ISTAR FINANCIAL INC
Form 10-Q
August 08, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2006

OR

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

For the transition period from ____ to ____

Commission File No. 1-15371

iSTAR FINANCIAL INC.

(Exact name of registrant as specified in its charter)

Maryland	**95-6881527**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
1114 Avenue of the Americas, 27th Floor **New York, NY** (Address of principal executive offices)	**10036** (Zip code)

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

Indicate by check mark whether the registrant: (i) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports); and (ii) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, or a non-accelerated filer, see definition of accelerated filer and large accelerated filer in Rule 12-b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

As of July 31, 2006, there were 113,311,946 shares of common stock of iStar Financial Inc. $0.001/par value per share outstanding (Common Stock).

iStar Financial Inc.
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PART I. CONSOLIDATED FINANCIAL INFORMATION

Item 1. Financial Statements

iStar Financial Inc.
Consolidated Balance Sheets
(In thousands, except per share data)
(unaudited)

	As of June 30, 2006	As of December 31, 2005
ASSETS		
Loans and other lending investments, net	$ 5,338,334	$ 4,661,915
Corporate tenant lease assets, net	3,098,797	3,115,361
Other investments	250,266	240,470
Investments in joint ventures	196,686	202,128
Assets held for sale.	16,021	
Cash and cash equivalents	78,171	115,370
Restricted cash	51,701	28,804
Accrued interest and operating lease income receivable	53,094	32,166
Deferred operating lease income receivable	68,859	76,874
Deferred expenses and other assets	89,386	50,005
Goodwill	9,203	9,203
Total assets	$ 9,250,518	$ 8,532,296
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Accounts payable, accrued expenses and other liabilities	$ 180,729	$ 192,522
Debt obligations	6,471,721	5,859,592
Total liabilities	6,652,450	6,052,114
Commitments and contingencies		
Minority interest in consolidated entities	44,533	33,511
Shareholders equity:		
Series D Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 4,000 shares issued and outstanding at June 30, 2006 and December 31, 2005	4	4
Series E Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 5,600 shares issued and outstanding at June 30, 2006 and December 31, 2005	6	6
Series F Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 4,000 shares issued and outstanding at June 30, 2006 and December 31, 2005	4	4
Series G Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 3,200 shares issued and outstanding at June 30, 2006 and December 31, 2005	3	3
Series I Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 5,000 shares issued and outstanding at June 30, 2006 and December 31, 2005	5	5
High Performance Units	9,830	8,797
Common Stock, $0.001 par value, 200,000 shares authorized, 113,303 and 113,209 shares issued and outstanding at June 30, 2006 and December 31, 2005, respectively	113	113
Options	2,001	6,450
Additional paid-in capital	2,894,673	2,886,434
Retained earnings (deficit)	(375,126)	(442,758)
Accumulated other comprehensive income (See Note 14)	48,294	13,885
Treasury stock (at cost)	(26,272)	(26,272)
Total shareholders equity	2,553,535	2,446,671
Total liabilities and shareholders equity	$ 9,250,518	$ 8,532,296

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

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2006	2005	2006	2005
Revenue:				
Interest income	$ 135,075	$ 105,869	$ 261,124	$ 197,487
Operating lease income	83,154	76,511	166,373	151,571
Other income	18,561	14,265	32,826	26,870
Total revenue	236,790	196,645	460,323	375,928
Costs and expenses:				
Interest expense	101,351	81,654	194,885	150,605
Operating costs corporate tenant lease assets	6,309	5,544	12,108	11,066
Depreciation and amortization	19,407	17,776	38,547	35,227
General and administrative(1)	20,424	14,807	39,556	30,810
Provision for loan losses	2,000		3,000	2,250
Total costs and expenses	149,491	119,781	288,096	229,958
Income before equity in earnings from joint ventures, minority interest and other items	87,299	76,864	172,227	145,970
Equity in earnings (loss) from joint ventures	767	(5)	1,053	(165)
Minority interest in consolidated entities	(821)	(74)	(1,069)	(280)
Income from continuing operations	87,245	76,785	172,211	145,525
Income from discontinued operations	901	1,547	1,739	3,126
Gain from discontinued operations	2,353	407	4,536	407
Net income	90,499	78,739	178,486	149,058
Preferred dividend requirements	(10,580)	(10,580)	(21,160)	(21,160)
Net income allocable to common shareholders and HPU holders(2)	$ 79,919	$ 68,159	$ 157,326	$ 127,898
Basic earnings per common share(3)	$ 0.69	$ 0.59	$ 1.36	$ 1.11
Diluted earnings per common share(4) (5)	$ 0.68	$ 0.58	$ 1.34	$ 1.10

Explanatory Notes:

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(1) General and administrative costs include $1,747 and $641 of stock-based compensation expense for the three months ended June 30, 2006 and 2005, respectively, and $2,950 and $1,283 for the six months ended June 30, 2006 and 2005, respectively.

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

(3) For the three months ended June 30, 2006 and 2005, excludes $1,953 and $1,675 of net income allocable to HPU holders, respectively. For the six months ended June 30, 2006 and 2005, excludes $3,846 and $3,159 of net income allocable to HPU holders, respectively.

(4) For the three months ended June 30, 2006 and 2005, excludes $1,935 and $1,659 of net income allocable to HPU holders, respectively. For the six months ended June 30, 2006 and 2005, excludes $3,811 and $3,126 of net income allocable to HPU holders, respectively.

(5) For the three months ended June 30, 2006 and 2005, includes $28 and $0 of joint venture income, respectively. For the six months ended June 30, 2006 and 2005, includes $56 and $0 of joint venture income, respectively.

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

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

	Series D Preferred Stock	Series E Preferred Stock	Series F Preferred Stock	Series G Preferred Stock	Series I Preferred Stock	HPUs	Common Stock at Par	Options	Additional Paid-In Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income	Treasury Stock	Total
Balance at December 31, 2005	$4	$6	$4	$3	$5	$8,797	$113	$6,450	$2,886,434	$(442,758)	$13,885	$(26,272)	$2,446,671
Exercise of options								(4,449)	5,345				896
Dividends declared-preferred										(21,160)			(21,160)
Dividends declared-common										(87,523)			(87,523)
Dividends declared-HPU										(2,171)			(2,171)
Issuance of stock-vested restricted stock units									1,706				1,706
High performance units sold to employees						1,033							1,033
Issuance of stock-DRIP/ Stock purchase plan									1,188				1,188
Net income for the period										178,486			178,486
Change in accumulated other comprehensive income											34,409		34,409
Balance at June 30, 2006	$4	$6	$4	$3	$5	$9,830	$113	$2,001	$2,894,673	$(375,126)	$48,294	$(26,272)	$2,553,535

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

iStar Financial Inc.
Consolidated Statements of Cash Flows
(In thousands)
(unaudited)

	For the Three Months Ended June 30, 2006	2005	For the Six Months Ended June 30, 2006	2005
Cash flows from operating activities:				
Net income	$ 90,499	$ 78,739	$ 178,486	$ 149,058
Adjustments to reconcile net income to cash flows from operating activities:				
Minority interest in consolidated entities	821	74	1,069	280
Non-cash expense for stock-based compensation	1,882	698	3,208	1,411
Depreciation, depletion and amortization	20,093	18,506	41,099	36,757
Depreciation, amortization and impairment from discontinued operations	7,752	20	8,046	53
Amortization of deferred financing costs	6,155	7,975	12,268	15,501
Amortization of discounts/premiums, deferred interest and costs on lending investments	(20,679)	(13,008)	(37,952)	(31,727)
Discounts, loan fees and deferred interest received	25,933	3,026	32,009	42,418
Equity in (earnings)/loss from joint ventures	(767)	5	(1,053)	165
Distributions from operations of joint ventures	3,071		6,496	
Deferred operating lease income receivable	4,016	(3,961)	730	(7,948)
Gain from discontinued operations	(2,353)	(407)	(4,536)	(407)
Provision for loan losses	2,000		3,000	2,250
Changes in assets and liabilities:				
Changes in accrued interest and operating lease income receivable	(7,590)	1,701	(20,928)	(2,842)
Changes in deferred expenses and other assets	(2,299)	(4,159)	(27,513)	5,793
Changes in accounts payable, accrued expenses and other liabilities	27,404	24,135	10,115	5,276
Cash flows from operating activities	155,938	113,344	204,544	216,038
Cash flows from investing activities:				
New investment originations	(735,819)	(817,142)	(1,346,638)	(1,658,789)
Net investments in and advances to unconsolidated joint ventures		(151,851)		(151,851)
Cash paid for acquisition of Falcon Financial				(113,696)
Add-on fundings under existing loan commitments	(130,595)	(62,531)	(317,015)	(155,736)
Net proceeds from sale of corporate tenant lease assets	12,831	5,998	21,874	5,998
Repayments of and principal collections on loans and other lending investments	496,936	554,277	971,104	976,363
Distributions from unconsolidated entities, net of contributions	(6,356)		(8,692)	
Capital improvements for build-to-suit facilities	(15,581)	(4,249)	(32,904)	(4,249)
Capital improvement projects on corporate tenant lease assets	(1,541)	(648)	(4,910)	(4,502)
Other capital expenditures on corporate tenant lease assets	(2,547)	(1,497)	(4,239)	(3,636)
Cash flows from investing activities	(382,672)	(477,643)	(721,420)	(1,110,098)
Cash flows from financing activities:				
Borrowings under secured revolving credit facilities	76,000	617,000	181,073	1,127,000
Repayments under secured revolving credit facilities	(76,000)	(631,710)	(181,073)	(1,192,262)
Borrowings under unsecured revolving credit facilities	2,804,157	1,286,000	3,578,157	2,440,000
Repayments under unsecured revolving credit facilities	(2,356,000)	(1,341,000)	(3,915,000)	(2,722,000)
Borrowings under term loans	38,161	1,617	38,161	5,431
Repayments under term loans	(2,083)	(2,296)	(19,138)	(5,186)
Borrowings under unsecured bond offerings		494,640	991,489	1,585,117
Repayments under unsecured notes	(50,000)	(47)	(50,000)	(47)
Repayments under secured notes		(130,368)		(217,203)
Borrowings under foreign lines of credit	66,307		146,950	
Repayments under foreign lines of credit	(155,181)		(155,181)	
Contribution from minority interest partners	10,618	4,644	11,025	5,682
Changes in restricted cash held in connection with debt obligations	(14,121)	7,500	(22,897)	1,366
Payments for deferred financing costs	(12,501)	(715)	(15,065)	(1,846)
Distributions to minority interest partners	(511)	(1,184)	(1,071)	(1,557)
Common dividends paid	(87,523)	(82,481)	(87,523)	(82,481)
Preferred dividends paid	(10,580)	(10,580)	(21,160)	(21,160)
HPU dividends paid	(2,171)	(2,064)	(2,171)	(2,064)
HPUs issued	1,024	19	1,033	965
Proceeds from exercise of options and issuance of DRIP/Stock purchase shares	1,066	1,193	2,068	2,255

Cash flows from financing activities	230,662	210,168	479,677	922,010
Changes in cash and cash equivalents	3,928	(154,131)	(37,199)	27,950
Cash and cash equivalents at beginning of period	74,243	270,503	115,370	88,422
Cash and cash equivalents at end of period	$ 78,171	$ 116,372	$ 78,171	$ 116,372

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

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iStar Financial Inc.
Notes to Consolidated Financial Statements

Note 1 Business and Organization

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

The lending business is primarily comprised of senior and mezzanine loans that typically range in size from $20 million to $150 million and have maturities generally ranging from three to ten years. These loans may be either fixed rate (based on the U.S. Treasury rate plus a spread) or variable rate (based on LIBOR plus a spread) and are structured to meet the specific financing needs of the borrowers. The Company also provides senior and mezzanine capital to corporations engaged in real estate or real estate-related businesses. These financings may be either secured or unsecured, typically range in size from $20 million to $150 million and have maturities generally ranging from five to ten years. As part of the lending business, the Company also acquires whole loans and loan participations which present attractive risk-reward opportunities. Acquired loan positions typically range in size from $20 million to $100 million.

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

The Company s investment strategy targets specific sectors of the real estate credit markets in which it believes it can deliver the highest quality, flexible financial solutions to its customers, thereby differentiating its financial products from those offered by other capital providers.

The Company has implemented its investment strategy by:

- Focusing on the origination of large, structured mortgage, corporate and lease financings where customers require flexible financial solutions and one-call responsiveness post-closing.

- Avoiding commodity businesses in which there is significant direct competition from other providers of capital such as conduit lending and investment in commercial or residential mortgage-backed securities.

- Developing direct relationships with borrowers and corporate customers as opposed to sourcing transactions solely through intermediaries.

- Adding value beyond simply providing capital by offering borrowers and corporate customers specific lending expertise, flexibility, certainty and continuing relationships beyond the closing of a particular financing transaction.

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

Note 1 Business and Organization (Continued)

- Taking advantage of market anomalies in the real estate financing markets when the Company believes credit is mispriced by other providers of capital, such as the spread between lease yields and the yields on corporate customers underlying credit obligations.

Organization The Company began its business in 1993 through private investment funds formed to capitalize on inefficiencies in the real estate finance market. In March 1998, these funds contributed their assets to the Company s predecessor in exchange for a controlling interest in that company. The Company later acquired its former external advisor in exchange for shares of the Company s common stock (Common Stock) and converted its organizational form to a Maryland corporation. As part of the conversion to a Maryland corporation, the Company replaced its former dual class common share structure with a single class of Common Stock. The Company s Common Stock began trading on the New York Stock Exchange on November 4, 1999. Prior to this date, the Company s Common Stock was traded on the American Stock Exchange. Since that time, the Company has grown by originating new lending and leasing transactions, as well as through corporate acquisitions, including the acquisition in 1999 of TriNet Corporate Realty Trust, Inc. (TriNet).

Note 2 Basis of Presentation

The accompanying unaudited Consolidated Financial Statements have been prepared in conformity with the instructions to Form 10-Q and Article 10-01 of Regulation S-X for interim financial statements. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles in the United States of America (GAAP) for complete financial statements. The Consolidated Financial Statements include the accounts of the Company, its qualified REIT subsidiaries, its majority-owned and controlled partnerships and other entities that are consolidated under the provisions of FASB Interpretation No. 46, Consolidation of Variable Interest Entities, an interpretation of ARB 51 (FIN 46R) (see Note 6).

Certain investments in joint ventures or other entities which the Company does not control are accounted for under the equity method (see Note 6). All significant intercompany balances and transactions have been eliminated in consolidation.

In the opinion of management, the accompanying Consolidated Financial Statements contain all adjustments, consisting of normal recurring adjustments, necessary for a fair statement of the Company s consolidated financial position at June 30, 2006 and December 31, 2005 and the results of operations and its cash flows for the three and six months ended June 30, 2006 and 2005, respectively, and its changes in shareholders equity for the six months ended June 30, 2006. Such operating results may not be indicative of the expected results for any other interim periods or the entire year.

Note 3 Summary of Significant Accounting Policies

Loans and other lending investments, net As described in Note 4, Loans and Other Lending Investments, includes the following investments: senior mortgages, subordinate mortgages, corporate/partnership loans and other lending investments-securities. Management considers nearly all of its loans and other lending investments to be held-to-maturity, although a small number of investments may be classified as available-for-sale. Items classified as held-to-maturity are reflected at amortized

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

Note 3 Summary of Significant Accounting Policies (Continued)

historical cost. Items classified as available-for-sale are reported at fair values with unrealized gains and losses included in Accumulated other comprehensive income (losses) on the Company s Consolidated Balance Sheets and are not included in the Company s net income.

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

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

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

Above-market and below-market in-place lease values for owned CTL assets are recorded based on the present value (using a discount rate reflecting the risks associated with the leases acquired) of the difference between: (1) the contractual amounts to be paid pursuant to the leases negotiated and in-place at the time of acquisition of the facilities; and (2) management s estimate of fair market lease rates for the facility or equivalent facility, measured over a period equal to the remaining non-cancelable term of the lease. The capitalized above-market (or below-market) lease value is amortized as a reduction of (or, increase to) operating lease income over the remaining non-cancelable term of each lease plus any renewal periods with fixed rental terms that are considered to be below-market. The Company generally engages in sale/leaseback transactions and typically executes leases simultaneously with the purchase of the CTL asset at market-rate rents. Because of this, no above-market or below-market lease value is ascribed to these transactions.

The total amount of other intangible assets are allocated to in-place lease values and customer relationship intangible values based on management s evaluation of the specific characteristics of each customer s lease and the Company s overall relationship with each customer. Characteristics to be considered in allocating these values include the nature and extent of the existing relationship with the customer, prospects for developing new business with the customer, the customer s credit quality and the expectation of lease renewals among other factors. Factors considered by management s analysis include the estimated carrying costs of the facility during a hypothetical expected lease-up period, current market conditions and costs to execute similar leases. Management also considers information obtained about a property in connection with its pre-acquisition due diligence. Estimated carrying costs include real estate

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

Note 3 Summary of Significant Accounting Policies (Continued)

taxes, insurance, other property operating costs and estimates of lost operating lease income at market rates during the hypothetical expected lease-up periods, based on management s assessment of specific market conditions. Management estimates costs to execute leases including commissions and legal costs to the extent that such costs are not already incurred with a new lease that has been negotiated in connection with the purchase of the facility. Management s estimates are used to determine these values. These intangible assets are included in Other investments on the Company s Consolidated Balance Sheets (see Note 7).

The value of above-market or below-market in-place leases are amortized as a reduction of (or, increase to) operating lease income over the remaining initial term of each lease. The value of customer relationship intangibles are amortized to expense over the initial and renewal terms of the leases, but no amortization period for intangible assets will exceed the remaining depreciable life of the building. In the event that a customer terminates its lease, the unamortized portion of each intangible, including market rate adjustments, lease origination costs, in-place lease values and customer relationship values, would be charged to expense.

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

Timber carrying costs, such as real estate taxes, insect and wildlife control and timberland management fees, are expensed as incurred. Net carrying value of the timber and timberlands is used to compute the gain or loss in connection with timberland sales. Timber and timberlands are included in Other investments on the Company s Consolidated Balance Sheets (see Note 7).

Capitalized interest The Company capitalizes interest costs incurred during the construction periods for qualified build-to-suit projects for corporate tenants, including investments in joint ventures accounted for under the equity method. Capitalized interest was approximately $490,000 and $19,500 for the three months ended June 30, 2006 and 2005, respectively, and $831,000 and $19,500 for the six months ended June 30, 2006 and 2005, respectively.

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

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

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

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

Note 3 Summary of Significant Accounting Policies (Continued)

Identified intangible assets and goodwill Upon the acquisition of a business, the Company records intangible assets acquired at their estimated fair values separate and apart from goodwill. The Company determines whether such intangible assets have finite or indefinite lives. As of June 30, 2006, all such intangible assets acquired by the Company have finite lives. The Company amortizes finite lived intangible assets based on the period over which the assets are expected to contribute directly or indirectly to the future cash flows of the business acquired. The Company reviews finite lived intangible assets for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. The Company recognizes impairment loss on finite lived intangible assets if the carrying amount of an intangible asset is not recoverable and its carrying amount exceeds its estimated fair value.

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

Fair values for goodwill and other finite lived intangible assets are determined based on discounted cash flows or appraised values, as appropriate.

During the first quarter 2005, the Company acquired Falcon Financial Investment Trust (Falcon Financial) in a business combination and identified finite lived intangible assets of approximately $2.0 million and goodwill of $7.7 million (see Note 4 for further discussion). These identified intangible assets are included in Deferred expenses and other assets on the Company s Consolidated Balance Sheets.

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

Loans and other lending investments: Management considers nearly all of its loans and other lending investments to be held-to-maturity, although a small number of investments may be classified as available-for-sale. The Company reflects held-to-maturity investments at historical cost adjusted for allowance for loan losses, unamortized acquisition premiums or discounts and unamortized deferred loan fees.

Unrealized gains and losses on available-for-sale investments are included in Accumulated other comprehensive income (losses) on the Company s Consolidated Balance Sheets and are not included in the Company s net income. On occasion, the Company may acquire loans at generally small premiums or discounts based on the credit characteristics of such loans. These premiums or discounts are recognized as yield adjustments over the lives of the related loans. Loan origination or exit fees, as well as direct loan origination costs, are also deferred and recognized over the lives of the related loans as a yield adjustment, if management believes it is probable that such amounts will be received. If loans with premiums, discounts, loan origination or exit fees are prepaid, the Company immediately recognizes the unamortized portion as a decrease or increase in the prepayment gain or loss which is included in Other income on the Company s Consolidated Statements of Operations. Interest income is recognized using the effective interest method applied on a loan-by-loan basis.

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

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

Note 3 Summary of Significant Accounting Policies (Continued)

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

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

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

Reserve for loan losses **The** Company s accounting policies require that an allowance for estimated loan losses be maintained at a level that management, based upon an evaluation of known and inherent risks in the portfolio, considers adequate to provide for loan losses. In establishing loan loss reserves, management periodically evaluates and analyzes the Company s assets, historical and industry loss experience, economic conditions and trends, collateral values and quality, and other relevant factors. Specific valuation allowances are established for impaired loans in the amount by which the carrying value, before allowance for estimated losses, exceeds the fair value of collateral less disposition costs on an individual loan basis. Management considers a loan to be impaired when, based upon current information and events, it believes that it is probable that the Company will be unable to collect all amounts due under the loan agreement on a timely basis. Management carries these impaired loans at the fair value of the loans underlying collateral less estimated disposition costs. Impaired loans may be left on accrual status during the period the Company is pursuing repayment of the loan; however, these loans are placed on non-accrual status at such time as: (1) management determines the borrower is incapable of, or has ceased efforts toward, curing the cause of the impairment; (2) the loans become 90 days delinquent; (3) the loan has a maturity default; or (4) the net realizable value of the loan s underlying collateral approximates the Company s carrying value of such loan. While on non-accrual status, interest income is recognized only upon actual receipt. Impairment losses are recognized as direct write-downs of the related loan with a corresponding charge to the reserve for loan losses. Charge-offs occur when loans, or a portion thereof, are considered uncollectible and of such little value that further pursuit of collection is not warranted. Management also provides a loan portfolio reserve based upon its periodic evaluation and analysis of the portfolio, historical and industry loss experience, economic conditions and trends, collateral values and quality, and other relevant factors.

The Company s loans are generally collateralized by real estate assets or are corporate lending arrangements to entities with significant real estate holdings and other corporate assets. While the underlying real estate assets for the corporate lending instruments may not serve as collateral for the Company s investments in all cases, the Company evaluates the underlying real estate assets when estimating loan loss exposure because the Company s loans generally have restrictions as to how much senior and/or secured debt the customer may borrow ahead of the Company s position.

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

Note 3 Summary of Significant Accounting Policies (Continued)

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

Derivative instruments and hedging activity In accordance with Statement of Financial Accounting Standards No. 133 (SFAS No. 133), Accounting for Derivative Instruments and Hedging Activities as amended, the Company recognizes all derivatives as either assets or liabilities in the statement of financial position and measures those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as a hedge of the exposure to changes in the fair value of a recognized asset or liability or a hedge of the exposure to variable cash flows of a forecasted transaction.

The Company formally documents all hedging relationships at inception, including its risk management objective and strategy for undertaking the hedge transaction. The hedge instrument and the hedged item are designated at the execution of the hedge instrument or upon re-designation during the life of the hedge. At inception and at least quarterly, the Company also formally assesses whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the hedged items to which they are designated and whether those derivatives may be expected to remain highly effective in future periods through the use of regression testing or dollar offset tests. Hedge effectiveness is assessed and measured under identical time periods. To the extent that hedges qualify under paragraph 68 of SFAS No. 133, the Company uses the short-cut method to assess effectiveness. Otherwise, the Company utilizes the cumulative hypothetical derivative method to assess and measure effectiveness. In addition, the Company does not exclude any component of the derivative s gain or loss in the assessment of effectiveness.

Stock-based compensation During the third quarter of 2002, with retroactive application to the beginning of that year, the Company adopted the fair-value method of accounting for options issued to employees or directors. Accordingly, the Company recognizes a charge equal to the fair value of these options at the date of grant multiplied by the number of options issued. This charge is amortized over the related remaining vesting terms to individuals as additional compensation.

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

Impairment or disposal of long-lived assets In accordance with the Statement of Financial Accounting Standards No. 144 (SFAS No. 144), Accounting for the Impairment or Disposal of Long-Lived Assets the Company presents current operations prior to the disposition of CTL assets and prior period results of such operations in discontinued operations on the Company s Consolidated Statements of Operations.

Depletion **Depletion** relates to the Company s investment in timberland assets. Assumptions and estimates are used in the recording of depletion. With the help of foresters and industry-standard computer software, merchantable standing timber inventory is estimated annually. An annual depletion rate for each timberland investment is established by dividing book cost of timber by standing merchantable inventory. Changes in the assumptions and/or estimations used in these calculations may

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

Note 3 Summary of Significant Accounting Policies (Continued)

affect the Company s results, in particular depletion costs. Factors that can impact timber volume include weather changes, losses due to natural causes, differences in actual versus estimated growth rates and changes in the age when timber is considered merchantable.

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

The Company can participate in certain activities from which it was previously precluded in order to maintain its qualification as a REIT, as long as these activities are conducted in entities which elect to be treated as taxable subsidiaries under the Code, subject to certain limitations. As such, the Company, through its taxable REIT subsidiaries (TRSs), is engaged in various real estate related opportunities, including: (i) servicing certain loan portfolios owned by third parties through iStar Asset Services, Inc. (iSAS); (ii) servicing securitized loans acquired in the acquisition of Falcon Financial through Falcon Financial II, Inc. (Falcon); (iii) certain activities related to the purchase and sale of timber and timberlands through TimberStar TRS, Inc. and TRS II, Inc. (collectively, TimberStar TRS); and (iv) managing corporate credit-oriented investment strategies through four taxable REIT subsidiaries, iStar Alpha TRS, Inc., iStar Alpha LLC Holding TRS, Inc., iStar Alpha LLC Holdings TRS II, Inc. and iStar OHCOF GP TRS, Inc. (collectively, iStar Alpha). The Company will consider other investments through TRS entities if suitable opportunities arise. The Company s TRS entities are not consolidated for federal income tax purposes and are taxed as corporations. For financial reporting purposes, current and deferred taxes are provided for in the portion of earnings recognized by the Company with respect to its interest in TRS entities. Such amounts are immaterial. Accordingly, except for the Company s taxable REIT subsidiaries, no current or deferred federal taxes are provided for in the Consolidated Financial Statements.

Earnings per common share In accordance with the Statement of Financial Accounting Standards No. 128 (SFAS No. 128), Earnings per Share, the Company presents both basic and diluted earnings per share (EPS). Basic earnings per share (Basic EPS) is computed by dividing net income allocable to common shareholders by the weighted average number of shares outstanding for the period. Diluted earnings per share (Diluted EPS) reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, where such exercise or conversion would result in a lower earnings per share amount.

Reclassification Certain prior year amounts have been reclassified in the Consolidated Financial Statements and the related notes to conform to the 2006 presentation.

Use of estimates 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

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

Note 3 Summary of Significant Accounting Policies (Continued)

amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

New accounting standards In July 2006, the FASB released Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement 109.   FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. A tax benefit from an uncertain position may be recognized only if it is   more likely than not   that the position is sustainable, based on its technical merits. The tax benefit is the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with a taxing authority having full knowledge of all relevant information. FIN 48 is effective as of the beginning of fiscal years that start after December 15, 2006. The Company will adopt FIN 48 on January 1, 2007, as required, and does not believe it will have a significant impact on the Company s Consolidated Financial Statements.

In March 2005, the FASB released Interpretation No. 47 (FIN 47),   Accounting for Conditional Asset Retirement Obligations.   FIN 47 clarifies that the term conditional asset retirement obligation as used in FASB Statement No. 143,   Accounting for Asset Retirement Obligations   (SFAS No. 143), as a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement. Thus, the timing and/or method of settlement may be conditional on a future event. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The fair value of a liability for the conditional asset retirement obligation should be recognized when incurred generally upon acquisition, construction, or development and/or through the normal operation of the asset. Uncertainty about the timing and/or method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. SFAS No. 143 acknowledges that in some cases, sufficient information may not be available to reasonably estimate the fair value of an asset retirement obligation. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The Company adopted FIN 47 during 2005 and it did not have a significant impact on the Company s Consolidated Financial Statements.

In December 2004, the FASB released Statement of Financial Accounting Standards No. 153 (SFAS No. 153),   Accounting for Non-monetary Transactions.   SFAS No. 153 requires non-monetary exchanges to be accounted for at fair value, recognizing any gain or loss, if the transactions meet a commercial-substance criterion and fair value is determinable. SFAS No. 153 is effective for non-monetary transactions occurring in fiscal years beginning after June 15, 2005. The Company adopted the provisions of this statement, as required, on January 1, 2006, and it did not have a significant impact on the Company s Consolidated Financial Statements.

In June 2005, the Emerging Issues Task Force reached a consensus on EITF 04-5,   Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights.   EITF 04-5 states that a sole general partner is presumed to control a limited partnership (or similar entity) and should consolidate the limited partnership unless one of the following two conditions exist: (1) the limited partners possess substantive

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

Note 3 Summary of Significant Accounting Policies (Continued)

kick-out rights, or (2) the limited partners possess substantive participating rights. A kick-out right is defined as the substantive ability to remove the sole general partner without cause or otherwise dissolve (liquidate) the limited partnership. Substantive participating rights are when the limited partners have the substantive right to participate in certain financial and operating decisions of the limited partnership that are made in the ordinary course of business. The consensus guidance in EITF 04-5 is effective for all agreements entered into or modified after June 29, 2005. For all pre-existing agreements that are not modified, the consensus is effective as of the beginning of the first fiscal reporting period beginning after December 15, 2005. The Company adopted the provisions of this statement, as required, and it did not have a significant impact on the Company s Consolidated Financial Statements.

In December 2004, the FASB released Statement of Financial Accounting Standards No. 123R (SFAS No. 123R), Share-Based Payment. This standard requires issuers to measure the cost of equity-based service awards based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award or the requisite service period (typically the vesting period). No compensation cost is recognized for equity instruments for which employees do not render the requisite service. The Company will initially measure the cost of liability-based service awards based on their current fair value. The fair value of that award will be remeasured subsequently at each reporting date through the settlement date. Changes in fair value during the requisite service period will be recognized as compensation cost over that period. The grant-date fair value of employee share options and similar instruments will be estimated using option-pricing models adjusted for the unique characteristics of those instruments. If an equity award is modified after the grant date, incremental compensation cost will be recognized in an amount equal to the excess of the fair value of the modified award over the fair value of the original award immediately before the modification. Companies can comply with SFAS No. 123R using one of three transition methods: (1) the modified prospective method; (2) the modified retrospective method; or (3) a variation of the modified retrospective method. The provisions of this statement are effective for annual periods beginning after June 15, 2005. The Company adopted the provisions of SFAS No. 123R, as required, on January 1, 2006, and it did not have a significant financial impact on the Company s Consolidated Financial Statements.

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

Note 4 Loans and Other Lending Investments

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

tment	Underlying Property Type	# of Borrowers In Class	Principal Balances Outstanding	Carrying Value as of June 30, 2006	December 31, 2005	Effective Maturity Dates	Contractual Interest Payment Rates(2)	Contractual Interest Accrual Rates(2)	Principal Amortization (3)
ges(5)	Office/Residential/Retail/ Industrial, R&D/Mixed Use/Hotel/Entertainment, Leisure/Other	104	$3,403,789	$3,368,231	$3,149,767	2006 to 2026	Fixed: 6.50% to 30.00% Variable: LIBOR + 1.86% to LIBOR + 7.00%	Fixed: 6.50% to 30.00% Variable: LIBOR + 1.86% to LIBOR + 7.00%	Yes
	Office/Residential/Retail/ Mixed Use/Hotel/ Entertainment, Leisure/Other	20	476,820	473,363	413,853	2006 to 2025	Fixed: 7.32% to 18.00% Variable: LIBOR + 1.25% to LIBOR + 5.25%	Fixed: 7.32% to 25.00% Variable: LIBOR + 1.25% to LIBOR + 5.25%	Yes
nership	Office/Residential/Retail/ Industrial, R&D/Mixed Use/Hotel/ Other	22	770,123	756,184	797,456	2006 to 2021	Fixed: 7.62% to 15.00% Variable: LIBOR + 2.50% to LIBOR + 7.50%	Fixed: 7.62% to 17.50% Variable: LIBOR + 2.50% to LIBOR + 7.50%	Yes
	Residential/Retail/ Mixed Use/ Industrial, R&D/ Entertainment, Leisure/Other	10	805,124	790,432	347,715	2007 to 2023	Fixed: 6.00% to 12.00% Variable: LIBOR + 0.85% to LIBOR + 5.63%	Fixed: 6.00% to 12.00% Variable: LIBOR + 0.85% to LIBOR + 5.63%	Yes
g Value				$ 5,388,210	$ 4,708,791				
an				(49,876)	(46,876)				
				$ 5,338,334	$ 4,661,915				

Explanatory Notes:

(1) Details (other than carrying values) are for loans outstanding as of June 30, 2006.

(2) Substantially all variable-rate loans are based on 30-day LIBOR and reprice monthly. The 30-day LIBOR on June 30, 2006 was 5.33%. As of June 30, 2006, two loans with a combined carrying value of $66.1 million have a stated accrual rate that exceeds the stated pay rate; one of these loans, with a carrying value of $27.1 million, has been placed on non-accrual status and therefore is considered a non-performing loan (see Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations Risk Management) and the Company is only recognizing income based on cash received for interest.

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

(4) Under some of the loans, the Company may receive additional payments representing additional interest from participation in available cash flow from operations of the underlying real estate collateral.

(5) Includes one loan with a carrying value of $46.9 million which the Company has currently ceased accruing the contractual exit fees as of January 1, 2006.

(6) Includes one loan with a stated accrual rate of 25.00% per annum, however, no interest is due until its scheduled maturity in 2009.

(7) Includes two unsecured loans with an aggregate carrying value of $75.3 million as of June 30, 2006.

(8) Typically consists of senior loans, term preferred stock or debt interests that are originated or structured to meet customer financing requirements and the Company s investment criteria.

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

Note 4 Loans and Other Lending Investments (Continued)

During the six months ended June 30, 2006 and 2005, respectively, the Company and its affiliated ventures originated or acquired an aggregate of approximately $1.32 billion and $1.45 billion (excluding the acquisition of Falcon Financial) in loans and other lending investments, funded $317.0 million and $155.7 million under existing loan commitments and received principal repayments of $971.1 million and $976.5 million (excluding loan repayments in escrow of $99.9 million during the period ended June 30, 2005 for which cash was received by the Company on July 7, 2005).

As of June 30, 2006, the Company had 46 loans with unfunded commitments. The total unfunded commitment amount was approximately $1.91 billion, of which $48.0 million was discretionary and $1.86 billion was non-discretionary.

The Company has reflected provisions for loan losses of approximately $2.0 million and $0 in its results of operations during the three months ended June 30, 2006 and 2005, respectively, and approximately $3.0 million and $2.3 million during the six months ended June 30, 2006 and 2005. These provisions represent loan portfolio reserves based on management s evaluation of general market conditions, the Company s internal risk management policies and credit risk ratings system, industry loss experience, the likelihood of delinquencies or defaults and the credit quality of the underlying collateral.

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

Reserve for loan losses, December 31, 2004	$ 42,436
Additional provision for loan losses	2,250
Additional provision acquired in acquisition of Falcon Financial	2,190
Charge-offs	
Reserve for loan losses, December 31, 2005	46,876
Additional provision for loan losses	3,000
Charge-offs	
Reserve for loan losses, June 30, 2006	$ 49,876

Acquisition of Falcon Financial Investment Trust *On* January 20, 2005, the Company signed a definitive agreement to acquire Falcon Financial, an independent finance company dedicated to providing long-term capital to automotive dealers throughout North America. Falcon Financial was a borrower of the Company at the time of signing the definitive agreement. Under the terms of the agreement, the Company commenced a cash tender offer to acquire all of Falcon Financial s outstanding shares at a price of $7.50 per share for an aggregate equity purchase price of approximately $120.0 million. The offer expired on February 28, 2005, and as of the expiration, approximately 15.6 million common shares of beneficial interest, representing approximately 97.70% of Falcon Financial s issued and outstanding shares, had been tendered and not withdrawn. On March 3, 2005, the Company completed the merger of Falcon Financial with an acquisition subsidiary of the Company. As a result of the merger, all outstanding shares of Falcon Financial not purchased by the Company in the tender offer were converted into the right to receive $7.50 per share, without interest and the Company acquired 100.00% ownership of Falcon Financial.

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

Note 4 Loans and Other Lending Investments (Continued)

The following is a summary of the effects of this transaction on the Company s consolidated financial position (in thousands):

Fair value of:	
Assets acquired (loans and other lending investments)	$ 255,503
Acquired finite lived intangible assets and goodwill	9,778
Acquired accrued interest and other assets	3,140
iStar line-of-credit to Falcon Financial plus accrued interest	(151,784)
Other liabilities assumed	(2,941)
Net cash paid for Falcon Financial acquisition	$ 113,696

The purchase of Falcon Financial was accounted for as a business combination, and therefore the Company applied the principles of SFAS No. 141 and Statement of Financial Standards No. 142 (SFAS No. 142), Goodwill and Other Intangible Assets, to the transaction. There were approximately $2.0 million of finite lived intangibles identified in the business combination that will be amortized over two to 21 years. These intangibles are included in Deferred expenses and other assets on the Company s Consolidated Balance Sheets. As of June 30, 2006, the Company had unamortized purchase related finite lived intangible assets of approximately $1.6 million related to the Falcon Financial acquisition. In addition, the acquisition resulted in approximately $7.7 million of goodwill. The goodwill was adjusted by approximately $1.5 million subsequent to the acquisition to reflect severance payments to certain individuals and other costs which resulted in an increase of goodwill to $9.2 million. The goodwill is tested annually for impairment as required by SFAS No. 142. The most recent impairment test was performed by the Company during the fourth quarter of 2005 and no impairment was identified. On May 1, 2005, the assets acquired in the Falcon Financial acquisition were merged with AutoStar Realty Operating Partnership, L.P. (see Note 6 for further description of AutoStar Realty Operating Partnership, L.P.).

Note 5 Corporate Tenant Lease Assets

During the six months ended June 30, 2006 and 2005, respectively, the Company acquired an aggregate of approximately $17.2 million and $149.4 million in CTL assets and disposed of CTL assets for net proceeds of approximately $21.9 million and $6.0 million. The Company did not allocate any of the purchase costs to intangible assets in relation to the CTL assets acquired during the six months ended June 30, 2006 (see Note 3). As of June 30, 2006 and December 31, 2005, the Company had unamortized purchase related finite lived intangible assets of approximately $41.1 million and $42.5 million, respectively, and included these in Other investments on the Company s Consolidated Balance Sheets.

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

	June 30, 2006	**December 31, 2005**
Facilities and improvements	$ 2,667,052	$ 2,657,306
Land and land improvements	751,184	747,724
Less: accumulated depreciation	(319,439)	(289,669)
Corporate tenant lease assets, net	$ 3,098,797	$ 3,115,361

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

Note 5 Corporate Tenant Lease Assets (Continued)

Under certain leases, the Company is entitled to receive additional participating lease payments to the extent gross revenues of the corporate customer exceed a base amount. The Company did not earn any such additional participating lease payments on these leases in the six months ended June 30, 2006 and 2005. In addition, the Company also receives reimbursements from customers for certain facility operating expenses including common area costs, insurance and real estate taxes. Customer expense reimbursements for the three months ended June 30, 2006 and 2005 were approximately $7.0 million and $6.1 million, respectively, and $14.0 million and $12.3 million for the six months ended June 30, 2006 and 2005, respectively, and are included as a reduction of Operating costs corporate tenant lease assets on the Company s Consolidated Statements of Operations.

The Company is subject to expansion option agreements with three existing customers that could require the Company to fund and to construct up to 171,000 square feet of additional adjacent space on which the Company would receive additional operating lease income under the terms of the option agreements. In addition, upon exercise of such expansion option agreements, the corporate customers would be required to simultaneously extend their existing lease terms for additional periods ranging from six to ten years.

The Company also has $51.6 million of unfunded commitments, of which $3.3 million was discretionary and $48.3 million was non-discretionary related to 12 CTL investments. These commitments generally fall into two categories: (1) pre-approved capital improvement projects; and (2) new or additional construction costs. Upon funding, the Company would receive additional operating lease income from the customers. In addition, the Company has $16.6 million of non-discretionary unfunded commitments related to 20 existing customers in the form of tenant improvements which were negotiated between the Company and customers at the commencement of the leases.

On April 13, 2006, the Company signed a lease termination agreement with a customer that occupied 12 facilities that were subject to separate cross-defaulted leases. Of these 12 leases, nine were assigned to the Company as of June 30, 2006 and three were amended and will expire between 2007 and 2011. Three of the nine assigned leases have sub-leases that expire between 2008 and 2018 and the remaining six facilities are vacant. The Company negotiated to receive a $20.0 million letter of credit from the tenant under a previous amendment to the lease. The letter of credit was cashed by the Company upon execution of the current lease amendment and termination and allocated between each of the leases as a lease termination fee. Subsequent to the termination, the Company determined it would sell six of the nine facilities with terminated leases and designated those facilities as Assets held for sale on the Company's Consolidated Balance Sheets as of June 30, 2006. In addition, the Company determined that the six facilities held for sale were impaired and recorded a $7.6 million charge. The impairment charge and the operating results of the six facilities, including a net termination fee of $7.8 million (net of the write-off of $3.2 million of deferred operating lease income), are included in Income from discontinued operations on the Company's Consolidated Statements of Operations for the three and six months ended June 30, 2006. Approximately $3.6 million of the termination fee associated with the three amended leases was recorded to Deferred operating lease income receivable on the Company's Consolidated Balance Sheets, to be amortized on a straight-line basis over the remaining term of the leases. The remaining net termination fee of $3.8 million (net of the write-off of $1.6 million of deferred operating lease income), was recorded in Other income on the Company's Consolidated Statements of Operations.

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

Note 5 Corporate Tenant Lease Assets (Continued)

On May 26, 2006, the Company sold one CTL asset for net proceeds of approximately $12.8 million and realized a gain of approximately $2.4 million. On March 6, 2006, the Company sold two CTL assets for net proceeds of approximately $9.0 million and realized a gain of approximately $2.2 million.

On May 27, 2005, the Company sold one CTL asset for net proceeds of approximately $6.0 million and realized a gain of approximately $407,000.

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

Note 6 Joint Ventures and Minority Interest

Investments in unconsolidated joint ventures Income or loss generated from the Company s joint venture investments is included in Equity in earnings (loss) from joint ventures on the Company s Consolidated Statements of Operations.

At June 30, 2006, the Company had a 50% investment in Corporate Technology Centre Associates, LLC (CTC), whose external member is Corporate Technology Centre Partners, LLC. This venture was formed for the purpose of operating, acquiring and, in certain cases, developing CTL facilities. At June 30, 2006, the CTC venture held one facility. The Company s investment in this joint venture at June 30, 2006 was $4.9 million. The joint venture s carrying value for the one facility owned at June 30, 2006 was $17.5 million. The joint venture had total assets of $18.9 million as of June 30, 2006 and a net loss of $(119,000) and $(241,000) for the three and six months ended June 30, 2006, respectively. The Company accounts for this investment under the equity method because the Company s joint venture partner has certain participating rights giving them shared control over the venture.

In addition, the Company has 47.5% investments in Oak Hill Advisors, L.P. and Oak Hill Credit Alpha MGP, a 47.0% investment in OHSF GP Partners II, LLC and a 45.5% investment in Oak Hill Credit Opportunities MGP, LLC (collectively, Oak Hill). The Company has determined that all of these entities are VIE s (see Note 3) and that an external member is the primary beneficiary. As such, the Company accounts for these investments under the equity method. The Company s investment in these ventures at June 30, 2006 was $191.7 million. These ventures engage in investment and asset management services. Upon acquisition of the interests in Oak Hill there was a difference between the Company s book value of the equity investments and the underlying equity in the net assets of Oak Hill of approximately $199.8 million. Under the provisions of APB 18, The Equity Method of Accounting for Investments in Common Stock, the Company allocated this value to finite lived identifiable intangible assets of approximately $81.8 million and goodwill of $118.0 million. These intangible assets are amortized based on their determined useful lives through quarterly adjustments to Equity in earnings (loss) from joint ventures and Investments in joint ventures on the Company s Consolidated Financial Statements. As of June 30, 2006, the unamortized balance related to intangible assets for these investments was approximately $68.7 million.

Minority Interest Income or loss allocable to external partners in consolidated entities is included in Minority interest in consolidated entities on the Company s Consolidated Statements of Operations.

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

Note 6 Joint Ventures and Minority Interest (Continued)

As more fully discussed in Note 7, the Company consolidates the TimberStar Operating Partnership, L.P., created on January 19, 2005, for financial statement purposes and records the minority interest of the external partner in Minority interest in consolidated entities on the Company s Consolidated Balance Sheets.

During 2005, the Company had an investment in iStar Operating, Inc. (iStar Operating), a taxable REIT subsidiary that, through a wholly-owned subsidiary, serviced the Company s loans and certain loan portfolios owned by third parties. The Company owned all of the non-voting preferred stock and a 95% economic interest in iStar Operating. The Company determined that this entity was a VIE and the Company was the primary beneficiary, and therefore the Company consolidates this entity. On December 31, 2005, the Company acquired all the voting common stock in iStar Operating for a nominal amount and simultaneously merged it into an existing taxable REIT subsidiary of the Company.

On June 8, 2004, AutoStar Realty Operating Partnership, L.P. (the Operating Partnership) was created to provide real estate financing solutions to automotive dealerships and related automotive businesses. The Operating Partnership is owned 0.50% by AutoStar Realty GP LLC (the GP) and 99.50% by AutoStar Investors Partnership LLP (the LP). The GP is funded and owned 93.33% by iStar Automotive Investments, LLC, a wholly-owned subsidiary of the Company, and 6.67% by CP AutoStar, LP, an entity owned and controlled by two entities unrelated to the Company. The LP is funded and owned 93.33% by iStar Automotive Investments, LLC and 6.67% by CP AutoStar Co-Investors, LP, an entity controlled by two entities unrelated to the Company. This joint venture qualifies as a VIE and the Company is the primary beneficiary. Therefore, the Company consolidates this partnership for financial statement purposes and records the minority interest of the external partner in Minority interest in consolidated entities on the Company s Consolidated Balance Sheets.

On March 31, 2004, the Company began accounting for its 44.7% interest in TriNet Sunnyvale Partners, L.P. (Sunnyvale) as a VIE because the limited partners of Sunnyvale have the option to put their interest to the Company for cash; however, the Company may elect to deliver 297,728 shares of Common Stock in lieu of cash. The Company consolidates this partnership for financial statement purposes as it is the primary beneficiary. Prior to its consolidation, the Company accounted for this joint venture under the equity method for financial statement purposes and it was presented in Investments in joint ventures, on the Company s Consolidated Balance Sheets and earnings from the joint venture were included in Equity in earnings (loss) from joint ventures in the Company s Consolidated Statements of Operations.

In addition, the Company holds a majority interest in four other limited partnerships as of June 30, 2006 that are consolidated for financial statement purposes and records the minority interest of the external partner(s) in Minority interest in consolidated entities on the Company s Consolidated Balance Sheets.

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

Note 7 Other Investments

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

	June 30, 2006	December 31, 2005
Timber and timberlands, net of accumulated depletion (see Note 3)	$ 148,479	$ 152,114
CTL intangibles, net of accumulated amortization (see Note 3)	41,076	42,530
Investments other	59,115	39,174
Marketable securities, prepaid expenses and other receivables	1,596	6,652
Other investments	$ 250,266	$ 240,470

On January 19, 2005, TimberStar Operating Partnership, L.P. (TimberStar) was created to acquire and manage a diversified portfolio of timberlands. TimberStar is owned 0.50% by TimberStar Investor GP LLC (TimberStar GP) and 99.50% by TimberStar Investors Partnership LLP (TimberStar LP). TimberStar GP and TimberStar LP are both funded and owned 96% by iStar Timberland Investments LLC, a wholly-owned subsidiary of the Company, and 4% by T-Star Investor Partners, LLC, an entity unrelated to the Company. The Company consolidates this partnership for financial statement purposes and records the minority interest of the external partner in Minority interest in consolidated entities on the Company s Consolidated Balance Sheets. At June 30, 2006, the venture held approximately 337,000 acres of timberland located in the northeast, the majority of which is subject to a long-term supply agreement. The venture s net carrying value of the timber and timberlands at June 30, 2006 was $148.5 million. Net income for the venture is reflected in Other income on the Company s Consolidated Statements of Operations.

Note 8 Other Assets and Other Liabilities

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

	June 30, 2006	December 31, 2005
Deferred financing fees, net	$ 22,483	$ 13,731
Leasing costs, net	11,651	9,960
Corporate furniture, fixtures and equipment, net	4,794	3,777
Deferred derivative assets	27,192	13,176
Other assets	23,266	9,361
Deferred expenses and other assets	$ 89,386	$ 50,005

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

	June 30, 2006	December 31, 2005
Accrued interest payable	$ 76,167	$ 57,542
Security deposits from customers	23,609	23,274
Accrued expenses	17,718	27,794
Unearned operating lease income	12,004	20,778
Deferred derivative liabilities	41,106	32,148
Property taxes payable	5,001	4,578
Other liabilities	5,124	26,408
Accounts payable, accrued expenses and other liabilities	$ 180,729	$ 192,522

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

Note 9 Debt Obligations

As of June 30, 2006 and December 31, 2005 the Company has debt obligations under various arrangements with financial institutions as follows (in thousands):

	Maximum Amount Available	Carrying Value as of June 30, 2006	December 31, 2005	Stated Interest Rates(1)	Scheduled Maturity Date(1)
Secured revolving credit facility:					
Line of credit (2)	$ 500,000	$	$	LIBOR + 1.00% 2.00%	January 2009
Unsecured revolving credit facilities:					
Line of credit (3)	2,200,000	905,157	1,242,000	LIBOR + 0.525%	June 2011
Total revolving credit facilities	$2,700,000	905,157	1,242,000		
Secured term loans:					
Secured by CTL asset		129,977	132,246	7.44%	April 2009
Secured by CTL assets		143,565	145,586	6.80% 8.80%	Various through 2026
Secured by investments in corporate bonds and commerical mortgage backed securities (4)		90,945	67,224	LIBOR + 0.25% 0.70%	August 2006
Secured by CTL asset		59,022	59,430	6.41%	January 2013
Total term loans		423,509	404,486		
Debt (discount)/premium		6,369	6,658		
Total secured term loans		429,878	411,144		
Unsecured notes:					
LIBOR + 0.39% Senior Notes		400,000	400,000	LIBOR + 0.39%	March 2008
LIBOR + 0.55% Senior Notes		225,000	225,000	LIBOR + 0.55%	March 2009
LIBOR + 1.25% Senior Notes		200,000	200,000	LIBOR + 1.25%	March 2007
4.875% Senior Notes		350,000	350,000	4.875%	January 2009
5.125% Senior Notes		250,000	250,000	5.125%	April 2011
5.15% Senior Notes		700,000	700,000	5.15%	March 2012
5.375% Senior Notes		250,000	250,000	5.375%	April 2010
5.65% Senior Notes		500,000		5.65%	September 2011
5.70% Senior Notes		367,022	367,022	5.70%	March 2014
5.80% Senior Notes		250,000	250,000	5.80%	March 2011
5.875% Senior Notes		500,000		5.875%	March 2016
6.00% Senior Notes		350,000	350,000	6.00%	December 2010
6.05% Senior Notes		250,000	250,000	6.05%	April 2015
6.50% Senior Notes		150,000	150,000	6.50%	December 2013
7.00% Senior Notes		185,000	185,000	7.00%	March 2008
7.95% Notes			50,000	7.95%	May 2006
8.75% Notes		240,000	240,000	8.75%	August 2008
Total unsecured notes		5,167,022	4,217,022		
Debt discount		(78,817)	(78,151)		
Impact of pay-floating swap agreements (See Note 11)		(49,506)	(30,394)		
Total unsecured notes		5,038,699	4,108,477		
Other debt obligations		100,000	100,000	LIBOR + 1.50%	October 2035
Debt discount		(2,013)	(2,029)		
Total other debt obligations		97,987	97,971		
Total debt obligations		$ 6,471,721	$ 5,859,592		

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

Note 9 Debt Obligations (Continued) (Continued)

Explanatory Notes:

(1) All interest rates and maturity dates are for debt outstanding as of June 30, 2006. Most variable-rate debt obligations are based on 30-day LIBOR and reprice monthly. The 30-day LIBOR rate on June 30, 2006 was 5.33%. However, some variable-rate debt obligations are based on 90-day LIBOR and reprice every three months. The 90-day LIBOR rate on June 30, 2006 was 5.48%.

(2) Maturity date reflects one-year term-out extension at the Company s option.

(3) On June 28, 2006, the unsecured revolving credit facility was amended and restated with new terms. The maximum available to borrow under the facility was increased to $2.20 billion of which up to $750.0 million can be borrowed in multiple foreign currencies. The rate was decreased to LIBOR + 0.525% from LIBOR + 0.70%, the facility fee was decreased to 12.5 basis points from 15 basis points and the maturity date was extended to June 2011.

(4) Subsequent to quarter end, the Company extended the corporate bond portion of this financing for one year to August 2007 and the rate was reduced to LIBOR + 0.22% to LIBOR + 0.65%..

The Company s primary source of short-term funds is a $2.20 billion unsecured revolving credit facility. Under the facility the Company is required to meet certain financial covenants. As of June 30, 2006, there was approximately $1.27 billion available to draw under the facility. In addition, the Company has one secured revolving credit facility of which availability is based on percentage borrowing base calculations. The Company s debt obligations contain covenants that are both financial and non-financial in nature. Significant financial covenants include limitations on the Company s ability to incur indebtedness beyond specified levels, and a requirement to maintain specified ratios of unsecured indebtedness compared to unencumbered assets. Significant non-financial covenants include a requirement in its publicly-held debt securities that the Company offer to repurchase those securities at a premium if the Company undergoes a change of control. As of June 30, 2006, the Company believes it is in compliance with all financial and non-financial covenants on its debt obligations.