $ | 0.67 |
| Diluted | $ | (2.85) | $ | 0.14 | $ | (3.68) | $ | 0.67 |
| Weighted average number of common shares basic | | 99,769 | | 134,399 | | 102,671 | | 134,330 |
| Weighted average number of common shares diluted | | 99,769 | | 134,399 | | 102,671 | | 134,782 |
| **Per HPU share data(2)(4):** | | | | | | | | |
| Income (loss) attributable to iStar Financial Inc. from continuing operations: | | | | | | | | |
| Basic | $ | (538.80) | $ | (46.73) | $ | (718.14) | $ | 40.20 |
| Diluted | $ | (538.80) | $ | (46.73) | $ | (718.14) | $ | 40.13 |
| Net income (loss) attributable to iStar Financial Inc.: | | | | | | | | |
| Basic | $ | (539.00) | $ | 26.07 | $ | (697.07) | $ | 126.93 |
| Diluted | $ | (539.00) | $ | 26.07 | $ | (697.07) | $ | 126.53 |
| Weighted average number of HPU shares basic and diluted | | 15 | | 15 | | 15 | | 15 |

**Explanatory Notes:**

(1) On January 1, 2009, the Company adopted the provisions of FSP APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (including Partial Cash Settlement)," SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements an amendment of ARB No. 51," and FSP EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities." These new standards require retroactive application for prior periods presented. See Notes 3, 8, 9 and 12 for further details.

(2) HPU holders are Company employees who purchased high performance common stock units under the Company's High Performance Unit Program (see Note 12).

(3) Participating Security holders are Company employees and directors who hold unvested restricted stock units and common stock equivalents granted under the Company's Long Term Incentive Plans (see Notes 11 and 12).

(4) See Note 12 for amounts attributable to iStar Financial Inc. for income (loss) from continuing operations and further details on the calculation of earnings per share.

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

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**iStar Financial Inc.**

**Consolidated Statement of Changes in Equity**

**For the Six Months Ended June 30, 2009**

**(In thousands)**

**(unaudited)**

| | iStar Financial Inc. Shareholders' Equity | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 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 | Additional Paid-In Capital | Retained Earnings (Deficit) | Accumulated Other Comprehensive Income | Treasury Stock at cost | Noncontrolling Interests | Total |
| Balance at December 31, 2008, As Adjusted(1) | $ 4 | $ 6 | $ 4 | $ 3 | $ 5 | $ 9,800 | $ 137 | $ 3,731,379 | $ (1,232,506) | $ 1,707 | $ (121,159) | $ 27,663 | $ 2,417,043 |
| Adoption of FSP APB 14-1 (see Notes 3 and 8) | | | | | | | | 37,393 | (7,774) | | | | 29,619 |
| Adjusted beginning balance January 1, 2009 | $ 4 | $ 6 | $ 4 | $ 3 | $ 5 | $ 9,800 | $ 137 | $ 3,768,772 | $ (1,240,280) | $ 1,707 | $ (121,159) | $ 27,663 | $ 2,446,662 |
| Dividends declared preferred | | | | | | | | | (21,160) | | | | (21,160) |
| Repurchase of stock | | | | | | | | | | | (16,724) | | (16,724) |
| Issuance of stock vested restricted stock units | | | | | | | 1 | 12,925 | | | | | 12,926 |
| Net loss for the period(2) | | | | | | | | | (367,531) | | | (1,511) | (369,042) |
| Contributions from noncontrolling interests | | | | | | | | | | | | 5 | 5 |
| Distributions to noncontrolling interests | | | | | | | | | | | | (1,188) | (1,188) |
| Change in accumulated other comprehensive income | | | | | | | | | | 2,674 | | | 2,674 |
| Balance at June 30, 2009 | $ 4 | $ 6 | $ 4 | $ 3 | $ 5 | $ 9,800 | $ 138 | $ 3,781,697 | $ (1,628,971) | $ 4,381 | $ (137,883) | $ 24,969 | $ 2,054,153 |

**Explanatory Notes:**

(1) On January 1, 2009, the Company adopted the provisions of SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements an amendment of ARB No. 51." The new standard requires retroactive application for prior periods presented. See Notes 3 and 9 for further details.

(2) For the six months ended June 30, 2009, net loss excludes $3 attributable to redeemable noncontrolling interests.

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

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**iStar Financial Inc.**

**Consolidated Statements of Cash Flows**

**(In thousands)**

**(unaudited)**

| | For the Six Months Ended June 30, 2009 | For the Six Months Ended June 30, 2008, As Adjusted(1) |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income (loss) | $ (369,045) | $ 136,004 |
| Adjustments to reconcile net income (loss) to cash flows from operating activities: | | |
| Non-cash expense for stock-based compensation | 13,051 | 12,602 |
| Shares withheld for employee taxes on stock-based compensation arrangements | (535) | (2,845) |
| Impairment of goodwill | 4,186 | 39,092 |
| Impairment of other assets | 45,962 | 57,692 |
| Depreciation, depletion and amortization | 48,598 | 54,510 |
| Amortization of discounts/premiums and deferred financing costs on debt | 3,877 | 21,136 |
| Amortization of discounts/premiums, deferred interest and costs on lending investments | (66,257) | (112,376) |
| Discounts, loan fees and deferred interest received | 4,821 | 17,199 |
| (Income) loss from unconsolidated entities | 18,636 | (3,473) |
| Distributions from operations of unconsolidated entities | 18,149 | 32,133 |
| Deferred operating lease income receivable | (8,340) | (8,790) |
| Gain from discontinued operations | (11,617) | (52,532) |
| Gain on early extinguishment of debt | (355,256) | |
| Gain on sale of joint venture interest | | (280,219) |
| Provision for loan losses | 693,112 | 366,160 |
| Provision for deferred taxes | 1,342 | 2,486 |
| Other non-cash adjustments | (384) | (2,134) |
| Note receivable from investment redemption | | (44,228) |
| Changes in assets and liabilities: | | |
| Changes in accrued interest and operating lease income receivable, net | 19,748 | 26,032 |
| Changes in deferred expenses and other assets, net | 7,165 | (17,078) |
| Changes in accounts payable, accrued expenses and other liabilities | (29,557) | (25,090) |
| Cash flows from operating activities | 37,656 | 216,281 |
| Cash flows from investing activities: | | |
| New investment originations | | (13,559) |
| Add-on fundings under existing loan commitments | (734,107) | (1,912,899) |
| Purchase of securities | (11,137) | |
| Repayments of and principal collections on loans | 382,895 | 1,261,571 |
| Net proceeds from sales of loans | 399,720 | 179,008 |
| Net proceeds from sales of discontinued operations | 36,455 | 406,151 |
| Net proceeds from sales of other real estate owned | 145,572 | 86,176 |
| Net proceeds from sale of joint venture interest | | 416,970 |
| Net proceeds from repayments and sales of securities | 16,328 | 9,022 |
| Contributions to unconsolidated entities | (18,673) | (23,421) |
| Distributions from unconsolidated entities | 5,811 | 6,390 |
| Capital improvements for build-to-suit facilities | (7,152) | (60,307) |
| Capital expenditures and improvements on corporate tenant lease assets | (1,691) | (14,871) |
| Other investing activities, net | (5,588) | (12,809) |
| Cash flows from investing activities | 208,433 | 327,422 |
| Cash flows from financing activities: | | |

| | | |
|---|---|---|
| Borrowings under revolving credit facilities | 115,039 | 8,700,315 |
| Repayments under revolving credit facilities | (350,896) | (8,980,245) |
| Repayments under interim financing | | (1,289,811) |
| Borrowings under secured term loans | 1,000,000 | 1,307,776 |
| Repayments under secured term loans | (305,758) | (74,698) |
| Borrowings under unsecured notes | | 740,506 |
| Repayments under unsecured notes | (383,399) | (591,968) |
| Repurchases of unsecured notes | (423,691) | |
| Contributions from noncontrolling interests | 5 | 107 |
| Distributions to noncontrolling interests | (1,188) | (3,257) |
| Changes in restricted cash held in connection with debt obligations | 114,300 | (19,640) |
| Payments for deferred financing costs/proceeds from hedge settlements, net | (51,802) | (27,904) |
| Common dividends paid | | (151,921) |
| Preferred dividends paid | (21,160) | (21,160) |
| HPU dividends paid | | (3,156) |
| HPUs redeemed | | (11) |
| Purchase of treasury stock | (16,724) | (5,209) |
| Proceeds from exercise of options and issuance of DRIP/Stock purchase shares | | 6,612 |
| Cash flows from financing activities | (325,274) | (413,664) |
| Changes in cash and cash equivalents | (79,185) | 130,039 |
| Cash and cash equivalents at beginning of period | 496,537 | 104,507 |
| Cash and cash equivalents at end of period | $ 417,352 | $ 234,546 |

**Explanatory Note:**

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(1) On January 1, 2009, the Company adopted the provisions of FSP APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (including Partial Cash Settlement)" and SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements an amendment of ARB No. 51." Both new standards require retroactive application for prior periods presented. See Notes 3 and 8 for further details.

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

**iStar Financial Inc.**

**Notes to Consolidated Financial Statements**

**(unaudited)**

**Note 1 Business and Organization**

**Business** iStar Financial Inc., or the "Company," is a 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, as well as corporate net lease financing and equity. The Company, which is taxed as a real estate investment trust, or "REIT," provides innovative and value-added financing solutions to its customers. The Company delivers customized financing products to sophisticated real estate borrowers and corporate customers who require a high level of flexibility and service. 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 initial 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 initial 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 most of these leases provide for 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 its CTL properties. 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 its 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 and 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 and loan portfolio ("Fremont CRE") of Fremont Investment and Loan ("Fremont"), a division of Fremont General Corporation, in 2007.

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**iStar Financial Inc.**

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

**(unaudited)**

**Note 2 Basis of Presentation and Principles of Consolidation**

**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, 2008.

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.

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 June 30, 2009 and December 31, 2008, the results of its operations for the three and six months ended June 30, 2009 and 2008 and its changes in equity and its cash flows for the six months ended June 30, 2009 and 2008. Such operating results may not be indicative of the expected results for any other interim periods or the entire year.

Certain prior year amounts have been reclassified in the Consolidated Financial Statements and the related Notes to conform to the 2009 presentation. In addition, the Company adopted three new accounting standards on January 1, 2009 which required retroactive application for presentation of prior periods' Consolidated Financial Statements (see Notes 3, 8, 9 and 12 for further details).

**Principles of Consolidation** 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. 46(R), "Consolidation of Variable Interest Entities," an interpretation of ARB 51 ("FIN 46(R)"). The following are variable interest entities for which the Company is the primary beneficiary and has consolidated for financial statement purposes:

During 2008, the Company made a $49.0 million commitment to OHA Strategic Credit Fund Parallel I, LP ("OHA SCF"). OHA SCF was created to invest in distressed, stressed and undervalued loans, bonds, equities and other investments. The Fund intends to opportunistically invest capital following a period of credit market dislocation. The Company determined that OHA SCF is a variable interest entity ("VIE") and that the Company is the primary beneficiary. As such, the Company consolidates this entity for financial statement purposes. However, as the entity is managed by a third party, the Company does not have control over the entity's assets and liabilities. As of June 30, 2009, OHA SCF had $27.1 million of total assets, no debt and $0.1 million of noncontrolling interest. The investments held by this entity are presented in "Other investments" on the Company's Consolidated Balance Sheets. As of June 30, 2009, the Company had a total unfunded commitment of $32.2 million related to this entity.

During 2007, the Company made a €100.0 million commitment to 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

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**iStar Financial Inc.**

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

**(unaudited)**

**Note 2 Basis of Presentation and Principles of Consolidation (Continued)**

Company consolidates this entity for financial statement purposes. However, as the entity is managed by a third party, the Company does not have control over the entity's assets and liabilities. As of June 30, 2009, Moor Park had $9.4 million of total assets, no debt and $0.1 million of noncontrolling interest. The investments held by this entity are presented in "Loans and other lending investments, net" on the Company's Consolidated Balance Sheets. As of June 30, 2009, the Company had a total unfunded commitment of €63.3 million (or $88.8 million) related to this entity.

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. However, as the entity is managed by a third party, the Company does not have control over the entity's assets and liabilities. As of June 30, 2009, Madison DA had $62.9 million of total assets, no debt and $9.6 million of noncontrolling interest. The investments held by this entity are presented in "Loans and other lending investments" on the Company's Consolidated Balance Sheets.

**Note 3 Summary of Significant Accounting Policies**

As of June 30, 2009, the Company's significant accounting policies, which are detailed in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, had not changed materially.

**New accounting standards**

In June 2009, the Financial Accounting Standards Board ("FASB") issued FASB Statement of Financial Accounting Standards No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162" ("SFAS No. 168"), which will require the FASB Accounting Standards Codification ("Codification") to become the single official source of authoritative, nongovernmental U.S. generally accepted accounting principles ("GAAP"). The Codification will be effective for interim and annual periods ending on or after September 15, 2009. The Company will adopt SFAS No. 168 for the period ending September 30, 2009, as required, and is currently evaluating the impact of this adoption on its Consolidated Financial Statements.

In June 2009, the FASB issued FASB Statement of Financial Accounting Standards No. 167, "Amendments to FASB Interpretation No. 46(R)" ("SFAS No. 167"), which eliminates the exemption for qualifying special purpose entities, creates a new approach for determining who should consolidate a variable-interest entity and requires an ongoing reassessment to determine if a Company should consolidate a variable interest entity. The standard is effective through a cumulative-effect adjustment (with a retroactive option) at adoption and effective for interim and annual periods beginning after November 15, 2009. The Company will adopt SFAS No. 167 on January 1, 2010, as required, and is currently evaluating the impact of this adoption on its Consolidated Financial Statements.

In June 2009, the FASB issued FASB Statement of Financial Accounting Standards No. 166, "Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140" ("SFAS No. 166"), which eliminates the qualifying special-purpose entity concept, creates a new unit of account definition that must be met for transfers of portions of financial assets to be eligible for sale accounting,

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**iStar Financial Inc.**

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

**(unaudited)**

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

clarifies and changes the de-recognition criteria for a transfer to be accounted for as a sale, changes the amount of recognized gain or loss on a transfer of financial assets accounted for as a sale when beneficial interests are received by the transferor and requires new disclosures. The new standard is effective prospectively for transfers of financial assets occurring in interim and annual periods beginning after November 15, 2009. The Company will adopt SFAS No. 166 on January 1, 2010, as required, and is currently evaluating the impact of this adoption on its Consolidated Financial Statements.

In May 2009, the FASB issued FASB Statement of Financial Accounting Standards No. 165, "Subsequent Events" ("SFAS No. 165"), which moved the accounting requirements out of the auditing literature into the body of authoritative literature issued by the FASB. The standard replaced terminology of Type 1 and Type II with "recognized" and "unrecognized" subsequent events and requires disclosure of the date through which the entity has evaluated subsequent events; whether that evaluation date is the date of issuance or the date the financial statements were available to be issued. SFAS No. 165 is effective for interim or annual periods ending after June 15, 2009. The Company adopted the standard for the period ended June 30, 2009, as required. See Note 17 for additional disclosures required by the adoption of this standard.

On April 2, 2009, the FASB issued FASB Staff Position FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" ("FSP FAS 157-4"), which offers additional guidance for determining whether the market for a security is inactive and whether transactions in inactive markets are or are not distressed. It also enhances the guidance and illustrations for how to value securities in an inactive market. FSP FAS 157-4 is effective for interim and annual reporting periods ending after June 15, 2009. The Company adopted the standard for the period ended June 30, 2009, as required, and it did not have a significant impact on the Company's Consolidated Financial Statements.

On April 2, 2009, the FASB issued FASB Staff Positions FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments" ("FSP FAS 115-2"), which changes the method for determining whether an other-than-temporary impairment exists for debt securities and the amount of impairment charge to be recorded in earnings. To determine whether an other-than-temporary impairment exists, an entity will assess the likelihood of selling the security prior to recovering its cost basis, a change from the current requirements where an entity assesses whether it has the intent and ability to hold a security to recovery. If the criteria is met to assert that an entity has the positive intent to hold and will not have to sell the security before recovery, impairment charges related to credit losses would be recognized in earnings, while impairment charges related to non-credit loss (e.g. liquidity risk) would be reflected in other comprehensive income. Upon adoption, changes in assertions will require cumulative effect adjustments to the opening balance of retained earnings. FSP FAS 115-2 is effective for interim and annual reporting periods ending after June 15, 2009. The Company adopted the standard for the period ended June 30, 2009, as required, and it did not have a significant impact on the Company's Consolidated Financial Statements. See Note 4 for additional disclosures required by the adoption of this standard.

On April 2, 2009, the FASB issued FASB Staff Positions FAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments" ("FSP FAS 107-1"), which expands disclosures of fair values of financial instruments under FASB Statement No. 107, "Disclosures about Fair Value of Financial Instruments," to include interim financial statements. FSP FAS 107-1 is effective for interim and annual reporting periods ending after June 15, 2009. The Company adopted the standard for the period

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**iStar Financial Inc.**

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

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

ended June 30, 2009, as required. See Note 15 for additional disclosures required by the adoption of this standard.

In February 2009, the FASB issued FASB Staff Position FAS 141(R)-1, "Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies" ("FSP FAS 141(R)-1"), which amends provisions related to the initial recognition and measurement, subsequent measurement and disclosures of assets and liabilities arising from contingencies in a business combination under FASB No. 141(R), "Business Combinations" ("SFAS No. 141(R)"). The amendment carries forward the requirements for acquired contingencies under FASB No. 141, "Business Combinations," which recognizes contingencies at fair value on the acquisition date, if fair value can be reasonably estimated during the allocation period. Otherwise, companies would account for the acquired contingencies in accordance with FASB No. 5, "Accounting for Contingencies." In addition, the amendment eliminates the requirement to disclose an estimate of the range of outcomes for recognized contingencies at the acquisition date. FSP FAS 141(R)-1 is effective for all business combinations on or after January 1, 2009. The Company adopted this Staff Position on January 1, 2009, as required, and it did not have a significant impact on the Company's Consolidated Financial Statements.

In June 2008, the FASB issued FASB Staff Position EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities" ("FSP EITF 03-6-1"). FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in calculating earnings per share under the two-class method as described in SFAS No. 128, "Earnings per Share." Under the guidance in FSP EITF 03-6-1, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. All prior-period EPS data presented shall be adjusted retrospectively (including interim financial statements) to conform to the provisions of this FSP. The Company adopted this standard on January 1, 2009, as required. See Note 12 for further details on the impact of the adoption of this Staff Position.

In May 2008, the FASB issued FSP APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)" ("FSP APB 14-1"). This standard requires the initial proceeds from convertible debt that may be settled in cash be bifurcated between a liability component and an equity component. The objective of the guidance is to require the liability and equity components of convertible debt to be separately accounted for in a manner such that the interest expense recorded on the convertible debt would not equal the contractual rate of interest on the convertible debt, but instead would be recorded at a rate that would reflect the issuer's conventional non-convertible debt borrowing rate at the date of issuance. This is accomplished through the creation of a discount on the debt that would be accreted using the effective interest method as additional non-cash interest expense over the period the debt is expected to remain outstanding. The provisions of FSP APB 14-1 will be applied retrospectively to all periods presented for fiscal years beginning after December 31, 2008. The adoption of FSP APB 14-1 on January 1, 2009 resulted in a reduction of the carrying value of the debt and an increase to additional paid in capital (or equity) of $37.4 million, representing the conversion feature. In addition, beginning retained earnings was reduced by $7.8 million

**iStar Financial Inc.**

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

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

representing additional accretion of the new debt discount using the effective interest method of non-cash interest expense from inception to adoption. The Consolidated Statements of Operations for the three and six months ended June 30, 2008 were retroactively adjusted to include an additional $1.6 million and $3.2 million, respectively, of interest expense from the adoption of the guidance. See Notes 8 and 12 for further details on the impact of the adoption of this guidance.

In April 2008, the FASB issued FSP FAS 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP FAS 142-3"). FSP FAS 142-3 removes the requirement of SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142") for an entity to consider, when determining the useful life of an acquired intangible asset, whether the intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions associated with the intangible asset. FSP FAS 142-3 replaces the previous useful-life assessment criteria with a requirement that an entity considers its own experience in renewing similar arrangements. If the entity has no relevant experience, it would consider market participant assumptions regarding renewal. FSP FAS 142-3 is effective prospectively for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption was prohibited. The Company adopted this interpretation on January 1, 2009, as required, and it did not have a significant impact on the Company's Consolidated Financial Statements.

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 the 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, "Accounting for Derivative Instruments and Hedging Activities" ("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, is effective for fiscal years and interim periods beginning after November 15, 2008 and does not require comparative period disclosures in the year of adoption. The Company adopted SFAS No. 161 on January 1, 2009, as required. See Note 10 for the disclosures required by the adoption of this standard.

In February 2008, the FASB issued a FASB Staff Position 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 became effective for fiscal years beginning after November 15, 2008 and applies only to original transfers made after that date; early adoption was not allowed. The Company adopted this interpretation on January 1, 2009, as required, and it did not have a significant impact on the Company's Consolidated Financial Statements.

In February 2008, the FASB issued FASB Staff Position FSP 157-2, "Effective Date of FASB Statement No. 157" ("FSP 157-2"). FSP 157-2 provided 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 non-financial items include assets and liabilities such as reporting units measured at fair value in a goodwill impairment test and

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**iStar Financial Inc.**

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

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

non-financial assets acquired and liabilities assumed in a business combination. The Company adopted the provisions of FSP 157-2 on January 1, 2009, as required, and made the required fair value disclosures for non-recurring non-financial assets and non-financial liabilities (see Note 15 for further details).

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations" ("SFAS No. 141(R)"). SFAS No. 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 are reflected in revenue, not goodwill; changes the recognition timing for restructuring costs, and requires acquisition costs to be expensed as incurred. Adoption of SFAS No. 141(R) is required for combinations made in annual reporting periods on or after December 15, 2008. Early adoption and retroactive application of SFAS No. 141(R) to fiscal years preceding the effective date are not permitted. The Company adopted SFAS No. 141(R) on January 1, 2009, as required, and it did not have a significant impact on the Company's Consolidated Financial Statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements an amendment of ARB No. 51" ("SFAS No. 160"). SFAS No. 160 re-characterizes minority interests in consolidated subsidiaries as noncontrolling interests and requires the classification of minority interests as a component of equity. Under SFAS 160, a change in control is measured at fair value, with any gain or loss recognized in earnings. The effective date for SFAS No. 160 is for annual periods beginning on or after December 15, 2008. Early adoption and retroactive application of SFAS No. 160 to fiscal years preceding the effective date are not permitted. The Company adopted this standard on January 1, 2009, as required, and reclassified the carrying value of certain noncontrolling interests (previously referred to as minority interests) from the mezzanine section of the balance sheet to equity. Net income on the Consolidated Statements of Operations includes the operating results of both the Company and its related noncontrolling interest holders. In accordance with EITF Topic D-98, "Classification and Measurement of Redeemable Securities," subsidiaries where the noncontrolling interest holder has certain redemption rights have been classified as "Redeemable noncontrolling interests" on the Consolidated Balance Sheets and their related operating income or loss have been included in "Net (income) loss attributable to noncontrolling interests" on the Consolidated Statements of Operations. See Note 9 for additional disclosures required by the adoption of this standard.

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**iStar Financial Inc.**

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

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**Note 4 Loans and Other Lending Investments, net**

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

| | | | | Carrying Value as of | | | | |
|---|---|---|---|---|---|---|---|---|
| **Type of Investment** | **Underlying Property Type** | **# of Borrowers In Class** | **Principal Balances Outstanding** | **June 30, 2009** | **December 31, 2008** | **Effective Maturity Dates** | **Contractual Interest Payment Rates(2)** | **Contractual Interest Accrual Rates(2)** |
| Senior Mortgages(3)(4)(5)(6) | Residential/Retail/Land/ Industrial, R&D/Mixed Use/ Office/Hotel/Entertainment, Leisure/Other | 233 | $ 9,108,903 | $ 9,023,727 | $ 9,261,424 | 2009 to 2026 | Fixed: 5.71% to 21% Variable: LIBOR + 2% to LIBOR + 8.5% | Fixed: 5.71% to 21% Variable: LIBOR + 2% to LIBOR + 8.5% |
| Subordinate Mortgages(3)(4)(5)(6) | Residential/Retail/Land/ Mixed Use/Office/Hotel/ Entertainment, Leisure/Other | 22 | 518,692 | 515,960 | 589,414 | 2009 to 2018 | Fixed: 7.32% to 10.5% Variable: LIBOR + 2.85% to LIBOR + 11.5% | Fixed: 7.32% to 15% Variable: LIBOR + 2.85% to LIBOR + 11.5% |
| Corporate/Partnership Loans(3)(4)(5)(6) | Residential/Retail/Land/ Mixed Use/Office/Hotel/ Other | 34 | 1,262,491 | 1,241,716 | 1,435,941 | 2009 to 2046 | Fixed: 4.5% to 15% Variable: LIBOR + 2.15% to LIBOR + 7% | Fixed: 8.5% to 17% Variable: LIBOR + 2.15% to LIBOR + 14% |
| Total Loans | | | | 10,781,403 | 11,286,779 | | | |
| Reserve for Loan Losses | | | | (1,469,415) | (976,788) | | | |
| Total Loans, net | | | | 9,311,988 | 10,309,991 | | | |
| Other Lending Investments Securities(3) | Retail/Industrial, R&D/ Entertainment, Leisure/Other | 6 | 446,664 | 266,253 | 276,653 | 2012 to 2023 | Fixed: 6% to 9.25% | Fixed: 6% to 9.25% |
| Total Loans and Other Lending Investments, net | | | | $ 9,578,241 | $ 10,586,644 | | | |

**Explanatory Notes:**

(1) Details (other than carrying values) are for loans outstanding as of June 30, 2009. Differences between principal and carrying value primarily relate to unamortized deferred fees on loans and impairments on securities.

(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 rates on June 30, 2009 were 0.31% and 1.11%, respectively.

(3) 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 June 30, 2009, 90 loans with a combined carrying value of $4.16 billion are on non-accrual status. As of December 31, 2008, 68 loans with a combined carrying value of $3.11 billion were on non-accrual status.

(5) As of June 30, 2009, 18 loans with a combined carrying value of $846.1 million have a stated accrual rate that exceeds the stated pay rate. Of these, 11 loans with a combined carrying value of $533.8 million have stated accrual rates of up to 17%, however, no interest is due until their scheduled

maturities ranging from 2009 to 2017. One Corporate/Partnership loan, with a carrying value of $56.7 million, has a stated accrual rate of 7.54% and no interest is due until its scheduled maturity in 2046.

(6) As of June 30, 2009, balances include foreign denominated loans with combined carrying values of approximately £133.5 million, €180.5 million, CAD 59.1 million and SEK 101.3 million that have been converted to $536.9 million based on exchange rates in effect at June 30, 2009.

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**iStar Financial Inc.**

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

**(unaudited)**

**Note 4 Loans and Other Lending Investments, net (Continued)**

During the six months ended June 30, 2009, the Company funded $734.1 million under existing loan commitments and received gross principal repayments of $905.5 million, a portion of which was allocable to the Fremont Participation (as defined below). During the six months ended June 30, 2008, the Company funded $1.91 billion under existing loan commitments, originated or acquired an aggregate of $11.6 million in loans and other lending investments and received gross principal repayments of $2.40 billion, a portion of which was allocable to the Fremont Participation.

During the three and six months ended June 30, 2009, the Company sold loans for net proceeds of $154.1 million and $412.2 million, respectively, for which it recognized charge-offs of $41.0 million and $92.1 million, respectively. During the three and six months ended June 30, 2008, the Company sold loans for net proceeds of $20.3 million and $179.0 million, respectively, for which it recorded net realized losses of $1.5 million and $0.6 million, respectively.

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

| | |
|---|---|
| **Reserve for loan losses, December 31, 2007** | $ 217,910 |
| Provision for loan losses | 1,029,322 |
| Charge-offs | (270,444) |
| **Reserve for loan losses, December 31, 2008** | 976,788 |
| Provision for loan losses | 693,112 |
| Charge-offs | (200,485) |
| **Reserve for loan losses, June 30, 2009** | $ 1,469,415 |

As of June 30, 2009 and December 31, 2008, the Company identified loans with carrying values of $4.51 billion and $3.37 billion, respectively, and Managed Loan Values (as defined below) of $5.01 billion and $3.78 billion, respectively, that were impaired in accordance with FASB Statement No. 114, "Accounting by Creditors for Impairments of a Loan (an amendment of FASB Statement No. 5 and 15)" ("SFAS No. 114"). As of June 30, 2009, the Company assessed the impaired loans for specific impairment and determined that non-performing loans with a Managed Loan Value of $4.29 billion required specific reserves totaling $1.25 billion and that the remaining impaired loans did not require any specific reserves. The provision for loan losses for the three and six months ended June 30, 2009 was $435.0 million and $693.1 million, respectively, and $276.7 million and $366.2 million for the three and six months ended June 30, 2008, respectively. The total reserve for loan losses at June 30, 2009 and December 31, 2008, included SFAS No. 114 asset specific reserves of $1.25 billion and $799.6 million, respectively, and general reserves of $220.3 million and $177.2 million, respectively, in accordance with FASB Statement No. 5, "Accounting Contingencies" ("SFAS No. 5").

The average Managed Loan Value of total impaired loans was approximately $4.27 billion and $1.12 billion during the six months ended June 30, 2009 and 2008, respectively. The Company recorded interest income on cash payments from impaired loans of $5.9 million and $8.9 million for the three and six months ended June 30, 2009, respectively, and $0.9 million and $2.8 million for the three and six months ended June 30, 2008, respectively.

**iStar Financial Inc.**

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

**(unaudited)**

**Note 4 Loans and Other Lending Investments, net (Continued)**

**Managed Loan Value** Managed Loan Value represents the Company's carrying value of loans, gross of specific reserves, and the Fremont Participation interest (as defined below) outstanding on the Fremont CRE portfolio. The Fremont Participation receives 70% of all loan principal repayments, including repayments of principal that the Company has funded subsequent to the sale of the participation interest. Therefore, the Company is in the first loss position and believes that the total recorded investment is more relevant than the Company's carrying value when assessing the Company's risk of loss on the loans in the Fremont CRE portfolio and has disclosed both values where applicable.

**Securities** As of June 30, 2009, Other lending investments-securities included available-for-sale debt securities with an amortized cost of $3.8 million and a fair value of $7.3 million. In addition, as of June 30, 2009, available-for-sale debt securities included a gross unrealized gain of $3.5 million recorded in "Accumulated other comprehensive income." During the six months ended June 30, 2009, the Company sold available-for-sale securities with a cumulative carrying value of $7.2 million, for which it recorded a net realized gain of $0.5 million in "Other income" on the Company's Consolidated Statements of Operations.

In addition, as of June 30, 2009, Other lending investments-securities included held-to-maturity debt securities with an amortized cost basis and carrying value of $256.9 million, a fair value of $257.7 million and gross unrealized gains of $0.8 million.

During the six months ended June 30, 2009, the Company determined that unrealized losses on certain held-to-maturity and available-for-sale debt securities were other-than-temporary and recorded impairment charges totaling $9.5 million. During the three and six months ended June 30, 2008, the Company recorded impairment charges on held-to-maturity and available-for-sale debt securities totaling $40.0 million. There are no other-than-temporary impairments recorded in "Accumulated other comprehensive income" in the Consolidated Balance Sheet as of June 30, 2009.

As of June 30, 2009, $221.1 million of held-to-maturity securities mature in one to five years and $35.8 million of held-to-maturity securities and $7.3 million of available-for-sale securities 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 June 30, 2009 and December 31, 2008, the Company had SOP 03-3 loans with a cumulative principal balance of $202.4 million and $208.8 million, respectively, and a cumulative carrying value of $175.5 million and $175.1 million, respectively. The Company does not have a reasonable expectation about the timing and amount of cash flows expected to be collected on the SOP 03-3 loans and is recognizing income using the cash basis of accounting or applying cash to reduce the carrying value of the loans, using the cost recovery method. The majority of the Company's SOP 03-3 loans were acquired in the acquisition of Fremont CRE.

**Fremont Participation** On July 2, 2007, the Company sold a $4.20 billion participation interest ("Fremont Participation") 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. The Fremont CRE participation pays floating interest at LIBOR + 1.50%.

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**iStar Financial Inc.**

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

**(unaudited)**

**Note 4 Loans and Other Lending Investments, net (Continued)**

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

| | |
|---|---|
| **Loan participation, December 31, 2008** | $ 1,297,944 |
| Principal repayments(1) | (432,382) |
| **Loan participation, June 30, 2009** | $ 865,562 |

**Explanatory Note:**

(1) Includes $47.8 million of principal repayments received by the Company as of June 30, 2009 that had not yet been remitted to the Fremont Participation holder and are reflected as a payable in "Accounts payable, accrued expenses and other liabilities" on the Company's Consolidated Balance Sheets.

**Unfunded commitments** As of June 30, 2009, the Company had 122 loans with unfunded commitments totaling $1.34 billion, of which $161.8 million were discretionary and $1.17 billion were non-discretionary. Unfunded loan commitments are primarily related to construction loans.

**Other Real Estate Owned** During the six months ended June 30, 2009 and 2008, the Company received titles to properties in satisfaction of senior mortgage loans with cumulative carrying values of $375.8 million and $265.3 million, respectively, for which those properties had served as collateral, and recorded charge-offs totaling $96.2 million and $46.6 million, respectively, related to these loans. During the three and six months ended June 30, 2009, the Company sold OREO assets for net proceeds of $72.3 million and $145.6 million, respectively, resulting in net losses of $5.8 million and $10.7 million, respectively. During the six months ended June 30, 2008, the Company sold OREO assets for net proceeds of $81.3 million, and a net gain of $0.5 million.

Capital expenditures related to OREO assets totaled $3.3 million and $4.9 million during the three and six months ended June 30, 2009, respectively, and $8.0 million and $9.5 million during the three and six months ended June 30, 2008, respectively.

During the three and six months ended June 30, 2009, the Company recorded impairment charges to existing OREO properties totaling $16.4 million and $18.2 million, respectively, resulting from changing market conditions. In addition, the Company recorded expense related to holding costs for OREO properties of $7.0 million and $13.4 million during the three and six months ended June 30, 2009, respectively, and $4.8 million and $7.1 million during the three and six months ended June 30, 2008, respectively.

**Encumbered loans and OREO assets** As of June 30, 2009, loans and other lending investments with a cumulative carrying value of $4.36 billion and OREO assets with a cumulative carrying value $166.7 million were pledged as collateral under the Company's secured indebtedness. As of December 31, 2008, loans and other lending investments with a cumulative carrying value of $1.18 billion were pledged as collateral under the Company's secured indebtedness. See Note 8 for further details.

**Note 5 Corporate Tenant Lease Assets, net**

During the three and six months ended June 30, 2009, the Company disposed of CTL assets for net proceeds of $4.1 million and $36.5 million, respectively, which resulted in no gains for the three months ended June 30, 2009 and gains of $11.6 million for the six months ended June 30, 2009. During the three and six months ended June 30, 2008, the Company disposed of CTL assets for net proceeds of $245.1 million and $253.3 million, respectively, which resulted in gains of $23.3 million and $25.4 million, respectively.

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**iStar Financial Inc.**

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

**(unaudited)**

**Note 5 Corporate Tenant Lease Assets, net (Continued)**

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

| | As of June 30, 2009 | As of December 31, 2008 |
|---|---|---|
| Facilities and improvements | $2,810,083 | $ 2,828,747 |
| Land and land improvements | 668,987 | 669,320 |
| Less: accumulated depreciation | (486,784) | (453,256) |
| Corporate tenant lease assets, net | $2,992,286 | $ 3,044,811 |

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 an additional $0.1 million in participating lease payments on such leases during the six months ended June 30, 2009 and earned $1.4 million for the six months ended June 30, 2008. 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 were $10.4 million and $18.9 million for the three and six months ended June 30, 2009, respectively, and $10.0 million and $19.4 million for the three and six months ended June 30, 2008, respectively. Customer expense reimbursements are included as a reduction of "Operating costs corporate tenant lease assets" on the Company's Consolidated Statements of Operations.

**Capitalized interest** Capitalized interest was approximately $0.2 million and $2.1 million for the six months ended June 30, 2009 and 2008, respectively.

**Allowance for doubtful accounts** As of June 30, 2009 and December 31, 2008, the total allowance for doubtful accounts was $2.9 million and $5.3 million, respectively.

**Unfunded commitments** As of June 30, 2009, the Company had $11.3 million of non-discretionary unfunded commitments related to six existing customers in the form of tenant improvements which were negotiated between the Company and the customers at the commencement of the leases.

**Encumbered CTL assets** As of June 30, 2009 and December 31, 2008, CTL assets with an aggregate net book value of $2.61 billion and $1.52 billion, respectively, were encumbered with mortgages or pledged as collateral securing the Company's debt (see Note 8 for further detail).

**Note 6 Other Investments**

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

| | As of June 30, 2009 | As of December 31, 2008 |
|---|---|---|
| Equity method investments | $303,868 | $ 326,248 |
| CTL intangibles, net(1) | 55,049 | 58,499 |
| Cost method investments | 12,573 | 54,488 |
| Marketable securities at fair value | 19,802 | 8,083 |
| Other investments | $391,292 | $ 447,318 |

**Explanatory Note:**

(1) Accumulated amortization on CTL intangibles was $29.5 million and $24.1 million as of June 30, 2009 and December 31, 2008, respectively.

**iStar Financial Inc.**

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

**(unaudited)**

**Note 6 Other Investments (Continued)**

**Equity method investments**

**Oak Hill** As of June 30, 2009, 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, OHA Leveraged Loan Portfolio GenPar, LLC, Oak Hill Credit OPP Fund, LP 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 $48.3 million and $51.2 million as of June 30, 2009 and December 31, 2008, respectively. The Company's carrying value in Oak Hill was $171.4 million and $181.3 million at June 30, 2009 and December 31, 2008, respectively. The Company recognized equity in earnings from these entities of $2.6 million and $4.5 million for the three months ended June 30, 2009 and 2008, respectively, and $4.9 million and $7.9 million for the six months ended June 30, 2009 and 2008, respectively.

**Madison Funds** As of June 30, 2009, 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 and 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 $65.6 million and $60.4 million at June 30, 2009 and December 31, 2008, respectively. The Company recognized equity in earnings from the Madison Funds of $0.9 million and $1.1 million for the three months ended June 30, 2009 and 2008, respectively, and equity in losses of $7.6 million and $1.5 million for the six months ended June 30, 2009 and 2008, respectively.

**Other equity method investments** The Company also had smaller investments in several other entities that were accounted for under the equity method where the Company has ownership interests up to 50.0%. The Company's aggregate carrying value in these investments was $66.9 million and $84.5 million as of June 30, 2009 and December 31, 2008, respectively. During the six months ended June 30, 2009, the Company recognized a $4.7 million non-cash impairment charge for an equity method investment that was determined to be impaired. The Company recognized cumulative net equity in losses of $1.6 million and earnings of $0.5 million for the three months ended June 30, 2009 and 2008, respectively, and losses of $15.9 million and $2.9 million for the six months ended June 30, 2009 and 2008, respectively.

**TimberStar Southwest** Prior to selling its interest, the Company owned a 46.7% interest in TimberStar Southwest Holdco LLC ("TimberStar Southwest"), through its majority owned subsidiary TimberStar. The Company accounted for this investment under the equity method due to the venture's external partners having certain participating rights giving them shared control. In April 2008, the Company closed on the sale of TimberStar Southwest for a gross sales price of $1.71 billion, including the assumption of debt. The Company received net proceeds of approximately $417.0 million for its interest in the venture and recorded a gain of $280.2 million, which includes $18.6 million attributable to noncontrolling interests. The amounts were recorded in "Gain on sale of joint venture interest" and "Gain on sale of joint venture interest attributable to noncontrolling interests" on the Company's Consolidated Statements of Operations.

**iStar Financial Inc.**

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

**(unaudited)**

**Note 6 Other Investments (Continued)**

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

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| **Income Statement** | | | | |
| Revenues | $40,639 | $ 38,542 | $(237,707) | $114,199 |
| Costs and expenses | $35,108 | $ 50,199 | $ 89,341 | $124,537 |
| Net income (loss) | $ 5,531 | $(11,657) | $(327,048) | $ (10,338) |

During the three months ended March 31, 2009, the Company recorded a non-cash out-of-period charge of $9.4 million to recognize additional losses from an equity method investment as a result of additional depreciation expense that should have been recorded at the equity method entity. This adjustment was recorded as a reduction to "Other investments" in the Company's Consolidated Balance Sheets and an increase to "Loss from equity method investments," in the Company's Consolidated Statements of Operations. The Company concluded that the amount of losses that should have been recorded in periods beginning in July 2007 were not material to any of its previously issued financial statements. The Company also concluded that the cumulative out-of-period charge is not material to the quarter or estimated fiscal year in which it was recorded. As such, the charge was recorded in the Company's Consolidated Statements of Operations for the six months ended June 30, 2009, rather than restating prior periods.

**Unfunded commitments** As of June 30, 2009, the Company had $49.2 million of non-discretionary unfunded commitments related to nine equity method investments.

**CTL intangible assets, net**

As of June 30, 2009 and December 31, 2008, the Company had $55.0 million and $58.5 million, respectively, of unamortized finite lived intangible assets primarily related to the acquisition of prior CTL facilities. The total amortization expense for these intangible assets was $3.0 million and $2.5 million for the three months ended June 30, 2009 and 2008, respectively, and $5.1 million and $5.1 million for the six months ended June 30, 2009 and 2008, respectively.

**Cost method investments**

The Company has investments in several 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 $12.6 million and $54.5 million as of June 30, 2009 and December 31, 2008, respectively.

During the six months ended June 30, 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 received cash of $44.2 million and recorded an equal amount of income in "Other income" on the Company's Consolidated Statements of Operations.

**Timber and timberlands**

On June 30, 2008, the Company closed on the sale of its Maine timber property for net proceeds of $152.7 million, resulting in a total gain of $27.0 million, which includes $3.7 million attributable to noncontrolling interests. These gains are included in "Gain from discontinued operations" and "Gain from

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**iStar Financial Inc.**

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

**(unaudited)**

**Note 6 Other Investments (Continued)**

discontinued operations attributable to noncontrolling interests" on the Company's Consolidated Statements of Operations. The Company reflected net income from the operations of its Maine timber property of $0.6 million and $2.4 million in "Income from discontinued operations" for the three and six months ended June 30, 2008, respectively.

**Unfunded commitments** As of June 30, 2009, the Company had $8.0 million of non-discretionary unfunded commitments related to two cost method investments.

**Note 7 Other Assets and Other Liabilities**

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

| | As of June 30, 2009 | As of December 31, 2008 |
|---|---|---|
| Deferred financing fees, net(1) | $ 52,730 | $ 25,387 |
| Other receivables | 22,164 | 29,036 |
| Corporate furniture, fixtures and equipment, net(2) | 15,861 | 16,640 |
| Leasing costs, net(3) | 15,226 | 16,072 |
| Receivables due from asset sales | 12,505 | |
| Derivative assets | 2,786 | 3,872 |
| Intangible assets, net(4) | 2,020 | 2,687 |
| Deferred tax asset | 1,333 | 1,415 |
| Goodwill | | 4,186 |
| Other assets | 13,149 | 19,729 |
| Deferred expenses and other assets, net | $ 137,774 | $ 119,024 |

**Explanatory Notes:**

(1) Accumulated amortization on deferred financing fees was $36.3 million and $24.1 million as of June 30, 2009 and December 31, 2008, respectively.

(2) Accumulated depreciation on corporate furniture, fixture and equipment was $8.0 million and $7.2 million as of June 30, 2009 and December 31, 2008, respectively.

(3) Accumulated amortization on leasing costs was $9.9 million and $8.7 million as of June 30, 2009 and December 31, 2008, respectively.

(4) Accumulated amortization on intangible assets was $2.0 million and $1.6 million as of June 30, 2009 and December 31, 2008, respectively.

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**iStar Financial Inc.**

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

**(unaudited)**

**Note 7 Other Assets and Other Liabilities (Continued)**

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

| | As of June 30, 2009 | As of December 31, 2008 |
|---|---|---|
| Accrued interest payable | $ 64,769 | $ 87,057 |
| Fremont Participation payable (see Note 4) | 49,206 | 141,717 |
| Accrued expenses | 24,844 | 41,745 |
| Lease settlement liability | 21,190 | |
| Security deposits from customers | 16,937 | 17,550 |
| Unearned operating lease income | 16,818 | 21,659 |
| Deferred tax liabilities | 8,160 | 6,900 |
| Property taxes payable | 5,719 | 5,187 |
| Deferred income & liabilities | 3,576 | 3,980 |
| Other liabilities | 19,272 | 28,697 |
| Accounts payable, accrued expenses and other liabilities | $ 230,491 | $ 354,492 |

As a result of the Company's decision to remain in its current space that is leased through 2021, the Company entered into a settlement agreement with its landlord regarding a long-term lease for new headquarters space dated May 22, 2007 (as amended and restated, the "Lease"). Under the settlement, the Company agreed to pay the landlord a $42.4 million settlement payment over a period of six months in order to settle all disputes between the Company and the landlord relating to the Lease and the landlord agreed among other things, to terminate the Lease. For the three and six months ended June 30, 2009, the Company recognized a $42.4 million lease termination expense in "Other expense" on the Consolidated Statements of Operations.

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**iStar Financial Inc.**

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

**(unaudited)**

**Note 8 Debt Obligations, net**

As of June 30, 2009 and December 31, 2008, the Company had debt obligations under various arrangements with financial institutions as follows (in thousands):

| | Carrying Value as of | | | |
|---|---|---|---|---|
| | June 30, 2009 | December 31, 2008, As Adjusted(1) | Stated Interest Rates(2) | Scheduled Maturity Date(2) |
| **Secured revolving credit facilities:** | | | | |
| Line of credit | $ | $ 306,867 | | |
| Line of credit(3) | 626,471 | | LIBOR + 1.50%(4) | June 2011 |
| Line of credit | 334,180 | | LIBOR + 1.50%(4) | June 2012 |
| **Unsecured revolving credit facilities:** | | | | |
| Line of credit(5) | 501,396 | 2,122,904 | LIBOR + 0.85%(4) | June 2011 |
| Line of credit(6) | 244,326 | 1,158,369 | LIBOR + 0.85%(4) | June 2012 |
| Total revolving credit facilities | 1,706,373 | 3,588,140 | | |
| **Secured term loans:** | | | | |