

ISTAR FINANCIAL INC  
Form 10-Q  
November 08, 2011

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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 September 30, 2011

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

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subject to such filing requirements for the past 90 days. Yes  No

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

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

As of November 2, 2011, there were 81,917,894 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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Table of Contents**PART I. CONSOLIDATED FINANCIAL INFORMATION****Item 1. Financial Statements****iStar Financial Inc.****Consolidated Balance Sheets****(In thousands, except per share data)****(unaudited)**

|   | As of<br>September 30,<br>2011 | As of<br>December 31,<br>2010 |
|---|--------------------------------|-------------------------------|
| <b>ASSETS</b>   |                                |                               |
| Loans and other lending investments, net  | \$ 3,283,725                   | \$ 4,587,352                  |
| Net lease assets, net   | 1,726,922                      | 1,784,509                     |
| Real estate held for investment, net  | 954,646                        | 833,060                       |
| Other real estate owned   | 669,331                        | 746,081                       |
| Other investments   | 621,167                        | 532,358                       |
| Assets held for sale  | 33,759                         |                               |
| Cash and cash equivalents   | 217,015                        | 504,865                       |
| Restricted cash   | 39,316                         | 13,784                        |
| Accrued interest and operating lease income receivable,<br>net  | 15,924                         | 24,408                        |
| Deferred operating lease income receivable  | 69,417                         | 62,569                        |
| Deferred expenses and other assets, net   | 122,630                        | 85,528                        |
| <b>Total assets</b>   | <b>\$ 7,753,852</b>            | <b>\$ 9,174,514</b>           |
| <b>LIABILITIES AND EQUITY</b>   |                                |                               |
| Liabilities:  |                                |                               |
| Accounts payable, accrued expenses and other<br>liabilities   | \$ 154,095                     | \$ 134,422                    |
| Debt obligations, net   | 5,995,050                      | 7,345,433                     |
| <b>Total liabilities</b>  | <b>\$ 6,149,145</b>            | <b>\$ 7,479,855</b>           |
| Commitments and contingencies   |                                |                               |
| Equity:   |                                |                               |
| iStar Financial Inc. shareholders' equity:  |                                |                               |
| Preferred Stock Series D, E, F, G and I, liquidation<br>preference \$25.00 per share (see Note 12)  | 22                             | 22                            |
| High Performance Units  | 9,800                          | 9,800                         |
| Common Stock, \$0.001 par value, 200,000 shares<br>authorized, 138,616 issued and 80,509 outstanding at<br>September 30, 2011 and 138,189 issued and 92,336<br>outstanding at December 31, 2010 | 139                            | 138                           |
| Additional paid-in capital  | 3,825,793                      | 3,809,071                     |
| Retained earnings (deficit)   | (2,041,975)                    | (2,014,013)                   |
| Accumulated other comprehensive income (see<br>Note 15)   | 1,508                          | 1,609                         |
| Treasury stock, at cost, \$0.001 par value, 58,108 shares<br>at September 30, 2011 and 45,853 shares at<br>December 31, 2010  | (237,341)                      | (158,492)                     |

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|   |    |           |    |           |
|---|----|-----------|----|-----------|
| Total iStar Financial Inc. shareholders' equity | \$ | 1,557,946 | \$ | 1,648,135 |
| Noncontrolling interests                        |    | 46,761    |    | 46,524    |
| Total equity                                    | \$ | 1,604,707 | \$ | 1,694,659 |
| Total liabilities and equity                    | \$ | 7,753,852 | \$ | 9,174,514 |

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

Table of Contents**iStar Financial Inc.****Consolidated Statements of Operations****(In thousands, except per share data)****(unaudited)**

|   | <b>For the<br/>Three Months Ended<br/>September 30,</b> |                   | <b>For the<br/>Nine Months Ended<br/>September 30,</b> |                   |
|---|---|-------------------|--|-------------------|
|   | <b>2011</b>   | <b>2010</b>       | <b>2011</b>  | <b>2010</b>       |
| <b>Revenue:</b>   |   |                   |  |                   |
| Interest income   | \$ 45,851   | \$ 84,210         | \$ 186,805   | \$ 287,295        |
| Operating lease income  | 41,369  | 40,471            | 123,090  | 124,760           |
| Other income  | 10,140  | 8,616             | 26,413   | 22,869            |
| <b>Total revenue</b>  | <b>\$ 97,360</b>  | <b>\$ 133,297</b> | <b>\$ 336,308</b>                                      | <b>\$ 434,924</b> |
| <b>Costs and expenses:</b>  |   |                   |  |                   |
| Interest expense  | \$ 91,777   | \$ 77,286         | \$ 258,183   | \$ 246,815        |
| Operating costs net lease assets  | 5,048   | 5,226             | 14,303   | 11,279            |
| Operating costs REHI and OREO   | 19,792  | 19,111            | 55,582   | 45,166            |
| Depreciation and amortization   | 14,814  | 15,246            | 46,354   | 46,722            |
| General and administrative  | 26,978  | 24,239            | 77,077   | 76,569            |
| Provision for loan losses   | 9,232   | 78,414            | 30,462   | 277,242           |
| Impairment of assets  | 9,912   | 3,832             | 14,165   | 17,041            |
| Other expense   | 3,974   | 4,219             | 7,156  | 13,321            |
| <b>Total costs and expenses</b>   | <b>\$ 181,527</b>                                       | <b>\$ 227,573</b> | <b>\$ 503,282</b>                                      | <b>\$ 734,155</b> |
| Income (loss) before earnings from equity method investments and other items        | \$ (84,167)   | \$ (94,276)       | \$ (166,974)   | \$ (299,231)      |
| Gain (loss) on early extinguishment of debt, net                                    | (3,207)   | 9,525             | 102,348  | 118,305           |
| Earnings from equity method investments   | 10,817  | 6,523             | 54,881   | 31,703            |
| Income (loss) from continuing operations before income taxes                        | \$ (76,557)   | \$ (78,228)       | \$ (9,745)   | \$ (149,223)      |
| Income tax (expense) benefit  | (1,354)   | (722)             | (9,731)  | (2,557)           |
| Income (loss) from continuing operations(1)   | \$ (77,911)   | \$ (78,950)       | \$ (19,476)  | \$ (151,780)      |
| Income (loss) from discontinued operations  | 1,052   | (104)             | 498  | 20,473            |
| Gain from discontinued operations   | 22,198  | 4,422             | 22,198   | 270,382           |
| Net income (loss)   | \$ (54,661)   | \$ (74,632)       | \$ 3,220   | \$ 139,075        |
| Net (income) loss attributable to noncontrolling interests                          | 1,002   | (858)             | 558  | (857)             |
| Net income (loss) attributable to iStar Financial Inc.                              | \$ (53,659)   | \$ (75,490)       | \$ 3,778   | \$ 138,218        |
| Preferred dividends   | (10,580)  | (10,580)          | (31,740)   | (31,740)          |
| Net (income) loss allocable to HPU holders and Participating Security holders(2)(3) | 2,008   | 2,539             | 845  | (3,145)           |

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|  |             |             |             |            |
|--|-------------|-------------|-------------|------------|
| Net income (loss) allocable to common shareholders | \$ (62,231) | \$ (83,531) | \$ (27,117) | \$ 103,333 |
|--|-------------|-------------|-------------|------------|

**Per common share data(1):**

|  |           |           |           |           |
|--|-----------|-----------|-----------|-----------|
| Income (loss) attributable to iStar Financial Inc. from continuing operations: |           |           |           |           |
| Basic and diluted  | \$ (0.96) | \$ (0.94) | \$ (0.55) | \$ (1.91) |
| Net income (loss) attributable to iStar Financial Inc.:                        |           |           |           |           |
| Basic and diluted  | \$ (0.71) | \$ (0.89) | \$ (0.30) | \$ 1.10   |
| Weighted average number of common shares basic and diluted                     | 87,951    | 93,370    | 91,020    | 93,556    |

**Per HPU share data(1)(2):**

|  |             |             |             |             |
|--|-------------|-------------|-------------|-------------|
| Income (loss) attributable to iStar Financial Inc. from continuing operations: |             |             |             |             |
| Basic and diluted  | \$ (182.34) | \$ (177.74) | \$ (102.06) | \$ (361.26) |
| Net income (loss) attributable to iStar Financial Inc.:                        |             |             |             |             |
| Basic and diluted  | \$ (133.87) | \$ (169.27) | \$ (56.33)  | \$ 209.67   |
| Weighted average number of HPU shares basic and diluted                        | 15          | 15          | 15          | 15          |

**Explanatory Notes:**

- (1) Income (loss) from continuing operations attributable to iStar Financial Inc. for the three months ended September 30, 2011 and 2010 was \$(76,909) and \$(79,808), respectively, and for the nine months ended September 30, 2011 and 2010 was \$(18,918) and \$(152,637), respectively. See Note 14 for detail on the calculation of earnings per share.
- (2) HPU holders are current and former Company employees who purchased high performance common stock units under the Company's High Performance Unit Program.
- (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 that are eligible to receive dividends (see Note 13).

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

Table of Contents**iStar Financial Inc.****Consolidated Statement of Changes in Equity****For the Nine Months Ended September 30, 2011****(In thousands)****(unaudited)**

|  | iStar Financial Inc. Shareholders' Equity |          |                           |                                  |                                   |   |                              |                             |                 |
|--|---|----------|---------------------------|----------------------------------|-----------------------------------|---|------------------------------|-----------------------------|-----------------|
|  | Preferred<br>Stock(1)                     | HPU's    | Common<br>Stock<br>at Par | Additional<br>Paid-In<br>Capital | Retained<br>Earnings<br>(Deficit) | Accumulated<br>Other<br>Comprehensive<br>Income | Treasury<br>Stock<br>at cost | Noncontrolling<br>Interests | Total<br>Equity |
| Balance at December 31, 2010                                 | \$ 22                                     | \$ 9,800 | \$ 138                    | \$ 3,809,071                     | \$ (2,014,013)                    | \$ 1,609  | \$ (158,492)                 | \$ 46,524                   | \$ 1,694,659    |
| Dividends declared preferred                                 |   |          |                           |                                  | (31,740)                          |   |                              |                             | (31,740)        |
| Issuance of stock/restricted<br>stock unit amortization, net |   |          | 1                         | 16,722                           |                                   |   |                              |                             | 16,723          |
| Net income for the period(2)                                 |   |          |                           |                                  | 3,778                             |   |                              | (542)                       | 3,236           |
| Change in accumulated other<br>comprehensive income          |   |          |                           |                                  |                                   | (101)   |                              |                             | (101)           |
| Repurchase of stock  |   |          |                           |                                  |                                   |   | (78,849)                     |                             | (78,849)        |
| Contributions from<br>noncontrolling interests               |   |          |                           |                                  |                                   |   |                              | 1,900                       | 1,900           |
| Distributions to noncontrolling<br>interests                 |   |          |                           |                                  |                                   |   |                              | (1,121)                     | (1,121)         |
| Balance at September 30, 2011                                | \$ 22                                     | \$ 9,800 | \$ 139                    | \$ 3,825,793                     | \$ (2,041,975)                    | \$ 1,508  | \$ (237,341)                 | \$ 46,761                   | \$ 1,604,707    |

**Explanatory Notes:**

- (1) See Note 12 for details on the Company's Cumulative Redeemable Preferred Stock.
- (2) For the nine months ended September 30, 2011, net income shown above excludes \$16 of net loss attributable to redeemable noncontrolling interests.

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



Table of Contents**iStar Financial Inc.****Consolidated Statements of Cash Flows****(In thousands)****(unaudited)****For the Nine Months  
Ended September 30,****2011                      2010****Cash flows from operating activities:**

|   |    |          |    |           |
|---|----|----------|----|-----------|
| Net income  | \$ | 3,220    | \$ | 139,075   |
| Adjustments to reconcile net income to cash flows from operating activities:      |    |          |    |           |
| Provision for loan losses   |    | 30,462   |    | 277,242   |
| Non-cash expense for stock-based compensation                                     |    | 15,622   |    | 13,597    |
| Impairment of assets  |    | 14,140   |    | 18,903    |
| Depreciation and amortization   |    | 47,142   |    | 55,036    |
| Amortization of discounts/(premiums) and deferred financing costs on debt         |    | 23,489   |    | (15,899)  |
| Amortization of (discounts)/premiums and deferred interest on lending investments |    | (52,027) |    | (81,636)  |
| Discounts, loan fees and deferred interest received                               |    | 3,303    |    | 10,539    |
| Earnings from equity method investments   |    | (54,881) |    | (31,703)  |
| Distributions from operations of equity method investments                        |    | 45,846   |    | 26,245    |
| Deferred operating lease income   |    | (6,750)  |    | (8,010)   |
| Gain from discontinued operations   |    | (22,198) |    | (270,382) |
| Gain on early extinguishment of debt, net   |    | (98,624) |    | (119,457) |
| Other non-cash adjustments  |    | (2,497)  |    | 653       |
| Changes in assets and liabilities:  |    |          |    |           |
| Changes in accrued interest and operating lease income receivable, net            |    | 5,747    |    | 15,521    |
| Changes in deferred expenses and other assets, net                                |    | 1,720    |    | (6,021)   |
| Changes in accounts payable, accrued expenses and other liabilities               |    | 33,851   |    | (14,850)  |
| Cash flows from operating activities  | \$ | (12,435) | \$ | 8,853     |

**Cash flows from investing activities:**

|   |    |           |    |           |
|---|----|-----------|----|-----------|
| New investment originations   | \$ |           | \$ | (100,000) |
| Fundings under existing loan commitments                                |    | (58,141)  |    | (303,336) |
| Repayments of and principal collections on loans                        |    | 1,068,797 |    | 1,209,098 |
| Net proceeds from sales of loans  |    | 88,751    |    | 413,983   |
| Net proceeds from sales of net lease assets                             |    | 672       |    | 1,362,983 |
| Net proceeds from sales of other real estate owned                      |    | 139,279   |    | 374,881   |
| Net proceeds from repayments and sales of securities                    |    |           |    | 213,239   |
| Contributions to unconsolidated entities                                |    | (31,462)  |    | (15,793)  |
| Distributions from unconsolidated entities                              |    | 16,434    |    | 7,778     |
| Capital expenditures on net lease assets                                |    | (11,138)  |    | (10,108)  |
| Capital expenditures on REHI and OREO                                   |    | (34,915)  |    | (18,528)  |
| Changes in restricted cash held in connection with investing activities |    | (25,165)  |    | (260)     |
| Other investing activities, net   |    | 708       |    | (3,003)   |

|                                      |    |           |    |           |
|--------------------------------------|----|-----------|----|-----------|
| Cash flows from investing activities | \$ | 1,153,820 | \$ | 3,130,934 |
|--------------------------------------|----|-----------|----|-----------|

**Cash flows from financing activities:**

|  |    |             |    |             |
|--|----|-------------|----|-------------|
| Borrowings under secured credit facilities                 | \$ | 2,913,250   | \$ | 499         |
| Repayments under secured credit facilities                 |    | (1,385,602) |    |             |
| Repayments under unsecured credit facilities               |    | (506,600)   |    |             |
| Borrowings under secured term loans                        |    | 124,575     |    |             |
| Repayments under secured term loans                        |    | (1,682,009) |    | (1,131,186) |
| Repayments under unsecured notes                           |    | (375,127)   |    | (264,388)   |
| Repurchases and redemptions of secured and unsecured notes |    | (371,827)   |    | (811,773)   |
| Payments for deferred financing costs                      |    | (35,545)    |    |             |
| Preferred dividends paid                                   |    | (31,740)    |    | (31,740)    |

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|   |                |                |
|---|----------------|----------------|
| Purchase of treasury stock  | (78,849)       | (7,476)        |
| Changes in restricted cash held in connection with debt obligations | 200            | 11,189         |
| Other financing activities, net                                     | 39             | (9,903)        |
| Cash flows from financing activities                                | \$ (1,429,235) | \$ (2,244,778) |
| Changes in cash and cash equivalents                                | \$ (287,850)   | \$ 895,009     |
| Cash and cash equivalents at beginning of period                    | 504,865        | 224,632        |
| Cash and cash equivalents at end of period                          | \$ 217,015     | \$ 1,119,641   |

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

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**iStar Financial Inc.**

**Notes to Consolidated Financial Statements**

**(unaudited)**

**Note 1 Business and Organization**

**Business** iStar Financial Inc., or the "Company," is a fully-integrated finance and investment company focused on the commercial real estate industry. The Company provides custom-tailored investment capital to high-end private and corporate owners of real estate and invests directly across a range of real estate sectors. The Company is taxed as a real estate investment trust, or "REIT." The Company's primary business segments are lending, net leasing and real estate investment. See Note 11 for discussion of the impact of recent economic conditions on the Company and business risks and uncertainties.

**Organization** The Company began its business in 1993 through private investment funds and became publicly traded in 1998. 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 and the acquisition of the commercial real estate lending business and loan portfolio of Fremont Investment and Loan, a division of Fremont General Corporation, in 2007.

**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, 2010.

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 results for the interim periods presented. 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 2011 presentation.

**Principles of Consolidation** The Consolidated Financial Statements include the financial statements of the Company, its wholly owned subsidiaries, controlled partnerships and variable interest entities ("VIEs") for which the Company is the primary beneficiary. All significant intercompany balances and transactions have been eliminated in consolidation.

**Consolidated VIEs** The Company consolidates OHA Strategic Credit Fund Parallel I, L.P. ("OHA SCF"), which was created to invest in distressed and undervalued loans, bonds, equities and other investments. As of September 30, 2011 and December 31, 2010, OHA SCF had total assets of \$53.6 million and \$45.7 million, respectively, no debt and \$0.1 million of noncontrolling interests. The investments held

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**iStar Financial Inc.**

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

(unaudited)

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

by this entity are presented in "Other investments" on the Company's Consolidated Balance Sheets. As of September 30, 2011, the Company had a total unfunded commitment of \$21.9 million to this entity.

The Company also consolidates Madison Deutsche Andau Holdings, LP ("Madison DA"), which was created to invest in mortgage loans collateralized by real estate in Europe. As of September 30, 2011 and December 31, 2010, Madison DA had total assets of \$56.9 million and \$58.0 million, respectively, no debt and noncontrolling interests of \$8.3 million and \$8.6 million, respectively. The investments held by this entity are presented in "Loans and other lending investments, net" on the Company's Consolidated Balance Sheets.

**Unconsolidated VIEs** The Company determined that as of September 30, 2011, 24 of its other investments were in VIEs where it is not the primary beneficiary and accordingly the VIEs have not been consolidated in the Company's Consolidated Financial Statements. As of September 30, 2011, the Company's maximum exposure to loss from these investments does not exceed the sum of the \$235.9 million carrying value of the investments and \$8.1 million of related unfunded commitments.

**Note 3 Summary of Significant Accounting Policies**

As of September 30, 2011, 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, 2010, have not changed materially.

**New Accounting Pronouncements**

In June 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2011-05, "Presentation of Comprehensive Income," which requires entities to present net income and other comprehensive income in either a single continuous statement or in two separate, but consecutive, statements of net income and other comprehensive income. The new requirements are effective for interim and annual reporting periods beginning after December 15, 2011 and will be applied retrospectively. The Company will adopt this ASU for the reporting period ending March 31, 2012, as required.

In May 2011, the FASB issued ASU 2011-04, "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs." This ASU is a result of joint efforts by the FASB and IASB to develop a single, converged framework on how to measure fair value and what disclosures to provide about fair value measurements. This ASU is largely consistent with existing fair value measurement principles of U.S. GAAP, however, it expands existing disclosure requirements for fair value measurements. The ASU is effective for interim and annual reporting periods beginning after December 15, 2011 and should be applied prospectively. The Company will adopt this ASU for the reporting period ending March 31, 2012, as required.

In April 2011, the FASB issued ASU 2011-02, "A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring," which provides additional guidance to creditors for determining whether a loan modification is a troubled debt restructuring ("TDR"). The guidance provides additional considerations in determining whether a creditor has granted a concession and adds factors for creditors to consider in determining whether a debtor is experiencing financial difficulties. The new ASU is effective for the first interim or annual period beginning on or after June 15, 2011 with retrospective

Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 3 Summary of Significant Accounting Policies (Continued)**

application for loan modifications that have occurred from January 1, 2011. Loan modifications that qualify as TDRs are considered impaired and will be measured and recorded prospectively in the period of adoption. The Company adopted the standard in the period ended September 30, 2011, as required. As a result of this adoption, the Company reassessed all restructurings that occurred on or after January 1, 2011 for identification as troubled debt restructurings. As of September 30, 2011, the Company had a recorded investment of \$50.9 million in loans for which the allowance for credit losses was previously measured under a general allowance for credit losses methodology and are now specifically reviewed for impairment. Based on a current evaluation of potential losses, no specific reserves were required for these loans. See Note 4 for further details on the impact of the adoption of this guidance.

In January 2011, FASB issued ASU 2011-01, "Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20," which temporarily deferred the effective date in ASU 2010-20, "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses" in respect of disclosures related to troubled debt restructuring until FASB finalized ASU 2010-20 (see above). ASU 2010-20 requires companies to provide disaggregated levels of disclosure by portfolio segment and class to enable users of the financial statements to understand the nature of loan modifications and troubled debt restructurings. The Company adopted the TDR disclosure provisions of ASU 2010-20 in the period ended September 30, 2011, as required. See Note 4 for additional disclosures required by the adoption of these provisions.

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

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

| Type of Investment                             | As of                 |                      |
|--|-----------------------|----------------------|
|  | September 30,<br>2011 | December 31,<br>2010 |
| Senior mortgages                               | \$ 3,277,891          | \$ 4,390,770         |
| Subordinate mortgages                          | 214,405               | 305,245              |
| Corporate/Partnership loans                    | 485,708               | 689,535              |
| Total gross carrying value of loans(2)         | \$ 3,978,004          | \$ 5,385,550         |
| Reserves for loan losses                       | (710,117)             | (814,625)            |
| Total carrying value of loans                  | \$ 3,267,887          | \$ 4,570,925         |
| Other lending investments securities           | 15,838                | 16,427               |
| Total loans and other lending investments, net | \$ 3,283,725          | \$ 4,587,352         |

**Explanatory Notes:**

- (1) Loans and other lending investments are presented net of unearned income, unamortized discounts and premiums and net unamortized deferred fees and costs. In total, these amounts represented a net discount of \$94.0 million and \$62.7 million as of September 30, 2011 and December 31, 2010, respectively.
- (2) The Company's recorded investment in loans as of September 30, 2011 and December 31, 2010 was \$3.99 billion and \$5.41 billion, respectively, which consists of total gross carrying value of loans plus accrued interest of \$12.8 million and \$21.3 million, for the same two periods, respectively.



Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 4 Loans and Other Lending Investments, net (Continued)**

During the nine months ended September 30, 2011, the Company funded \$58.1 million under existing loan commitments and received principal repayments of \$1.07 billion. During the same period, the Company sold loans with a total carrying value of \$132.1 million, for which it recognized charge-offs of \$23.4 million.

During the nine months ended September 30, 2011, the Company received title to properties in full or partial satisfaction of non-performing mortgage loans with a gross carrying value of \$240.8 million, for which the properties had served as collateral, and recorded charge-offs totaling \$48.3 million related to these loans. These properties were recorded as real estate held for investment ("REHI") or other real estate owned ("OREO") on the Company's Consolidated Balance Sheets (see Note 5). In addition, during the same period, the Company received equity in an entity that took title to a property in satisfaction of a non-performing mortgage for which the property had served as collateral. The Company held a participation in the mortgage with a gross carrying value of \$74.6 million and charged-off \$29.2 million upon receiving the equity interest (see Note 7).

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

|   | For the Three Months<br>Ended September 30, |              | For the Nine Months<br>Ended September 30, |              |
|---|---|--------------|--|--------------|
|   | 2011  | 2010         | 2011                                       | 2010         |
| <b>Reserve for loan losses at beginning of period</b> | \$ 701,228                                  | \$ 1,181,288 | \$ 814,625                                 | \$ 1,417,949 |
| Provision for loan losses                             | 9,232                                       | 78,414       | 30,462                                     | 277,242      |
| Charge-offs   | (343)                                       | (235,041)    | (134,970)                                  | (670,530)    |
| <b>Reserve for loan losses at end of period</b>       | \$ 710,117                                  | \$ 1,024,661 | \$ 710,117                                 | \$ 1,024,661 |

The Company's recorded investment (comprised of a loan's carrying value plus accrued interest) in loans and the associated reserve for loan losses were as follows (\$ in thousands):

|                                  | Individually<br>Evaluated for<br>Impairment | Collectively<br>Evaluated for<br>Impairment | Loans Acquired<br>with Deteriorated<br>Credit Quality | Total        |
|----------------------------------|---|---|---|--------------|
| <b>As of September 30, 2011:</b> |   |   |   |              |
| Loans                            | \$ 1,900,885                                | \$ 2,014,760                                | \$ 75,130   | \$ 3,990,775 |
| Less: Reserve for loan losses    | (631,211)                                   | (76,700)                                    | (2,206)   | (710,117)    |
| Total                            | \$ 1,269,674                                | \$ 1,938,060                                | \$ 72,924   | \$ 3,280,658 |
| <b>As of December 31, 2010:</b>  |   |   |   |              |
| Loans                            | \$ 2,296,599                                | \$ 3,034,310                                | \$ 75,907   | \$ 5,406,816 |
| Less: Reserve for loan losses    | (692,610)                                   | (120,200)                                   | (1,815)   | (814,625)    |
| Total                            | \$ 1,603,989                                | \$ 2,914,110                                | \$ 74,092   | \$ 4,592,191 |





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

(unaudited)

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

**Credit Characteristics** As part of the Company's process for monitoring the credit quality of its loans, it performs a quarterly loan portfolio assessment and assigns risk ratings to each of its performing loans. The Company's recorded investment in performing loans, presented by class and by credit quality, as indicated by risk rating, was as follows (\$ in thousands)(1):

|                             | As of               |                                     |                     |                                     |
|-----------------------------|---------------------|-------------------------------------|---------------------|-------------------------------------|
|                             | September 30, 2011  |                                     | December 31, 2010   |                                     |
|                             | Performing<br>Loans | Weighted<br>Average<br>Risk Ratings | Performing<br>Loans | Weighted<br>Average<br>Risk Ratings |
| Senior mortgages            | \$ 1,683,232        | 3.29                                | \$ 2,394,270        | 3.48                                |
| Subordinate mortgages       | 192,082             | 3.22                                | 307,509             | 3.20                                |
| Corporate/Partnership loans | 478,134             | 3.62                                | 685,848             | 3.76                                |
| Total                       | \$ 2,353,448        | 3.35                                | \$ 3,387,627        | 3.51                                |

**Explanatory Note:**

(1) Ratings range from "1" to "5" with "1" representing the lowest risk of loss and "5" representing the highest risk of loss.

The Company's recorded investment in loans as of September 30, 2011, aged by payment status and presented by class, were as follows (\$ in thousands):

|                             | Current      | Less Than<br>and Equal<br>to 90 Days | Greater<br>Than<br>90 Days(1) | Total<br>Past Due | Total        |
|-----------------------------|--------------|--------------------------------------|-------------------------------|-------------------|--------------|
| Senior mortgages            | \$ 1,842,261 | \$ 68,147                            | \$ 1,375,201                  | \$ 1,443,348      | \$ 3,285,609 |
| Subordinate mortgages       | 215,740      |                                      |                               |                   | 215,740      |
| Corporate/Partnership loans | 478,132      |                                      | 11,294                        | 11,294            | 489,426      |
| Total                       | \$ 2,536,133 | \$ 68,147                            | \$ 1,386,495                  | \$ 1,454,642      | \$ 3,990,775 |

**Explanatory Note:**

(1) All loans with payments more than 90 days past due are classified as non-performing and are on non-accrual status.

Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 4 Loans and Other Lending Investments, net (Continued)****Impaired Loans** The Company's recorded investment in impaired loans, presented by class, were as follows (\$ in thousands)(1):

|  | As of September 30, 2011 |                                |                      | As of December 31, 2010 |                                |                      |
|--|--------------------------|--------------------------------|----------------------|-------------------------|--------------------------------|----------------------|
|  | Recorded<br>Investment   | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Recorded<br>Investment  | Unpaid<br>Principal<br>Balance | Related<br>Allowance |
| <b>With no related allowance recorded:</b> |                          |                                |                      |                         |                                |                      |
| Senior mortgages(2)                        | \$ 216,852               | \$ 217,945                     | \$                   | \$ 404,861              | \$ 404,126                     | \$                   |
| Corporate/Partnership loans                | 10,110                   | 10,160                         |                      | 10,110                  | 10,160                         |                      |
| Subtotal                                   | \$ 226,962               | \$ 228,105                     | \$                   | \$ 414,971              | \$ 414,286                     | \$                   |
| <b>With an allowance recorded:</b>         |                          |                                |                      |                         |                                |                      |
| Senior mortgages(2)                        | \$ 1,602,712             | \$ 1,592,418                   | \$ (599,472)         | \$ 1,834,008            | \$ 1,825,150                   | \$ (683,948)         |
| Subordinate mortgages                      | 23,657                   | 23,735                         | (23,657)             |                         |                                |                      |
| Corporate/Partnership loans                | 64,853                   | 65,140                         | (10,288)             | 64,465                  | 64,919                         | (10,477)             |
| Subtotal                                   | \$ 1,691,222             | \$ 1,681,293                   | \$ (633,417)         | \$ 1,898,473            | \$ 1,890,069                   | \$ (694,425)         |
| <b>Total:</b>                              |                          |                                |                      |                         |                                |                      |
| Senior mortgages                           | \$ 1,819,564             | \$ 1,810,363                   | \$ (599,472)         | \$ 2,238,869            | \$ 2,229,276                   | \$ (683,948)         |
| Subordinate mortgages                      | 23,657                   | 23,735                         | (23,657)             |                         |                                |                      |
| Corporate/Partnership loans                | 74,963                   | 75,300                         | (10,288)             | 74,575                  | 75,079                         | (10,477)             |
| Total                                      | \$ 1,918,184             | \$ 1,909,398                   | \$ (633,417)         | \$ 2,313,444            | \$ 2,304,355                   | \$ (694,425)         |

**Explanatory Notes:**

- (1) All of the Company's non-accrual loans are considered impaired and included in the table above. In addition, as of September 30, 2011 and December 31, 2010, certain loans modified through troubled debt restructurings with a recorded investment of \$280.9 million and \$294.3 million, respectively, are also included as impaired loans in accordance with GAAP although they are performing and on accrual status.
- (2) Amount includes impaired loans acquired with deteriorated credit quality.

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## iStar Financial Inc.

## Notes to Consolidated Financial Statements (Continued)

(unaudited)

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

The Company's average recorded investment in impaired loans and interest income recognized, presented by class, were as follows (\$ in thousands):

|  | For the Three Months Ended September 30, |                            |                             |                            | For the Nine Months Ended September 30, |                            |                             |                            |
|--|--|----------------------------|-----------------------------|----------------------------|---|----------------------------|-----------------------------|----------------------------|
|  | 2011                                     |                            | 2010                        |                            | 2011                                    |                            | 2010                        |                            |
|  | Average Recorded Investment              | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment             | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| <b>With no related allowance recorded:</b> |  |                            |                             |                            |   |                            |                             |                            |
| Senior mortgages                           | \$ 230,888                               | \$ 1,788                   | \$ 645,653                  | \$ 1,569                   | \$ 331,478                              | \$ 31,374                  | \$ 722,722                  | \$ 19,856                  |
| Subordinate mortgages                      |  |                            |                             |                            |   |                            | 1,755                       | 74                         |
| Corporate/Partnership loans                | 10,110                                   | 240                        | 21,044                      |                            | 10,110                                  | 560                        | 31,879                      | 1,310                      |
| Subtotal                                   | \$ 240,998                               | \$ 2,028                   | \$ 666,697                  | \$ 1,569                   | \$ 341,588                              | \$ 31,934                  | \$ 756,356                  | \$ 21,240                  |
| <b>With an allowance recorded:</b>         |  |                            |                             |                            |   |                            |                             |                            |
| Senior mortgages                           | \$ 1,583,105                             | \$ 1,873                   | \$ 2,195,637                | \$ 925                     | \$ 1,693,366                            | \$ 5,994                   | \$ 2,556,167                | \$ 4,694                   |
| Subordinate mortgages                      | 24,783                                   |                            | 93,912                      | 46                         | 18,726                                  |                            | 96,406                      | 107                        |
| Corporate/Partnership loans                | 67,446                                   | 81                         | 85,940                      |                            | 66,961                                  | 250                        | 65,282                      |                            |
| Subtotal                                   | \$ 1,675,334                             | \$ 1,954                   | \$ 2,375,489                | \$ 971                     | \$ 1,779,053                            | \$ 6,244                   | \$ 2,717,855                | \$ 4,801                   |
| <b>Total:</b>                              |  |                            |                             |                            |   |                            |                             |                            |
| Senior mortgages                           | \$ 1,813,993                             | \$ 3,661                   | \$ 2,841,290                | \$ 2,494                   | \$ 2,024,844                            | \$ 37,368                  | \$ 3,278,889                | \$ 24,550                  |
| Subordinate mortgages                      | 24,783                                   |                            | 93,912                      | 46                         | 18,726                                  |                            | 98,161                      | 181                        |
| Corporate/Partnership loans                | 77,556                                   | 321                        | 106,984                     |                            | 77,071                                  | 810                        | 97,161                      | 1,310                      |
| Total                                      | \$ 1,916,332                             | \$ 3,982                   | \$ 3,042,186                | \$ 2,540                   | \$ 2,120,641                            | \$ 38,178                  | \$ 3,474,211                | \$ 26,041                  |

During the nine months ended September 30, 2011, the Company recorded interest income of \$26.3 million related to the resolution of certain non-performing loans. Interest income was not previously recorded while the loans were on non-accrual status.

**Troubled Debt Restructurings** The Company's troubled debt restructurings, presented by class, had the following impact to its recorded investment in loans (\$ in thousands):

|  | For the Three Months Ended September 30, 2011 | For the Nine Months Ended September 30, 2011 |
|--|---|--|
|--|---|--|

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|                  | Pre-Modification |             | Post-Modification |        | Pre-Modification |             | Post-Modification |             |
|------------------|------------------|-------------|-------------------|--------|------------------|-------------|-------------------|-------------|
|                  | Number           | Outstanding | Outstanding       | Number | Outstanding      | Outstanding | Number            | Outstanding |
|                  | of               | Recorded    | Recorded          | of     | Recorded         | Recorded    | of                | Recorded    |
|                  | Loans            | Investment  | Investment        | Loans  | Investment       | Investment  | Loans             | Investment  |
| Senior mortgages | 3                | \$ 65,107   | \$ 65,107         | 7      | \$ 191,158       | \$ 190,893  |                   |             |

Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 4 Loans and Other Lending Investments, net (Continued)**

Troubled debt restructurings that subsequently defaulted during the period were as follows (\$ in thousands):

|                  | <b>For the<br/>Three Months Ended<br/>September 30, 2011</b> |  | <b>For the<br/>Nine Months Ended<br/>September 30, 2011</b> |  |
|------------------|--|--|---|--|
|                  | <b>Number<br/>of Loans</b>                                   | <b>Outstanding<br/>Recorded<br/>Investment</b> | <b>Number<br/>of Loans</b>                                  | <b>Outstanding<br/>Recorded<br/>Investment</b> |
| Senior mortgages | 1  | \$ 12,257                                      | 2   | \$ 40,262                                      |

During the three months ended September 30, 2011, the Company restructured three loans that were considered troubled debt restructurings. The Company extended the maturity of two of these loans with a combined recorded investment of \$49.3 million, while leaving the interest rate unchanged. The loans have a new weighted average maturity of 0.4 years with conditional extension options in certain cases dependent on pay down hurdles. The Company extended a discounted payoff option on the third loan that is currently classified as non-performing.

During the nine months ended September 30, 2011, the Company restructured seven loans that were considered troubled debt restructurings. In addition to the three loans modified during the current quarter that are described above, the Company restructured four additional loans in the first half of the year. The Company reduced the rate on three of these loans with a combined recorded investment of \$105.7 million, from a combined weighted average rate of 8.3% to 4.7% and extended the loans with a new weighted average maturity of 1.4 years, with conditional extension options in certain cases dependent on pay down hurdles. The Company extended the term of the remaining loan by six months with the interest rate unchanged. In addition, as of September 30, 2011, the Company had \$6.1 million of unfunded commitments on modified loans considered troubled debt restructurings.

For the six loans that were extended, the Company believes the borrowers can perform under the new terms and has classified these loans as performing. Generally when granting financial concessions, the Company will seek to protect its position by requiring incremental pay downs, additional collateral or guarantees and in some cases lookback features or equity kickers to offset concessions granted should conditions improve.

The Company's determination of credit losses is impacted by troubled debt restructurings whereby loans that have gone through troubled debt restructurings are considered impaired and assessed for specific reserves and are not included in the Company's assessment of general reserves. Loans previously restructured under troubled debt restructurings that subsequently default are reassessed to incorporate the Company's current assumptions on expected cash flows and additional provision expense is recorded to the extent necessary.

**Encumbered Loans** As of September 30, 2011 and December 31, 2010, loans and other lending investments with a carrying value of \$2.12 billion and \$2.83 billion, respectively, were pledged as collateral under the Company's secured indebtedness.

Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 5 Real Estate Held for Investment, net and Other Real Estate Owned**

During the nine months ended September 30, 2011, the Company received title to properties with an aggregate estimated fair value at the time of foreclosure of \$192.5 million, in full or partial satisfaction of non-performing mortgage loans for which those properties had served as collateral. Of these, properties with a value of \$124.1 million were classified as REHI and \$68.4 million were classified as OREO, based on management's current intention to either hold the properties over a longer period or to market them for sale in the near term.

**Real Estate Held for Investment, net** REHI consisted of the following (\$ in thousands):

|   | As of<br>September 30, 2011 | As of<br>December 31, 2010 |
|---|-----------------------------|----------------------------|
| Land held for investment and development        | \$ 635,467                  | \$ 606,083                 |
| Operating property                              |                             |                            |
| Land  | 82,266                      | 69,807                     |
| Buildings and improvements                      | 250,264                     | 165,025                    |
| Less: accumulated depreciation and amortization | (13,351)                    | (7,855)                    |
| Real estate held for investment, net            | \$ 954,646                  | \$ 833,060                 |

The Company recorded REHI operating income in "Other income" and REHI operating expenses in "Operating costs REHI and OREO," on its Consolidated Statements of Operations, as follows (\$ in thousands):

|                         | For the<br>Three Months Ended<br>September 30, |          | For the<br>Nine Months Ended<br>September 30, |           |
|-------------------------|--|----------|---|-----------|
|                         | 2011   | 2010     | 2011  | 2010      |
| REHI operating income   | \$ 8,207                                       | \$ 5,597 | \$ 22,356                                     | \$ 14,111 |
| REHI operating expenses | \$ 12,130                                      | \$ 8,944 | \$ 31,422                                     | \$ 21,113 |

**Other Real Estate Owned** During the nine months ended September 30, 2011, the Company sold OREO assets with a carrying value of \$142.8 million. For the three and nine months ended September 30, 2011, the Company recorded net impairment charges to OREO properties totaling \$9.3 million and \$12.6 million, respectively, and recorded net expenses related to holding costs for OREO properties of \$7.7 million and \$24.2 million, respectively.

For the three and nine months ended September 30, 2010, the Company recorded net (recoveries)/impairment charges to OREO properties totaling \$(0.4) million and \$16.8 million, respectively, and recorded net expenses related to holding costs for OREO properties of \$10.2 million and \$24.1 million, respectively.

**Encumbered REHI and OREO** As of September 30, 2011 and December 31, 2010, REHI assets with a carrying value of \$142.5 million and \$28.4 million, respectively, and OREO assets with a carrying value of \$163.8 million and \$232.1 million, respectively, were pledged as collateral for the Company's secured indebtedness.

Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 6 Net Lease Assets, net and Assets Held for Sale**

The Company's investments in net lease assets, at cost, were as follows (\$ in thousands):

|                                | As of<br>September 30, 2011 | As of<br>December 31, 2010 |
|--------------------------------|-----------------------------|----------------------------|
| Buildings and improvements     | \$ 1,619,747                | \$ 1,651,998               |
| Land and land improvements     | 448,153                     | 454,925                    |
| Less: accumulated depreciation | (340,978)                   | (322,414)                  |
| Net lease assets, net          | \$ 1,726,922                | \$ 1,784,509               |
| Assets held for sale           | \$ 33,759                   | \$                         |

During the three months ended September 30, 2011, the Company realized \$22.2 million of the gain previously deferred as part of its June 2010 sale of a portfolio of 32 net lease assets. At the time of sale, the Company had reduced its gain on sale and recorded a liability based upon certain contingent obligations, which have now been fully resolved. The gain has been recorded in "Gain from discontinued operations" on the Company's Consolidated Statements of Operations for the three and nine months ended September 30, 2011.

The Company receives reimbursements from customers for certain facility operating expenses including common area costs, insurance and real estate taxes. Customer expense reimbursements were \$6.1 million and \$17.6 million for the three and nine months ended September 30, 2011, respectively, and \$6.2 million and \$23.9 million for the three and nine months ended September 30, 2010, respectively. Of these amounts, \$5.8 million and \$18.0 million for the three and nine months ended September 30, 2010, respectively, were included as a reduction of "Operating costs net lease assets," and the remainder in 2010 was included in "Income (loss) from discontinued operations" on the Company's Consolidated Statements of Operations.

During the nine months ended September 30, 2010, the Company sold net lease assets with carrying values of \$1.17 billion, which resulted in initial gains of \$270.4 million. In addition, for the three and nine months ended September 30, 2010, the Company recorded impairment charges on net lease assets of \$5.7 million and \$6.1 million, respectively, of which \$1.5 million and \$1.9 million, respectively, were included in "Income (loss) from discontinued operations" on the Company's Consolidated Statements of Operations.

**Allowance for doubtful accounts** As of September 30, 2011 and December 31, 2010, the total allowance for doubtful accounts related to tenant receivables, including deferred operating lease income receivable, was \$3.0 million and \$1.4 million, respectively.

**Encumbered Net Lease Assets** As of September 30, 2011 and December 31, 2010, net lease assets with a carrying value of \$1.20 billion and \$1.02 billion, respectively, were encumbered with mortgages or pledged as collateral for the Company's secured indebtedness.

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

(unaudited)

**Note 7 Other Investments**

Other investments primarily consists of equity method investments. The Company's other investments and its proportionate share of results for equity method investments were as follows (\$ in thousands):

|  | Carrying value as of |                   | Equity in earnings                       |                 |   |                  |
|--|----------------------|-------------------|--|-----------------|---|------------------|
|  | September 30,        | December 31,      | For the Three Months Ended September 30, |                 | For the Nine Months Ended September 30, |                  |
|  | 2011                 | 2010              | 2011                                     | 2010            | 2011                                    | 2010             |
| Oak Hill(1)                            | \$ 162,679           | \$ 176,364        | \$ 1,078                                 | \$ 2,217        | \$ 8,788                                | \$ 10,707        |
| LNR                                    | 142,984              | 122,176           | 12,509                                   | 2,336           | 36,572                                  | 2,336            |
| Madison Funds                          | 114,581              | 92,265            | (941)                                    | 1,398           | 7,016                                   | 7,452            |
| Other equity method investments        | 190,417              | 131,418           | (1,829)                                  | 572             | 2,505                                   | 11,208           |
| <b>Total equity method investments</b> | <b>\$ 610,661</b>    | <b>\$ 522,223</b> | <b>\$ 10,817</b>                         | <b>\$ 6,523</b> | <b>\$ 54,881</b>                        | <b>\$ 31,703</b> |
| Other                                  | 10,506               | 10,135            |  |                 |   |                  |
| <b>Total other investments</b>         | <b>\$ 621,167</b>    | <b>\$ 532,358</b> |  |                 |   |                  |

**Explanatory Note:**

(1) Subsequent to quarter end, the Company sold a substantial portion of its interests in Oak Hill. See Note 18 for further details.

During the nine months ended September 30, 2011, the Company received an equity interest of \$45.4 million in an entity that received title to a property previously serving as collateral for a loan investment of the Company.

**Encumbered Other Investments** As of September 30, 2011, other investments with a carrying value of \$44.4 million were pledged as collateral for the Company's secured indebtedness.

**Summarized Financial Information**

**LNR** The Company owns approximately 24% of the outstanding equity of LNR and the Company's chairman and chief executive officer is the chairman of LNR's board of directors. The following table represents investee level summarized financial information for LNR (\$ in thousands)(1):

|                                | For the<br>Three Months Ended<br>June 30, 2011(2) | For the<br>Nine Months Ended<br>June 30, 2011(2) |
|--------------------------------|---|--|
| <b>Income Statement</b>        |   |  |
| Total revenue                  | \$ 73,167   | \$ 155,877                                       |
| Net income attributable to LNR | \$ 52,171   | \$ 152,537                                       |



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|                                 | As of<br>June 30, 2011 | As of<br>September 30, 2010 |
|---------------------------------|------------------------|-----------------------------|
| <b>Balance Sheet</b>            |                        |                             |
| Total assets(1)                 | \$ 1,307,568           | \$ 1,189,438                |
| Total liabilities(1)            | \$ 601,117             | \$ 724,311                  |
| Noncontrolling interests        | \$ 43,487              | \$ 37,092                   |
| LNR Property Corporation equity | \$ 662,964             | \$ 428,035                  |

**Explanatory Notes:**

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- (1) LNR consolidates certain commercial mortgage-backed securities and collateralized debt obligation trusts that are considered VIEs, and for which it is the primary beneficiary, that have been excluded from the amounts presented

Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 7 Other Investments (Continued)**

above. As of June 30, 2011 and September 30, 2010, the assets of these trusts which aggregate approximately \$138.80 billion and \$142.39 billion, respectively, are the sole source of repayment of the related liabilities, which aggregate approximately \$138.54 billion and \$141.99 billion, respectively, which are non-recourse to LNR and its equity holders, including the Company.

(2)

The Company records its investment in LNR on a one quarter lag, therefore, amounts in the Company's financial statements for the three and nine months ended September 30, 2011 are based on balances and results from LNR for the three and nine months ended June 30, 2011.

**Note 8 Other Assets and Other Liabilities**

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

|   | As of                 |                      |
|---|-----------------------|----------------------|
|   | September 30,<br>2011 | December 31,<br>2010 |
| Deferred financing fees, net(1)                     | \$ 25,250             | \$ 5,527             |
| Net lease in-place lease intangibles, net(2)        | 18,700                | 24,469               |
| Other receivables                                   | 12,078                | 13,521               |
| Leasing costs, net(3)                               | 11,958                | 8,267                |
| Corporate furniture, fixtures and equipment, net(4) | 9,453                 | 11,016               |
| Prepaid expenses                                    | 8,658                 | 5,265                |
| Loan receivables                                    | 7,835                 |                      |
| Other assets  | 28,698                | 17,463               |
| <b>Deferred expenses and other assets, net</b>      | <b>\$ 122,630</b>     | <b>\$ 85,528</b>     |

**Explanatory Notes:**

(1)

During the nine months ended September 30, 2011, in connection with the Secured Credit Facility, the Company recorded deferred financing fees of \$33.3 million (see Note 9). Accumulated amortization of deferred financing fees was \$10.3 million and \$21.1 million as of September 30, 2011 and December 31, 2010, respectively.

(2)

Represents unamortized finite lived intangible assets related to the prior acquisition of net lease assets. Accumulated amortization on net lease intangibles was \$31.7 million and \$26.6 million as of September 30, 2011 and December 31, 2010, respectively. Amortization expense related to these assets was \$1.7 million and \$5.1 million, for the three and nine months ended September 30, 2011, respectively, and \$1.6 million and \$4.8 million, for the three and nine months ended September 30, 2010, respectively.

(3)

Accumulated amortization on leasing costs was \$5.0 million and \$5.3 million as of September 30, 2011 and December 31, 2010, respectively.

(4)

Accumulated depreciation on corporate furniture, fixtures and equipment was \$7.6 million and \$7.2 million as of September 30, 2011 and December 31, 2010, respectively.

Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 8 Other Assets and Other Liabilities (Continued)**

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

|  | As of                 |                      |
|--|-----------------------|----------------------|
|  | September 30,<br>2011 | December 31,<br>2010 |
| Accrued expenses   | \$ 45,840             | \$ 19,800            |
| Accrued interest payable                                 | 41,658                | 38,143               |
| Deferred tax liabilities                                 | 18,804                | 13,729               |
| Property taxes payable                                   | 13,766                | 5,880                |
| Security deposits and other investment deposits          | 12,169                | 2,874                |
| Unearned operating lease income                          | 9,222                 | 10,423               |
| Other liabilities  | 12,636                | 43,573               |
| Accounts payable, accrued expenses and other liabilities | \$ 154,095            | \$ 134,422           |

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## iStar Financial Inc.

## Notes to Consolidated Financial Statements (Continued)

(unaudited)

## Note 9 Debt Obligations, net

As of September 30, 2011 and December 31, 2010, the Company's debt obligations were as follows (\$ in thousands):

|  | Carrying Value as of  |                      | Stated           | Scheduled               |
|--|-----------------------|----------------------|------------------|-------------------------|
|  | September 30,<br>2011 | December 31,<br>2010 | Interest Rates   | Maturity Date           |
| <b>Secured credit facilities:</b>                              |                       |                      |                  |                         |
| Tranche A-1 Facility   | \$ 1,071,332          | \$                   | LIBOR + 3.75%(1) | June 2013               |
| Tranche A-2 Facility   | 1,450,000             |                      | LIBOR + 5.75%(1) | June 2014               |
| Line of credit   |                       | 618,883              | LIBOR + 1.50%    | June 2011               |
| Line of credit   |                       | 334,180              | LIBOR + 1.50%    | June 2012               |
| <b>Unsecured credit facilities:</b>                            |                       |                      |                  |                         |
| Line of credit   |                       | 501,405              | LIBOR + 0.85%    | June 2011               |
| Line of credit   | 243,709               | 243,819              | LIBOR + 0.85%    | June 2012               |
| Total credit facilities  | \$ 2,765,041          | \$ 1,698,287         |                  |                         |
| <b>Secured term loans:</b>                                     |                       |                      |                  |                         |
| Collateralized by loans,<br>net lease, REHI and<br>OREO assets | \$                    | \$ 1,055,000         | LIBOR + 1.50%    | June 2011               |
| Collateralized by loans,<br>net lease, REHI and<br>OREO assets |                       | 612,222              | LIBOR + 1.50%    | June 2012               |
| Collateralized by net<br>lease assets                          | 309,537               | 190,223              | 5.05% - 7.68%    | Various through<br>2026 |
| Total secured term loans                                       | \$ 309,537            | \$ 1,857,445         |                  |                         |
| <b>Secured notes:</b>  |                       |                      |                  |                         |
| 10.0% senior notes   | \$                    | \$ 312,329           | 10.0%            | June 2014               |
| <b>Unsecured notes:</b>  |                       |                      |                  |                         |
| 5.80% senior notes   |                       | 107,766              | 5.80%            | March 2011              |
| 5.125% senior notes  |                       | 96,916               | 5.125%           | April 2011              |
| 5.65% senior notes   |                       | 196,593              | 5.65%            | September 2011          |
| 5.15% senior notes   | 288,521               | 322,006              | 5.15%            | March 2012              |
| 5.50% senior notes   | 102,345               | 102,345              | 5.50%            | June 2012               |
| LIBOR + 0.50% senior<br>convertible notes(2)                   | 787,750               | 787,750              | LIBOR + 0.50%    | October 2012            |
| 8.625% senior notes  | 501,701               | 501,701              | 8.625%           | June 2013               |
| 5.95% senior notes   | 448,453               | 448,453              | 5.95%            | October 2013            |
| 6.5% senior notes  | 67,055                | 67,055               | 6.5%             | December 2013           |
| 5.70% senior notes   | 200,601               | 200,601              | 5.70%            | March 2014              |
| 6.05% senior notes   | 105,765               | 105,765              | 6.05%            | April 2015              |
| 5.875% senior notes  | 261,403               | 261,403              | 5.875%           | March 2016              |
| 5.85% senior notes   | 99,722                | 99,722               | 5.85%            | March 2017              |
| Total unsecured notes  | \$ 2,863,316          | \$ 3,298,076         |                  |                         |
| Other debt obligations   | 100,000               | 100,000              | LIBOR + 1.5%     | October 2035            |
| <b>Total debt obligations</b>                                  | <b>\$ 6,037,894</b>   | <b>\$ 7,266,137</b>  |                  |                         |

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|  |          |        |
|--|----------|--------|
| Debt<br>premiums/(discounts),<br>net(2)(3) | (42,844) | 79,296 |
|--|----------|--------|

|  |                     |                     |
|--|---------------------|---------------------|
| <b>Total debt obligations,<br/>net</b> | <b>\$ 5,995,050</b> | <b>\$ 7,345,433</b> |
|--|---------------------|---------------------|

**Explanatory Notes:**

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- (1) These loans each have a LIBOR floor of 1.25%. As of September 30, 2011, inclusive of the floors, the Tranche A-1 Facility and Tranche A-2 Facility loans incurred interest at a rate of 5.00% and 7.00%, respectively.
- (2) The Company's convertible senior floating rate notes due October 2012 ("Convertible Notes") are convertible at the option of the holders into 22.2 shares per \$1,000 principal amount of Convertible Notes (reflecting a conversion price of \$45.05), on or after August 15, 2012, or prior to that date if certain conditions are met. None of the conversion conditions have been met as of

Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 9 Debt Obligations, net (Continued)**

September 30, 2011. As of September 30, 2011, the unamortized discount on these notes was \$13.3 million and the net carrying amount of the liability was \$774.5 million. For the three and nine months ended September 30, 2011, the Company recognized interest expense on the convertible notes of \$4.4 million and \$13.3 million, respectively, of which \$2.9 million and \$8.6 million, respectively, related to the amortization of the debt discount.

(3)

As of September 30, 2011, includes unamortized original issue debt discounts of \$26.2 million associated with the Secured Credit Facility completed in March 2011.

**Future Scheduled Maturities** As of September 30, 2011, future scheduled maturities of outstanding long-term debt obligations, net are as follows (\$ in thousands)(1):

|  |           |                  |
|--|-----------|------------------|
| 2011 (remaining three months)                | \$        | 14,122           |
| 2012   |           | 1,743,657        |
| 2013   |           | 1,971,319        |
| 2014   |           | 1,552,198        |
| 2015   |           | 105,765          |
| Thereafter                                   |           | 650,833          |
| <b>Total principal maturities</b>            | <b>\$</b> | <b>6,037,894</b> |
| Unamortized debt discounts, net              |           | (42,844)         |
| <b>Total long-term debt obligations, net</b> | <b>\$</b> | <b>5,995,050</b> |

**Explanatory Note:**

(1)

Includes minimum required amortization payments on the Secured Credit Facility.

**Secured Credit Facility** In March 2011, the Company entered into a new \$2.95 billion senior secured credit agreement comprised of a \$1.50 billion term loan facility bearing interest at a rate of LIBOR plus 3.75% and maturing in June 2013 (the "Tranche A-1 Facility") and a \$1.45 billion term loan facility bearing interest at a rate of LIBOR plus 5.75% maturing in June 2014 (the "Tranche A-2 Facility"), together the "Secured Credit Facility." Both tranches include a LIBOR floor of 1.25%. The Tranche A-1 Facility and Tranche A-2 Facility were issued at discounts to par of 1.0% and 1.5%, respectively. Proceeds from the Secured Credit Facility were used to fully repay the \$1.67 billion and \$0.9 billion outstanding under the Company's secured credit facilities, which were due to mature in June 2011 and June 2012, respectively, and to repay \$175.0 million of the Company's unsecured credit facilities due in June 2011. The remaining proceeds were used to repay other unsecured debt maturing in the first half of 2011.

The Secured Credit Facility is collateralized by a first lien on a fixed pool of assets consisting of loan, net lease, OREO and REHI assets. Proceeds from principal repayments and sales of collateral are applied to amortize the Secured Credit Facility. Proceeds received for interest, rent, lease payments, fee income and, under certain circumstances, additional amounts funded on assets serving as collateral are retained by the Company. The Tranche A-1 Facility requires that aggregate cumulative amortization payments of not less than \$200.0 million shall be made on or before December 30, 2011, not less than \$450.0 million on or before June 30, 2012, not less than \$750.0 million on or before December 31, 2012 and not less than \$1.50 billion on or before June 28, 2013. The Tranche A-2 Facility will begin amortizing six months after the repayment in full of the Tranche A-1 Facility, such that not less than \$150.0 million of cumulative amortization payments shall be made on or before the six month anniversary of repayment of the A-1



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**iStar Financial Inc.**

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

**(unaudited)**

**Note 9 Debt Obligations, net (Continued)**

Facility, with additional amortization payments of \$150.0 million due on or before each six month anniversary thereafter, with any unpaid principal amounts due at maturity in June 2014.

During the nine months ended September 30, 2011, the Company used proceeds from principal repayments and sales of collateral to repay \$428.7 million of its Tranche A-1 Facility. These repayments exceeded the \$200.0 million amortization requirement for December 30, 2011 and have reduced the cumulative amortization payments due on or before June 30, 2012 to \$21.3 million. Repayments of debt prior to maturity have resulted in losses on early extinguishment of debt of \$3.3 million and \$10.5 million, respectively, for the three and nine months ended September 30, 2011, related to the acceleration of discounts and unamortized deferred financing fees on the portion of debt that was repaid.

During the nine months ended September 30, 2011, the Company received \$9.1 million pursuant to an agreement with a holder of the Company's previously outstanding secured credit facilities. The amount effectively reduced the par value that was repaid to the debtholder and was accounted for under ASC 470-60, resulting in \$3.7 million being recognized during the nine months ended September 30, 2011, as a gain on extinguishment of debt. As the same lender participated in the new Secured Credit Facility, the remaining amount was recorded as a premium to that facility and will serve to reduce a portion of future interest expense through its maturity.

**Unsecured Credit Facilities** In June 2011, the Company repaid the \$329.9 million remaining principal balance of its LIBOR + 0.85% unsecured line of credit.

**Secured Term Loans** In June 2011, the Company entered into a \$120.0 million secured term loan financing maturing in July 2021. This financing is collateralized by net lease properties occupied by a single tenant and bears interest at 5.05%.

In March 2011, the Company refinanced its maturing \$47.7 million outstanding principal balance secured term loan. In addition, during June 2011, the Company entered into an additional \$4.6 million secured term loan. These loans bear interest at LIBOR + 4.50%, mature in 2014 and are cross-collateralized by the same net lease assets. Simultaneously with the financings, the Company entered into interest rate swaps to exchange the variable rates on the notes for fixed interest rates (see Note 10).

**Secured Notes** In January 2011, the Company fully redeemed the \$312.3 million remaining principal balance of its 10% senior secured notes due June 2014. In connection with this redemption, the Company recorded a gain on early extinguishment of debt of \$109.0 million in its Consolidated Statement of Operations for the nine months ended September 30, 2011.

**Unsecured Notes** During the nine months ended September 30, 2011, the Company repaid, upon maturity, the \$170.4 million outstanding principal balance of its 5.65% senior unsecured notes, the \$96.9 million outstanding principal balance of its 5.125% senior unsecured notes and the \$107.8 million outstanding principal balance of its 5.80% senior unsecured notes.

In addition, during the nine months ended September 30, 2011, the Company repurchased \$59.6 million par value of its senior unsecured notes with various maturities ranging from September 2011 to March 2012. In connection with these repurchases, the Company recorded an aggregate gain on early extinguishment of debt of \$0.1 million for both the three and nine months ended September 30, 2011.



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**iStar Financial Inc.**

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

**(unaudited)**

**Note 9 Debt Obligations, net (Continued)**

**Debt Covenants**

The Company's Secured Credit Facility contains certain covenants, including covenants relating to collateral coverage, dividend payments, restrictions on fundamental changes, transactions with affiliates, matters relating to the liens granted to the lenders and the delivery of information to the lenders. In particular, the Company is required to maintain collateral coverage of 1.25x outstanding borrowings. In addition, for so long as the Company maintains its qualification as a REIT, the Secured Credit Facility permits it to distribute 100% of its REIT taxable income on an annual basis. The Company may not pay common dividends if it ceases to qualify as a REIT.

The Company's outstanding unsecured debt securities contain corporate level covenants that include unencumbered assets to unsecured indebtedness and a fixed charge coverage ratio. The unencumbered assets to unsecured indebtedness covenant is a maintenance covenant, while the fixed charge coverage ratio is an incurrence test. Based on the Company's unsecured credit ratings, the financial covenants in its debt securities, including the fixed charge coverage ratio and maintenance of unencumbered assets to unsecured indebtedness ratio, are currently operative. If any of the Company's covenants is breached and not cured within applicable cure periods, the breach could result in acceleration of its debt securities unless a waiver or modification is agreed upon with the requisite percentage of the bondholders. While the Company expects that its ability to incur new indebtedness under the fixed charge coverage ratio will be limited for the foreseeable future, it will continue to be permitted to incur indebtedness for the purpose of refinancing existing indebtedness and for other permitted purposes under the indentures.

The Company's Secured Credit Facility contains cross default provisions that would allow the lenders to declare an event of default and accelerate the Company's indebtedness to them if the Company fails to pay amounts due in respect of its other recourse indebtedness in excess of specified thresholds or if the lenders under such other indebtedness are otherwise permitted to accelerate such indebtedness for any reason. The indentures governing the Company's unsecured public debt securities permit the bondholders to declare an event of default and accelerate the Company's indebtedness to them if the Company's other recourse indebtedness in excess of specified thresholds is not paid at final maturity or if such indebtedness is accelerated.

**Ratings Triggers**

Borrowings under the Company's unsecured credit facility bear interest at LIBOR based rates plus an applicable margin, which is based on the Company's corporate credit ratings. The Company's ability to borrow under this facility is not dependent on the level of its credit ratings.

**Note 10 Derivatives**

The Company's use of derivative financial instruments is primarily limited to the utilization of interest rate hedges or other instruments to manage interest rate risk exposure and foreign exchange hedges to manage its risk to changes in foreign currencies. The principal objective of such hedges are to minimize the risks and/or costs associated with the Company's operating and financial structure and to manage its exposure to foreign exchange rate movements.

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## iStar Financial Inc.

## Notes to Consolidated Financial Statements (Continued)

(unaudited)

## Note 10 Derivatives (Continued)

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the Consolidated Balance Sheets as of September 30, 2011 and December 31, 2010 (\$ in thousands):

| Derivative                   | Derivative Assets        |                 |                         |            | Derivative Liabilities   |                 |                         |               |
|------------------------------|--------------------------|-----------------|-------------------------|------------|--------------------------|-----------------|-------------------------|---------------|
|                              | As of September 30, 2011 |                 | As of December 31, 2010 |            | As of September 30, 2011 |                 | As of December 31, 2010 |               |
|                              | Balance Sheet Location   | Fair Value      | Balance Sheet Location  | Fair Value | Balance Sheet Location   | Fair Value      | Balance Sheet Location  | Fair Value    |
| Foreign exchange contracts   | Other Assets             | \$ 1,650        | Other Assets            | \$         | Other Liabilities        | \$ 1,202        | Other Liabilities       | \$ 223        |
| Cash flow interest rate swap | Other Assets             |                 | Other Assets            |            | Other Liabilities        | 1,179           | Other Liabilities       |               |
| <b>Total</b>                 |                          | <b>\$ 1,650</b> |                         | <b>\$</b>  |                          | <b>\$ 2,381</b> |                         | <b>\$ 223</b> |

The tables below present the effect of the Company's derivative financial instruments on the Consolidated Statements of Operations for the three and nine months ended September 30, 2011 (\$ in thousands):

| Derivatives Designated in Hedging Relationships      | Location of Gain (Loss) Recognized in Income on Derivative | Other Comprehensive Income | Amount of Gain (Loss) Recognized in Accumulated Other Comprehensive Income (Effective Portion) | Amount of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Earnings (Effective Portion) | Amount of Gain (Loss) Recognized in Earnings (Ineffective Portion) |
|--|--|----------------------------|--|--|--|
|  |  |                            |  |  |  |
| Cash flow interest rate swap                         | Accumulated Other Comprehensive Income                     |                            | \$ (529)   | \$ (181)   | N/A  |
| <b>For the Nine Months Ended September 30, 2011:</b> |  |                            | \$ (1,530)   | \$ (353)   | N/A  |
|  |  |                            |  |  |  |
| Derivatives not Designated in Hedging Relationships  | Location of Gain or (Loss) Recognized in Income on         |                            | Amount of Gain or (Loss) Recognized in Income on Derivative                                    |  |  |
|  |  |                            | For the Three Months Ended September 30, 2011  | For the Nine Months Ended September 30, 2011   | For the Nine Months Ended September 30, 2010                       |

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Derivative

|                            |               |           |            |           |          |
|----------------------------|---------------|-----------|------------|-----------|----------|
| Foreign Exchange Contracts | Other Expense | \$ 21,152 | \$ (2,109) | \$ 12,259 | \$ (908) |
|----------------------------|---------------|-----------|------------|-----------|----------|

**Non-designated hedges** Derivatives not designated as hedges are not speculative and are used to manage the Company's exposure to interest rate movements, foreign exchange rate movements, and other identified risks, but may not meet strict hedge accounting requirements. Changes in the fair value of derivatives not designated in hedging relationships are recorded directly in earnings.

Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 10 Derivatives (Continued)**

The following table presents the Company's foreign currency derivatives outstanding as of September 30, 2011 (\$ in thousands):

| Derivative Type            |   | Notional<br>Amount |    | Notional<br>(USD Equivalent) | Maturity      |
|----------------------------|---|--------------------|----|------------------------------|---------------|
| Sells EUR/Buys USD Forward | € | 141,500            | \$ | 189,937                      | December 2011 |
| Sells GBP/Buys USD Forward | £ | 50,110             | \$ | 78,308                       | December 2011 |
| Sells CAD/Buys USD Forward |   | CAD 52,941         | \$ | 50,745                       | December 2011 |

**Qualifying Cash Flow Hedges** During the nine months ended September 30, 2011, the Company entered into interest rate swaps to convert its variable rate debt to fixed rate. The following table presents the Company's interest rate swaps outstanding as of September 30, 2011 (\$ in thousands):

| Derivative Type    | Notional Amount | Variable Rate | Fixed Rate | Maturity   |
|--------------------|-----------------|---------------|------------|------------|
| Interest rate swap | \$ 47,731       | LIBOR + 4.50% | 6.11%      | March 2014 |
| Interest rate swap | \$ 4,575        | LIBOR + 4.50% | 5.575%     | June 2014  |

Over the next 12 months, the Company expects that \$0.9 million of expense and \$0.7 million of income related to the qualifying cash flow hedges and previously terminated cash flow hedges, respectively, will be reclassified from Accumulated other comprehensive income into earnings.

**Credit risk-related contingent features** The Company has agreements with each of its derivative counterparties that contain a provision where if the Company either defaults or is capable of being declared in default on any of its indebtedness, then the Company could also be declared in default on its derivative obligations.

In connection with its foreign currency derivatives, as of September 30, 2011, the Company has posted collateral of \$13.1 million, which is included in "Restricted cash" on the Company's Consolidated Balance Sheets.

**Note 11 Commitments and Contingencies**

**Business Risks and Uncertainties** The economic recession and tightening of capital markets adversely affected the Company's business. The Company experienced significant provisions for loan losses and impairments resulting from high levels of non-performing loans and increasing amounts of real estate owned as the Company took title to assets of defaulting borrowers. The economic conditions and their effect on the Company's operations also resulted in increases in its financing costs and an inability to access the unsecured debt markets. Since the beginning of the crisis, the Company has significantly curtailed asset originations and has focused primarily on resolving problem assets, generating liquidity, retiring debt, decreasing leverage and preserving shareholder value.

The Company saw signs of an economic recovery during 2010 and early 2011, including some improvements in the commercial real estate market and capital markets. These conditions resulted in reduced additions to non-performing loans, reductions in provisions for loan losses and increased levels of liquidity to fund operations, which allowed the Company to complete the Secured Credit Facility in March of 2011. The current volatility within the capital markets and commercial real estate market continues to

Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 11 Commitments and Contingencies (Continued)**

have an effect on the Company's operations, primarily evidenced by continuing elevated levels of non-performing assets and limited access to liquidity. Additionally, improvement in the Company's financial condition and operating results and its ability to generate future liquidity, are dependent on a sustained economic recovery, which cannot be predicted with certainty.

As of September 30, 2011, the Company had \$1.76 billion of debt maturing and minimum required amortization payments due on or before December 31, 2012. The Company had \$217.0 million of unrestricted cash outstanding at quarter-end and its capital sources in the coming year will primarily include loan repayments, proceeds from strategic asset sales and may include debt refinancings and equity capital raising transactions. However, the timing and amounts of proceeds from asset repayments and sales, and the Company's ability to consummate debt refinancings and equity capital raising transactions are subject to factors outside its control and cannot be predicted with certainty. The Company's plans are dynamic and it may adjust its plans in response to changes in its expectations and changes in market conditions. The Company would be materially adversely affected if it is unable to repay or refinance its debt as it comes due.

**Unfunded Commitments** As of September 30, 2011, the maximum amount of fundings the Company may be required to make under each category, assuming all performance hurdles and milestones are met under the Performance-Based Commitments, that it approves all Discretionary Fundings and that 100% of its capital committed to Strategic Investments is drawn down, are as follows (\$ in thousands):

|                                  | Loans      | Net Lease<br>Assets | Strategic<br>Investments | Total      |
|----------------------------------|------------|---------------------|--------------------------|------------|
| Performance-Based<br>Commitments | \$ 57,568  | \$ 9,880            | \$                       | \$ 67,448  |
| Discretionary Fundings           | 155,574    |                     |                          | 155,574    |
| Other                            |            |                     | 30,493                   | 30,493     |
| Total                            | \$ 213,142 | \$ 9,880            | \$ 30,493                | \$ 253,515 |

**Note 12 Equity**

**Preferred Stock** The Company had the following series of Cumulative Redeemable Preferred Stock outstanding as of September 30, 2011 and December 31, 2010:

| Series | Shares Authorized,<br>Issued and<br>Outstanding<br>(\$ in thousands) | Par Value | Cumulative Preferential Cash<br>Dividends(1)(2)            |   |
|--------|--|-----------|--|---|
|        |  |           | Rate per Annum of<br>the \$25.00 Liquidation<br>Preference | Equivalent to Fixed<br>Annual Rate<br>(per share) |
| D      | 4,000  | \$ 0.001  | 8.00%  | \$ 2.00   |
| E      | 5,600  | \$ 0.001  | 7.875%   | \$ 1.97   |
| F      | 4,000  | \$ 0.001  | 7.8%   | \$ 1.95   |
| G      | 3,200  | \$ 0.001  | 7.65%  | \$ 1.91   |
| I      | 5,000  | \$ 0.001  | 7.50%  | \$ 1.88   |

21,800

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**iStar Financial Inc.**

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

**(unaudited)**

**Note 12 Equity (Continued)**

**Explanatory Notes:**

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- (1) Holders of shares of the Series D, E, F, G and I preferred stock are entitled to receive dividends, when and as declared by the Board of Directors, out of funds legally available for the payment of dividends. Dividends are cumulative from the date of original issue and are payable quarterly in arrears on or before the 15th day of each March, June, September and December or, if not a business day, the next succeeding business day. Any dividend payable on the preferred stock for any partial dividend period will be computed on the basis of a 360-day year consisting of twelve 30-day months. Dividends will be payable to holders of record as of the close of business on the first day of the calendar month in which the applicable dividend payment date falls or on another date designated by the Board of Directors of the Company for the payment of dividends that is not more than 30 nor less than ten days prior to the dividend payment date.
- (2) The Company declared and paid dividends aggregating \$6.0 million, \$8.3 million, \$5.8 million, \$4.6 million and \$7.0 million on its Series D, E, F, G, and I preferred stock, respectively, during the nine months ended September 30, 2011. There are no dividend arrearages on any of the preferred shares currently outstanding.

**Dividends** In order to maintain its election to qualify as a REIT, the Company must currently distribute, at a minimum, an amount equal to 90% of its taxable income, excluding net capital gains, and must distribute 100% of its taxable income (including net capital gains) to avoid paying corporate federal income taxes. The Company has recorded net operating losses and may record net operating losses in the future, which may reduce its taxable income in future periods and lower or eliminate entirely the Company's obligation to pay dividends for such periods in order to maintain its REIT qualification. Because taxable income differs from cash flow from operations due to non-cash revenues and expenses (such as depreciation and certain asset impairments), in certain circumstances, the Company may generate operating cash flow in excess of its dividends or, alternatively, may be required to borrow to make sufficient dividend payments. The Company's Secured Credit Facility permits the Company to distribute 100% of its REIT taxable income on an annual basis, for so long as the Company maintains its qualification as a REIT. The Secured Credit Facility restricts the Company from paying any common dividends if it ceases to qualify as a REIT. The Company did not declare or pay any Common Stock dividends for the nine months ended September 30, 2011 and 2010.

**Stock Repurchase Programs** On August 8, 2011, the Company's Board of Directors authorized the repurchase of up to \$65.0 million of its Common Stock from time to time in open market and privately negotiated purchases, including pursuant to one or more trading plans.

During the nine months ended September 30, 2011, the Company repurchased 12.3 million shares of its outstanding Common Stock for approximately \$78.8 million, at an average cost of \$6.40 per share, and repurchases were recorded at cost. As of September 30, 2011, the Company had \$0.6 million of Common Stock available to repurchase under its Board authorized stock repurchase programs.

**Note 13 Stock-Based Compensation Plans and Employee Benefits**

**Stock-based Compensation** The Company recorded stock-based compensation expense of \$7.2 million and \$15.6 million for the three and nine months ended September 30, 2011, respectively, and \$3.9 million and \$13.6 million for the three and nine months ended September 30, 2010, respectively, in "General and administrative" on the Company's Consolidated Statements of Operations. As of September 30, 2011, there was \$28.1 million of total unrecognized compensation cost related to all unvested restricted stock units. That cost is expected to be recognized over a weighted average remaining

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**iStar Financial Inc.**

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

(unaudited)

**Note 13 Stock-Based Compensation Plans and Employee Benefits (Continued)**

vesting/service period of 0.77 years. As of September 30, 2011, an aggregate of 3.3 million shares remain available for issuance pursuant to future awards under the Company's 2006 and 2009 Long-Term Incentive Plans.

**Restricted Stock Units**

**2011 Awards** During the nine months ended September 30, 2011, the Company granted 721,257 service-based restricted stock units to employees with original vesting terms ranging from two to three years. Unit holders will receive shares of the Company's Common Stock in the amount of the units granted, net of statutory minimum tax withholdings, if and when the units vest. As of September 30, 2011, 720,057 of the awards remain outstanding. These awards carry dividend equivalent rights that entitle the holder to receive dividend payments prior to vesting, if and when dividends are paid on shares of the Company's Common Stock. The aggregate grant date fair value of these awards was \$6.3 million.

**Other Outstanding Awards** In addition to the awards granted in 2011, noted above, the following awards remained outstanding as of September 30, 2011:

1,346,566 service-based restricted stock units granted to employees that represent the right to receive an equivalent number of shares of the Company's Common Stock. Unit holders will receive shares of the Company's Common Stock in the amount of the units granted, net of statutory minimum tax withholdings, if and when the units vest. These units will cliff vest on February 17, 2012 if the employee is employed by the Company on that date and carry dividend equivalent rights that entitle the holder to receive dividend payments prior to vesting, if and when dividends are paid on shares of the Company's Common Stock.

806,518 performance-based restricted stock units granted to the Company's Chairman and Chief Executive Officer that represent the right to receive an equivalent number of shares of the Company's Common Stock. The unit holder will receive shares of the Company's Common Stock in the amount of the units granted, net of statutory minimum tax withholdings, if and when the units vest. The performance-based units will cliff vest on March 2, 2012 if certain performance and service conditions have been achieved, relating to reductions in the Company's general and administrative expenses, retirement of debt and continued employment. The performance conditions were satisfied during the year ended December 31, 2010, therefore, vesting is now based solely on continued employment through March 2, 2012. Since the performance conditions have been achieved, these units now carry dividend equivalent rights that entitle the holder to receive dividend payments, if and when dividends are paid on shares of the Company's Common Stock.

8,305,000 market-condition based restricted stock units granted to executives and other officers of the Company on December 19, 2008. These units will vest in one installment on January 1, 2012 if the Common Stock achieves a price of \$10.00 or more (average NYSE closing price over 20 consecutive trading days) prior to December 19, 2011 and the employee is thereafter employed on the vesting date. If this price target is achieved, the units will thereafter be entitled to dividend equivalent payments as dividends are paid on the Company's Common Stock. Upon vesting of these units, holders will receive shares of the Company's Common Stock in the amount of the vested units, net of statutory minimum tax withholdings. The Company modified the terms of these restricted stock units (the "Original Units") to provide that if the remaining share price target of

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**iStar Financial Inc.**

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

(unaudited)

**Note 13 Stock-Based Compensation Plans and Employee Benefits (Continued)**

\$10.00 has not been met before December 19, 2011, a portion of the Original Units (the "Amended Units") will become eligible for future vesting if extended service period requirements are met. The number of Amended Units will be equal to 75% of the Original Units granted to an employee *less*, in the case of each executive level employee, the number of restricted stock units granted to the executive in March 2011. The Amended Units will vest ratably on each of January 1, 2012, 2013 and 2014, so long as the employee remains employed by the Company on the vesting dates. The amendment is expected to result in additional estimated non-cash expense of approximately \$14.9 million which will be recognized over the extended service period through January 1, 2014. If the \$10 price target is met prior to December 19, 2011, the remaining unamortized expense will be accelerated and recognized prior to the end of 2011. The incremental expense was measured based on the fair value of the modified award in excess of the fair value of the original award measured immediately before the terms were modified based on current assumptions. The estimated expense is based upon a number of assumptions and the actual expense could vary from the estimate if the actual experience regarding, among other things, forfeiture and vesting is different from the assumptions.

2,000,000 market-condition based restricted stock units contingently awarded to the Company's Chairman and Chief Executive Officer on October 9, 2008 and approved by shareholders on May 27, 2009. These units will cliff vest in one installment on October 9, 2011 only if the total shareholder return on the Company's Common Stock is at least 25% per year (compounded at the end of the three year vesting period, including dividends). Total shareholder return will be based on the average NYSE closing prices for the Company's Common Stock for the 20 days prior to: (a) the date of the award on October 9, 2008; and (b) the vesting date. No dividends will be paid on these units prior to vesting. Upon vesting of these units, the holder will receive shares of the Company's Common Stock in the amount of the vested units, net of statutory minimum tax withholdings. Subsequent to quarter end, these units were canceled as the shareholder return target was not achieved. On October 7, 2011, the Company granted 2,000,000 service-based restricted stock units to the Company's Chairman and Chief Executive Officer which will vest in installments of 40% on October 15, 2011 and 30% each on June 15 of 2013 and 2014.

1,525,000 restricted stock units awarded to certain officers on October 9, 2008, as special retention incentive, which will cliff vest in one installment on October 9, 2011, if the holders are employed on the vesting date. The unvested units are entitled to receive dividend equivalent payments as dividends are paid on shares of the Company's Common Stock. These units all vested subsequent to quarter end and as a result, 997,061 shares were issued to certain officers, after deducting the minimum required shares for statutory withholding taxes.

61,330 service-based restricted stock units granted to employees with original vesting terms ranging from three to five years that are entitled to be paid dividends as dividends are paid on shares of the Company's Common Stock.

The fair value of the modified December 19, 2008 market-condition based restricted stock units, were determined by utilizing a Monte Carlo model to simulate a range of possible future stock prices for the



Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 13 Stock-Based Compensation Plans and Employee Benefits (Continued)**

Company's Common Stock. The following assumptions were used to estimate the fair value of this market-condition based award:

|                                 | Valued As of<br>July 1, 2011 |
|---------------------------------|------------------------------|
| Risk-free interest rate         | 0.092%                       |
| Expected stock price volatility | 57.75%                       |
| Expected annual dividend        |                              |

**Stock Options** As of September 30, 2011, the Company had 44,296 stock options outstanding and exercisable with a weighted average strike price of \$29.82 and a weighted average remaining contractual life of 0.66 years.

**Common Stock Equivalents ("CSEs")** During the nine months ended September 30, 2011, the Company awarded to Directors 61,160 CSEs with a service vesting period ending in May 2012. These CSEs pay dividends in an amount equal to the dividends paid on the equivalent number of shares of the Company's Common Stock from the date of grant, as and when dividends are paid on the Common Stock. The aggregate grant date fair value of these awards was \$0.5 million. As of September 30, 2011, 343,118 CSEs granted to Directors remained outstanding and had an aggregate intrinsic value of \$2.0 million.

During the nine months ended September 30, 2011, the Company's Board of Directors decided pursuant to the terms of the non-employee directors deferral plan to require settlement of CSEs in shares of the Company's Common Stock, thereby eliminating the cash settlement option. This modification converted these liability-based awards to equity awards and as such, the Company reclassified \$2.4 million from "Accounts payable, accrued expenses and other liabilities" to "Additional paid-in capital" during the nine months ended September 30, 2011.

**401(k) Plan** The Company made gross contributions to its 401(k) Plan of approximately \$0.2 million and \$0.6 million for the three and nine months ended September 30, 2011, respectively, and \$0.1 million and \$0.9 million for the three and nine months ended September 30, 2010, respectively.

**Note 14 Earnings Per Share**

The following table presents a reconciliation of income (loss) from continuing operations used in the basic and diluted EPS calculations (\$ in thousands, except for per share data):

|  | For the<br>Three Months Ended<br>September 30, |             | For the<br>Nine Months Ended<br>September 30, |              |
|--|--|-------------|---|--------------|
|  | 2011   | 2010        | 2011  | 2010         |
| Income (loss) from continuing operations   | \$ (77,911)                                    | \$ (78,950) | \$ (19,476)                                   | \$ (151,780) |
| Net (income) loss attributable to noncontrolling interests   | 1,002  | (858)       | 558   | (857)        |
| Preferred dividends  | (10,580)                                       | (10,580)    | (31,740)                                      | (31,740)     |
| Income (loss) from continuing operations attributable to iStar Financial Inc. and allocable to common shareholders, HPU holders and Participating Security holders | \$ (87,489)                                    | \$ (90,388) | \$ (50,658)                                   | \$ (184,377) |

Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 14 Earnings Per Share (Continued)**

Earnings per share allocable to common shares and HPU shares are calculated as follows (\$ in thousands, except for per share data):

|  | <b>For the<br/>Three Months Ended<br/>September 30,</b> |             | <b>For the<br/>Nine Months Ended<br/>September 30,</b> |              |
|--|---|-------------|--|--------------|
|  | <b>2011</b>   | <b>2010</b> | <b>2011</b>  | <b>2010</b>  |
| <b>Earnings allocable to common shares:</b>  |   |             |  |              |
| <i>Numerator for basic and diluted earnings per share:</i>   |   |             |  |              |
| Income (loss) from continuing operations attributable to iStar Financial Inc. and allocable to common shareholders | \$ (84,754)   | \$ (87,722) | \$ (49,127)  | \$ (178,958) |
| Income (loss) from discontinued operations   | 1,019   | (101)       | 483  | 19,870       |
| Gain from discontinued operations  | 21,504  | 4,292       | 21,527   | 262,421      |
| Net income (loss) attributable to iStar Financial Inc. and allocable to common shareholders                        | \$ (62,231)   | \$ (83,531) | \$ (27,117)  | \$ 103,333   |
| <i>Denominator for basic and diluted earnings per share:</i>   |   |             |  |              |
| Weighted average common shares outstanding for basic and diluted earnings per common share                         | 87,951  | 93,370      | 91,020   | 93,556       |
| <b>Basic and diluted earnings per common share:</b>  |   |             |  |              |
| Income (loss) from continuing operations attributable to iStar Financial Inc. and allocable to common shareholders | \$ (0.96)   | \$ (0.94)   | \$ (0.55)  | \$ (1.91)    |
| Income (loss) from discontinued operations   | 0.01  | (0.01)      | 0.01   | 0.21         |
| Gain from discontinued operations  | 0.24  | 0.05        | 0.24   | 2.80         |
| Net income (loss) attributable to iStar Financial Inc. and allocable to common shareholders                        | \$ (0.71)   | \$ (0.89)   | \$ (0.30)  | \$ 1.10      |
| <b>Earnings allocable to High Performance Units:</b>   |   |             |  |              |
| <i>Numerator for basic and diluted earnings per HPU share:</i>   |   |             |  |              |
| Income (loss) from continuing operations attributable to iStar Financial Inc. and allocable to HPU holders         | \$ (2,735)  | \$ (2,666)  | \$ (1,531)   | \$ (5,419)   |
| Income (loss) from discontinued operations   | 33  | (3)         | 15   | 603          |
| Gain from discontinued operations  | 694   | 130         | 671  | 7,961        |
| Net income (loss) attributable to iStar Financial Inc. and allocable to HPU holders                                | \$ (2,008)  | \$ (2,539)  | \$ (845)   | \$ 3,145     |
| <i>Denominator for basic and diluted earnings per HPU share:</i>   |   |             |  |              |
| Weighted average High Performance Units outstanding for basic and diluted earnings per share                       | 15  | 15          | 15   | 15           |
| <b>Basic and diluted earnings per HPU share:</b>   |   |             |  |              |
| Income (loss) from continuing operations attributable to iStar Financial Inc. and allocable to HPU holders         | \$ (182.34)   | \$ (177.74) | \$ (102.06)  | \$ (361.26)  |
| Income (loss) from discontinued operations   | 2.20  | (0.20)      | 1.00   | 40.20        |
| Gain from discontinued operations  | 46.27   | 8.67        | 44.73  | 530.73       |
| Net income (loss) attributable to iStar Financial Inc. and allocable to HPU holders                                | \$ (133.87)   | \$ (169.27) | \$ (56.33)   | \$ 209.67    |

Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 14 Earnings Per Share (Continued)**

For the three and nine months ended September 30, 2011 and 2010, the following shares were anti-dilutive (in thousands):

|                      | <b>For the Three and<br/>Nine Months Ended<br/>September 30,</b> |             |
|----------------------|--|-------------|
|                      | <b>2011</b>  | <b>2010</b> |
| Joint venture shares | 298  | 298         |
| Stock options        | 44   | 143         |

**Note 15 Comprehensive Income (Loss)**

The statement of comprehensive income (loss) attributable to iStar Financial, Inc. is as follows (\$ in thousands):

|  | <b>For the<br/>Three Months Ended<br/>September 30,</b> |             | <b>For the<br/>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2011</b>   | <b>2010</b> | <b>2011</b>  | <b>2010</b> |
| Net income (loss)  | \$ (54,661)   | \$ (74,632) | \$ 3,220   | \$ 139,075  |
| Other comprehensive income:  |   |             |  |             |
| Reclassification of (gains)/losses on available-for-sale securities into earnings upon realization |   |             |  | (4,206)     |
| Reclassification of (gains)/losses on cash flow hedges into earnings upon realization              | (178)   | 79          | (531)  | (340)       |
| Unrealized gains/(losses) on available-for-sale securities   | (129)   | 36          | 499  | 76          |
| Unrealized gains/(losses) on cash flow hedges  | (284)   |             | (877)  |             |
| Unrealized gains/(losses) on cumulative translation adjustment                                     | (922)   | 1,780       | 808  | 352         |
| Comprehensive income (loss)  | \$ (56,174)   | \$ (72,737) | \$ 3,119   | \$ 134,957  |
| Net (income) loss attributable to noncontrolling interests   | 1,002   | (858)       | 558  | (857)       |
| Comprehensive income (loss) attributable to iStar Financial Inc.                                   | \$ (55,172)   | \$ (73,595) | \$ 3,677   | \$ 134,100  |

Accumulated other comprehensive income reflected in the Company's shareholders' equity is comprised of the following (\$ in thousands):

|  | <b>As of</b>                  |                              |
|--|-------------------------------|------------------------------|
|  | <b>September 30,<br/>2011</b> | <b>December 31,<br/>2010</b> |
| Unrealized gains on available-for-sale securities      | \$ 697                        | \$ 198                       |
| Unrealized gains on cash flow hedges                   | 1,949                         | 3,357                        |
| Unrealized losses on cumulative translation adjustment | (1,138)                       | (1,946)                      |
| Accumulated other comprehensive income                 | \$ 1,508                      | \$ 1,609                     |

Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 16 Fair Values**

Fair value represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following fair value hierarchy prioritizes the inputs to be used in valuation techniques to measure fair value:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2: Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability; and

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

Certain of the Company's assets and liabilities are recorded at fair value either on a recurring or non-recurring basis. Assets required to be marked-to-market and reported at fair value every reporting period are classified as being valued on a recurring basis. Other assets not required to be recorded at fair value every period may be recorded at fair value if a specific provision or other impairment is recorded within the period to mark the carrying value of the asset to market as of the reporting date. Such assets are classified as being valued on a non-recurring basis.

The following table summarizes the Company's assets and liabilities for which fair value adjustments were recorded as of the end of the respective periods (\$ in thousands):

|   | Total      | Quoted<br>market prices<br>in active<br>markets<br>(Level 1) | Fair Value Using<br>Significant<br>other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
|---|------------|--|---|--|
| <b>As of September 30, 2011:</b>        |            |  |   |  |
| Recurring basis:                        |            |  |   |  |
| Financial Assets:                       |            |  |   |  |
| Marketable securities equity securities | \$ 434     | \$ 434   | \$  | \$   |
| Derivative assets                       | \$ 1,650   | \$   | \$ 1,650  | \$   |
| Financial Liabilities:                  |            |  |   |  |
| Derivative liabilities                  | \$ 2,381   | \$   | \$ 2,381  | \$   |
| Non-recurring basis:                    |            |  |   |  |
| Financial Assets:                       |            |  |   |  |
| Impaired loans                          | \$ 214,760 | \$   | \$  | \$ 214,760   |
| Non-financial Assets:                   |            |  |   |  |
| Impaired OREO                           | \$ 55,325  | \$   | \$  | \$ 55,325  |

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

(unaudited)

**Note 16 Fair Values (Continued)**

|   | Total      | Quoted<br>market prices<br>in active<br>markets<br>(Level 1) | Fair Value Using<br>Significant<br>other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
|---|------------|--|---|--|
| <b>As of December 31, 2010:</b>         |            |  |   |  |
| Recurring basis:                        |            |  |   |  |
| Financial Assets:                       |            |  |   |  |
| Marketable securities equity securities | \$ 699     | \$ 699   | \$  | \$   |
| Financial Liabilities:                  |            |  |   |  |
| Derivative liabilities                  | \$ 223     | \$   | \$ 223  | \$   |
| Non-recurring basis:                    |            |  |   |  |
| Financial Assets:                       |            |  |   |  |
| Impaired loans                          | \$ 616,070 | \$   | \$  | \$ 616,070   |
| Impaired equity method investment       | \$ 1,535   | \$   | \$  | \$ 1,535   |
| Non-financial Assets:                   |            |  |   |  |
| Impaired OREO                           | \$ 54,141  | \$   | \$  | \$ 54,141  |

In addition to the Company's disclosures regarding assets and liabilities recorded at fair value in the financial statements, it is also required to disclose the estimated fair values of all financial instruments, regardless of whether they are recorded at fair value in the financial statements.

The carrying and estimated fair values of financial instruments were as follows (\$ in thousands)(1):

|  | As of September 30, 2011 |              | As of December 31, 2010 |              |
|--|--------------------------|--------------|-------------------------|--------------|
|  | Carrying Value           | Fair Value   | Carrying Value          | Fair Value   |
| <b>Financial assets:</b>                 |                          |              |                         |              |
| Loans and other lending investments, net | \$ 3,283,725             | \$ 3,140,431 | \$ 4,587,352            | \$ 4,256,663 |
| <b>Financial liabilities:</b>            |                          |              |                         |              |
| Debt obligations, net                    | \$ 5,995,050             | \$ 5,569,033 | \$ 7,345,433            | \$ 6,767,968 |
| <b>Explanatory Note:</b>                 |                          |              |                         |              |

- (1) The carrying values of other financial instruments including cash and cash equivalents, restricted cash, accrued interest receivable and accounts payable, approximate the fair values of the instruments. The fair value of other financial instruments, including derivative assets and liabilities and marketable securities are included in the previous table.

Given the nature of certain assets and liabilities, clearly determinable market based valuation inputs are often not available, therefore, these assets and liabilities are valued using internal valuation techniques. Subjectivity exists with respect to these internal valuation techniques, therefore, the fair values disclosed may not ultimately be realized by the Company if the assets were sold or the liabilities were settled with third parties. The methods the Company used to estimate the fair values presented in the two tables are described more fully below for each type of asset and liability.

**Derivatives** The Company uses interest rate swaps and foreign currency derivatives to manage its interest rate and foreign currency risk. The valuation of these instruments is determined using discounted

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**iStar Financial Inc.**

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

**(unaudited)**

**Note 16 Fair Values (Continued)**

cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves, foreign exchange rates, and implied volatilities. The Company incorporates credit valuation adjustments to appropriately reflect both its own non-performance risk and the respective counterparty's non-performance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of non-performance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees. The Company has determined that the significant inputs used to value its derivatives fall within Level 2 of the fair value hierarchy.

**Securities** All of the Company's available-for-sale and impaired held-to-maturity debt and equity securities are actively traded and have been valued using quoted market prices. The Company's traded marketable securities are valued using market quotes, to the extent they are available, or broker quotes that fall within Level 2 of the fair value hierarchy.

**Impaired loans** The Company's loans identified as being impaired are nearly all collateral dependent loans and are evaluated for impairment by comparing the estimated fair value of the underlying collateral, less costs to sell, to the carrying value of each loan. Due to the nature of the individual properties collateralizing the Company's loans, the Company generally uses a discounted cash flow methodology through internally developed valuation models to estimate the fair value of the collateral. This approach requires the Company to make significant judgments in respect to discount rates, capitalization rates and the timing and amounts of estimated future cash flows that are all considered Level 3 inputs. These cash flows generally include property revenues, lot and unit sale prices and velocity, operating costs, and costs of completion. In more limited cases, the Company obtains external "as is" appraisals for loan collateral, generally when third party participations exist, and appraised values may be discounted when real estate markets rapidly deteriorate.

**Impaired OREO assets** If the Company determines an OREO asset is impaired it records an impairment charge to adjust the asset to its estimated fair market value less costs to sell. Due to the nature of the individual properties in the OREO portfolio, the Company generally uses a discounted cash flow methodology through internally developed valuation models to estimate the fair value of the assets. This approach requires the Company to make significant judgments with respect to discount rates, capitalization rates and the timing and amounts of estimated future cash flows that are all considered Level 3 inputs. These cash flows generally include property revenues, lot and unit sale prices and velocity, operating costs, and costs of completion.

**Impaired equity method investments** If the Company determines an equity method investment is other than temporarily impaired it records an impairment charge to adjust the investment to its estimated fair market value. To estimate the fair value of an investment in a fund that invests in real estate, the Company estimates the fair value of the individual properties held within the fund using a discounted cash flow methodology through internally developed valuation models. This approach requires the Company to make significant judgments with respect to discount rates, capitalization rates and the timing and amounts of estimated future cash flows that are all considered Level 3 inputs. These cash flows are primarily based on expected future leasing rates, operating costs and sales prices.

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**iStar Financial Inc.**

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

**(unaudited)**

**Note 16 Fair Values (Continued)**

**Impaired cost method investments** If the Company determines a cost method investment is other than temporarily impaired, it records an impairment charge to adjust the investment to its estimated fair market value. The Company estimates the fair value of its impaired cost method investments using internally developed valuation models.

**Loans and other lending investments** The Company estimates the fair value of its performing loans and other lending investments using a discounted cash flow methodology. This method discounts estimated future cash flows using rates management determines best reflect current market interest rates that would be offered for loans with similar characteristics and credit quality.

**Debt obligations, net** For debt obligations traded in secondary markets, the Company uses market quotes, to the extent they are available, to determine fair value. For debt obligations not traded in secondary markets, the Company determines fair value using a discounted cash flow methodology, whereby contractual cash flows are discounted at rates that management determines best reflect current market interest rates that would be charged for debt with similar characteristics and credit quality.

Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 17 Segment Reporting**

The Company has determined that it has three reportable segments based on how management reviews and manages its business. These reportable segments include: Real Estate Lending, Net Leasing and Real Estate Investment. The Real Estate Lending segment includes all of the Company's activities related to senior and mezzanine real estate debt and corporate capital investments. The Net Leasing segment includes all of the Company's activities related to the ownership and leasing of corporate facilities. The Real Estate Investment segment includes all of the Company's activities related to the operations, repositioning and ultimate disposition of REHI and OREO properties.

The Company evaluates performance based on the following financial measures for each segment (\$ in thousands):

|   | Real Estate<br>Lending | Net<br>Leasing | Real Estate<br>Investment | Corporate/<br>Other(1) | Company<br>Total |
|---|------------------------|----------------|---------------------------|------------------------|------------------|
| <b>Three months ended</b>                         |                        |                |                           |                        |                  |
| <b>September 30, 2011:</b>                        |                        |                |                           |                        |                  |
| Total revenue(2)                                  | \$ 47,290              | \$ 41,369      | \$ 8,207                  | \$ 494                 | \$ 97,360        |
| Earnings (loss) from equity<br>method investments |                        | 650            | (1,267)                   | 11,434                 | 10,817           |
| Operating costs                                   | (1,382)                | (5,048)        | (19,792)                  | (2,592)                | (28,814)         |
| Interest expense                                  | (41,858)               | (22,915)       | (20,387)                  | (6,617)                | (91,777)         |
| General and<br>administrative(3)                  | (4,801)                | (2,628)        | (2,338)                   | (10,058)               | (19,825)         |
| Segment profit (loss)(4)                          | \$ (751)               | \$ 11,428      | \$ (35,577)               | \$ (7,339)             | \$ (32,239)      |
| Other significant non-cash<br>items:              |                        |                |                           |                        |                  |
| Provision for loan losses                         | \$ 9,232               | \$             | \$                        | \$                     | \$ 9,232         |
| Impairment of assets                              | \$                     | \$ 650         | \$ 9,262                  | \$                     | \$ 9,912         |
| Depreciation and<br>amortization                  | \$                     | \$ 13,544      | \$ 761                    | \$ 509                 | \$ 14,814        |
| Capitalized expenditures                          | \$                     | \$ 6,237       | \$ 18,949                 | \$                     | \$ 25,186        |
| <b>Three months ended</b>                         |                        |                |                           |                        |                  |
| <b>September 30, 2010(5):</b>                     |                        |                |                           |                        |                  |
| Total revenue(2)                                  | \$ 86,464              | \$ 40,471      | \$ 5,597                  | \$ 765                 | \$ 133,297       |
| Earnings from equity<br>method investments        |                        | 605            |                           | 5,918                  | 6,523            |
| Operating costs                                   | (1,691)                | (5,226)        | (19,111)                  | (2,528)                | (28,556)         |
| Interest expense                                  | (46,109)               | (15,536)       | (12,147)                  | (3,494)                | (77,286)         |
| General and<br>administrative(3)                  | (6,489)                | (2,186)        | (1,709)                   | (9,972)                | (20,356)         |
| Segment profit (loss)(4)                          | \$ 32,175              | \$ 18,128      | \$ (27,370)               | \$ (9,311)             | \$ 13,622        |
| Other significant non-cash<br>items:              |                        |                |                           |                        |                  |
| Provision for loan losses                         | \$ 78,414              | \$             | \$                        | \$                     | \$ 78,414        |
| Impairment of assets                              | \$                     | \$ 4,202       | \$ (370)                  | \$                     | \$ 3,832         |
| Depreciation and<br>amortization                  | \$                     | \$ 13,262      | \$ 1,373                  | \$ 611                 | \$ 15,246        |
| Capitalized expenditures                          | \$                     | \$ 2,395       | \$ 7,593                  | \$                     | \$ 9,988         |



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## iStar Financial Inc.

## Notes to Consolidated Financial Statements (Continued)

(unaudited)

## Note 17 Segment Reporting (Continued)

|   | Real Estate<br>Lending | Net<br>Leasing | Real Estate<br>Investment | Corporate/<br>Other(1) | Company<br>Total |
|---|------------------------|----------------|---------------------------|------------------------|------------------|
| <b><i>Nine months ended</i></b>                   |                        |                |                           |                        |                  |
| <b><i>September 30, 2011:</i></b>                 |                        |                |                           |                        |                  |
| Total revenue(2)                                  | \$ 189,273             | \$ 123,090     | \$ 22,356                 | \$ 1,589               | \$ 336,308       |
| Earnings (loss) from equity<br>method investments |                        | 1,919          | (6,718)                   | 59,680                 | 54,881           |
| Operating costs                                   | (1,697)                | (14,303)       | (55,582)                  | (5,459)                | (77,041)         |
| Interest expense                                  | (127,105)              | (60,837)       | (53,080)                  | (17,161)               | (258,183)        |
| General and<br>administrative(3)                  | (15,750)               | (7,538)        | (6,577)                   | (31,590)               | (61,455)         |
| Segment profit (loss)(4)                          | \$ 44,721              | \$ 42,331      | \$ (99,601)               | \$ 7,059               | \$ (5,490)       |
| Other significant non-cash<br>items:              |                        |                |                           |                        |                  |
| Provision for loan losses                         | \$ 30,462              | \$             | \$                        | \$                     | \$ 30,462        |
| Impairment of assets                              | \$                     | \$ 650         | \$ 12,643                 | \$ 872                 | \$ 14,165        |
| Depreciation and<br>amortization                  | \$                     | \$ 40,474      | \$ 4,315                  | \$ 1,565               | \$ 46,354        |
| Capitalized expenditures                          | \$                     | \$ 11,138      | \$ 34,915                 | \$                     | \$ 46,053        |
| <b><i>Nine months ended</i></b>                   |                        |                |                           |                        |                  |
| <b><i>September 30, 2010(5):</i></b>              |                        |                |                           |                        |                  |
| Total revenue(2)                                  | \$ 293,902             | \$ 124,760     | \$ 14,111                 | \$ 2,151               | \$ 434,924       |
| Earnings from equity<br>method investments        |                        | 1,873          |                           | 29,830                 | 31,703           |
| Operating costs                                   | (9,340)                | (11,279)       | (45,166)                  | (3,981)                | (69,766)         |
| Interest expense                                  | (166,062)              | (34,232)       | (36,270)                  | (10,251)               | (246,815)        |
| General and<br>administrative(3)                  | (20,145)               | (7,855)        | (4,400)                   | (30,572)               | (62,972)         |
| Segment profit (loss)(4)                          | \$ 98,355              | \$ 73,267      | \$ (71,725)               | \$ (12,823)            | \$ 87,074        |
| Other significant non-cash<br>items:              |                        |                |                           |                        |                  |
| Provision for loan losses                         | \$ 277,242             | \$             | \$                        | \$                     | \$ 277,242       |
| Impairment of assets                              | \$ (3,925)             | \$ 4,202       | \$ 16,764                 | \$                     | \$ 17,041        |
| Depreciation and<br>amortization                  | \$                     | \$ 39,907      | \$ 3,757                  | \$ 3,058               | \$ 46,722        |
| Capitalized expenditures                          | \$                     | \$ 10,108      | \$ 18,528                 | \$                     | \$ 28,636        |
| <b><i>As of September 30, 2011:</i></b>           |                        |                |                           |                        |                  |
| Total assets(6)                                   | \$ 3,314,539           | \$ 1,895,826   | \$ 1,708,325              | \$ 835,162             | \$ 7,753,852     |
| <b><i>As of December 31, 2010:</i></b>            |                        |                |                           |                        |                  |
| Total assets(6)                                   | \$ 4,636,777           | \$ 1,915,164   | \$ 1,594,859              | \$ 1,027,714           | \$ 9,174,514     |

## Explanatory Notes:

(1)

Corporate/Other represents all corporate level and unallocated items including any intercompany eliminations necessary to reconcile to consolidated Company totals. This caption also includes the Company's joint venture investments and strategic investments that are not related to the other reportable segments above, including the Company's equity investment in LNR of \$143.0 million and \$122.2 million, as of September 30, 2011 and

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December 31, 2010, respectively, and the Company's share of equity in earnings from LNR of \$12.5 million and \$36.6 million, for the three and nine months ended September 30, 2011, respectively, and \$2.3 million for both the three and nine months ended September 30, 2010. See Note 7 for further details on the Company's investment in LNR and summarized financial information of LNR.

Table of Contents**iStar Financial Inc.****Notes to Consolidated Financial Statements (Continued)****(unaudited)****Note 17 Segment Reporting (Continued)**

- (2) Total revenue represents all revenue earned during the period related to the assets in each segment. Revenue from the Real Estate Lending segment primarily represents interest income, revenue from the Net Leasing segment primarily represents operating lease income and revenue from Real Estate Investment primarily represents operating revenues from REHI properties.
- (3) General and administrative excludes stock-based compensation expense of \$7.2 million and \$15.6 million for the three and nine months ended September 30, 2011, respectively, and \$3.9 million and \$13.6 million for the three and nine months ended September 30, 2010, respectively.
- (4) The following is a reconciliation of segment profit (loss) to income (loss) from continuing operations (\$ in thousands):

|   | For the<br>Three Months Ended<br>September 30, |             | For the<br>Nine Months Ended<br>September 30, |              |
|---|--|-------------|---|--------------|
|   | 2011   | 2010        | 2011  | 2010         |
| Segment profit (loss)                                 | \$ (32,239)                                    | \$ 13,622   | \$ (5,490)                                    | \$ 87,074    |
| Less: Provision for loan losses                       | (9,232)  | (78,414)    | (30,462)                                      | (277,242)    |
| Less: Impairment of assets                            | (9,912)  | (3,832)     | (14,165)                                      | (17,041)     |
| Less: Stock-based compensation expense                | (7,153)  | (3,883)     | (15,622)                                      | (13,597)     |
| Less: Depreciation and amortization                   | (14,814)                                       | (15,246)    | (46,354)                                      | (46,722)     |
| Add: Income tax (expense) benefit                     | (1,354)  | (722)       | (9,731)                                       | (2,557)      |
| Add: Gain (loss) on early extinguishment of debt, net | (3,207)  | 9,525       | 102,348                                       | 118,305      |
| Income (loss) from continuing operations              | \$ (77,911)                                    | \$ (78,950) | \$ (19,476)                                   | \$ (151,780) |

- (5) Prior period presentation has been reclassified to conform with current period presentation.
- (6) Intangible assets included in Net Leasing at September 30, 2011 and December 31, 2010 were \$18.7 million and \$24.5 million, respectively.

**Note 18 Subsequent Events**

On October 25, 2011, the Company sold a substantial portion of its interests in Oak Hill Advisors, L.P. and related entities in an all cash transaction. The transaction was completed in part through sales of interests to an unrelated third party and to the principals of Oak Hill, and in part through a redemption of interests by Oak Hill Advisors, L.P. The Company expects to record a pre-tax gain of approximately \$30 million on the carrying value of the investment in the fourth quarter of 2011. Glenn R. August, a director of the Company who was appointed to its board of directors in connection with the Company's acquisition of the Oak Hill interests in 2005, is the president and senior partner of Oak Hill Advisors, L.P. and acquired a portion of the interests in the transaction.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Certain statements in this report, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based, are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements are included with respect to, among other things, iStar Financial Inc.'s (the "Company's") current business plan, business strategy, portfolio management, prospects and liquidity. These forward-looking statements generally are identified by the words "believe," "project," "expect," "anticipate," "estimate," "intend," "strategy," "plan," "may," "should," "will," "would," "will be," "will continue," "will likely result," and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results or outcomes to differ materially from those contained in the forward-looking statements. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise. In assessing all forward-looking statements, readers are urged to read carefully all cautionary statements contained in this Form 10-Q and the uncertainties and risks described in Item 1A "Risk Factors" in our 2010 Annual Report (as defined below), all of which could affect our future results of operations, financial condition and liquidity. For purposes of Management's Discussion and Analysis of Financial Condition and Results of Operations, the terms "we," "our" and "us" refer to iStar Financial Inc. and its consolidated subsidiaries, unless the context indicates otherwise.

The discussion below should be read in conjunction with our consolidated financial statements and related notes in this quarterly report on Form 10-Q and our annual report on Form 10-K for the year ended December 31, 2010 (the "2010 Annual Report"). These historical financial statements may not be indicative of our future performance. We have reclassified certain items in our consolidated financial statements of prior periods to conform to our current financial statements presentation.

***Introduction***

iStar Financial Inc. is a fully-integrated finance and investment company focused on the commercial real estate industry. We provide custom-tailored investment capital to high-end private and corporate owners of real estate and invest directly across a range of real estate sectors. We are taxed as a real estate investment trust, or "REIT," and have invested more than \$35 billion over the past two decades. Our primary business segments are lending, net leasing and real estate investment.

The lending portfolio is primarily comprised of senior and mezzanine real estate loans that typically range in size from \$20 million to \$150 million and have original terms 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 borrowers. Our portfolio also includes senior and subordinated loans 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. Our loan portfolio includes whole loans, loan participations and debt securities.

Our net lease portfolio is primarily comprised of properties owned by us and leased to single creditworthy tenants, where the properties are generally mission critical headquarters or distribution facilities that are subject to long-term leases. Most of the leases provide for expenses at the facility to be paid by the tenant on a triple net lease basis. Net lease transactions have initial terms generally ranging from 15 to 20 years and typically range in size from \$20 million to \$150 million.

Our real estate investment portfolio includes real estate held for investment ("REHI") and other real estate owned ("OREO") properties acquired through foreclosure or through deed-in-lieu of foreclosure in

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full or partial satisfaction of non-performing loans. We have developed significant expertise in the ownership and repositioning of multifamily, condominium, master planned and development properties, and through the infusion of capital and/or intensive asset management, we generally seek to reposition these assets with the objective of maximizing our recovery with respect to the investments.

Our 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 properties. We primarily generate 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 net lease operations. Going forward, we also expect to earn income from our other real estate investments. Income from real estate investments may include operating revenues as well as income from sales of properties either in bulk or through unit sales. This income will be reduced by holding costs while the real estate investments are redeveloped, repositioned and eventually sold.

*Executive Overview*

For the quarter ended September 30, 2011, we incurred a net loss of \$53.6 million, compared to a net loss of \$75.5 million for the same period last year. The year-over-year improvement is due to a lower loan loss provision and impairments of \$19.1 million in the current quarter, compared to \$83.8 million in the same period last year, as well as a \$22.2 million gain from discontinued operations previously deferred as part of the June 2010 sale of a portfolio of 32 net lease assets. The improvement was partially offset due to lower revenue of \$97.4 million compared to \$133.3 million in the same period last year, as well as higher interest expense of \$91.8 million compared to \$77.3 million in the prior year end. Increased interest costs from our senior secured credit facility will continue to impact our future earnings.

From a credit perspective, the provision for loan losses and the risk ratings of our performing loan and net lease portfolios continued to trend lower relative to the prior year. Our balance of non-performing loans decreased to \$1.02 billion at quarter-end, compared to \$1.07 billion in the preceding quarter, and we also experienced a reduction in loans on our watch list. During the quarter, transfers of assets into REHI and OREO were offset by OREO condominium unit sales, which left the combined balance in these portfolios at \$1.62 billion at quarter-end as compared to \$1.59 billion at June 30, 2011. We continue our intensive asset management work on repositioning assets within these portfolios as we seek to maximize their value. The costs of carrying and repositioning these assets, net of REHI revenues, totaled \$11.6 million in the quarter ended September 30, 2011.

During the quarter we generated \$318.2 million of proceeds from our portfolio which, together with cash on hand, enabled us to retire \$402.5 million of debt, including \$183.8 million on the A-1 Tranche of our secured credit facility and the repurchase of \$48.3 million par value of our senior unsecured notes. As of September 30, 2011, we had \$1.76 billion of debt maturing and minimum required amortization payments due on or before December 31, 2012. During the quarter we repurchased approximately 13.0% of our outstanding common shares, or 12.1 million shares for \$77.0 million, increasing our book value per share. In addition, we funded a total of \$55.1 million of investments. We had \$217.0 million of unrestricted cash outstanding at quarter-end. We expect that our capital sources in the coming year will primarily include loan repayments and proceeds from strategic asset sales, and may include proceeds from debt refinancings and equity capital raising transactions.

In the near term, we expect that new investments will be limited relative to expected repayments and that we will continue to use excess proceeds primarily to deleverage, thereby further strengthening the balance sheet and reducing our asset base. Improvement in our financial condition and operating results, as well as our ability to generate future liquidity, are dependent on a sustained economic recovery, which cannot be predicted with certainty.

Table of Contents**Results of Operations for the Three Months Ended September 30, 2011 compared to the Three Months Ended September 30, 2010**

|   | For the Three Months<br>Ended September 30, |                 | \$ Change       | % Change  |
|---|---|-----------------|-----------------|-----------|
|   | 2011  | 2010            |                 |           |
|   | (\$ in thousands)                           |                 |                 |           |
| Interest income                                     | \$ 45,851                                   | \$ 84,210       | \$ (38,359)     | (46)%     |
| Operating lease income                              | 41,369                                      | 40,471          | 898             | 2%        |
| Other income  | 10,140                                      | 8,616           | 1,524           | 18%       |
| <br>Total revenue                                   | <br>\$ 97,360                               | <br>\$ 133,297  | <br>\$ (35,937) | <br>(27)% |
| Interest expense                                    | \$ 91,777                                   | \$ 77,286       | \$ 14,491       | 19%       |
| Operating costs net lease assets                    | 5,048                                       | 5,226           | (178)           | (3)%      |
| Operating costs REHI and<br>OREO                    | 19,792                                      | 19,111          | 681             | 4%        |
| Depreciation and amortization                       | 14,814                                      | 15,246          | (432)           | (3)%      |
| General and administrative                          | 26,978                                      | 24,239          | 2,739           | 11%       |
| Provision for loan losses                           | 9,232                                       | 78,414          | (69,182)        | (88)%     |
| Impairment of assets                                | 9,912                                       | 3,832           | 6,080           | >100%     |
| Other expense                                       | 3,974                                       | 4,219           | (245)           | (6)%      |
| <br>Total costs and expenses                        | <br>\$ 181,527                              | <br>\$ 227,573  | <br>\$ (46,046) | <br>(20)% |
| Gain (loss) on early<br>extinguishment of debt, net | (3,207)                                     | 9,525           | (12,732)        | >(100)%   |
| Earnings from equity method<br>investments          | 10,817                                      | 6,523           | 4,294           | 66%       |
| Income tax (expense) benefit                        | (1,354)                                     | (722)           | (632)           | 88%       |
| Income (loss) from discontinued<br>operations       | 1,052                                       | (104)           | 1,156           | >100%     |
| Gain from discontinued<br>operations                | 22,198                                      | 4,422           | 17,776          | >100%     |
| <br>Net income (loss)                               | <br>\$ (54,661)                             | <br>\$ (74,632) | <br>\$ 19,971   | <br>27%   |

**Revenue** The decrease in interest income is primarily due to a decline in the average balance of performing loans to \$2.42 billion for the three months ended September 30, 2011 from \$3.87 billion for the three months ended September 30, 2010. The decrease in performing loans was primarily due to loan repayments and sales as well as performing loans moving to non-performing status (see Risk Management below).

Operating lease income recognized on net lease assets increased primarily due to new tenant leases entered into during the past year.

The increase in other income was primarily driven by an increase in operating income from additional REHI assets acquired during the last twelve months, and slightly offset by less loan prepayment penalties received.

**Costs and expenses** Total costs and expenses decreased primarily due to lower provisions for loan losses resulting from fewer loans moving to non-performing status and a lower overall balance of non-performing loans during the three months ended September 30, 2011 as compared to the same period in 2010. Additionally, repayments and sales of performing loans resulted in a reduction in the required general loan loss reserve. (See Risk Management below.)

Offsetting the decline were increases in interest expense, impairment of assets and general and administrative expenses. Interest expense increased primarily due to higher interest rates on our Secured Credit Facility entered into during 2011, partially offset by lower average outstanding borrowings. Our weighted average effective cost of debt increased to 5.74% for the three months ended September 30, 2011 as compared to 3.57% during the same period in 2010. The average outstanding balance of our debt

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declined to \$6.26 billion for the three months ended September 30, 2011 from \$8.48 billion for the three months ended September 30, 2010.

Impairment of assets recorded in each period related to OREO assets that were sold or marked to market based on changing market conditions.

The increase in general and administrative expenses was primarily due to additional stock-based compensation expense resulting from the modification of our December 19, 2008 restricted stock units. See Note 13 of the Notes to the Consolidated Financial Statements for further details on the modification of the December 19, 2008 awards.

***Gain (loss) on early extinguishment of debt, net*** During the third quarter of 2011, we recognized a net loss on early extinguishment of debt, primarily related to the write-off of unamortized deferred fees and debt discount resulting from repayments of the Tranche A-1 facility. During the same period in 2010, we retired \$125.0 million par value of our senior unsecured notes prior to maturity and recognized an aggregate gain on early extinguishment of debt of \$9.5 million.

***Earnings from equity method investments*** The increase in earnings from equity method investments was primarily attributable to our investment in LNR. During the three months ended September 30, 2011, we recorded \$12.5 million of earnings from this investment compared to only \$2.3 million during the three months ended September 30, 2010. This increase was partially offset by losses and lower returns recorded by certain of our strategic investments primarily due to weaker market performance as compared to 2010.

***Gain from discontinued operations*** During the three months ended September 30, 2011, upon full resolution of contingent obligations, we realized a \$22.2 million gain from discontinued operations previously deferred as part of the June 2010 sale of a portfolio of 32 net lease assets.

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**Results of Operations for the Nine Months Ended September 30, 2011 compared to the Nine Months Ended September 30, 2010**

|   | For the Nine Months<br>Ended September 30, |                | \$ Change        | % Change  |
|---|--|----------------|------------------|-----------|
|   | 2011                                       | 2010           |                  |           |
|   | (\$ in thousands)                          |                |                  |           |
| Interest income                           | \$ 186,805                                 | \$ 287,295     | \$ (100,490)     | (35)%     |
| Operating lease income                    | 123,090                                    | 124,760        | (1,670)          | (1)%      |
| Other income                              | 26,413                                     | 22,869         | 3,544            | 15%       |
| <br>Total revenue                         | <br>\$ 336,308                             | <br>\$ 434,924 | <br>\$ (98,616)  | <br>(23)% |
| Interest expense                          | \$ 258,183                                 | \$ 246,815     | \$ 11,368        | 5%        |
| Operating costs net lease assets          | 14,303                                     | 11,279         | 3,024            | 27%       |
| Operating costs REHI and OREO             | 55,582                                     | 45,166         | 10,416           | 23%       |
| Depreciation and amortization             | 46,354                                     | 46,722         | (368)            | (1)%      |
| General and administrative                | 77,077                                     | 76,569         | 508              | 1%        |
| Provision for loan losses                 | 30,462                                     | 277,242        | (246,780)        | (89)%     |
| Impairment of assets                      | 14,165                                     | 17,041         | (2,876)          | (17)%     |
| Other expense                             | 7,156                                      | 13,321         | (6,165)          | (46)%     |
| <br>Total costs and expenses              | <br>\$ 503,282                             | <br>\$ 734,155 | <br>\$ (230,873) | <br>(31)% |
| Gain on early extinguishment of debt, net | 102,348                                    | 118,305        | (15,957)         | (13)%     |
| Earnings from equity method investments   | 54,881                                     | 31,703         | 23,178           | 73%       |
| Income tax (expense) benefit              | (9,731)                                    | (2,557)        | (7,174)          | >100%     |
| Income from discontinued operations       | 498  | 20,473         | (19,975)         | (98)%     |
| Gain from discontinued operations         | 22,198                                     | 270,382        | (248,184)        | (92)%     |
| <br>Net income (loss)                     | <br>\$ 3,220                               | <br>\$ 139,075 | <br>\$ (135,855) | <br>(98)% |

**Revenue** The decrease in interest income is primarily due to a decline in the average balance of performing loans to \$2.73 billion for the nine months ended September 30, 2011 from \$4.12 billion for the nine months ended September 30, 2010. The decrease in performing loans was primarily due to loan repayments and sales as well as performing loans moving to non-performing status (see Risk Management below). The decrease was partially offset by \$26.3 million of interest income recorded during the nine months ended September 30, 2011, related to certain non-performing loans that were resolved, including interest not previously recorded due to the loans being on non-accrual status.

Operating lease income from net lease assets decreased primarily due to tenant lease expirations and lower percentage rent earned period to period.

The increase in other income was primarily driven by an increase in operating income from additional REHI assets acquired during the last twelve months, and slightly offset by less loan prepayment penalties received.

**Costs and expenses** Total costs and expenses decreased primarily due to lower provisions for loan losses and other expenses. The decline in our provisions for loan losses primarily resulted from fewer loans moving to non-performing status and a lower overall balance of non-performing loans during the nine months ended September 30, 2011 as compared to the same period in 2010. Additionally, repayments and sales of performing loans resulted in a lower portfolio balance leading to a reduction in the required general loan loss reserve. (See Risk Management below.)

Other expense was lower primarily due to reduced loan costs and loan restructuring costs incurred during the nine months ended September 30, 2011.





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Offsetting these declines in expenses were increases in interest expense and operating costs for net lease assets, REHI and OREO assets. Interest expense increased primarily due to higher interest rates on our Secured Credit Facility entered into during 2011, partially offset by lower average outstanding borrowings. Our weighted average effective cost of debt increased to 5.09% for the nine months ended September 30, 2011 as compared to 3.39% during the same period in 2010. The average outstanding balance of our debt declined to \$6.69 billion for the nine months ended September 30, 2011 from \$9.60 billion for the nine months ended September 30, 2010.

The increase in operating costs for net lease assets were primarily due to increases in bad debt expenses and other general property cost increases.

Operating costs for REHI and OREO were greater due to an increase in the number of properties held in the current period.

***Gain on early extinguishment of debt, net*** During the nine months ended September 30, 2011, we fully redeemed our \$312.3 million remaining principal amount of 10% senior secured notes due June 2014 and recorded a \$109.0 million gain on early extinguishment of debt. This was partially offset by losses on extinguishment of debt related to the write-off of unamortized deferred fees and debt discount resulting from repayments of our secured credit facilities and the Tranche A-1 facility. During the same period in 2010, we recorded an aggregate gain on early extinguishment of debt of \$118.3 million related to the retirement of \$582.5 million par value of our senior secured and unsecured notes, the redemption of \$282.3 million of senior secured notes, and the write-off of unamortized deferred financing and other costs resulting from the repayment of our secured term loans that were collateralized by net lease assets sold during the period.

***Earnings from equity method investments*** The increase in earnings from equity method investments was primarily attributable to our investment in LNR that was made in July 2010. During the nine months ended September 30, 2011, we recorded \$36.6 million of earnings from this investment as compared to only \$2.3 million during the same period in 2010 due to the fact that this was a new investment. This increase was partially offset by losses and lower returns recorded by certain of our strategic investments primarily due to weaker market performance as compared to 2010.

***Income tax (expense) benefit*** Income tax expense increased during the nine months ended September 30, 2011, as compared to the same period last year, primarily due to taxable income generated from our investment in LNR Property Corporation, which was originated in the third quarter of 2010 and is held in a taxable REIT subsidiary.

***Income from discontinued operations*** During the nine months ended September 30, 2011, income from discontinued operations included the operating results from a net lease asset held for sale. During the same period of 2010, income from discontinued operations included operating results of net lease assets sold in the previous 12 months including the sale of the portfolio of 32 net lease assets, which was sold during the second quarter of 2010, as well as assets held for sale as of September 30, 2011.

***Gain from discontinued operations*** During the nine months ended September 30, 2011, upon full resolution of contingent obligations, we realized a \$22.2 million gain from discontinued operations previously deferred as part of the June 2010 sale of a portfolio of 32 net lease assets. During the same period in 2010, we sold net lease assets, including a portfolio of 32 net lease assets, and recognized an aggregate initial gain of \$270.4 million.

Table of Contents**Adjusted EBITDA**

In addition to net income, we use Adjusted EBITDA to measure our operating performance. Adjusted EBITDA represents net income (loss) plus the sum of interest expense, income taxes, depreciation and amortization, provision for loan losses, impairment of assets and stock-based compensation expense, less the gain/loss on early extinguishment of debt, net.

We believe Adjusted EBITDA is a useful measure to consider, in addition to net income (loss), as it may help investors evaluate core operating performance prior to interest expense, income taxes and certain non-cash items.

Adjusted EBITDA should be examined in conjunction with net income (loss) as shown in our Consolidated Statements of Operations. Adjusted EBITDA should not be considered as an alternative to net income (loss) (determined in accordance with GAAP), as an indicator of our performance, or to cash flows from operating activities (determined in accordance with GAAP) as a measure of our liquidity, nor is Adjusted EBITDA indicative of funds available to fund our cash needs or available for distribution to shareholders. Rather, Adjusted EBITDA is an additional measure for us to use to analyze how our business is performing. It should be noted that our manner of calculating Adjusted EBITDA may differ from the calculations of similarly-titled measures by other companies.

|  | <b>For the<br/>Three Months Ended<br/>September 30,</b> |               | <b>For the<br/>Nine Months Ended<br/>September 30,</b> |                |
|--|---|---------------|--|----------------|
|  | <b>2011</b>   | <b>2010</b>   | <b>2011</b>  | <b>2010</b>    |
|  | <b>(in thousands)</b>                                   |               |  |                |
| <b>Adjusted EBITDA</b>                                 |   |               |  |                |
| Net income (loss)                                      | \$ (54,661)   | \$ (74,632)   | \$ 3,220   | \$ 139,075     |
| Add: Interest expense(1)                               | 91,777  | 77,286        | 258,183  | 277,330        |
| Add: Income taxes                                      | 1,354   | 722           | 9,731  | 2,557          |
| Add: Depreciation and amortization(2)                  | 15,077  | 15,915        | 47,142   | 55,051         |
| Add: Provision for loan losses                         | 9,232   | 78,414        | 30,462   | 277,242        |
| Add: Impairment of assets(3)                           | 9,912   | 5,375         | 14,140   | 18,902         |
| Add: Stock-based compensation expense                  | 7,153   | 3,883         | 15,622   | 13,597         |
| Less: (Gain) loss on early extinguishment of debt, net | 3,207   | (9,525)       | (102,348)  | (118,305)      |
| <br>Adjusted EBITDA                                    | <br>\$ 83,051   | <br>\$ 97,438 | <br>\$ 276,152   | <br>\$ 665,449 |

**Explanatory Notes:**

- 
- (1) Interest expense of \$30,515 for the nine months ended September 30, 2010 is included in discontinued operations.
- (2) Depreciation and amortization of \$263 and \$789 for the three and nine months ended September 30, 2011, respectively, and \$669 and \$8,329 for the three and nine months ended September 30, 2010, respectively, is included in discontinued operations.
- (3) Impairment of assets of \$(25) for the nine months ended September 30, 2011, and \$1,543 and \$1,861 for the three and nine months ended September 30, 2010, respectively, is included in discontinued operations.

Table of Contents**Risk Management**

**Loan Credit Statistics** The table below summarizes our non-performing loans, watch list loans and the reserves for loan losses associated with our loans (\$ in thousands):

|   | As of                 |                      |
|---|-----------------------|----------------------|
|   | September 30,<br>2011 | December 31,<br>2010 |
| <b>Non-performing loans</b>                                     |                       |                      |
| Carrying value(1)   | \$ 1,024,142          | \$ 1,351,410         |
| As a percentage of total carrying value of loans                | 31.3%                 | 29.6%                |
| <b>Watch list loans</b>   |                       |                      |
| Carrying value  | \$ 41,820             | \$ 190,553           |
| As a percentage of total carrying value of loans                | 1.3%                  | 4.2%                 |
| <b>Reserve for loan losses</b>                                  |                       |                      |
| Total reserve for loan losses                                   | \$ 710,117            | \$ 814,625           |
| As a percentage of total loans before loan loss reserves        | 17.9%                 | 15.1%                |
| Non-performing loan asset-specific reserves for loan losses     | \$ 613,185            | \$ 667,779           |
| As a percentage of gross carrying value of non-performing loans | 37.5%                 | 33.1%                |

**Explanatory Note:**

- (1) As of September 30, 2011 and December 31, 2010, carrying values of non-performing loans are net of asset-specific reserves for loan losses of \$613.2 million and \$667.8 million, respectively.

**Non-Performing Loans** We designate loans as non-performing at such time as: (1) the loan becomes 90 days delinquent; (2) the loan has a maturity default; or (3) management determines it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan. All non-performing loans are placed on non-accrual status and income is only recognized in certain cases upon actual cash receipt. As of September 30, 2011, we had non-performing loans with an aggregate carrying value of \$1.02 billion. Our non-performing loans decreased during the nine months ended September 30, 2011, primarily due to transfers of non-performing loans to REHI and OREO as well as sales and repayments.

**Watch List Loans** During our quarterly loan portfolio assessments, loans are put on the watch list if deteriorating performance indicates they warrant a higher degree of monitoring and senior management attention. As of September 30, 2011, we had loans on the watch list (excluding non-performing loans) with an aggregate carrying value of \$41.8 million.

**Reserve for Loan Losses** The reserve for loan losses was \$710.1 million as of September 30, 2011, or 17.9% of the gross carrying value of total loans, compared to \$814.6 million or 15.1% at December 31, 2010. The change in the balance of the reserve was the result of \$30.5 million of provisioning for loan losses, reduced by \$134.9 million of charge-offs during the nine months ended September 30, 2011. Due to the continued volatility of the commercial real estate market, the process of estimating collateral values and reserves continues to require us to use significant judgment. We currently believe there is adequate collateral and reserves to support the carrying values of the loans.

The reserve for loan losses includes an asset-specific component and a formula-based component. An asset-specific reserve is established for an impaired loan when the estimated fair value of the loan's collateral less costs to sell is lower than the carrying value of the loan. As of September 30, 2011, asset-specific reserves decreased to \$633.4 million compared to \$694.4 million at December 31, 2010,

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primarily due to charge-offs on assets that were sold or transferred to REHI and OREO. The decrease was offset primarily by impairments on new non-performing loans.

The formula-based general reserve is derived from estimated principal default probabilities and loss severities applied to groups of performing loans based upon risk ratings assigned to loans with similar risk characteristics during our quarterly loan portfolio assessment. During this assessment we perform a comprehensive analysis of our loan portfolio and assign risk ratings to loans that incorporate management's current judgments about their credit quality based on all known and relevant factors that may affect collectability. We consider, among other things, payment status, lien position, borrower financial resources and investment in collateral, collateral type, project economics and geographical location as well as national and regional economic factors. This methodology results in loans being segmented by risk classification into risk rating categories that are associated with estimated probabilities of default and principal loss. We estimate loss rates based on historical realized losses experienced within our portfolio and take into account current economic conditions affecting the commercial real estate market when establishing appropriate time frames to evaluate loss experience.

The general reserve was \$76.7 million or 3.3% of the gross carrying value of performing loans as of September 30, 2011, compared to \$120.2 million or 3.6% of the gross carrying value of performing loans at December 31, 2010. The decrease in the balance of the general reserve was primarily due to the decrease in performing loans outstanding to \$2.34 billion as of September 30, 2011 from \$3.37 billion as of December 31, 2010. The reduction in general reserves as a percentage of performing loans outstanding was primarily attributable to an improvement in the weighted average risk ratings of performing loans outstanding to 3.35 at the end of the current period compared to 3.51 as of December 31, 2010.

**Risk concentrations** As of September 30, 2011, our total investment portfolio was comprised of the following property/collateral types (\$ in thousands)(1):

| Property/Collateral Types       | Performing<br>Loans | Net Lease<br>Assets | Non-performing<br>Loans | REHI              | OREO              | Total               | % of<br>Total |
|---------------------------------|---------------------|---------------------|-------------------------|-------------------|-------------------|---------------------|---------------|
| Land                            | \$ 210,920          | \$ 56,023           | \$ 346,492              | \$ 661,048        | \$ 105,836        | \$ 1,380,319        | 18.7%         |
| Apartment / Residential         | 618,009             |                     | 263,656                 | 37,255            | 429,272           | 1,348,192           | 18.3%         |
| Retail                          | 384,063             | 159,622             | 188,091                 | 59,777            | 31,453            | 823,006             | 11.2%         |
| Office                          | 173,688             | 493,699             | 51,509                  | 17,125            | 5,700             | 741,721             | 10.1%         |
| Industrial / R&D                | 88,048              | 494,958             | 21,393                  | 48,911            | 1,100             | 654,410             | 8.9%          |
| Hotel                           | 355,828             | 129,278             | 74,473                  | 42,464            | 16,046            | 618,089             | 8.4%          |
| Entertainment / Leisure         | 78,232              | 427,101             | 78,529                  |                   | 1,066             | 584,928             | 7.9%          |
| Mixed Use / Mixed<br>Collateral | 242,452             |                     |                         | 88,066            | 78,858            | 409,376             | 5.6%          |
| Other property types            | 185,042             |                     |                         |                   |                   | 185,042             | 2.5%          |
| Other Investments               |                     |                     |                         |                   |                   | 621,167             | 8.4%          |
| <b>Total</b>                    | <b>\$ 2,336,282</b> | <b>\$ 1,760,681</b> | <b>\$ 1,024,143</b>     | <b>\$ 954,646</b> | <b>\$ 669,331</b> | <b>\$ 7,366,250</b> | <b>100.0%</b> |

**Explanatory Note:**

(1)

Based on the carrying value of our total investment portfolio gross of general loan loss reserves.

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As of September 30, 2011, our total investment portfolio had the following characteristics by geographical region (\$ in thousands)(1):

| <b>Geographic Location</b> | <b>Carrying Value(2)</b> | <b>% of Total</b> |
|----------------------------|--------------------------|-------------------|
| West                       | \$ 1,698,790             | 23.0%             |
| Northeast                  | 1,348,952                | 18.3%             |
| Southeast                  | 1,094,044                | 14.9%             |
| Southwest                  | 794,718                  | 10.8%             |
| Various                    | 711,782                  | 9.7%              |
| Mid-Atlantic               | 704,833                  | 9.6%              |
| Central                    | 422,224                  | 5.7%              |
| International              | 302,009                  | 4.1%              |
| Northwest                  | 288,898                  | 3.9%              |
| <b>Total</b>               | <b>\$ 7,366,250</b>      | <b>100.0%</b>     |

**Explanatory Notes:**

- (1) Substantially all of our assets are located in the United States, with California 15.0% and Florida 10.7% representing the only significant concentrations (greater than 10.0%) as of September 30, 2011.
- (2) Based on the carrying value of our total investment portfolio gross of general loan loss reserves.

**Liquidity and Capital Resources**

During the three months ended September 30, 2011, we generated a total of \$318.2 million in proceeds from our portfolio, including \$271.8 million in loan principal repayments and \$46.4 million from sales of OREO assets. These proceeds, together with cash on hand, enabled us to retire \$402.5 million of debt, including \$183.8 million on the A-1 Tranche of our secured credit facility, the remaining \$170.4 million of our 5.65% senior unsecured notes due September 2011 and the repurchase of \$48.3 million par value of our senior unsecured notes. The cumulative amount repaid on the A-1 Tranche is \$428.7 million as of September 30, 2011, which exceeds the \$200 million minimum amortization requirement due to be paid on or before December 30, 2011. During the quarter, we repurchased 12.1 million shares of common stock for \$77.0 million. In addition, we funded a total of \$55.1 million of investments and paid preferred dividends totaling \$10.6 million during the three months ended September 30, 2011.

As of September 30, 2011, we have \$1.76 billion of debt maturing and minimum required amortization payments due on or before December 31, 2012. We had \$217.0 million of unrestricted cash outstanding at quarter-end and our capital sources in the coming year will primarily include loan repayments, proceeds from strategic asset sales and may include proceeds from debt refinancings and equity capital raising transactions. For the remainder of the year, we expect to use these capital sources to supplement operating revenues in order to repay our debt obligations and to fund loan commitments, investment activities and operating expenses, including costs to reposition our OREO and REHI assets during the next 12 months.

We believe that our available cash, expected proceeds from asset repayments and sales and other financing alternatives will be sufficient to meet our obligations during the remainder of the year. However, the timing and amounts of proceeds from asset repayments and sales, and our ability to consummate debt refinancings and equity capital raising transactions are subject to factors outside our control and cannot be predicted with certainty. We actively manage our liquidity and continually work on initiatives to address our liquidity needs. Our plans are dynamic and we may adjust our plans in response to changes in our expectations and changes in market conditions. We would be materially adversely affected if we were unable to repay or refinance our debt as it comes due.

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**Contractual Obligations** The following table outlines the contractual obligations related to our long-term debt agreements and operating lease obligations as of September 30, 2011.

|                                    | Total               | Principal And Interest Payments Due By Period |                     |                   |                   |                   |
|------------------------------------|---------------------|---|---------------------|-------------------|-------------------|-------------------|
|                                    |                     | Less Than<br>1 Year(1)                        | 2 - 3<br>Years(1)   | 4 - 5<br>Years    | 6 - 10<br>Years   | After<br>10 Years |
| (\$ in thousands)                  |                     |   |                     |                   |                   |                   |
| <b>Long-Term Debt Obligations:</b> |                     |   |                     |                   |                   |                   |
| Secured credit facilities          | \$ 2,521,332        | \$ 21,332                                     | \$ 2,500,000        | \$                | \$                | \$                |
| Unsecured notes                    | 2,075,566           | 390,866                                       | 1,217,810           | 367,168           | 99,722            |                   |
| Convertible notes                  | 787,750             |   | 787,750             |                   |                   |                   |
| Unsecured credit facilities        | 243,709             | 243,709                                       |                     |                   |                   |                   |
| Secured term loans                 | 309,537             | 14,122  | 105,707             |                   | 163,201           | 26,507            |
| Trust preferred                    | 100,000             |   |                     |                   |                   | 100,000           |
| <br>                               |                     |   |                     |                   |                   |                   |
| Total principal maturities         | \$ 6,037,894        | \$ 670,029                                    | \$ 4,611,267        | \$ 367,168        | \$ 262,923        | \$ 126,507        |
| <b>Interest Payable(2)</b>         | <b>852,819</b>      | <b>312,617</b>                                | <b>400,091</b>      | <b>63,728</b>     | <b>47,988</b>     | <b>28,395</b>     |
| <b>Operating Lease Obligations</b> | <b>36,186</b>       | <b>5,416</b>                                  | <b>8,630</b>        | <b>7,835</b>      | <b>14,305</b>     |                   |
| <br>                               |                     |   |                     |                   |                   |                   |
| <b>Total</b>                       | <b>\$ 6,926,899</b> | <b>\$ 988,062</b>                             | <b>\$ 5,019,988</b> | <b>\$ 438,731</b> | <b>\$ 325,216</b> | <b>\$ 154,902</b> |

### Explanatory Notes:

- (1) Long-term debt obligations due during the years ending December 31, 2012 and 2013 are \$1.74 billion and \$1.97 billion, respectively.
- (2) All variable-rate debt assumes a 30-day LIBOR rate of 0.24% (the 30-day LIBOR rate at September 30, 2011).

**Secured Credit Facility** In March 2011, we entered into a new \$2.95 billion senior secured credit agreement comprised of a \$1.50 billion term loan facility bearing interest at a rate of LIBOR plus 3.75% and maturing in June 2013 (the "Tranche A-1 Facility") and a \$1.45 billion term loan facility bearing interest at a rate of LIBOR plus 5.75% maturing in June 2014 (the "Tranche A-2 Facility"), together the "Secured Credit Facility." Both tranches include a LIBOR floor of 1.25%. The Tranche A-1 Facility and Tranche A-2 Facility were issued at discounts to par of 1.0% and 1.5%, respectively. Proceeds from the Secured Credit Facility were used to fully repay the \$1.67 billion and \$0.9 billion outstanding under the Company's secured credit facilities, which were due to mature in June 2011 and June 2012, respectively, and to repay \$175.0 million of our unsecured credit facilities due in June 2011. The remaining proceeds were used to repay other unsecured debt maturing in the first half of 2011.

The Secured Credit Facility is collateralized by a first lien on a fixed pool of assets consisting of loan, net lease, OREO and REHI assets. Proceeds from principal repayments and sales of collateral are applied to amortize the Secured Credit Facility. Proceeds received for interest, rent, lease payments, fee income and, under certain circumstances, additional amounts funded on assets serving as collateral are retained by us. The Tranche A-1 Facility requires that aggregate cumulative amortization payments of not less than \$200.0 million shall be made on or before December 30, 2011, not less than \$450.0 million on or before June 30, 2012, not less than \$750.0 million on or before December 31, 2012 and not less than \$1.50 billion on or before June 28, 2013. The Tranche A-2 Facility will begin amortizing six months after the repayment in full of the Tranche A-1 Facility, such that not less than \$150.0 million of cumulative amortization payments shall be made on or before the six month anniversary of repayment of the A-1 Facility, with additional amortization payments of \$150.0 million due on or before each six month anniversary thereafter, with any unpaid principal amounts due at maturity in June 2014.

During the nine months ended September 30, 2011, we used proceeds from principal repayments and sales of collateral to repay \$428.7 million of the Tranche A-1 Facility. These repayments exceeded the \$200.0 million amortization requirement for December 30, 2011 and have reduced the cumulative





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amortization payments due on or before June 30, 2012 to \$21.3 million. Repayments of debt prior to maturity have resulted in losses on early extinguishment of debt of \$3.3 million and \$10.5 million, respectively, for the three and nine months ended September 30, 2011, related to the acceleration of discounts and unamortized deferred financing fees on the portion of debt that was repaid.

During the nine months ended September 30, 2011, we received \$9.1 million pursuant to an agreement with a holder of our previously outstanding secured credit facilities. The amount effectively reduced the par value that was repaid to the debtholder and was accounted for under ASC 470-60, resulting in \$3.7 million being recognized during the nine months ended September 30, 2011, as a gain on extinguishment of debt. As the same lender participated in the new Secured Credit Facility, the remaining amount was recorded as a premium to that facility and will serve to reduce a portion of future interest expense through its maturity.

**Unsecured Credit Facilities** In June 2011, we repaid the \$329.9 million remaining principal balance of our LIBOR + 0.85% unsecured line of credit.

**Secured Term Loans** In June 2011, we entered into a \$120.0 million secured term loan financing maturing in July 2021. This financing is collateralized by net lease properties occupied by a single tenant and bears interest at 5.05%.

In March 2011, we refinanced our maturing \$47.7 million outstanding principal balance secured term loan. In addition, during June 2011, we entered into an additional \$4.6 million secured term loan. These loans bear interest at LIBOR + 4.50%, mature in 2014 and are cross-collateralized by the same net lease assets. Simultaneously with the financings, we entered into interest rate swaps to exchange the variable rates on the notes for fixed interest rates (see Note 10).

**Secured Notes** In January 2011, we fully redeemed the \$312.3 million remaining principal balance of our 10% senior secured notes due June 2014. In connection with this redemption, we recorded a gain on early extinguishment of debt of \$109.0 million in our Consolidated Statement of Operations for the nine months ended September 30, 2011.

**Unsecured Notes** During the nine months ended September 30, 2011, we repaid, upon maturity, the \$170.4 million outstanding principal balance of our 5.65% senior unsecured notes, the \$96.9 million outstanding principal balance of our 5.125% senior unsecured notes and the \$107.8 million outstanding principal balance of our 5.80% senior unsecured notes.

In addition, during the nine months ended September 30, 2011, we repurchased \$59.6 million par value of our senior unsecured notes with various maturities ranging from September 2011 to March 2012. In connection with these repurchases, we recorded an aggregate gain on early extinguishment of debt of \$0.1 million for both the three and nine months ended September 30, 2011.

**Unencumbered/Encumbered Assets** As of September 30, 2011, we had unencumbered assets with a gross carrying value of \$4.83 billion, gross of \$752.1 million of accumulated depreciation and loan loss reserves.

The carrying value of our encumbered assets by asset type is as follows (\$ in thousands):

|                     | As of                 |                      |
|---------------------|-----------------------|----------------------|
|                     | September 30,<br>2011 | December 31,<br>2010 |
| Loans and other     |                       |                      |
| lending investments | \$ 2,120,490          | \$ 2,832,184         |
| Net lease assets    | 1,195,408             | 1,021,783            |
| REHI                | 142,476               | 28,376               |
| OREO                | 163,755               | 232,150              |
| Other investments   | 44,432                |                      |
| <br>                |                       |                      |
| Total               | \$ 3,666,561          | \$ 4,114,493         |

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**Debt Covenants** Our Secured Credit Facility contains certain covenants, including covenants relating to collateral coverage, dividend payments, restrictions on fundamental changes, transactions with affiliates, matters relating to the liens granted to the lenders and the delivery of information to the lenders. In particular, we are required to maintain collateral coverage of 1.25x outstanding borrowings. In addition, for so long as we maintain our qualification as a REIT, the Secured Credit Facility permits us to distribute 100% of our REIT taxable income on an annual basis. We may not pay common dividends if we cease to qualify as a REIT.

Our outstanding unsecured debt securities contain corporate level covenants that include unencumbered assets to unsecured indebtedness and a fixed charge coverage ratio. The unencumbered assets to unsecured indebtedness covenant is a maintenance covenant, while the fixed charge coverage ratio is an incurrence test. Based on our unsecured credit ratings, the financial covenants in our debt securities, including the fixed charge coverage ratio and maintenance of unencumbered assets to unsecured indebtedness ratio, are currently operative. If any of our covenants are breached and not cured within applicable cure periods, the breach could result in acceleration of our debt securities unless a waiver or modification is agreed upon with the requisite percentage of the bondholders. While we expect that our ability to incur new indebtedness under the fixed charge coverage ratio will be limited for the foreseeable future, we will continue to be permitted to incur indebtedness for the purpose of refinancing existing indebtedness and for other permitted purposes under the indentures.

Our Secured Credit Facility contains cross default provisions that would allow the lenders to declare an event of default and accelerate our indebtedness to them if we fail to pay amounts due in respect of our other recourse indebtedness in excess of specified thresholds or if the lenders under such other indebtedness are otherwise permitted to accelerate such indebtedness for any reason. The indentures governing our unsecured public debt securities permit the bondholders to declare an event of default and accelerate our indebtedness to them if our other recourse indebtedness in excess of specified thresholds is not paid at final maturity or if such indebtedness is accelerated.

**Ratings Triggers** Borrowings under our unsecured credit facility bear interest at LIBOR based rates plus an applicable margin, which is based on our corporate credit ratings. Our ability to borrow under this facility is not dependent on the level of our credit ratings.

**Derivatives** Our use of derivative financial instruments is primarily limited to the utilization of interest rate hedges or other instruments to manage interest rate risk exposure and foreign exchange hedges to manage our risk to changes in foreign currencies. The principal objectives of such hedges are to minimize the risks and/or costs associated with our operating and financial structure and to manage our exposure to foreign exchange rate movements. As a result of the repayment of the secured credit facilities a portion of our multi-currency borrowing capacity was extinguished. Accordingly, upon repayment of the facilities we simultaneously entered into foreign currency hedges to manage our exposure on foreign denominated investment assets. See Note 10 of the Notes to the Consolidated Financial Statements.

**Off-Balance Sheet Transactions** We are not dependent on the use of any off-balance sheet financing arrangements for liquidity.

**Unfunded Commitments** We generally fund construction and development loans and build-outs of space in net lease assets over a period of time if and when the borrowers and tenants meet established milestones and other performance criteria. We refer to these arrangements as Performance-Based Commitments. In addition, we sometimes establish a maximum amount of additional funding which we will make available to a borrower or tenant for an expansion or addition to a project if we approve of the expansion or addition in our sole discretion. We refer to these arrangements as Discretionary Fundings. Finally, we have committed to invest capital in several real estate funds and other ventures. These arrangements are referred to as Strategic Investments. As of September 30, 2011, the maximum amounts of the fundings we may make under each category, assuming all performance hurdles and milestones are

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met under the Performance-Based Commitments, that we approve all Discretionary Fundings and that 100% of our capital committed to Strategic Investments is drawn down, are as follows (\$ in thousands):

|                               | Loans      | Net Lease<br>Assets | Strategic<br>Investments | Total      |
|-------------------------------|------------|---------------------|--------------------------|------------|
| Performance-Based Commitments | \$ 57,568  | \$ 9,880            | \$                       | \$ 67,448  |
| Discretionary Fundings        | 155,574    |                     |                          | 155,574    |
| Other                         |            |                     | 30,493                   | 30,493     |
| Total                         | \$ 213,142 | \$ 9,880            | \$ 30,493                | \$ 253,515 |

**Transactions with Related Parties** We have substantial investments in non-controlling interests of Oak Hill Advisors, L.P. and 13 related entities. In relation to our investment in these entities in 2005, we appointed Glenn R. August to our Board of Directors. Mr. August is the president and senior partner of Oak Hill Advisors, L.P. and holds a substantial investment in these same entities. As of September 30, 2011 we have \$22.4 million of unfunded commitments to these entities. See Subsequent Events below.

**Equity** On August 8, 2011, our Board of Directors authorized the repurchase of up to \$65.0 million of our Common Stock from time to time in open market and privately negotiated purchases, including pursuant to one or more trading plans. During the nine months ended September 30, 2011, we repurchased 12.3 million shares of our outstanding Common Stock for approximately \$78.8 million, at an average cost of \$6.40 per share, and repurchases were recorded at cost. As of September 30, 2011, we had \$0.6 million of Common Stock available to repurchase under our Board authorized stock repurchase programs.

**Subsequent Events** On October 25, 2011, we sold a substantial portion of our interests in Oak Hill Advisors, L.P. and related entities in an all cash transaction. The transaction was completed in part through sales of interests to an unrelated third party and to the principals of Oak Hill, and in part through a redemption of interests by Oak Hill Advisors, L.P. We expect to record a pre-tax gain of approximately \$30 million on the carrying value of the investment in the fourth quarter of 2011. Glenn R. August, a director of our board who was appointed to our board of directors in connection with our acquisition of the Oak Hill interests in 2005, is the president and senior partner of Oak Hill Advisors, L.P. and acquired a portion of the interests in the transaction.

### Critical Accounting Estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates and judgments in certain circumstances that affect amounts reported as assets, liabilities, revenues and expenses. We have established detailed policies and control procedures intended to ensure that valuation methods, including any judgments made as part of such methods, are well controlled, reviewed and applied consistently from period to period. We base our estimates on corporate and industry experience and various other assumptions that we believe to be appropriate under the circumstances.

A summary of our critical accounting estimates is included in our Annual Report on Form 10-K for the year ended December 31, 2010 in Management's Discussion and Analysis of Financial Condition. There have been no significant changes to our critical accounting estimates as of September 30, 2011.

**New Accounting Pronouncements** For a discussion of the impact of new accounting pronouncements on our financial condition or results of operations, see Note 3 of the Notes to the Consolidated Financial Statements.

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

There have been no material changes in Quantitative and Qualitative Disclosures About Market Risk for the first nine months of 2011 as compared to the disclosures included in our Annual Report on Form 10-K for the year ended December 31, 2010. See discussion of quantitative and qualitative disclosures about market risk under Item 7a "Quantitative and Qualitative Disclosures about Market Risk," included in our Annual Report on Form 10-K for the year ended December 31, 2010.

**ITEM 4. CONTROLS AND PROCEDURES**

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. The Company has formed a disclosure committee that is responsible for considering the materiality of information and determining the disclosure obligations of the Company on a timely basis. The disclosure committee reports directly to the Company's Chief Executive Officer and Chief Financial Officer.

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the disclosure committee and other members of management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(b) or Rule 15d-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to provide reasonable assurance that the information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and (ii) accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding disclosure.

There have been no changes during the last fiscal quarter in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Notwithstanding the foregoing, a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in the Company's periodic reports.

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**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The Company and/or one or more of its subsidiaries is party to various pending litigation matters that are considered ordinary routine litigation incidental to its business as a finance and investment company focused on the commercial real estate industry, including loan foreclosure and foreclosure-related proceedings. In addition to such matters, the Company or its subsidiaries is a party to, or any of their property is the subject of, the following pending legal proceedings.

**Citiline Holdings, Inc., et al. v. iStar Financial, Inc., et al.**

In April 2008, two putative class action complaints were filed in the United States District Court for the Southern District of New York naming the Company and certain of its current and former executive officers as defendants and alleging violations of federal securities laws. Both suits were purportedly filed on behalf of the same putative class of investors who purchased Common Stock in the Company's December 13, 2007 public offering (the "Company's Offering"). The two complaints were consolidated in a single proceeding (the "Citiline Action") on April 30, 2008.

On November 17, 2008, Plumbers Union Local No. 12 Pension Fund and Citiline Holdings, Inc. were appointed Lead Plaintiffs to pursue the Citiline Action. Plaintiffs filed a Consolidated Amended Complaint on February 2, 2009, purportedly on behalf of a putative class of investors who purchased the Company's Common Stock between December 6, 2007 and March 6, 2008 (the "Complaint"). The Complaint named as defendants the Company, certain of its current and former executive officers, and certain investment banks who served as underwriters in the Company's Offering. The Complaint reasserted claims for alleged violations of Sections 11, 12(a)(2) and 15 of the Securities Act, and added claims for alleged violations of Sections 10(b) and 20(a) of the Exchange Act. Plaintiffs allege the defendants made certain material misstatements and omissions relating to the Company's continuing operations, including the value of the Company's loan portfolio and certain debt securities held by the Company. The Complaint seeks certification as a class action, unspecified compensatory damages plus interest and attorney's fees, and rescission of the public offering. No class has been certified. The Company and its current and former officers filed a motion to dismiss the Complaint on April 27, 2009 and, on March 26, 2010, the Court issued its order granting, in part, the dismissal of certain Securities Act claims against certain of the Company's current and former officers, but denying the motion as to all claims asserted against the Company. Accordingly, the discovery process has commenced. The Company believes the Citiline Action has no merit and intends to continue defending itself vigorously against it.

**Shareholder Derivative Actions**

Two shareholder derivative actions, filed in April and May 2010, are pending in the United States District Court for the Southern District of New York. The complaints in these actions were filed, purportedly on the Company's behalf, against the Company's Board of Directors and certain current and former executive officers. These actions arise out of the same facts and circumstances alleged in the Citiline Action (described above) and assert that the individual defendants breached their fiduciary duties to the Company and were liable to the Company for unjust enrichment, abuse of control, gross mismanagement and waste of corporate assets.

Plaintiffs in these derivative actions have sought monetary damages, reimbursement for professional fees, improvements in governance and controls and disgorgement of profits. The Company, as a nominal defendant on whose behalf the plaintiffs claim they are acting, filed motions to dismiss these claims on the basis that neither shareholder had established the right to usurp the Board of Directors' power to decide whether and when a suit should be filed. On March 31, 2011, the Court issued its order dismissing one of these suits, Kautz v. Sugarman, et al., in its entirety. The Plaintiff in the Kautz matter has appealed this dismissal. Briefing before the United States Court of Appeals for the Second Circuit is complete and oral

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argument has been set. Also on March 31, 2011, the Court denied the Company's motion to dismiss the other action, Vancil v. Sugarman, et al., and granted Plaintiff the opportunity to conduct limited discovery related to the subject matter of the suit. Discovery in the Vancil matter is underway and is scheduled to be completed in the fourth quarter of 2011.

**Shareholder Letters**

In 2010, the Company received letters from two shareholders alleging that certain current and former officers and directors breached their fiduciary duties to the Company. The allegations made in these two letters are materially the same as those made in the Vancil suit described in the preceding paragraph. A special committee of independent directors was formed by the Board of Directors to investigate the claims made in these letters. The shareholders on whose behalf these letters were written complied with the special committee's request to furnish evidence of their continuous ownership of iStar shares. The special committee of independent directors undertook a thorough investigation of the claims made in these letters and concluded there is no substantiation for the claims of wrongful conduct referenced in the letters. After careful analysis and deliberation of the findings and recommendations of the special committee, the Board of Directors voted unanimously to adopt the special committee's recommendation to reject the demands contained in these letters and to terminate any pending derivative actions based upon such demands.

**ITEM 1A. RISK FACTORS**

See the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table sets forth the information with respect to purchases made by or on behalf of the Company of its common stock during the three months ended September 30, 2011:

|                                     | Total Number of<br>Shares<br>Purchased | Average Price<br>Paid per<br>Share | Total Number of<br>Shares Purchased<br>as Part of<br>Publicly<br>Announced<br>Plans | Maximum Dollar<br>Value of Shares<br>that May Yet be<br>Purchased Under<br>the Plans(1)(2) |
|-------------------------------------|--|------------------------------------|---|--|
| August 1 - August 31, 2011          | 8,285,390                              | \$ 6.20                            | 8,285,390   | \$ 26,269,547  |
| September 1 - September 30,<br>2011 | 3,787,287                              | \$ 6.77                            | 3,787,287   | \$ 642,504   |

**Explanatory Notes:**

- (1) On August 8, 2011, the Company authorized the repurchase, from time to time, on the open market or otherwise, of up to an additional \$65 million of its Common Stock at prevailing market prices or at negotiated prices, including pursuant to one or more trading plans. There is no fixed expiration dates to this stock repurchase program.
- (2) On March 13, 2009, the Company authorized the repurchase, from time to time, on the open market or otherwise, of up to an additional \$50 million of its Common Stock at prevailing market prices or at negotiated prices, including pursuant to one or more trading plans. There is no fixed expiration dates to this stock repurchase program.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4. (REMOVED AND RESERVED)**

None

**ITEM 5. OTHER INFORMATION**

None



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**ITEM 6. EXHIBITS**

a. Exhibits

| <b>Exhibit Number</b> | <b>Document Description</b>   |
|-----------------------|---|
| 31.0                  | Certifications pursuant to Section 302 of the Sarbanes-Oxley Act.   |
| 32.0                  | Certifications pursuant to Section 906 of the Sarbanes-Oxley Act.   |
| 101                   | The following financial information from the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2011, is formatted in XBRL (" <i>eXtensible Business Reporting Language</i> "): (i) the Consolidated Balance Sheets (unaudited) as of September 30, 2011 and December 31, 2010, (ii) the Consolidated Statements of Operations (unaudited) for the three and nine months ended September 30, 2011 and 2010, (iii) the Consolidated Statement of Changes in Equity (unaudited) for the nine months ended September 30, 2011, (iv) the Consolidated Statements of Cash Flows (unaudited) for the nine months ended September 30, 2011 and 2010 and (v) the Notes to Consolidated Financial Statements (unaudited).* |

\*  
In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Exchange Act of 1934 and otherwise is not subject to liability under these sections.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

iSTAR FINANCIAL INC.

*Registrant*

Date: November 8, 2011

/s/ JAY SUGARMAN

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Jay Sugarman

*Chairman of the Board of Directors and Chief Executive Officer (principal executive officer)*

iSTAR FINANCIAL INC.

*Registrant*

Date: November 8, 2011

/s/ DAVID M. DISTASO

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David M. DiStaso

*Chief Financial Officer (principal financial and accounting officer)*

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