iStar Financial
2004 Annual Report

# evolve

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iStar Financial is the leading publicly traded financial services company dedicated to providing capital to the high-end commercial real estate markets.

We create shareholder value by tailoring loans, mortgages and corporate sale/leaseback financing for private and corporate owners and developers of signature office buildings, prestigious multifamily developments, hotels and other multimillion-dollar properties nationwide.

We are traded on the New York Stock Exchange under the ticker "SFI" and are professionally managed by a team of industry veterans. We have a diversified asset and customer base with a strong record of profitability and customer service.

At iStar, we seek to deliver a growing dividend and superior risk-adjusted returns on equity to our shareholders. We have consistently grown our revenue and asset base, increased our annual dividend per share, and demonstrated growing returns on shareholder equity since becoming a public company in 1998.

# iStar Financial: Creative Capital Solutions

## When did we begin our business?

We began our business in 1993 and operated as part of a private company for the next five years. During that time, we raised over $750 million in equity capital from leading institutional and high-net worth investors such as the IBM, DuPont and GM pension funds, as well as the Ziff, Pritzker and Burden (Vanderbilt) families. From 1998 through 2000, we completed a number of strategic corporate acquisitions to complement our organic growth and enhance our business franchise. The company began trading on the New York Stock Exchange on November 4, 1999. As of December 31, 2004, we had approximately $7.1 billion in diverse loan and lease assets under management.

## Who guides our company?

Our management group is deep, with a proven record through many market and interest rate cycles. Our team of professionals has extensive experience and industry expertise in corporate credit, real estate and capital markets.

We think of ourselves as a “private banker” to the high-end corporate real estate market, building our business on trust, integrity and dedication to our customers, employees and shareholders.

We work hard to reward our customers with fast, flexible and highly customized capital solutions for all their real estate needs. That strategy has rewarded our shareholders with superior double-digit returns on equity, increased dividends and helped us build a $5 billion plus equity market capitalization at the end of fiscal 2004.

## What do we do?

Our goal is to achieve superior returns by providing sophisticated customers with custom-tailored capital.

We have six product lines including senior mortgage loans, junior mortgage loans, construction loans, mezzanine loans, corporate loans and corporate sale/leaseback financing.

We earn money on both the interest we charge on our loans and on the rents we collect from our building and property leases.

Currently, we operate our business primarily in asset-rich major metropolitan markets throughout the United States including New York, Atlanta, Boston, Dallas, San Francisco and Chicago. Our in-house loan-servicing center is based in Hartford, Connecticut, and our Corporate Headquarters is located in New York City.

## What makes us different?

Since our inception, we have structured and originated over $12 billion of real estate financing transactions, with approximately 55% of these transactions coming from repeat customers who value the iStar experience. We believe we have established superior relationships with our customers, with a consistent record of solving their complicated real estate issues. We earned these valued relationships with creative, custom-tailored financing solutions…competitive pricing…speed…flexibility…and a dedication to providing the highest level of customer service with professionalism and integrity.

Unlike most of our competition, we keep all of our financings on our balance sheet. We offer complete in-house service and support to our customers from an integrated team of professionals both pre- and post-financing. This team provides our customers access to market intelligence and is comprised of financing experts, asset managers, construction engineers and loan servicers. This means our customers have a responsive, single point of contact for questions on their loan or lease. Our deep and experienced team also plays an important role in protecting the company’s assets and helps ensure that iStar finances the best opportunities.

We hold “investment grade” status at Moody’s, Standard & Poor’s and Fitch, the three major rating agencies. We operate as a Real Estate Investment Trust or REIT, which means we do not pay corporate federal income taxes. However, we are different from many of the traditional REITs who are focused on property investment.

Think of us as a premium finance company focusing on the high-end commercial real estate markets–markets where customers expect first-class service and support. It is a segment of the market where customers require large-scale, innovative, custom-tailored financing alternatives…iStar Financial's specialty.

We believe this high-service, high-quality strategy yields superior results. In a world of commodity providers of financing, we offer an alternative: custom-tailored financing from an experienced team of professionals that is one call away for the life of the loan or corporate lease.

***"It has been our pleasure to work repeatedly with the real estate financing experts at iStar Financial. Their team of professionals continues to impress us with their speed, flexibility and creative custom-tailored solutions. Our experience has clearly had a positive impact on our business."***

Mark Schlossberg
Managing Director
Southwest Value Partners

## How strong is our balance sheet?

With over $2 billion of tangible book equity, an equity market cap in excess of $5 billion and one of the lowest loss ratios in the financing industry, we clearly have one of the strongest balance sheets in the sector.

Our risk management team continually monitors and fine-tunes our growing and diverse portfolio of assets to mitigate risk. We seek to minimize any interest rate exposure so that our earnings are shielded from changes in interest rates. This means we try to match our fixed and floating rate assets (loans and leases) with our fixed and floating rate liabilities (corporate debt) with similar maturity profiles.

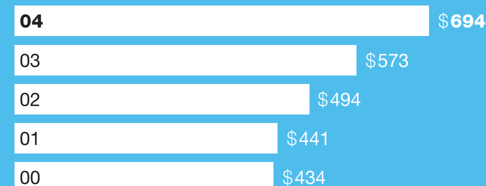
From a credit perspective, we are currently rated "investment grade" by all three major rating agencies.

## Why might you consider an investment in iStar?

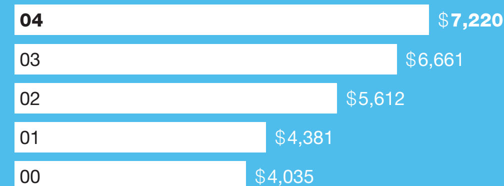
We have a consistent record of producing growing dividends and returns on equity in the 15% – 20% range. We have an experienced and growing management team that is clearly aligned with shareholder interests. We have a portfolio of high-value investments in major assets across the country.

We believe you will find the long-term prospects of our company attractive, having proven our ability for over a decade to consistently identify favorable market opportunities, attract new customers, build long-term business relationships, and deliver consistent value to our shareholders.

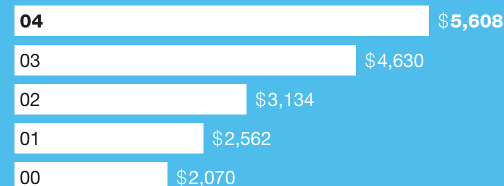
Revenues
*dollars in millions*



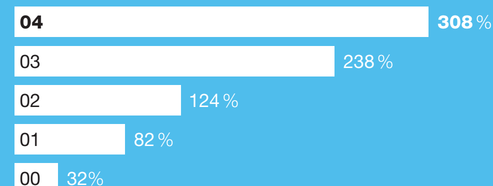

Total Assets
*dollars in millions*




Equity Market Capitalization
*dollars in millions*




Five-Year Total Cumulative Shareholder Returns
*(including dividends)*



# iStar Financial
# A Plan for Growth…
# A Strategy for Success

## Phase 1
## Foundation

We began our company in 1993 to capture what we believed were significant opportunities in the underserved segments of the high-end real estate market. As a private company for our first five years, we built a solid foundation for iStar. We added marquee clients, many of whom are still our customers today. We learned many important lessons about the high-end marketplace, formed our views on many markets and asset classes and developed our competitive advantages, namely our ability to cross over seamlessly between the real estate markets, capital markets and corporate finance markets. We also began identifying those customers who were most interested in iStar's highly personalized, high-integrity approach to the business.

Our mission remains the same today as it was at our inception: to be the premier provider of flexible financing solutions to underserved segments of the high-end real estate market while delivering attractive risk-adjusted returns to our valued shareholders. And we have not changed the core values that guide the way we do business, operating with a high degree of integrity, honesty and customer service.

## Phase 2
## Expansion

Moving into the public markets kicked off phase two, which began in earnest with the $1.5 billion acquisition of TriNet Corporate Realty Trust, which was then the largest triple net lease company in the public markets.

Success led to a natural expansion of our business as we established the company's reach with our customers. We focused on educating the market on iStar's unique approach to real estate financing, clearly differentiating our model from the more prevalent syndication, securitization and commercial finance models that then existed.

We made a number of other strategic corporate acquisitions to complement our organic growth and extend our business franchise during this phase. We took a number of important steps that have helped make iStar Financial the leading publicly traded finance company focused on the commercial real estate industry. In 2004, we received "investment grade" ratings from all three major rating agencies, significantly strengthening our cost advantage in the marketplace. At the end of 2004, we had approximately $7.1 billion in diverse loan and lease assets under management.

Our financial results during this phase have been excellent, demonstrating our commitment to our shareholders. For example, we grew our revenues by 168%, increased our total assets by approximately 90% and delivered total cumulative shareholder returns, including dividends, of 308%.

## Phase 3
## Evolution

Today, we continue to look at the various changes in the market and make what we believe are prudent, strategic decisions to better position and realign the company to adjust to these dynamics. We are going to utilize the same type of forward thinking that served us so well in phases one and two, while remaining true to the strengths and market position we have clearly staked out with our customers. We are executing our plans to move the business forward with what we believe is a natural evolution of our business. Over the next five years, we expect to focus on expanding our market-leading platforms, adding key personnel, building strategic relationships and working on delivering the most comprehensive capital solutions to the marketplace.

iStar
core
values >

a plan
for growth
...a strategy
for success

# The evolution of iStar Financial

**creative capital solutions** — disciplined investment strategy — foresight — proven track record — investment grade — natural evolution

# To Our Valued Shareholders:

2004 marked the final year of a highly successful five-year period for iStar Financial and its shareholders. During 2004, iStar's revenues and originations reached record levels with shareholder returns exceeding 20% for the fifth consecutive year. These strong results capped a five-year period in which iStar's total revenue increased by 168%, net investment income increased by 144%, total equity market value surpassed $5 billion and cumulative shareholder returns exceeded 300%.

By challenging conventional thinking about the real estate finance world and bringing a range of new ideas to bear for our high-end customers, we were able to convincingly meet the very high goals we set for ourselves when we first laid out the iStar story to the public markets in late 1999.

But markets rarely stand still and we have begun to see change affect our markets. Having worked for years to convince others that iStar's real estate finance transactions represented some of the best risk-adjusted returns in the entire capital markets, we were not altogether surprised that the rest of the

capital markets finally reached the same conclusion during 2004. This was evidenced by dramatic capital inflows into the sector and increasingly tighter spreads during the year. Working with our deep customer base, we continued to lead the market, while realizing the time was approaching when we would need to expand our capabilities and once again position ourselves ahead of the market and apart from the conventional thinking that usually governs the majority of capital.

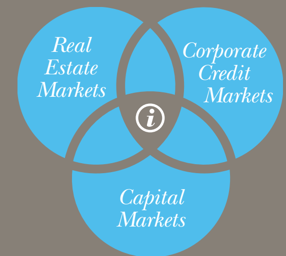
As a result, we have launched a series of initiatives in order to maintain our leading position in the high-end of the market for real estate finance, and have set ambitious goals for our company for the coming five years. I want to use this letter to outline those goals and to give you our views on how the market and iStar will evolve over that time period.

## The Next Five Years

Our objective over the next five years is ambitious and wide-ranging – to build a world-class commercial real estate finance platform with market-leading expertise in the real estate arena, in the corporate finance sector and in the capital markets pricing of risk.

Given the nearly $200 billion estimated market size of the high-end real estate finance market, we believe this platform will enable us to access a broad spectrum of market opportunities and to grow our business over this period at very attractive rates. To achieve this goal, we will not need to operate differently, but rather, we will continually build on the foundation we have established since our inception.

As those of you who have followed our company know, over the years we have started almost every presentation of our company with the diagram you see to the right – a diagram that captures much of our thinking about our business.




Crossover
Market Strategy

Two important concepts can be found in this simple diagram. First, our belief that the most attractive investment areas, and often the ones most overlooked or least understood, stand at the intersection of markets – in transactions that do not necessarily fit neatly into any simple category, but combine elements of several different markets. iStar has a long history of combining expertise from multiple markets to deliver faster, better, more creative capital solutions to customers who fall into these zones.

Second, our belief that real estate is not a separate asset class with different investment rules than the general market, but one that is inextricably tied to what is going on in the corporate credit and capital markets.

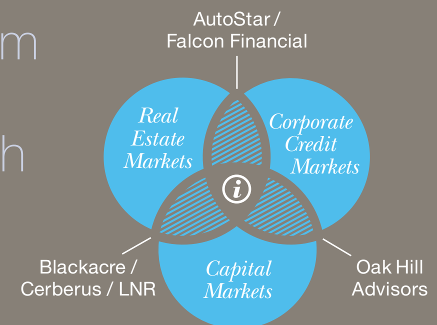
To identify good real estate investments, we need to be watching the entire spectrum of investments taking place in the capital markets and understand trends developing throughout the corporate credit markets – only then can we truly identify "better than market" opportunities. For our shareholders, our expertise in real estate, corporate credit analysis and capital market pricing has consistently enabled us to identify favorable transactions that offer better than market returns with substantially less risk.

Both of these concepts have driven our strategy since the beginning and each will play a key role in our strategy over the next five years. After much analysis, we have concluded the most important step for iStar during 2005 is to significantly expand our knowledge base in each of our core disciplines, positioning us to increasingly mine the crossover sectors that have historically yielded the richest financing opportunities.

# Key Initiatives

Recently, we announced several key initiatives that will go a long way to helping us expand our information platforms in each of the crossover sectors we are targeting. As you can see in the expanded diagram to the right, these initiatives show the natural evolution of our core business strategy as we push further into the crossover sectors.

Let me explain these initiatives in detail.




Expanded Crossover Market Strategy

First, it has always been one of our goals to have a world-class corporate credit ability as part of iStar. We have been building a strong in-house credit group for many years to support our existing sale/leaseback and lending platforms. However, as we sought to expand our capabilities to meet our customers' needs, it became clear that the opportunities were going to outstrip our in-house resources. The goal we set out as part of our five-year plan was to link up with an existing powerhouse credit platform in a way that would deliver both the reach and expertise we sought, but not fundamentally change our business or the management of our business.

The solution we recently announced was to acquire a substantial minority interest in what we believe is one of the oldest, strongest and most respected corporate credit investors in the market, Oak Hill Advisors.

Oak Hill Advisors met the extensive criteria we set out for the right partner in the corporate credit field, including a senior management team of highly motivated individuals, a leading position in the field and a wealth of corporate information flows. The firm currently has over $5 billion in assets under management and has a long history covering over $25 billion of investments in the corporate credit world. Finally, and most importantly, Oak Hill Advisors' corporate culture and investment philosophy were nearly identical to iStar's.

We believe Oak Hill Advisors' long-standing strategic relationship with the Robert Bass organization and the other Oak Hill partnerships will lead to further opportunities to extend our reach with one of the leading investment platforms in the country. Our goal is to have at our fingertips a deep and highly knowledgeable network of experts in a variety of fields via our Oak Hill Advisors relationship, and the capability to better capture opportunities that fall in

the crossover between the corporate finance and real estate arenas. Given that Oak Hill Advisors has invested in over 400 different corporate credits in its history, we know this investment can quickly enhance our underwriting capabilities on a wide range of transactions.

A second major initiative that will mark the coming years involves large niche businesses where the operating side of a business is inextricably tied to a large real estate investment. The target customer in these sectors needs a finance source that not only can understand its real estate, but also can understand its unique operating business – with the necessary crossover expertise significantly narrowing the field of competitors.

Just as importantly, very few finance providers can then go the additional step and offer a fully customized suite of finance products to meet almost any capital need the customer might have. We are targeting such markets with a new series of "iStar" branded platforms, each with three major criteria:

I. The ability to reach $1 billion in assets within a three-year time frame

II. The existence of high-end customers who will have significant capital needs in the coming years

III. The absence of any qualified full-service provider today who can equal iStar in the range of products offered

The most visible of our projected platforms is AutoStar, a platform that combines iStar's capital and financing expertise with the nuts and bolts automotive retailing expertise of the Staubach organization and the automotive industry capital markets knowledge of Presidio Capital.

Why AutoStar? Well, let's look at the three criteria we set out for our "iStar" branded platforms:

$1 billion potential? The Staubach organization estimates that over $50 billion of real estate is tied up in auto dealerships, so we think our $1 billion goal is a very realistic one.

Existence of high-end customers with significant capital needs in the years ahead? We believe the auto-retailing sector has a large proportion of high-net-worth owners who are now faced with capital-intensive imaging upgrade campaigns from most of the major automakers. There is no question that the industry is beginning a period of major capital deployment, and dealers will be looking for new and creative capital solutions.

No one-stop provider of choice? While various firms offer one or more pieces of the capital puzzle for auto dealers, we have not been able to identify anyone truly offering the range of long and short-term capital that iStar can provide, as well as the range of advisory services the Staubach organization can deliver. Together, we think we offer a compelling package to the auto dealer community.

In order to accelerate our penetration in this market, we recently announced the acquisition of Falcon Financial, a public company that has provided financing to the auto dealer world for the last seven years. We believe that under the iStar umbrella, we can bring a fundamentally better mousetrap to the Falcon business and, together with the AutoStar platform, begin to make a meaningful impact on this $50 billion-plus market. While AutoStar is the first of our "iStar" branded platforms, we expect over the next five years to create other businesses that fit this same profile.

Lastly, as more real estate finance flows throughout the commercial mortgage backed securities (CMBS) world, we think it is important to have a window into that world to round out our market leading information flows and to keep close tabs on the ongoing interaction of the real estate and capital markets. While not a core market for us, we are working to make sure we have an understanding of this marketplace and we were pleased to announce a third key initiative at the beginning of 2005.

iStar customer Blackacre Capital and its parent Cerberus Capital, one of the most active investors in the investment world today, recently acquired LNR Property Corporation, a company long recognized as having one of the largest platforms in the CMBS and special servicing world. Recognizing both the opportunity and potential that Blackacre / Cerberus will have after acquiring the LNR platform, we moved quickly to become the lead investor in the acquisition financing put in place by the new owners, taking leading positions in the senior debt, the mezzanine debt and corporate level debt, as well as taking a

small equity position alongside Blackacre / Cerberus. Knowing both Blackacre and LNR quite well, we believe Blackacre / Cerberus will materially expand the LNR platform in the years to come and we believe iStar will be well-positioned to provide them with custom-tailored capital when the need arises.

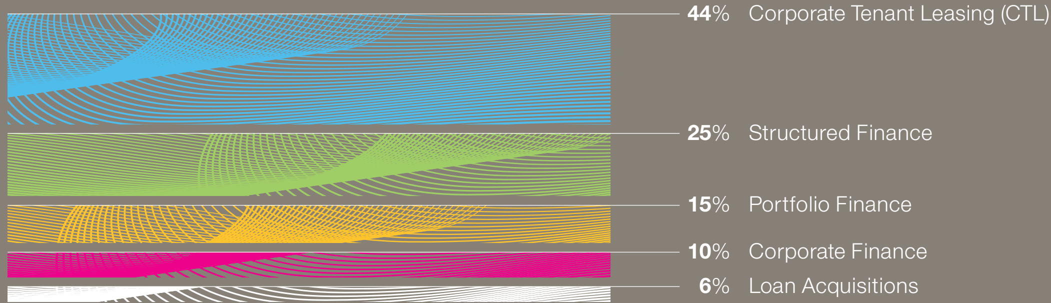
With these initiatives in place, we are making the investments necessary to strengthen the position of our company for the next five years. We believe our expanded strategy is a natural evolution of our business and one that will help us continue to deliver solid and consistent returns to our shareholders. We thank you for your continued support.

Sincerely,

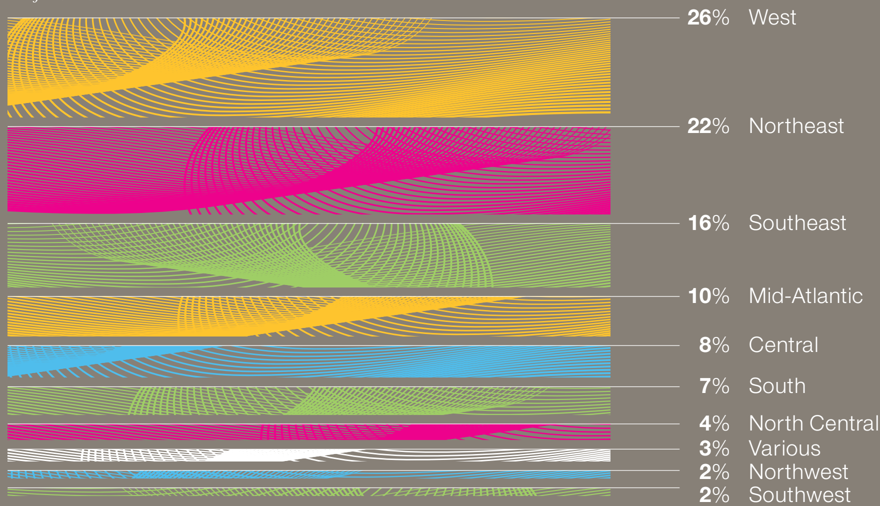
Jay Sugarman
Chairman and Chief Executive Officer

# iStar Financial: Portfolio Highlights

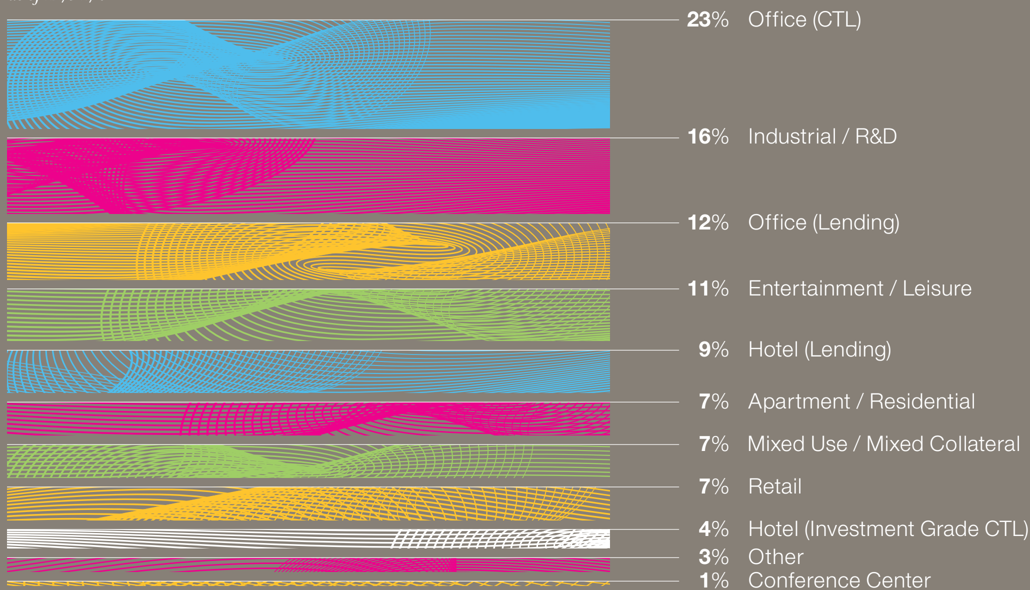
## Product Line
*as of 12/31/04*




## Geographic Diversification of Assets
*as of 12/31/04*




## Property Type
*as of 12/31/04*



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## SELECTED FINANCIAL DATA

The following table sets forth selected financial data on a consolidated historical basis for the Company. This information should be read in conjunction with the discussions set forth in "Management's Discussion and Analysis of Financial Condition and Results of Operations." Certain prior year amounts have been reclassified to conform to the 2004 presentation.

| For the Years Ended December 31, | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| | | (In thousands, except per share data and ratios) | | | |
| **Operating Data:** | | | | | |
| Interest income | **$ 353,799** | $ 304,391 | $ 255,631 | $ 254,119 | $ 268,011 |
| Operating lease income | **286,389** | 232,043 | 210,033 | 155,980 | 148,144 |
| Other income | **54,236** | 36,677 | 27,993 | 30,921 | 17,902 |
| Total revenue | **694,424** | 573,111 | 493,657 | 441,020 | 434,057 |
| Interest expense | **231,027** | 192,296 | 184,932 | 169,585 | 173,143 |
| Operating costs – corporate tenant lease assets | **22,417** | 11,553 | 6,735 | 5,198 | 5,811 |
| Depreciation and amortization | **64,541** | 50,626 | 42,579 | 30,645 | 29,913 |
| General and administrative | **47,912** | 38,153 | 30,449 | 24,151 | 25,706 |
| General and administrative – stock-based compensation | **109,676** | 3,633 | 17,998 | 3,574 | 2,864 |
| Provision for loan losses | **9,000** | 7,500 | 8,250 | 7,000 | 6,500 |
| Loss on early extinguishment of debt | **13,091** | – | 12,166 | 1,620 | 705 |
| Total costs and expenses | **497,664** | 303,761 | 303,109 | 241,773 | 244,642 |
| Income before equity in earnings from joint ventures and unconsolidated subsidiaries, minority interest and other items | **196,760** | 269,350 | 190,548 | 199,247 | 189,415 |
| Equity in earnings (loss) from joint ventures and unconsolidated subsidiaries | **2,909** | (4,284) | 1,222 | 7,361 | 4,796 |
| Minority interest in consolidated entities | **(716)** | (249) | (162) | (218) | (195) |
| Cumulative effect of change in accounting principle[1] | **–** | – | – | (282) | – |
| Income from continuing operations | **198,953** | 264,817 | 191,608 | 206,108 | 194,016 |
| Income from discontinued operations | **18,119** | 22,173 | 22,945 | 22,659 | 20,622 |
| Gain from discontinued operations | **43,375** | 5,167 | 717 | 1,145 | 2,948 |
| Net income | **$ 260,447** | $ 292,157 | $ 215,270 | $ 229,912 | $ 217,586 |
| Preferred dividend requirements | **(51,340)** | (36,908) | (36,908) | (36,908) | (36,908) |
| Net income allocable to common shareholders and HPU holders[2] | **$ 209,107** | $ 255,249 | $ 178,362 | $ 193,004 | $ 180,678 |
| Basic earnings per common share[3] | **$ 1.87** | $ 2.52 | $ 1.98 | $ 2.24 | $ 2.11 |
| Diluted earnings per common share[3][4] | **$ 1.83** | $ 2.43 | $ 1.93 | $ 2.19 | $ 2.10 |
| Dividends declared per common share[5] | **$ 2.79** | $ 2.65 | $ 2.52 | $ 2.45 | $ 2.40 |
| **Supplemental Data:** | | | | | |
| Adjusted diluted earnings allocable to common shareholders and HPU holders[6][8] | **$ 270,946** | $ 341,777 | $ 262,786 | $ 254,095 | $ 230,371 |
| EBITDA[7][8] | **$ 561,849** | $ 543,235 | $ 448,673 | $ 435,675 | $ 425,991 |
| Ratio of EBITDA to interest expense | **2.41x** | 2.79x | 2.42x | 2.56x | 2.45x |
| Ratio of EBITDA to combined fixed charges[9] | **1.98x** | 2.34x | 2.02x | 2.10x | 2.02x |
| Ratio of earnings to fixed charges[10] | **1.84x** | 2.39x | 2.05x | 2.18x | 2.11x |
| Ratio of earnings to fixed charges and preferred stock dividends[10] | **1.51x** | 2.01x | 1.71x | 1.80x | 1.74x |
| Weighted average common shares outstanding – basic | **110,205** | 100,314 | 89,886 | 86,349 | 85,441 |
| Weighted average common shares outstanding – diluted | **112,464** | 104,101 | 92,649 | 88,234 | 86,151 |
| Cash flows from: | | | | | |
| Operating activities | **$ 363,132** | $ 338,262 | $ 348,793 | $ 293,260 | $ 219,868 |
| Investing activities | **(532,395)** | (974,354) | (1,149,070) | (349,525) | (193,805) |
| Financing activities | **177,595** | 700,248 | 800,541 | 49,183 | (37,719) |

| For the Years Ended December 31, | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| | | (In thousands, except per share data and ratios) | | | |
| **Balance Sheet Data:** | | | | | |
| Loans and other lending investments, net | **$3,946,189** | $3,702,674 | $3,050,342 | $2,377,763 | $2,227,083 |
| Corporate tenant lease assets, net | **2,877,042** | 2,535,885 | 2,291,805 | 1,781,565 | 1,592,087 |
| Total assets | **7,220,237** | 6,660,590 | 5,611,697 | 4,380,640 | 4,034,775 |
| Debt obligations | **4,605,674** | 4,113,732 | 3,461,590 | 2,495,369 | 2,131,967 |
| Minority interest in consolidated entities | **19,246** | 5,106 | 2,581 | 2,650 | 6,224 |
| Shareholders' equity | **2,455,242** | 2,415,228 | 2,025,300 | 1,787,778 | 1,787,885 |
| **Supplemental Data:** | | | | | |
| Total debt to shareholders' equity | **1.9x** | 1.7x | 1.7x | 1.4x | 1.2x |

**Explanatory Notes:**

(1) Represents one-time effect of adoption of Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" as of January 1, 2001.

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

(3) For the 12 months ended December 31, 2004, net income used to calculate earnings per basic and diluted common share excludes $3,314 and $3,265 of net income allocable to HPU holders, respectively. For the 12 months ended December 31, 2003, net income used to calculate earnings per basic and diluted common share excludes $2,066 and $1,994 of net income allocable to HPU holders, respectively.

(4) For the 12 months ended December 31, 2004 and 2003, net income used to calculate earnings per diluted common share includes joint venture income of $3 and $167, respectively.

(5) The Company generally declares common and preferred dividends in the month subsequent to the end of the quarter.

(6) Adjusted earnings represents net income allocable to common shareholders and HPU holders computed in accordance with GAAP, before depreciation, amortization, gain from discontinued operations, extraordinary items and cumulative effect of change in accounting principle. For the year ended December 31, 2004, adjusted earnings includes a $106.9 million charge related to performance-based vesting of 100,000 restricted shares granted under the Company's long-term incentive plan to the Chief Financial Officer, the vesting of 2.0 million phantom shares on March 30, 2004 to the Chief Executive Officer, the one-time award of Common Stock with a value of $10.0 million to the Chief Executive Officer, the vesting of 155,000 restricted shares granted to several employees and the Company's share of taxes associated with these transactions. For the year ended December 31, 2002, adjusted earnings includes the $15.0 million charge related to the performance based vesting of restricted shares granted under the Company's long-term incentive plan. For years ended December 31, 2004, 2003, 2002, 2001 and 2000, adjusted diluted earnings includes approximately $9.6 million, $0, $4.0 million, $1.0 million and $317,000 of cash paid for prepayment penalties associated with early extinguishment of debt. (See reconciliation in "Management's Discussion and Analysis of Financial Condition and Results of Operations").

(7) EBITDA is calculated as net income plus the sum of interest expense and depreciation and amortization (which includes the interest expense and depreciation and amortization reclassed to income from discontinued operations).

| For the Years Ended December 31, | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| Net income | **$260,447** | $292,157 | $215,270 | $229,912 | $217,586 |
| Add: Interest expense[1] | **232,919** | 194,999 | 185,362 | 170,121 | 173,891 |
| Add: Depreciation and amortization[2] | **68,483** | 56,079 | 48,041 | 35,642 | 34,514 |
| EBITDA | **$561,849** | $543,235 | $448,673 | $435,675 | $425,991 |

**Explanatory Notes:**

(1) For the years ended December 31, 2004, 2003, 2002, 2001 and 2000, interest expense includes $1,892, $2,703, $430, $536 and $748 of interest expense reclassed to discontinued operations.

(2) For the years ended December 31, 2004, 2003, 2002, 2001 and 2000, depreciation and amortization includes $3,942, $5,453, $5,462, $4,997 and $4,601 of depreciation and amortization reclassed to discontinued operations.

(8) Each of adjusted earnings and EBITDA should be examined in conjunction with net income as shown in the Consolidated Statements of Operations. Neither adjusted earnings nor EBITDA should be considered as an alternative to net income (determined in accordance with GAAP) as an indicator of the Company's performance, or to cash flows from operating activities (determined in accordance with GAAP) as a measure of the Company's liquidity, nor is either measure indicative of funds available to fund the Company's cash needs or available for distribution to shareholders. Rather, adjusted earnings and EBITDA are additional measures the Company uses to analyze how its business is performing. Its should be noted that the Company's manner of calculating adjusted earnings and EBITDA may differ from the calculations of similarly-titled measures by other companies.

(9) Combined fixed charges comprise interest expense (including amortization of original issue discount) and preferred stock dividend requirements.

(10) For the purposes of calculating the ratio of earnings to fixed charges, "earnings" consist of income from continuing operations before adjustment for minority interest in consolidated subsidiaries, or income or loss from equity investees, income taxes and cumulative effect of change in accounting principle plus "fixed charges" and certain other adjustments. "Fixed charges" consist of interest incurred on all indebtedness related to continuing and discontinued operations (including amortization of original issue discount) and the implied interest component of the Company's rent obligations in the years presented.

**General**

The Company is in the business of providing custom-tailored financing solutions to high-end private and corporate owners of real estate. Depending upon market conditions and the Company's views about the economy generally and real estate markets specifically, the Company will adjust its investment focus from time to time and emphasize certain products, industries and geographic markets over others.

The Company began its business in 1993 through private investment funds formed to take advantage of the underserved segments of the commercial real estate financing markets and what it felt were a lack of well-capitalized lenders capable of servicing the needs of customers in its markets. In March 1998, these private investment funds contributed their approximately $1.1 billion of assets to the Company's predecessor in exchange for a controlling interest in that public company. In November 1999, the Company acquired its leasing subsidiary, TriNet Corporate Realty Trust, Inc. ("TriNet" or the "Leasing Subsidiary"), which was then the largest publicly-traded company specializing in corporate sale/leaseback financing for office and industrial facilities (the "TriNet Acquisition"). Concurrent with the TriNet Acquisition, the Company also acquired its former external advisor in exchange for shares of its Common Stock and converted its organizational form to a Maryland corporation. The Company's Common Stock began trading on the New York Stock Exchange under the symbol "SFI" in November 1999.

The Company has experienced significant growth since becoming a public company in 1998, having made a number of strategic acquisitions to complement its organic growth and extending its business franchise. Transaction volume for the fiscal year ended December 31, 2004 was $2.8 billion, compared to $2.2 billion in 2003 and $1.7 billion in 2002. The Company completed 53 financing commitments in 2004, compared to 60 in 2003 and 41 in 2002. Repeat customer business has become a key source of transaction volume for the Company, accounting for approximately 55% of the Company's cumulative volume through the end of 2004. Based upon feedback from its customers, the Company believes that greater recognition of the Company and its reputation for completing highly structured transactions in an efficient manner, have contributed to increases in its transaction volume. The benefits of higher investment volumes were mitigated to an extent by the extremely low interest rate environment in 2002, 2003 and 2004. Low interest rates benefit the Company in that its borrowing costs decrease, but similarly, earnings on its variable-rate lending investments also decrease.

During the difficult economic and real estate market conditions of 2002 and 2003, the Company focused its investment activity on lower risk investments such as first mortgages and CTL transactions that met its risk adjusted return standards. The Company has experienced minimal losses on its lending investments. In 2003, the Company also focused on re-leasing space at its CTL facilities under longer-term leases in an effort to reduce the impact of lease expirations on the Company's earnings. As of December 31, 2004, the weighted average lease term on the Company's CTL portfolio was 11.2 years and the portfolio was 95% leased.

The Company has continued to broaden its sources of capital and was particularly active in the capital markets over the past two years. The Company's strong performance and the low interest rate environment enabled the Company to issue preferred equity and debt securities on attractive pricing terms. The Company used the proceeds from the issuances to repay secured indebtedness, to refinance higher cost capital and to fund additional investments. In 2004, the Company continued to make progress on migrating its debt obligations from secured debt towards unsecured debt. While the Company considers it prudent to have a broad array of sources of capital, including secured financing arrangements, the Company will continue to seek to reduce its use of secured debt and increase its use of unsecured debt. As a result of its shift to unsecured debt and its strong credit and operating history, in October of 2004 the Company's senior unsecured debt rating was upgraded to investment grade by Standard & Poor's ("S&P") and Moody's Investors Service ("Moody's"). As an investment grade issuer, the Company believes that it will have greater access to the unsecured debt markets and a reduced cost of debt capital.

Beginning in 2003, and throughout 2004, the commercial real estate industry attracted large amounts of investment capital. The Company intends to maintain its disciplined approach to underwriting its investments and will adjust its focus away from markets and products where the Company believes that the available pricing terms do not fairly reflect the risks of the investments. As a result of increased investment activity in both the public and private commercial real estate markets, many of the Company's borrowers were able to prepay loans with proceeds from initial public offerings, asset sales or refinancings. As a consequence, the Company experienced a higher level of prepayments in 2004 than in previous years. If interest rates remain low in 2005, the Company expects to see continued levels of high prepayments. The Company's loans generally have some form of call protection, so many of the prepayments generated significant prepayment penalties. Increased prepayment penalties will result in higher current "Other income" on the Company's Consolidated Statements of Operations, which will be offset by reduced "Interest income" on the Company's Consolidated Statement of Operations. In 2004, the Company took advantage of the strong real estate sales market by selectively selling certain non-core CTL assets. Sales of assets will result in a reduction in "Operating lease income" on the Company's Consolidated Statements of Operations and will also result in "Gains from discontinued operations" on the Company's Consolidated Statements of Operations.

The Company continues to see strong capital inflows into the real estate sector as interest rates remain at historical low levels and as most markets continue to show improved underlying fundamentals. This increased capital has resulted in a highly competitive real estate financing environment with reduced financing spreads. Despite this trend, the Company will continue to maintain its disciplined investment strategy and deploy its capital to those opportunities that demonstrate the most attractive returns. The Company's lower cost of funds, due to its senior unsecured debt rating upgrade to investment grade by S&P and Moody's in October 2004, should enable the Company to increase the velocity of its originations by making attractive investments that the Company was previously unable to compete effectively for due to its higher cost of capital. In response to these market trends and as part of the continued expansion of its existing real estate,

corporate credit and capital markets capabilities, the Company is investing in several new acquisitions and strategic business relationships which should enable it to offer new financing products and to bring its custom-tailored financing approach to several new markets. (See Note 17 – Subsequent Events to the Company's Consolidated Financial Statements.)

## Results of Operations

The Company's earnings for the 12 months ended December 31, 2004, reflect the following charges from the first quarter of 2004:

- A $106.9 million stock-based compensation charge relating to the full vesting of: (1) 2.0 million incentive shares awarded to its Chief Executive Officer under his March 2001 employment agreement; (2) 236,167 shares of Common Stock awarded to its Chief Executive Officer that are restricted from sale for five years unless performance thresholds in the Company's Common Stock price are met; (3) 100,000 restricted performance shares awarded to its Chief Financial Officer when she joined the Company in 2002; and (4) 155,000 shares of Common Stock awarded to several employees during 2002;
- An $11.5 million charge relating to the redemption of $110.0 million of the Company's 8.75% Senior Notes due 2008 at a redemption price of 108.75% of the principal amount of the notes being redeemed; and
- A $9.0 million charge to net income allocable to common shareholders and HPU holders relating to the redemption of all the Company's outstanding 9.375% Series B and 9.200% Series C Cumulative Redeemable Preferred Stock.

### Year Ended December 31, 2004 Compared to Year Ended December 31, 2003

**Interest income** – Interest income increased by $49.4 million to $353.8 million for the 12 months ended December 31, 2004 from $304.4 million for the same period in 2003. This increase was primarily due to $106.4 million of interest income on new originations or additional fundings, offset by a $56.1 million decrease from the repayment of loans and other lending investments. This increase was also due to an increase in interest income on the Company's variable-rate lending investments as a result of higher average one-month LIBOR rates of 1.50% in 2004, compared to 1.21% in 2003.

**Operating lease income** – Operating lease income increased by $54.4 million to $286.4 million for the 12 months ended December 31, 2004 from $232.0 million for the same period in 2003. Of this increase, $63.7 million was attributable to new CTL investments and the consolidation of Sunnyvale in March 2004 and ACRE Simon in November 2004. This increase was partially offset by $9.2 million of lower operating lease income due to vacancies and lower rental rates on certain CTL assets.

**Other income** – Other income generally consists of prepayment penalties and realized gains from the early repayment of loans and other lending investments, financial advisory and asset management fees, lease termination fees, mortgage servicing fees, loan participation payments and dividends on certain investments. During the 12 months ended December 31, 2004, other income included realized gains on sale of lending investments of $8.3 million, income from loan repayments and prepayment penalties of $37.2 million, lease termination, asset management, mortgage servicing and other fees of approximately $6.3 million and other miscellaneous income such as dividend payments of $2.4 million.

During the 12 months ended December 31, 2003, other income included realized gains on sale of lending investments of $16.3 million, income from loan repayments and prepayment penalties of $17.3 million, asset management, mortgage servicing and other fees of approximately $2.6 million and other miscellaneous income such as dividend payments of $489,000.

**Interest expense** – For the 12 months ended December 31, 2004, interest expense increased by $38.7 million to $231.0 million from $192.3 million for the same period in 2003. This increase was primarily due to higher average borrowings on the Company's unsecured debt obligations. This increase was also due to higher average one-month LIBOR rates, which averaged 1.50% in 2004 compared to 1.21% in 2003, on the unhedged portion of the Company's variable-rate debt and by a $3.0 million increase in amortization of deferred financing costs on the Company's debt obligations in 2004 compared to the same period in 2003.

**Operating costs – corporate tenant lease assets** – For the 12 months ended December 31, 2004, operating costs increased by approximately $10.8 million to $22.4 million from $11.6 million for the same period in 2003. This increase is primarily related to new CTL investments and higher unrecoverable operating costs due to vacancies on certain CTL assets.

**Depreciation and amortization** – Depreciation and amortization increased by $13.9 million to $64.5 million for the 12 months ended December 31, 2004 from $50.6 million for the same period in 2003. This increase is primarily due to depreciation on new CTL investments.

**General and administrative** – For the 12 months ended December 31, 2004, general and administrative expenses increased by $9.7 million to $47.9 million, compared to $38.2 million for the same period in 2003. This increase is primarily due to an increase in payroll related and other costs resulting from employee growth and the consolidation of iStar Operating.

**General and administrative – stock-based compensation** – General and administrative – stock-based compensation increased by $106.1 million to $109.7 million for the 12 months ended December 31, 2004 compared to $3.6 million for the same period in 2003. In the first quarter 2004, the Company recognized a charge of approximately $106.9 million composed of $4.1 million for the performance-based vesting of 100,000 restricted shares granted under the Company's long-term incentive plan to the Chief Financial Officer, $86.0 million for the vesting of 2.0 million phantom shares on March 30, 2004 granted to the Chief Executive Officer, $10.1 million for the one-time award of Common Stock to the Chief Executive Officer and $6.7 million for the vesting of 155,000 restricted shares granted to several employees.

**Provision for loan losses** – The Company's charge for provision for loan losses increased to $9.0 million for the 12 months ended December 31, 2004 compared to $7.5 million in the same period in 2003. As more fully discussed in Note 4 to the Company's Consolidated Financial Statements, the Company has experienced minimal actual losses on its loan investments to date. The Company considers it prudent to reflect provisions for loan losses on a portfolio basis based upon the Company's assessment of general market conditions, the Company's internal risk management policies and credit risk rating system, industry loss experience, the Company's assessment of the likelihood of delinquencies or defaults, and the value of the collateral underlying its investments. Accordingly, since its first full quarter operating its current business as a public company (the quarter ended June 30, 1998), management has reflected quarterly provisions for loan losses in its operating results.

**Loss on early extinguishment of debt** – During the 12 months ended December 31, 2004, the Company incurred $755,000 of losses on early extinguishment of debt associated with the amortization of deferred financing costs related to the early repayment of the Company's $48.0 million term loan which had an original maturity of July 2008. The Company also incurred a loss of $251,000 associated with the amortization of deferred financing costs related to the early termination of the Company's $300.0 million unsecured credit facility maturing July 2004. In addition, the Company had $11.5 million of losses on early extinguishment of debt associated with the prepayment penalties and amortization of deferred financing costs related to the redemption of $110.0 million of the Company's 8.75% Senior Notes due 2008. In addition, the Company incurred $428,000 of losses associated with the amortization of deferred financing costs related to the early repayment of the Company's $60.0 million term loan which had an original maturity of June 2004. The Company also incurred a loss of $287,000 associated with amortization of deferred financing costs related to the early repayment of the Company's $193.0 million term loan which had an original maturity of July 2004. The Company also incurred a gain of $87,000 associated with the write off of the premium related to the early repayment of the Company's $9.8 million term loan which had an original maturity of June 2005. All of these activities related to the Company's strategies of migrating its borrowings toward more unsecured debt and taking advantage of lower cost refinancing opportunities.

During the 12 months ended December 31, 2003, the Company had no losses on early extinguishment of debt.

**Equity in earnings (loss) from joint ventures and unconsolidated subsidiaries** – For the 12 months ended December 31, 2004, equity in earnings (loss) from joint ventures and unconsolidated subsidiaries increased by $7.2 million to $2.9 million from $(4.3) million for the same period in 2003. This increase is primarily due to certain lease terminations in 2003 and the conveyance by one of the Company's CTL joint ventures of its interest in two buildings and the related property to the mortgage lender in exchange for satisfaction of its obligations of the related loan in the first quarter of 2004. In addition, the increase is due to the consolidation of iStar Operating and is partially offset by vacancies, the sale of one of the Company's CTL joint venture interests in five buildings in September 2004, the consolidation of Sunnyvale in March 2004 and the consolidation of ACRE Simon in November 2004 (see Note 6 to the Company's Consolidated Financial Statements).

**Income from discontinued operations** – For the 12 months ended December 31, 2004 and 2003, operating income earned by the Company on CTL assets sold (prior to their sale) and assets held for sale of approximately $18.1 million and $22.2 million, respectively, is classified as "discontinued operations," even though such income was recognized by the Company prior to the asset dispositions or classification as "Assets held for sale" on the Company's Consolidated Balance Sheets.

**Gain from discontinued operations** – During 2004, the Company disposed of 22 CTL assets for net proceeds of $279.6 million, and recognized a gain of approximately $43.4 million.

During 2003, the Company disposed of nine CTL assets for net proceeds of $47.6 million, and recognized a gain of approximately $5.2 million.

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

**Interest income** – Interest income increased by $48.8 million to $304.4 million for the 12 months ended December 31, 2003 from $255.6 million for the same period in 2002. This increase was primarily due to $102.3 million of interest income on new originations or additional fundings, offset by a $51.2 million decrease from the repayment of loans and other lending investments. This increase was partially offset by a decrease in interest income on the Company's variable-rate lending investments as the result of lower average one-month LIBOR rates of 1.21% in 2003, compared to 1.77% in 2002.

**Operating lease income** – Operating lease income increased by $22.0 million to $232.0 million for the 12 months ended December 31, 2003 from $210.0 million for the same period in 2002. Of this increase, $33.8 million was attributable to new CTL investments. This increase was partially offset by $7.0 million of lower operating lease income due to vacancies on certain CTL assets.

**Other income** – Other income generally consists of prepayment penalties and realized gains from the early repayment of loans and other lending investments, financial advisory and asset management fees, lease termination fees, mortgage servicing fees, loan participation payments and dividends on certain investments. During the 12 months ended December 31, 2003, other income included realized gains on sale of lending investments of $16.3 million, income from loan repayments and prepayment penalties of $17.3 million, asset management, mortgage servicing and other fees of approximately $2.6 million and other miscellaneous income such as dividend payments of $489,000.

During the 12 months ended December 30, 2002, other income included prepayment penalties and realized gains on sale of lending investments of $12.6 million, asset management, mortgage servicing fees and other fees of approximately $9.0 million, lease termination fees of $2.9 million, loan participation payments of $3.3 million and other miscellaneous income such as dividend payments and insurance claims of $994,000.

**Interest expense** – For the 12 months ended December 31, 2003, interest expense increased by $7.4 million to $192.3 million from $184.9 million for the same period in 2002. This increase was primarily due to the higher average borrowings on the Company's debt obligations, term loans and secured notes. This increase was partially offset by lower average one-month LIBOR rates, which averaged 1.21% in 2003 compared to 1.77% in 2002 on the unhedged portion of the Company's variable-rate debt and by a $4.5 million decrease in amortization of deferred financing costs on the Company's debt obligations in 2003 compared to the same period in 2002.

**Operating costs – corporate tenant lease assets** – For the 12 months ended December 31, 2003, operating costs increased by approximately $4.9 million to $11.6 million from $6.7 million for the same period in 2002. This increase is primarily related to new CTL investments and higher unrecoverable operating costs due to vacancies on certain CTL assets.

**Depreciation and amortization** – Depreciation and amortization increased by $8.0 million to $50.6 million for the 12 months ended December 31, 2003 from $42.6 million for the same period in 2002. This increase is primarily due to depreciation on new CTL investments.

**General and administrative** – For the 12 months ended December 31, 2003, general and administrative expenses increased by $7.8 million to $38.2 million, compared to $30.4 million for the same period in 2002. This increase is primarily due to the consolidation of iStar Operating and the result of compensation expense recognized for dividends paid on the Chief Executive Officer's contingently vested phantom shares (see Note 10 to Company's Consolidated Financial Statements).

**General and administrative – stock-based compensation** – General and administrative – stock-based compensation decreased by $14.4 million for the 12 months ended December 31, 2003 compared to the same period in 2002. In 2002, the Company recognized a charge of approximately $15.0 million related to the performance-based vesting of 500,000 restricted shares granted under the Company's long-term incentive plan and tied to overall shareholder performance (see Note 10 to the Company's Consolidated Financial Statements).

**Provision for loan losses** – The Company's charge for provision for loan losses decreased to $7.5 million for the 12 months ended December 31, 2003 compared to $8.3 million for the same period in 2002. As more fully discussed in Note 4 to the Company's Consolidated Financial Statements, the Company has experienced minimal actual losses on its loan investments to date. The Company considers it prudent to reflect provisions for loan losses on a portfolio basis based upon the Company's assessment of general market conditions, the Company's internal risk management policies and credit risk rating system, industry loss experience, the Company's assessment of the likelihood of delinquencies or defaults, and the value of the collateral underlying its investments. Accordingly, since its first full quarter operating its current business as a public company (the quarter ended June 30, 1998), management has reflected quarterly provisions for loan losses in its operating results.

**Loss on early extinguishment of debt** – During the 12 months ended December 31, 2003, the Company had no losses on early extinguishment of debt.

During the 12 months ended December 31, 2002, the Company had $12.2 million of losses on early extinguishment of debt associated with the prepayment penalties and amortization of deferred financing fees related to the repayment of the STARs, Series 2000-1 bonds. This loss of $12.2 million represented approximately $8.2 million in unamortized deferred financing costs and approximately $4.0 million in prepayment penalties. In accordance with SFAS No. 145 these costs were reclassified from "Extraordinary loss on early extinguishment of debt" into continuing operations for comparative purposes for financial statements for periods after January 1, 2003.

**Equity in earnings (loss) from joint ventures and unconsolidated subsidiaries** – During the 12 months ended December 31, 2003, equity in earnings (loss) from joint ventures and unconsolidated subsidiaries decreased by $5.5 million to $(4.3) million from $1.2 million for the same period in 2002. This decrease is primarily due to certain lease terminations in one of the Company's CTL joint venture investments (see Note 6 to the Company's Consolidated Financial Statements).

**Income from discontinued operations** – For the 12 months ended December 31, 2003 and 2002, operating income earned by the Company on CTL assets sold (prior to their sale) and assets held for sale of approximately $22.2 million and $22.9 million, respectively, is classified as "discontinued operations," even though such income was recognized by the Company prior to the asset dispositions or classification as "Assets held for sale" on the Company's Consolidated Balance Sheets.

**Gain from discontinued operations** – During 2003, the Company disposed of nine CTL assets for net proceeds of $47.6 million, and recognized a gain of approximately $5.2 million.

During 2002, the Company disposed of one CTL asset for net proceeds of $3.7 million, and recognized a gain of approximately $595,000. In addition, one of the Company's customers exercised an option to terminate its lease on 50.00% of the land leased from the Company. In connection with this termination, the Company realized $17.5 million in cash lease termination payments, offset by a $17.4 million impairment charge in connection with the termination, resulting in a net gain of approximately $123,000.

## Adjusted Earnings

The Company measures its performance using adjusted earnings in addition to net income. Adjusted earnings represents net income allocable to common shareholders and HPU holders computed in accordance with GAAP, before depreciation, amortization, gain (loss) from discontinued operations, extraordinary items and cumulative effect of change in accounting principle. Adjustments for unconsolidated partnerships and joint ventures reflect the Company's share of adjusted earnings calculated on the same basis.

The Company believes that adjusted earnings is a helpful measure to consider, in addition to net income, because this measure helps the Company to evaluate how its commercial real estate finance business is performing compared to other commercial finance companies, without the effects of certain GAAP adjustments that are not necessarily indicative of current operating performance. The most significant GAAP adjustments that the Company excludes in determining adjusted earnings are depreciation and amortization. As a commercial finance company that focuses on real estate lending and corporate tenant leasing, the Company records significant depreciation on its real estate assets and amortization of deferred financing costs associated with its borrowings. These items do not affect the Company's daily operations, but they do impact financial results under GAAP. By measuring its performance using adjusted earnings and net income, the Company is able to evaluate how its business is performing both before and after giving effect to recurring GAAP adjustments such as depreciation and amortization and, in the case of adjusted earnings, after including earnings from its joint venture interests on the same basis and excluding gains or losses from the sale of assets that will no longer be part of its continuing operations.

Adjusted earnings is not an alternative or substitute for net income in accordance with GAAP as a measure of the Company's performance. Rather, the Company believes that adjusted earnings is an additional measure that helps analyze how its business is performing. This measure is also used to track compliance with covenants in the Company's borrowing arrangements because several of its material borrowing arrangements have covenants based upon this measure. Adjusted earnings should not be viewed as an alternative measure of either the Company's liquidity or funds available for its cash needs or for distribution to its shareholders. In addition, the Company may not calculate adjusted earnings in the same manner as other companies that use a similarly titled measure.

| For the Years Ended December 31, | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| | | | (In thousands, unaudited) | | |
| Adjusted earnings: | | | | | |
| Net income allocable to common shareholders and HPU holders | **$209,107** | $255,249 | $178,362 | $193,004 | $180,678 |
| Add: Joint venture income | **166** | 593 | 991 | 965 | 937 |
| Add: Depreciation | **67,853** | 55,905 | 48,041 | 35,642 | 34,514 |
| Add: Joint venture depreciation and amortization | **3,544** | 7,417 | 4,433 | 4,044 | 3,662 |
| Add: Amortization of deferred financing costs | **33,651** | 27,180 | 31,676 | 21,303 | 13,528 |
| Less: Gains from discontinued operations | **(43,375)** | (5,167) | (717) | (1,145) | (2,948) |
| Add: Cumulative effect of change in accounting principle(1) | **–** | – | – | 282 | – |
| Adjusted diluted earnings allocable to common shareholders and HPU holders(2)(3)(4)(5) | **$270,946** | $341,177 | $262,786 | $254,095 | $230,371 |
| Weighted average diluted common shares outstanding(6) | **112,537** | 104,248 | 93,020 | 88,606 | 86,523 |

**Explanatory Notes:**

(1) Represents one-time effect of adoption of Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" as of January 1, 2001.

(2) For the years ended December 31, 2004 and 2003, adjusted diluted earnings allocable to common shareholders and HPU holders includes $4,261 and $2,659 of adjusted earnings allocable to HPU holders, respectively.

(3) For years ended December 31, 2004, 2003, 2002, 2001 and 2000, adjusted diluted earnings allocable to common shareholders includes approximately $9.6 million, $0, $4.0 million, $1.0 million and $317,000 of cash paid for prepayment penalties associated with early extinguishment of debt.

(4) For the year ended December 31, 2004, adjusted diluted earnings allocable to common shareholders includes a $106.9 million charge related to performance-based vesting of 100,000 restricted shares granted under the Company's long-term incentive plan to the Chief Financial Officer, the vesting of 2.0 million phantom shares on March 30, 2004 granted to the Chief Executive Officer, the one-time award of Common Stock with a value of $10.0 million to the Chief Executive Officer, the vesting of 155,000 restricted shares granted to several employees and the Company's share of taxes associated with all transactions.

(5) For the year ended December 31, 2002, adjusted diluted earnings allocable to common shareholders includes a $15.0 million charge related to performance-based vesting of restricted shares granted under the Company's long-term incentive plan.

(6) In addition to the GAAP defined weighted average diluted shares outstanding these balances include an additional 73,000 shares, 147,000 shares, 371,000 shares, 372,000 shares and 372,000 shares for the years ended December 31, 2004, 2003, 2002, 2001 and 2000, respectively, relating to the additional dilution of joint venture shares.

## Risk Management

First Dollar and Last Dollar Exposure – One component of the Company's risk management assessment is an analysis of the Company's first and last dollar loan-to-value percentage with respect to the facilities or companies the Company finances. First dollar loan-to-value represents the weighted average beginning point for the Company's lending exposure in the aggregate capitalization of the underlying facilities or companies it finances. Last dollar loan-to-value represents the weighted average ending point for the Company's lending exposure in the aggregate capitalization of the underlying facilities or companies it finances.

Loans and Other Lending Investments Credit Statistics – The table below summarizes the Company's loans and other lending investments that are more than 90 days past due in scheduled payments and details the provision for loan losses associated with the Company's lending investments for the 12 months ended December 31, 2004 and 2003 (in thousands):

| As of December 31, | 2004 | | 2003 | |
|---|---|---|---|---|
| | $ | % | $ | % |
| Carrying value of loans past due 90 days or more/ | | | | |
| As a percentage of total assets | **$27,526** | **0.38%** | $27,480 | 0.41% |
| As a percentage of total loans | | **0.69%** | | 0.74% |
| Provision for loan losses/ | | | | |
| As a percentage of total assets | **42,436** | **0.59%** | 33,436 | 0.50% |
| As a percentage of total loans | | **1.06%** | | 0.89% |
| Net charge-offs/ | | | | |
| As a percentage of total assets | **–** | **0.00%** | 3,314 | 0.05% |
| As a percentage of total loans | | **0.00%** | | 0.09% |

**Non-Performing Loans** – Non-performing loans includes all loans on non-accrual status and repossessed real estate collateral. The Company transfers loans to non-accrual status at such time as: (1) the loan becomes 90 days delinquent; (2) the loan has a maturity default; or (3) the net realizable value of the loan's underlying collateral approximates the Company's carrying value of such loan. Interest income is recognized only upon actual cash receipt for loans on non-accrual status. As of December 31, 2004, the Company's non-performing loans included two non-accrual loans with an aggregate carrying value of $27.5 million, or 0.38% of total assets, compared to 0.41% at December 31, 2003, and no repossessed real estate collateral. Management believes there is adequate collateral to support the book values of the assets.

**Watch List Assets** – The Company conducts a quarterly comprehensive credit review, resulting in an individual risk rating being assigned to each asset. This review is designed to enable management to evaluate and proactively manage asset-specific credit issues and identify credit trends on a portfolio-wide basis as an "early warning system." As of December 31, 2004, the Company had two assets on its credit watch list, excluding those assets included in non-performing loans above, with an aggregate carrying value of $64.1 million, or 0.89% of total assets.

## Liquidity and Capital Resources

The Company requires significant capital to fund its investment activities and operating expenses. The Company has sufficient access to capital resources to fund its existing business plan, which includes the expansion of its real estate lending and corporate tenant leasing businesses. The Company's capital sources include cash flow from operations, borrowings under lines of credit, additional term borrowings, unsecured corporate debt financing, financings secured by the Company's assets, and the issuance of common, convertible and/or preferred equity securities. Further, the Company may acquire other businesses or assets using its capital stock, cash or a combination thereof.

The distribution requirements under the REIT provisions of the Code limit the Company's ability to retain earnings and thereby replenish or increase capital committed to its operations. However, the Company believes that its access to significant capital resources and financing will enable the Company to meet current and anticipated capital requirements.

The Company believes that its existing sources of funds will be adequate for purposes of meeting its short- and long-term liquidity needs. The Company's ability to meet its long-term (i.e., beyond one year) liquidity requirements is subject to obtaining additional debt and equity financing. Any decision by the Company's lenders and investors to provide the Company with financing will depend upon a number of factors, such as the Company's compliance with the terms of its existing credit arrangements, the Company's financial performance, industry or market trends, the general availability of and rates applicable to financing transactions, such lenders' and investors' resources and policies concerning the terms under which they make capital commitments and the relative attractiveness of alternative investment or lending opportunities.

The following table outlines the contractual obligations related to the Company's long-term debt agreements and operating lease obligations as of December 31, 2004. There are no other long-term liabilities of the Company that would constitute a contractual obligation.

| | | Principal Payments Due By Period[1] | | | | |
|---|---|---|---|---|---|---|
| | **Total** | **Less Than 1 Year** | **2–3 Years** | **4–5 Years** | **6–10 Years** | **After 10 Years** |
| | | | | (In thousands) | | |
| **Long-Term Debt Obligations:** | | | | | | |
| Unsecured notes | $2,125,000 | $ – | $250,000 | $ 775,000 | $1,000,000 | $100,000 |
| iStar Asset Receivables secured notes[2] | 932,914 | 113,309 | – | 202,052 | 617,553 | – |
| Unsecured revolving credit facilities | 840,000 | – | – | 840,000 | – | – |
| Secured term loans[3] | 686,408 | 76,670 | 132,164 | 289,199 | 98,306 | 90,069 |
| Secured revolving credit facilities | 78,586 | – | 78,586 | – | – | – |
| Total | 4,662,908 | 189,979 | 460,750 | 2,106,251 | 1,715,859 | 190,069 |
| **Operating Lease Obligations:**[4] | 12,868 | 2,871 | 5,688 | 3,784 | 525 | – |
| Total | $4,675,776 | $192,850 | $466,438 | $2,110,035 | $1,716,384 | $190,069 |

**Explanatory Notes:**

(1) Assumes exercise of extensions on the Company's long-term debt obligations to the extent such extensions are at the Company's option.
(2) Based on expected proceeds from principal payments received on loan assets collateralizing such notes.
(3) The Company also has a $6.6 million letter of credit outstanding as additional collateral for one of its secured term loans.
(4) The Company also has a $1.0 million letter of credit outstanding as security for its primary corporate office lease.

The Company's primary credit facility is an unsecured credit facility totaling $1,250.0 million which bears interest at LIBOR + 0.875% per annum and matures in April 2008. At December 31, 2004, the Company had $840.0 million drawn under this facility (see Note 7 to the Company's Consolidated Financial Statements). The Company also has four LIBOR-based secured revolving credit facilities with an aggregate maximum capacity of $1.8 billion, of which $78.6 million was drawn as of December 31, 2004. Availability under these facilities is based on collateral provided under a borrowing base calculation.

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 December 31, 2004, the Company believes it is in compliance with all financial and non-financial covenants on its debt obligations.

Unencumbered Assets/Unsecured Debt – The Company has made and will continue to make progress in migrating its balance sheet towards more unsecured debt, which generally results in a corresponding reduction of secured debt and an increase in unencumbered assets. The exact timing in which the Company will issue or borrow unsecured debt will be subject to market conditions. The following table shows the ratio of unencumbered assets to unsecured debt at December 31, 2004 and 2003 (in thousands):

| | As of December 31, | |
|---|---|---|
| | **2004** | **2003** |
| Total Unencumbered Assets | **$4,687,044** | $2,167,388 |
| Total Unsecured Debt[(1)] | **$2,965,000** | $1,315,000 |
| Unencumbered Assets/Unsecured Debt | **158%** | 165% |

**Explanatory Note:**

(1) See Note 7 to the Company's Consolidated Financial Statements for a more detailed description of the Company's unsecured debt.

Capital Markets Financings – The Company was an active issuer in the capital markets in the year ended December 31, 2004. The continued strength of the Company's operating performance and the low interest rate environment provided the Company with the opportunity to issue preferred equity and unsecured debt securities on attractive pricing terms. During the 12 months ended December 31, 2004, the Company issued $850.0 million aggregate principal amount of fixed-rate Senior Notes bearing interest at annual rates ranging from 4.875% to 5.700% and maturing between 2009 and 2014, and $200.0 million of variable-rate Senior Notes bearing interest at an annual rate of three-month LIBOR + 1.25% and maturing in 2007. The Company issued 8.3 million shares of preferred stock in two series with cumulative annual dividend rates of 7.50%.

During the 12 months ended December 31, 2003, the Company issued $685.0 million aggregate principal amount of fixed-rate Senior Notes bearing interest at annual rates ranging from 6.00% to 7.00% and maturing between 2008 and 2013. The Company issued 12.8 million shares of preferred stock in three series with cumulative annual dividend rates ranging from 7.650% to 7.875%. All of the shares of preferred stock have a liquidation preference of $25.00 per share. The Company also issued 5.0 million shares of Common Stock in 2003 at a price to the public of $38.50 per share.

The Company primarily used the proceeds from the issuances of securities described above to repay secured indebtedness as it migrates its balance sheet towards more unsecured debt and to refinance higher yielding obligations. During the 12 months ended December 31, 2004, the Company redeemed approximately $110.0 million aggregate principal amount of its outstanding 8.75% Senior Notes due 2008 at a price of 108.75% of par. In connection with this redemption, the Company recognized a charge to income of $11.5 million included in "Loss on early extinguishment of debt" on the Company's Consolidated Statements of Operations. The Company also retired its 3.3 million shares of Series H Variable Rate Cumulative Redeemable Preferred Stock. In addition, the Company redeemed all of its 2.0 million shares of 9.375% Series B Cumulative Redeemable Preferred Stock and all of its 1.3 million shares of 9.200% Series C Cumulative Redeemable Preferred Stock. In connection with this redemption, the Company recognized a charge to net income allocable to common shareholders and HPU holders of approximately $9.0 million included in "Preferred dividend requirements" on the Company's Consolidated Statements of Operations.

During the 12 months ended December 31, 2003, the Company retired all of its 4.0 million shares of 9.50% Series A Cumulative Redeemable Preferred Stock and the 6.75% Dealer Remarketable Securities of its Leasing Subsidiary.

On November 14, 2002, the Company completed an underwritten public offering of 8.0 million primary shares of the Company's Common Stock. The Company received approximately $202.9 million from the offering and used these proceeds to repay a portion of its secured debt.

Unsecured/Secured Credit Facilities Activity – On July 20, 2004, one of the Company's $500.0 million secured facilities was amended to reduce the maximum amount available to $350.0 million, to extend the final maturity to August 2005 and to reduce the stated interest rate on first mortgage collateral to LIBOR + 1.50%.

On April 19, 2004, the Company completed a new $850.0 million unsecured revolving credit facility with 19 banks and financial institutions. The new facility has a three-year initial term with a one-year extension at the Company's option. The facility bears interest, based upon the Company's current credit ratings, at a rate of LIBOR + 0.875% and a 17.5 basis point annual facility fee decreased from LIBOR + 1.00% and 25 basis points, respectively, due to an upgrade in the Company's senior unsecured debt rating to investment grade by S&P. On December 17, 2004, the commitment on this facility was increased to $1,250.0 million and the accordion feature was amended to increase the facility to $1.5 billion in the future if necessary. This new facility replaced a $300.0 million unsecured credit facility with a scheduled maturity of July 2004.

On March 12, 2004, one of the Company's $700.0 million secured facilities was amended to reduce the maximum amount available to $250.0 million, to shorten the maturity to March 2005 and to reduce the stated interest rate on first mortgages and CTL assets to LIBOR + 1.50% and on subordinate and mezzanine lending investments to LIBOR + 2.05%.

On January 13, 2004, the Company closed $200.0 million of term financing that is secured by certain corporate bond investments and other lending securities. A number of these investments were previously financed under existing credit facilities. The new facility bears interest at LIBOR + 1.05% – 1.50% and has a final maturity date of January 2006.

On January 27, 2003, the Company extended the maturity on one of its $700.0 million secured facilities to January 2007, which includes a one-year "term-out" at the Company's option.

On September 30, 2002, the Company closed a $500.0 million secured revolving credit facility with a leading financial institution. The facility had a three-year term and bears interest at LIBOR + 1.50% to 2.25%, depending upon the collateral contributed to the borrowing base. The facility accepts a broad range of structured finance and CTL assets and has a final maturity of September 2005. On November 4, 2003, this facility was amended to include subordinate and mezzanine lending investments as collateral at stated interest rates of LIBOR + 2.15% – 2.25%

Other Financing Activity – During the 12 months ended December 31, 2004, the Company purchased the remaining interest in the ACRE Simon joint venture from the former ACRE Simon external member for $40.1 million. Upon purchase of the interest, the ACRE Simon joint venture became fully consolidated for accounting purposes and approximately $31.8 million of secured term debt is reflected on the Company's Consolidated Balance Sheets. The term loans bear interest at rates of 7.61% to 8.73% and mature between 2005 and 2011. In addition, the Company repaid a total of $314.6 million in term loan financing, $9.8 million of which was part of the ACRE Simon acquisition.

During the 12 months ended December 31, 2003, the Company closed an aggregate of $233.0 million in secured term debt bearing interest at rates ranging from LIBOR + 0.60% – 2.125% and maturing between 2003 to 2008. In addition, the Company repaid $125.0 million of term loan financing, $50.0 million of which had been closed during the same year.

In addition, during the 12 months ended December 31, 2003, a wholly-owned subsidiary of the Company issued iStar Asset Receivables ("STARs"), Series 2003-1, the Company's proprietary match funding program, consisting of $645.8 million of investment-grade bonds secured by the subsidiary's structured finance and CTL assets, which had an aggregate outstanding carrying value of approximately $738.1 million at inception. Principal payments received on the assets will be utilized to repay the most senior class of the bonds then outstanding. The maturity of the bonds match funds the maturity of the underlying assets financed under the program. The weighted average interest rate on the bonds, on an all-floating-rate basis, was approximately LIBOR + 0.47% at inception. For accounting purposes, this transaction was treated as a secured financing; the underlying assets and STARs liabilities remained on the Company's Consolidated Balance Sheets, and no gain on sale was recognized.

During the 12 months ended December 31, 2002, the Company purchased the remaining interest in the Milpitas joint venture from the Milpitas external member for $27.9 million. Upon purchase of the interest, the Milpitas joint venture became fully consolidated for accounting purposes and approximately $79.1 million of secured term debt is reflected on the Company's Consolidated Balance Sheets. This term loan bears interest at 6.55% and matures in 2005. In addition, the Company closed a $61.5 million term loan financing with a leading institution to fund a portion of an $82.1 million CTL investment. The non-recourse loan is fixed rate and bears interest at 6.412%, matures in 2013 and amortizes over a 30-year schedule.

In addition, during the 12 months ended December 31, 2002, the Company repaid the then remaining $446.2 million of bonds outstanding under its STARs, Series 2000-1 financing. Simultaneously, a wholly-owned subsidiary of the Company issued STARs, Series 2002-1, consisting of $885.1 million of investment-grade bonds secured by the subsidiary's structured finance and CTL assets, which had an aggregate outstanding carrying value of approximately $1.1 billion at inception. Principal payments received on the assets will be utilized to repay the most senior class of the bonds then outstanding. The maturity of the bonds match funds the maturity of the underlying assets financed under the program. The weighted average interest rate on the bonds, on an all-floating-rate basis, was approximately LIBOR + 0.56% at inception. For accounting purposes, this transaction was treated as a secured financing: the underlying assets and STARs liabilities remained on the Company's Consolidated Balance Sheets, and no gain on sale was recognized.

Hedging Activities – The Company has variable-rate lending assets and variable-rate debt obligations. These assets and liabilities create a natural hedge against changes in variable interest rates. This means that as interest rates increase, the Company earns more on its variable-rate lending assets and pays more on its variable-rate debt obligations and, conversely, as interest rates decrease, the Company earns less on its variable-rate lending assets and pays less on its variable-rate debt obligations. When the amount of the Company's variable-rate debt obligations exceeds the amount of its variable-rate lending assets, the Company utilizes derivative instruments to limit the impact of changing interest rates on its net income. The Company has a policy in place, that is administered by the Audit Committee, which requires the Company to enter into hedging transactions to mitigate the impact of rising interest rates on the Company's earnings. The policy states that a 100 basis point increase in short-term rates cannot have a greater than 2.50% impact on quarterly earnings. The Company does not use derivative instruments to hedge assets or for speculative purposes. The derivative instruments the Company uses are typically in the form of interest rate swaps and interest rate caps. Interest rate swaps effectively change variable-rate debt obligations to fixed-rate debt obligations. Interest rate caps effectively limit the maximum interest rate on variable-rate debt obligations.

In addition, when appropriate the Company enters into interest rate swaps that convert fixed-rate debt to variable rate in order to mitigate the risk of changes in fair value of the fixed-rate debt obligations.

The primary risks from the Company's use of derivative instruments are the risks that a counterparty to a hedging arrangement could default on its obligation and the risk that the Company may have to pay certain costs, such as transaction fees or breakage costs, if a hedging arrangement is terminated by the Company. As a matter of policy, the Company enters into hedging arrangements with counterparties that are large, creditworthy financial institutions typically rated at least "A" by S&P and "A2" by Moody's. The Company's hedging strategy is approved and monitored by the Company's Audit Committee on behalf of its Board of Directors and may be changed by the Board of Directors without shareholder approval.

The Company has entered into the following cash flow and fair value hedges that are outstanding as of December 31, 2004. All hedges are currently effective and no ineffectiveness exists. The net value (liability) associated with these hedges is reflected on the Company's Consolidated Balance Sheets (in thousands).

| Type of Hedge | Notional Amount | Strike Price or Swap Rate | Trade Date | Maturity Date | Estimated Value at December 31, 2004 |
|---|---|---|---|---|---|
| Pay-Fixed Swap | $125,000 | 2.885% | 1/23/03 | 6/25/06 | **$ 544** |
| Pay-Fixed Swap | 125,000 | 2.838% | 2/11/03 | 6/25/06 | **632** |
| Pay-Fixed Swap | 67,000 | 4.659% | 12/09/04 | 3/31/15 | **217** |
| Pay-Fixed Swap | 67,000 | 4.659% | 12/09/04 | 3/31/15 | **217** |
| Pay-Fixed Swap | 66,000 | 4.660% | 12/09/04 | 3/31/15 | **208** |
| Pay-Floating Swap | 200,000 | 4.381% | 12/17/03 | 12/15/10 | **(55)** |
| Pay-Floating Swap | 105,000 | 3.678% | 1/15/04 | 1/15/09 | **(1,339)** |
| Pay-Floating Swap | 100,000 | 4.345% | 12/17/03 | 12/15/10 | **(219)** |
| Pay-Floating Swap | 100,000 | 3.878% | 11/27/02 | 8/15/08 | **1,030** |
| Pay-Floating Swap | 100,000 | 3.713% | 1/15/04 | 1/15/09 | **(1,128)** |
| Pay-Floating Swap | 100,000 | 3.686% | 1/15/04 | 1/15/09 | **(1,239)** |
| Pay-Floating Swap | 50,000 | 3.810% | 11/27/02 | 8/15/08 | **389** |
| Pay-Floating Swap | 50,000 | 4.290% | 12/17/03 | 12/15/10 | **(256)** |
| Pay-Floating Swap | 45,000 | 3.684% | 1/15/04 | 1/15/09 | **(562)** |
| LIBOR Cap | 345,000 | 8.000% | 5/22/02 | 5/28/14 | **4,465** |
| LIBOR Cap | 135,000 | 6.000% | 9/29/03 | 10/15/06 | **19** |
| Total Estimated Value | | | | | **$ 2,923** |

Between January 1, 2003 and December 31, 2004, the Company also had outstanding the following cash flow hedges that have expired or been settled (in thousands):

| Type of Hedge | Notional Amount | Strike Price or Swap Rate | Trade Date | Maturity Date |
|---|---|---|---|---|
| Pay-Fixed Swap | $235,000 | 1.135% | 3/11/04 | 9/15/04 |
| Pay-Fixed Swap | 200,000 | 1.144% | 3/11/04 | 9/15/04 |
| Pay-Fixed Swap | 200,000 | 1.144% | 3/11/04 | 9/15/04 |
| Pay-Fixed Swap | 125,000 | 7.058% | 6/15/00 | 6/25/03 |
| Pay-Fixed Swap | 125,000 | 7.055% | 6/15/00 | 6/25/03 |
| Pay-Fixed Swap | 100,000 | 4.139% | 9/29/03 | 1/2/11 |
| Pay-Fixed Swap | 100,000 | 4.643% | 9/29/03 | 1/2/14 |
| Pay-Fixed Swap | 100,000 | 4.484% | 1/16/04 | 5/1/14 |
| Pay-Fixed Swap | 75,000 | 5.580% | 11/4/99(1) | 12/1/04 |
| Pay-Fixed Swap | 50,000 | 4.502% | 1/16/04 | 5/1/14 |
| Pay-Fixed Swap | 50,000 | 4.500% | 1/16/04 | 5/1/14 |
| LIBOR Cap | 75,000 | 7.750% | 11/4/99(1) | 12/1/04 |
| LIBOR Cap | 35,000 | 7.750% | 11/4/99(1) | 12/1/04 |

**Explanatory Note:**

(1) Acquired in connection with the TriNet Acquisition (see Note 1).

On December 9, 2004, the Company entered into three forward-starting swaps all with ten-year terms and rates of 4.659%, 4.659% and 4.660% and notional amounts of $67.0 million, $67.0 million and $66.0 million, respectively, and are being used to lock-in swap rates related to a portion of planned future corporate unsecured fixed-rate bond issuances. These three swaps were settled on March 1, 2005 in connection with the Company's issuance of $700.0 million of seven-year Senior Notes (see Note 17 to the Company's Consolidated Financial Statements).

On March 11, 2004, the Company entered into three pay-fixed interest rate swaps all with six-month terms, rates of 1.135%, 1.144% and 1.144% and notional amounts of $235.0 million, $200.0 million and $200.0 million, respectively. These three swaps matured on September 15, 2004.

On January 16, 2004, the Company entered into three forward-starting swaps all with ten-year terms and rates of 4.484%, 4.502% and 4.500% and notional amounts of $100.0 million, $50.0 million and $50.0 million, respectively, and were used to lock-in swap rates related to a portion of planned future corporate unsecured fixed-rate bond issuances. These three swaps were settled in connection with the Company's issuance of $250.0 million of ten-year Senior Notes in March 2004.

On January 15, 2004, in connection with the Company's fixed-rate corporate bonds, the Company entered into four pay-floating interest rate swaps struck at 3.678%, 3.713%, 3.686% and 3.684% with notional amounts of $105.0 million, $100.0 million, $100.0 million and $45.0 million, respectively, and maturing on January 15, 2009. The Company pays six-month LIBOR and receives the stated fixed rate in return. These swaps mitigate the risk of changes in the fair value of $350.0 million of five-year Senior Notes attributable to changes in LIBOR. For accounting purposes, the difference between the fixed rate received and the LIBOR rate paid on the notional amount of the swap is recorded as "Interest expense" on the Company's Consolidated Statements of Operations. In addition, the Company adjusts the value of the swap to its fair value and adjusts the carrying amount of the hedged liability by an offsetting amount on a quarterly basis.

During 2003, the Company entered into two 90-day forward-starting swaps each having a $100.0 million notional amount. These pay-fixed swaps which were effective in September 2003, had rates of 4.139% and 4.643%, had seven-year and ten-year terms, respectively, and were used to lock-in swap rates related to a portion of planned future corporate unsecured fixed-rate bond issuances. These two swaps were settled in connection with the Company's issuance of $350.0 million of seven-year Senior Notes and $150.0 million of ten-year Senior Notes. In addition, effective in September 2003, the Company entered into a $135.0 million cap with a rate of 6.00% to hedge the Company's current outstanding floating-rate debt. This cap has a three-year term. Further, the Company entered into two $125.0 million forward-starting swaps in the first quarter 2003 that became effective in June 2003. These forward-starting swaps replaced the two $125.0 million pay-fixed swaps that expired in June 2003. The two new pay-fixed swaps have a three-year term and expire on June 25, 2006.

In addition, in connection with a portion of the Company's fixed-rate corporate bonds, the Company entered into three pay-floating interest rate swaps in December 2003 struck at 4.381%, 4.345% and 4.29% with notional amounts of $200.0 million, $100.0 million and $50.0 million, respectively, and maturing on December 15, 2010 and also entered into two pay-floating interest rate swaps in November 2002 struck at 3.8775% and 3.81% with notional amounts of $100.0 million and $50.0 million, respectively, and maturing on August 15, 2008. The Company pays six-month LIBOR on the swaps entered into in December 2003 and one-month LIBOR on the swaps entered into in November 2002 and receives the stated fixed rate in return. These swaps mitigate the risk of changes in the fair value of $350.0 million of seven-year Senior Notes and $150.0 million of ten-year Senior Notes attributable to changes in LIBOR. For accounting purposes, the difference between the fixed rate received and the LIBOR rate paid on the notional amount of the swap is recorded as "Interest expense" on the Company's Consolidated Statements of Operations. In addition, the Company adjusts the value of the swap to its fair value and adjusts the carrying amount of the hedged liability by an offsetting amount on a quarterly basis.

In connection with STARs, Series 2003-1 in May 2003, the Company entered into a LIBOR interest rate cap struck at 6.95% in the notional amount of $270.6 million, and simultaneously sold a LIBOR interest rate cap with the same terms. Since these instruments do not change the Company's net interest rate risk exposure, they do not qualify as hedges and changes in their respective values are charged to earnings. As the terms of these arrangements are substantially the same, the effects of a revaluation of these two instruments substantially offset one another.

In connection with STARs, Series 2002-1 in May 2002, the Company entered into a LIBOR interest rate cap struck at 8.00% in the notional amount of $345.0 million. The Company utilizes the provisions of SFAS No. 133 with respect to such instruments. SFAS No. 133 provides that the up-front fees paid on option-based products such as caps should be expensed into earnings based on the allocation of the premium to the affected periods as if the agreement were a series of "caplets." These allocated premiums are then reflected as a charge to income (as part of interest expense) in the affected period. On May 28, 2002, in connection with the STARs, Series 2002-1 transaction, the Company paid a premium of $13.7 million for this interest rate cap. Using the "caplet" methodology discussed above, amortization of the cap premium is dependent upon the actual value of the caplets at inception.

During the year ended December 31, 1999, the Company refinanced its $125.0 million term loan maturing March 15, 1999 with a $155.4 million term loan maturing March 5, 2009. The term loan bears interest at 7.44% per annum, payable monthly, and amortizes over an approximately 22-year schedule. The term loan represented forecasted transactions for which the Company had previously entered into U.S. Treasury-based hedging transactions. The net $3.4 million cost of the settlement of such hedges has been deferred and is being amortized as an increase to the effective financing cost of the term loan over its effective ten-year term.

Off-Balance Sheet Transactions – The Company is not dependent on the use of any off-balance sheet financing arrangements for liquidity. As of December 31, 2004, the Company did not have any CTL joint ventures accounted for under the equity method, which had third-party debt.

The Company's STARs securitizations are all on-balance sheet financings.

The Company has certain discretionary and non-discretionary unfunded commitments related to its loans and other lending investments

that it may need to, or choose to, fund in the future. Discretionary commitments are those under which the Company has sole discretion with respect to future funding. Non-discretionary commitments are those that the Company is generally obligated to fund at the request of the borrower or upon the occurrence of events outside of the Company's direct control. As of December 31, 2004, the Company had 25 loans with unfunded commitments totaling $678.9 million, of which $202.5 million was discretionary and $476.4 million was non-discretionary. In addition, the Company has $32.8 million of non-discretionary unfunded commitments related to two existing customers. These commitments generally fall into two categories: (1) pre-approved capital improvement projects; and (2) new or additional construction costs. Currently, the Company has committed $18.1 million in pre-approved capital improvement projects and $14.7 million in new construction costs. Further, the Company had one equity investment with unfunded non-discretionary commitments of $5.0 million.

Ratings Triggers – The $1,250.0 million unsecured revolving credit facility that the Company has in place at December 31, 2004, bears interest at LIBOR + 0.875% per annum based on the Company's senior unsecured credit ratings of BBB- from S&P, Baa3 from Moody's and BBB- from Fitch Ratings. This rate was reduced from LIBOR + 1.00% due to the Company achieving an investment grade senior unsecured debt rating from S&P in October 2004. There are no other ratings triggers in any of the Company's debt instruments or other operating or financial agreements at December 31, 2004.

On October 6, 2004, Moody's upgraded the Company's senior unsecured debt ratings to Baa3, with a stable outlook, up from Ba1. The upgraded rating reflects the shift towards unsecured debt and the resulting increase in unencumbered assets, the continued profitable growth in iStar's business franchise, the strong quality of both the structured finance and CTL business and the active management of those businesses.

On October 5, 2004, the Company's senior unsecured credit rating was upgraded to an investment-grade rating of BBB- from BB+ by S&P as a result of the Company's positive track record of improving performance through a slightly difficult real estate cycle, its strong underwriting and servicing capabilities, the increase in capital base, the shift towards unsecured debt to free up assets and the staggering of maturities on secured debt.

On July 30, 2002, the Company's senior unsecured credit rating was upgraded to an investment-grade rating of BBB- from BB+ by Fitch Ratings.

Transactions with Related Parties – The Company has an investment in iStar Operating Inc. ("iStar Operating"), a taxable subsidiary that, through a wholly-owned subsidiary, services the Company's loans and certain loan portfolios owned by third parties. The Company owns all of the non-voting preferred stock and a 95.00% economic interest in iStar Operating. The common shareholder, an entity controlled by a former director of the Company, is the owner of all the voting common stock and a 5.00% economic interest in iStar Operating. As of December 31, 2004, there have never been any distributions to the common shareholder, nor does the Company expect to make any in the future. At any time, the Company has the right to acquire all of the common stock of iStar Operating at fair market value, which the Company believes to be nominal.

iStar Operating has elected to be treated as a taxable REIT subsidiary for purposes of maintaining compliance with the REIT provisions of the Code. Prior to July 1, 2003 it was accounted for under the equity method for financial statement reporting purposes and was presented in "Investments in and advances to joint ventures and unconsolidated subsidiaries" on the Company's Consolidated Balance Sheets. As of July 1, 2003, the Company consolidates this entity as a VIE (see Note 3 to the Company's Consolidated Financial Statements) with no material impact. Prior to its consolidation, the Company charged an allocated portion of its general overhead expenses to iStar Operating based on the number of employees at iStar Operating as a percentage of the Company's total employees. These general overhead expenses were in addition to the direct general and administrative costs of iStar Operating. As of December 31, 2004, iStar Operating had no debt obligations.

In addition, the Company had an investment in TriNet Management Operating Company, Inc. ("TMOC"), an entity originally formed to make a $2.0 million investment in the convertible debt securities of a real estate company which trades on the Mexican Stock Exchange. This investment was made by TriNet prior to its acquisition by the Company in 1999. On June 30, 2003, the $2.0 million investment was fully repaid and during the third quarter 2003, the entity was liquidated.

As more fully described in Note 10 to the Company's Consolidated Financial Statements certain affiliates of Starwood Opportunity Fund IV, L.P. and the Company's Executive Officer have reimbursed the Company for the value of restricted shares awarded to the Company's former President in excess of 350,000 shares.

DRIP/Stock Purchase Plan – The Company maintains a dividend reinvestment and direct stock purchase plan. Under the dividend reinvestment component of the plan, the Company's shareholders may purchase additional shares of Common Stock without payment of brokerage commissions or service charges by automatically reinvesting all or a portion of their Common Stock cash dividends. Under the direct stock purchase component of the plan, the Company's shareholders and new investors may purchase shares of Common Stock directly from the Company without payment of brokerage commissions or service charges. All purchases of shares in excess of $10,000 per month pursuant to the direct purchase component are at the Company's sole discretion. Shares issued under the plan may reflect a discount of up to 3.00% from the prevailing market price of the Company's Common Stock. The Company is authorized to issue up to 8.0 million shares of Common Stock pursuant to the dividend reinvestment and direct stock purchase plan. During the 12 months ended December 31, 2004 and 2003, the Company issued a total of approximately 427,000 and 2.6 million shares of its Common Stock, respectively, through the direct stock purchase component of the plan. Net proceeds during the 12 months ended December 31, 2004 and 2003 were approximately $17.6 million and $89.1 million, respectively. There are approximately 3.1 million shares available for issuance under the plan as of December 31, 2004.

Stock Repurchase Program – The Board of Directors approved, and the Company has implemented, a stock repurchase program under which the Company is authorized to repurchase up to 5.0 million shares of its Common Stock from time to time, primarily using proceeds from the disposition of assets or loan repayments and excess cash flow from operations, but also using borrowings under its credit facilities if the Company determines that it

is advantageous to do so. As of December 31, 2004, the Company had repurchased a total of approximately 2.3 million shares at an aggregate cost of approximately $40.7 million. The Company has not repurchased any shares under the stock repurchase program since November 2000.

## Critical Accounting Policies

The Company's Consolidated Financial Statements include the accounts of the Company and all majority-owned and controlled subsidiaries. The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying consolidated financial statements. In preparing these financial statements, management has made its best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. The Company does not believe that there is a great likelihood that materially different amounts would be reported related to the accounting policies described below. However, application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates.

Management has the obligation to ensure that its policies and methodologies are in accordance with GAAP. During 2004, management reviewed and evaluated its critical accounting policies and believes them to be appropriate. The Company's accounting policies are described in Note 3 to the Company's Consolidated Financial Statements. Management believes the more significant of these to be as follows:

Revenue Recognition – The most significant sources of the Company's revenue come from its lending operations and its CTL operations. For its lending operations, the Company reflects income using the effective yield method, which recognizes periodic income over the expected term of the investment on a constant yield basis. For CTL assets, the Company recognizes income on the straight-line method, which effectively recognizes contractual lease payments to be received by the Company evenly over the term of the lease. Management believes the Company's revenue recognition policies are appropriate to reflect the substance of the underlying transactions.

Provision for Loan Losses – The Company's accounting policies require that an allowance for estimated credit losses be reflected in the financial statements based upon an evaluation of known and inherent risks in its private lending assets. While the Company and its private predecessors have experienced minimal actual losses on their lending investments, management considers it prudent to reflect provisions for loan losses on a portfolio basis based upon the Company's assessment of general market conditions, the Company's internal risk management policies and credit risk rating system, industry loss experience, the Company's assessment of the likelihood of delinquencies or defaults, and the value of the collateral underlying its investments. Actual losses, if any, could ultimately differ from these estimates.

Allowance for Doubtful Accounts – The Company's accounting policy requires 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.

Impairment of Long-Lived Assets – CTL assets represent "long-lived" assets for accounting purposes. The Company periodically reviews long-lived assets to be held and used in its leasing operations for impairment in value whenever any events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. In management's opinion, based on this analysis, CTL assets to be held and used are not carried at amounts in excess of their estimated recoverable amounts.

Risk Management and Financial Instrument – The Company has historically utilized derivative financial instruments only as a means to help to manage its interest rate risk exposure on a portion of its variable-rate debt obligations (i.e., as cash flow hedges). Some of the instruments utilized are pay-fixed swaps or LIBOR-based interest rate caps which are widely used in the industry and typically with major financial institutions. The Company's accounting policies generally reflect these instruments at their fair value with unrealized changes in fair value reflected in "Accumulated other comprehensive income (losses)" on the Company's Consolidated Balance Sheets. Realized effects on the Company's cash flows are generally recognized currently in income.

However, when appropriate the Company enters into interest rate swaps that convert fixed-rate debt to variable rate in order to mitigate the risk of changes in fair value of its fixed-rate debt obligations. The Company reflects these instruments at their fair value and adjusts the carrying amount of the hedged liability by an offsetting amount.

Income Taxes – The Company's financial results generally do not reflect provisions for current or deferred income taxes. Management believes that the Company has and intends to continue to operate in a manner that will continue to allow it to be taxed as a REIT and, as a result, does not expect to pay substantial corporate-level taxes. Many of these requirements, however, are highly technical and complex. If the Company were to fail to meet these requirements, the Company would be subject to Federal income tax.

Executive Compensation – The Company's accounting policies generally provide cash compensation to be estimated and recognized over the period of service. With respect to stock-based compensation arrangements, as of July 1, 2002 (with retroactive application to the beginning of the calendar year), the Company has adopted the fair value method allowed under SFAS No. 123 on a prospective basis, which values options on the date of grant and recognizes an expense equal to the fair value of the option multiplied by the number of options granted over the related service period. Prior to the third quarter 2002, the Company elected to use APB 25 accounting, which measured the compensation charges based on the intrinsic value of such securities when they become fixed and determinable, and recognized such expense over the related service period. These arrangements are often complex and generally structured to align the interests of management with those of the Company's shareholders. See Note 10 to the Company's Consolidated Financial Statements for a detailed discussion of such arrangements and the related accounting effects.

During 2002 the Company entered into a three-year employment agreement with its Chief Financial Officer. In addition, during 2004 the Company entered into a three-year employment agreement with its

President. See Note 10 to the Company's Consolidated Financial Statements for a more detailed description of these employment agreements.

On April 29, 2002, the 500,000 unvested restricted shares awarded to the former President became contingently vested as the total shareholder return exceeded 60.00% and became fully-vested on September 30, 2002 as all employment contingencies were met. The Company incurred a charge of approximately $15.0 million related to these vested shares, recognized ratably over the service period from the date of contingent vesting through September 30, 2002.

On February 11, 2004, the Company entered into a new employment agreement with its Chief Executive Officer that took effect upon the expiration of the old agreement. The new agreement has an initial term of three years and provides for the following compensation:

- an annual salary of $1.0 million;
- a potential annual cash incentive award of up to $5.0 million if performance goals set by the Compensation Committee of the Board of Directors in consultation with the Chief Executive Officer are met; and
- a one-time award of Common Stock with a value of $10.0 million at March 31, 2004 (based upon the trailing 20-day average closing price of the Common Stock); the award will be fully-vested when granted and dividends will be paid on the shares from the date of grant, but the shares cannot be sold for five years unless the price of the Common Stock during the 12 months ending March 31 of each year increases by at least 15.00%, in which case the sale restrictions on 25.00% of the shares awarded will lapse in respect of each 12-month period. In connection with this award the Company recorded a $10.1 million charge in "General and administrative – stock-based compensation expense" on the Company's Consolidated Statements of Operations. The Chief Executive Officer notified the Company that subsequent to this award he contributed an equivalent number of shares to a newly established charitable foundation.

In addition, the Chief Executive Officer purchased an 80.00% interest in the Company's 2006 High Performance Unit Program for directors and executive officers. This performance program was approved by the Company's shareholders in 2003 and is described in detail in the Company's 2003 annual proxy statement. The purchase price to be paid by the Chief Executive Officer will be based upon a valuation prepared by an independent investment-banking firm. The interests purchased by the Chief Executive Officer will only have nominal value to him unless the Company achieves total shareholder returns in excess of those achieved by peer group indices, all as more fully described in the Company's 2003 annual proxy statement.

**New Accounting Standards**

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 FASB No. 123R using one of three transition methods: (1) the modified prospective method; (2) a variation of the modified prospective method; or (3) the modified retrospective method. The provisions of this statement are effective for interim and annual periods beginning after June 15, 2005, however, in the third quarter 2002, in anticipation of this new literature, the Company adopted the second transition method (with retroactive application of fair-value accounting to the beginning of the calendar year), which did not have a significant financial impact on the Company's Consolidated Financial Statements.

In December 2003, the SEC issued Staff Accounting Bulletin No. 104 ("SAB 104"), "Revenue Recognition" which supercedes SAB 101, "Revenue Recognition in Financial Statements." SAB 104's primary purpose is to rescind the accounting guidance contained in SAB 101 related to multiple element revenue arrangements, superceded as a result of the issuance of EITF 00-21. The Company adopted the provisions of this statement immediately, as required, and it did not have a significant impact on the Company's Consolidated Financial Statements.

EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables," issued during the third quarter of 2003, provides guidance on revenue recognition for revenues derived from a single contract that contain multiple products or services. EITF 00-21 also provides additional requirements to determine when these revenues may be recorded separately for accounting purposes. The Company adopted EITF 00-21 on July 1, 2003, as required, and it did not have a significant impact on the Company's Consolidated Financial Statements.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150 ("SFAS No. 150"), "Accounting for Certain Financial Instruments With Characteristics of Both Liabilities and Equity." This standard requires issuers to classify as liabilities the following three types of freestanding financial instruments: (1) mandatorily redeemable financial instruments; (2) obligations to repurchase the issuer's equity shares by transferring assets; and (3) certain obligations to issue a variable number of

shares. The FASB recently issued FASB Staff Position ("FSP") 150-3, which defers the provisions of paragraphs 9 and 10 of SFAS No. 150 indefinitely as they apply to mandatorily redeemable noncontrolling interests associated with finite-lived entities. The Company adopted the provisions of this statement, as required, on July 1, 2003, and it did not have a significant financial impact on the Company's Consolidated Financial Statements.

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities," an interpretation of ARB 51. FIN 46 provides guidance on identifying entities for which control is achieved through means other than through voting rights (a "variable interest entity" or "VIE"), and how to determine when and which business enterprise should consolidate a VIE. In addition, FIN 46 requires that both the primary beneficiary and all other enterprises with a significant variable interest in a VIE make additional disclosures. The transitional disclosure requirements took effect immediately and were required for all financial statements initially issued or modified after January 31, 2003. Immediate consolidation is required for VIEs entered into or modified after February 1, 2003 in which the Company is deemed the primary beneficiary. For VIEs in which the Company entered into prior to February 1, 2003 FIN 46 was deferred to the quarter ended March 31, 2004. In December 2003, the FASB issued a revised FIN 46 that modifies and clarifies various aspects of the original Interpretation. FIN 46 applies when either: (1) the equity investors (if any) lack one or more of the essential characteristics of controlling financial interest; (2) the equity investment at risk is insufficient to finance that entity's activities without additional subordinated financial support; or (3) the equity investors have voting rights that are not proportionate to their economic interest. The adoption of the additional consolidation provisions of FIN 46 did not have a material impact on the Company's Consolidated Financial Statements.

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148 ("SFAS No. 148"), "Accounting for Stock-Based Compensation – Transition and Disclosure," an amendment of FASB Statement No. 123 ("SFAS No. 123"). This statement provides alternative transition methods for a voluntary change to the fair value basis of accounting for stock-based employee compensation. However, this Statement does not permit the use of the original SFAS No. 123 prospective method of transition for changes to the fair value based method made in fiscal years beginning after December 15, 2003. In addition, this Statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation, description of transition method utilized and the effect of the method used on reported results. The Company adopted SFAS No. 148 with retroactive application to grants made subsequent to January 1, 2002 with no material effect on the Company's Consolidated Financial Statements.

In November 2002, the FASB issued FASB Interpretation No. 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," an interpretation of Statement of Financial Accounting Standards No. 5 ("SFAS No. 5"), "Accounting for Contingencies," Statement of Financial Accounting Standards No. 57, "Related Party Disclosures," Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments" and rescinds FASB Interpretation No. 34, "Disclosure of Indirect Guarantees of Indebtedness of Others, an Interpretation of SFAS No. 5." It requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under that guarantee regardless if the Company receives separately identifiable consideration (e.g., a premium). The disclosure requirements are effective December 31, 2002. The adoption of FIN 45 did not have a material impact on the Company's Consolidated Financial Statements, nor is it expected to have a material impact in the future.

In September 2002, the FASB issued Statement of Financial Accounting Standards No. 147 ("SFAS No. 147"), "Acquisitions of Certain Financial Institutions," an amendment of FASB Statements No. 72 and 144 and FASB Interpretation No. 9. SFAS No. 147 provides guidance on the accounting for the acquisitions of financial institutions, except those acquisitions between two or more mutual enterprises. SFAS No. 147 removes acquisitions of financial institutions from the scope of both FASB No. 72, "Accounting for Certain Acquisitions of Banking or Thrift Institutions," and FASB Interpretation No. 9, Applying APB Opinions No. 16 and 17, "When a Savings and Loan Association or a Similar Institution Is Acquired in a Business Combination Accounted for by the Purchase Method," and requires that those transactions be accounted for in accordance with SFAS No. 141 and SFAS No. 142. SFAS No. 147 also amends SFAS No. 144 to include in its scope long-term, customer-relationship intangible assets of financial institutions such as depositor-relationship and borrower-relationship intangible assets and credit cardholder intangible assets. The Company adopted the provisions of this statement, as required, on October 1, 2002, and it did not have a significant financial impact on the Company's Consolidated Financial Statements.

In June 2002, the FASB issued Statement of Financial Accounting Standards No. 146 ("SFAS No. 146"), "Accounting for Exit or Disposal Activities," to address significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for pursuant to the guidance that the Emerging Issues Task Force ("EITF") has set forth in EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The scope of SFAS No. 146 also includes: (1) costs related to terminating a contract that is not a capital lease; and (2) termination benefits received by employees involuntarily terminated under the terms of a one-time benefit arrangement that is not an on-going benefit arrangement or an individual deferred-compensation contract. The Company adopted the provisions of SFAS 146 on December 31, 2002, as required, and it did not have a material effect on the Company's Consolidated Financial Statements.

# QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

## Market Risks

Market risk is the exposure to loss resulting from changes in interest rates, foreign currency exchange rates, commodity prices and equity prices. In pursuing its business plan, the primary market risk to which the Company is exposed is interest rate risk. Consistent with its liability management objectives, the Company has implemented an interest rate risk management policy based on match funding, with the objective that variable-rate assets be primarily financed by variable-rate liabilities and fixed-rate assets be primarily financed by fixed-rate liabilities.

The Company's operating results will depend in part on the difference between the interest and related income earned on its assets and the interest expense incurred in connection with its interest-bearing liabilities. Competition from other providers of real estate financing may lead to a decrease in the interest rate earned on the Company's interest-bearing assets, which the Company may not be able to offset by obtaining lower interest costs on its borrowings. Changes in the general level of interest rates prevailing in the financial markets may affect the spread (the difference in the principal amount outstanding) between the Company's interest-earning assets and interest-bearing liabilities. Any significant compression of the spreads between interest-earning assets and interest-bearing liabilities could have a material adverse effect on the Company. In addition, an increase in interest rates could, among other things, reduce the value of the Company's interest-bearing assets and its ability to realize gains from the sale of such assets, and a decrease in interest rates could reduce the average life of the Company's interest-earning assets.

A substantial portion of the Company's loan investments are subject to significant prepayment protection in the form of lock-outs, yield maintenance provisions or other prepayment premiums which provide substantial yield protection to the Company. Those assets generally not subject to prepayment penalties include: (1) variable-rate loans based on LIBOR, originated or acquired at par, which would not result in any gain or loss upon repayment; and (2) discount loans and loan participations acquired at discounts to face values, which would result in gains upon repayment. Further, while the Company generally seeks to enter into loan investments which provide for substantial prepayment protection, in the event of declining interest rates, the Company could receive such prepayments and may not be able to reinvest such proceeds at favorable returns. Such prepayments could have an adverse effect on the spreads between interest-earning assets and interest-bearing liabilities.

## Interest Rate Risks

While the Company has not experienced any significant credit losses, in the event of a significant rising interest rate environment and/or economic downturn, defaults could increase and result in credit losses to the Company which adversely affect its liquidity and operating results. Further, such delinquencies or defaults could have an adverse effect on the spreads between interest-earning assets and interest-bearing liabilities.

Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political conditions, and other factors beyond the control of the Company. As more fully discussed in Note 9 to the Company's Consolidated Financial Statements, the Company employs match funding-based hedging strategies to limit the effects of changes in interest rates on its operations, including engaging in interest rate caps, floors, swaps, futures and other interest rate-related derivative contracts. These strategies are specifically designed to reduce the Company's exposure, on specific transactions or on a portfolio basis, to changes in cash flows as a result of interest rate movements in the market. The Company does not enter into derivative contracts for speculative purposes nor as a hedge against changes in credit risk of its borrowers or of the Company itself.

Each interest rate cap or floor agreement is a legal contract between the Company and a third party (the "counterparty"). When the Company purchases a cap or floor contract, the Company makes an up-front payment to the counterparty and the counterparty agrees to make payments to the Company in the future should the reference rate (typically one- or three-month LIBOR) rise above (cap agreements) or fall below (floor agreements) the "strike" rate specified in the contract. Each contract has a notional face amount. Should the reference rate rise above the contractual strike rate in a cap, the Company will earn cap income. Should the reference rate fall below the contractual strike rate in a floor, the Company will earn floor income. Payments on an annualized basis will equal the contractual notional face amount multiplied by the difference between the actual reference rate and the contracted strike rate. The Company utilizes the provisions of SFAS No. 133 with respect to such instruments. SFAS No. 133 provides that the up-front fees paid on option-based products such as caps be expensed into earnings based on the allocation of the premium to the affected periods as if the agreement were a series of "caplets." These allocated premiums are then reflected as a charge to income and are included in "Interest expense" on the Company's Consolidated Statements of Operations in the affected period.

Interest rate swaps are agreements in which a series of interest rate flows are exchanged over a prescribed period. The notional amount on which swaps are based is not exchanged. The Company's swaps are either "pay fixed" swaps involving the exchange of variable-rate interest payments from the counterparty for fixed interest payments from the Company or "pay floating" swaps involving the exchange of fixed-rate interest payments from the counterparty for variable-rate interest payments from the Company, which mitigates the risk of changes in fair value of the Company's fixed-rate debt obligations.

Interest rate futures are contracts, generally settled in cash, in which the seller agrees to deliver on a specified future date the cash equivalent of the difference between the specified price or yield indicated in the contract and the value of the specified instrument (i.e., U.S. Treasury securities) upon settlement. Under these agreements, the Company would generally receive additional cash flow at settlement if interest rates rise and pay cash if interest rates fall. The effects of such receipts or payments would be deferred and amortized over the term of the specific related fixed-rate borrowings. In the event that, in the opinion of management, it is no longer probable that a forecasted transaction will occur under terms substantially equivalent to those projected, the Company would cease recognizing such transactions as hedges and immediately recognize related gains or losses based on actual settlement or estimated settlement value.

While a REIT may freely utilize derivative instruments to hedge interest rate risk on its liabilities, the use of derivatives for other purposes, including hedging asset-related risks such as credit, prepayment or interest rate exposure on the Company's loan assets, could generate income which is not qualified income for purposes of maintaining REIT status. As a consequence, the Company may only engage in such instruments to hedge such risks on a limited basis.

There can be no assurance that the Company's profitability will not be adversely affected during any period as a result of changing interest rates. In addition, hedging transactions using derivative instruments involve certain additional risks such as counterparty credit risk, legal enforceability of hedging contracts and the risk that unanticipated and significant changes in interest rates will cause a significant loss of basis in the contract. With regard to loss of basis in a hedging contract, indices upon which contracts are based may be more or less variable than the indices upon which the hedged assets or liabilities are based, thereby making the hedge less effective. The counterparties to these contractual arrangements are major financial institutions with which the Company and its affiliates may also have other financial relationships. The Company is potentially exposed to credit loss in the event of nonperformance by these counterparties. However, because of their high credit ratings, the Company does not anticipate that any of the counterparties will fail to meet their obligations. There can be no assurance that the Company will be able to adequately protect against the foregoing risks and that the Company will ultimately realize an economic benefit from any hedging contract it enters into which exceeds the related costs incurred in connection with engaging in such hedges.

The following table quantifies the potential changes in net investment income and net fair value of financial instruments should interest rates increase or decrease 50, 100 or 200 basis points, assuming no change in the shape of the yield curve (i.e., relative interest rates). Net investment income is calculated as revenue from loans and other lending investments and operating leases (as of December 31, 2004), less related interest expense and operating costs on CTL assets, for the year ended December 31, 2004. Net fair value of financial instruments is calculated as the sum of the value of derivative instruments and the present value of cash in-flows generated from interest-earning assets, less cash out-flows in respect to interest-bearing liabilities as of December 31, 2004. The cash flows associated with the Company's assets are calculated based on management's best estimate of expected payments for each loan based on loan characteristics such as loan-to-value ratio, interest rate, credit history, prepayment penalty, term and collateral type. Most of the Company's loans are protected from prepayment as a result of prepayment penalties, yield maintenance fees or contractual terms which prohibit prepayments during specified periods. However, for those loans where prepayments are not currently precluded by contract, declines in interest rates may increase prepayment speeds. The base interest rate scenario assumes the one-month LIBOR rate of 2.40% as of December 31, 2004. Actual results could differ significantly from those estimated in the table.

Net fair value of financial instruments in the table below does not include CTL assets (approximately 40% of the Company's total assets) and certain forms of corporate finance investments but includes debt associated with the financing of these CTL assets. Therefore, the table below is not a meaningful representation of the estimated percentage change in net fair value of financial instruments with change in interest rates.

The estimated percentage change in net investment income does include operating lease income from CTL assets and therefore is a more accurate representation of the impact of changes in interest rates on net investment income.

| | Estimated Percentage Change In | |
|---|---|---|
| **Change in Interest Rates** | **Net Investment Income** | **Net Fair Value of Financial Instruments** |
| –100 Basis Points | 2.30% | 24.65% |
| –50 Basis Points | 0.68% | 12.68% |
| Base Interest Rate | 0.00% | 0.00% |
| +100 Basis Points | (0.23)% | (5.63)% |
| +200 Basis Points | (0.43)% | (10.02)% |

## MANAGEMENT'S REPORT ON INTERNAL CONTROLS OVER FINANCIAL REPORTING

**Evaluation of Disclosure Controls and Procedures** – The Company has established and 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 SEC'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. The Chief Financial Officer is currently a member of the disclosure committee.

Based upon their evaluation as of December 31, 2004, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) under the Securities and Exchange Act of 1934, as amended (the "Exchange Act")) are effective in recording, processing, summarizing and reporting, on a timely basis, information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's Exchange Act filings.

**Management's Report on Internal Controls Over Financial Reporting** – Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of the disclosure committee and other members of management, including the Chief Executive Officer and Chief Financial Officer, management carried out its evaluation of the effectiveness of the Company's internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the Company's evaluation under the framework in *Internal Control – Integrated Framework*, management has concluded that its internal control over financial reporting was effective as of December 31, 2004. Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2004, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein.

**Changes in Internal Controls Over Financial Reporting** – There have been no significant changes during the last fiscal quarter in the Company's internal controls identified in connection with the evaluation required by paragraph (d) of Rules 13a-15 or 15d-15 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

# REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders
of iStar Financial Inc.:

We have completed an integrated audit of iStar Financial Inc.'s 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2004 and audits of its 2003 and 2002 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

**Consolidated financial statements**

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, shareholders' equity and cash flows present fairly, in all material respects, the financial position of iStar Financial Inc. and its subsidiaries (collectively, the "Company") at December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

**Internal control over financial reporting**

Also, in our opinion, management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that the Company maintained effective internal control over financial reporting as of December 31, 2004 based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control – Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

New York, New York
March 14, 2005

## CONSOLIDATED BALANCE SHEETS

| As of December 31, | 2004 | 2003 |
|---|---|---|
| | (In thousands, except per share data) | |
| **Assets** | | |
| Loans and other lending investments, net | **$3,946,189** | $3,702,674 |
| Corporate tenant lease assets, net | **2,877,042** | 2,535,885 |
| Investments in and advances to joint ventures and unconsolidated subsidiaries | **5,663** | 25,019 |
| Assets held for sale | **–** | 24,800 |
| Cash and cash equivalents | **88,422** | 80,090 |
| Restricted cash | **39,568** | 57,665 |
| Accrued interest and operating lease income receivable | **25,633** | 26,076 |
| Deferred operating lease income receivable | **62,092** | 51,447 |
| Deferred expenses and other assets | **175,628** | 156,934 |
| Total assets | **$7,220,237** | $6,660,590 |
| **Liabilities and Shareholders' Equity** | | |
| Liabilities: | | |
| Accounts payable, accrued expenses and other liabilities | **$ 140,075** | $126,524 |
| Debt obligations | **4,605,674** | 4,113,732 |
| Total liabilities | **4,745,749** | 4,240,256 |
| Commitments and contingencies | **–** | – |
| Minority interest in consolidated entities | **19,246** | 5,106 |
| Shareholders' equity: | | |
| Series B Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 0 and 2,000 shares issued and outstanding at December 31, 2004 and 2003, respectively | **–** | 2 |
| Series C Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 0 and 1,300 shares issued and outstanding at December 31, 2004 and 2003, respectively | **–** | 1 |
| Series D Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 4,000 shares issued and outstanding at December 31, 2004 and 2003, respectively | **4** | 4 |
| Series E Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 5,600 shares issued and outstanding at December 31, 2004 and 2003, respectively | **6** | 6 |
| Series F Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 4,000 shares issued and outstanding at December 31, 2004 and 2003, respectively | **4** | 4 |
| Series G Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 3,200 shares issued and outstanding at December 31, 2004 and 2003, respectively | **3** | 3 |
| Series I Preferred Stock, $0.001 par value, liquidation preference $25.00 per share, 5,000 and 0 shares issued and outstanding at December 31, 2004 and 2003, respectively | **5** | – |
| High Performance Units | **7,828** | 5,131 |
| Common Stock, $0.001 par value, 200,000 shares authorized, 111,432 and 107,215 shares issued and outstanding at December 31, 2004 and 2003, respectively | **111** | 107 |
| Warrants and options | **6,458** | 20,695 |
| Additional paid-in capital | **2,840,062** | 2,678,772 |
| Retained earnings (deficit) | **(349,097)** | (242,449) |
| Accumulated other comprehensive income (losses) (See Note 12) | **(2,086)** | 1,008 |
| Treasury stock (at cost) | **(48,056)** | (48,056) |
| Total shareholders' equity | **2,455,242** | 2,415,228 |
| Total liabilities and shareholders' equity | **$7,220,237** | $6,660,590 |

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

## CONSOLIDATED STATEMENTS OF OPERATIONS

| For the Years Ended December 31, | 2004 | 2003 | 2002 |
|---|---|---|---|
| | | (In thousands, except per share data) | |
| **Revenue:** | | | |
| Interest income | **$353,799** | $304,391 | $255,631 |
| Operating lease income | **286,389** | 232,043 | 210,033 |
| Other income | **54,236** | 36,677 | 27,993 |
| Total revenue | **694,424** | 573,111 | 493,657 |
| **Costs and expenses:** | | | |
| Interest expense | **231,027** | 192,296 | 184,932 |
| Operating costs – corporate tenant lease assets | **22,417** | 11,553 | 6,735 |
| Depreciation and amortization | **64,541** | 50,626 | 42,579 |
| General and administrative | **47,912** | 38,153 | 30,449 |
| General and administrative – stock-based compensation expense | **109,676** | 3,633 | 17,998 |
| Provision for loan losses | **9,000** | 7,500 | 8,250 |
| Loss on early extinguishment of debt | **13,091** | – | 12,166 |
| Total costs and expenses | **497,664** | 303,761 | 303,109 |
| Income before equity in earnings from joint ventures and unconsolidated subsidiaries, minority interest and other items | **196,760** | 269,350 | 190,548 |
| Equity in earnings (loss) from joint ventures and unconsolidated subsidiaries | **2,909** | (4,284) | 1,222 |
| Minority interest in consolidated entities | **(716)** | (249) | (162) |
| Income from continuing operations | **198,953** | 264,817 | 191,608 |
| Income from discontinued operations | **18,119** | 22,173 | 22,945 |
| Gain from discontinued operations | **43,375** | 5,167 | 717 |
| Net income | **260,447** | 292,157 | 215,270 |
| Preferred dividend requirements | **(51,340)** | (36,908) | (36,908) |
| Net income allocable to common shareholders and HPU holders[1] | **$209,107** | $255,249 | $178,362 |
| Basic earnings per common share[2] | **$ 1.87** | $ 2.52 | $ 1.98 |
| Diluted earnings per common share[3][4] | **$ 1.83** | $ 2.43 | $ 1.93 |

**Explanatory Notes:**

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

(2) For the 12 months ended December 31, 2004, 2003 and 2002, excludes $3,314, $2,066 and $0 of net income allocable to HPU holders, respectively.

(3) For the 12 months ended December 31, 2004, 2003 and 2002, excludes $3,265, $1,994 and $0 of net income allocable to HPU holders, respectively.

(4) For the 12 months ended December 31, 2004, 2003 and 2002, includes $3, $167 and $0 of joint venture income, respectively.

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

| | Series A Preferred Stock | Series B Preferred Stock | Series C Preferred Stock | Series D Preferred Stock | Series E Preferred Stock | Series F Preferred Stock | Series G Preferred Stock | Series H Preferred Stock | Series I Preferred Stock |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | (In thousands) | | | | |
| Balance at December 31, 2001 | $ 4 | $ 2 | $ 1 | $ 4 | $ – | $ – | $ – | $ – | $ – |
| Exercise of options | – | – | – | – | – | – | – | – | – |
| Proceeds from equity offering | – | – | – | – | – | – | – | – | – |
| Dividends declared – preferred | – | – | – | – | – | – | – | – | – |
| Dividends declared – common | – | – | – | – | – | – | – | – | – |
| Restricted stock units granted to employees | – | – | – | – | – | – | – | – | – |
| Options granted to employees | – | – | – | – | – | – | – | – | – |
| High performance units sold to employees | – | – | – | – | – | – | – | – | – |
| Contributions from significant shareholder | – | – | – | – | – | – | – | – | – |
| Issuance of stock – DRIP plan | – | – | – | – | – | – | – | – | – |
| Purchase of treasury shares | – | – | – | – | – | – | – | – | – |
| Net income for the period | – | – | – | – | – | – | – | – | – |
| Change in accumulated other comprehensive income (losses) | – | – | – | – | – | – | – | – | – |
| Balance at December 31, 2002 | $ 4 | $ 2 | $ 1 | $ 4 | $ – | $ – | $ – | $ – | $ – |
| Exercise of options | – | – | – | – | – | – | – | – | – |
| Net proceeds from preferred offering/exchange | (4) | – | – | – | 6 | 4 | 3 | – | – |
| Proceeds from equity offering | – | – | – | – | – | – | – | – | – |
| Dividends declared – preferred | – | – | – | – | – | – | – | – | – |
| Dividends declared – common | – | – | – | – | – | – | – | – | – |
| Dividends declared – HPU's | – | – | – | – | – | – | – | – | – |
| Restricted stock units granted to employees | – | – | – | – | – | – | – | – | – |
| Options granted to employees | – | – | – | – | – | – | – | – | – |
| High performance units sold to employees | – | – | – | – | – | – | – | – | – |
| Issuance of stock – DRIP/Stock purchase plan | – | – | – | – | – | – | – | – | – |
| Net income for the period | – | – | – | – | – | – | – | – | – |
| Change in accumulated other comprehensive income (losses) | – | – | – | – | – | – | – | – | – |
| Balance at December 31, 2003 | $ – | $ 2 | $ 1 | $ 4 | $ 6 | $ 4 | $ 3 | $ – | $ – |
| Exercise of options and warrants | – | – | – | – | – | – | – | – | – |
| Net proceeds from preferred offering/exchange | – | – | – | – | – | – | – | 3 | 5 |
| Proceeds from equity offering | – | (2) | (1) | – | – | – | – | (3) | – |
| Dividends declared – preferred | – | – | – | – | – | – | – | – | – |
| Dividends declared – common | – | – | – | – | – | – | – | – | – |
| Dividends declared – HPU's | – | – | – | – | – | – | – | – | – |
| Restricted stock units granted to employees | – | – | – | – | – | – | – | – | – |
| High performance units sold to employees | – | – | – | – | – | – | – | – | – |
| Issuance of stock – DRIP/Stock purchase plan | – | – | – | – | – | – | – | – | – |
| Contribution from significant shareholder | – | – | – | – | – | – | – | – | – |
| Net income for the period | – | – | – | – | – | – | – | – | – |
| Change in accumulated other comprehensive income (losses) | – | – | – | – | – | – | – | – | – |
| **Balance at December 31, 2004** | **$ –** | **$ –** | **$ –** | **$ 4** | **$ 6** | **$ 4** | **$ 3** | **$ –** | **$ 5** |

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

(continued)

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (continued)

(In thousands)

| | HPU's | Common Stock at Par | Warrants and Options | Additional Paid-in Capital | Retained Earnings (Deficit) | Accumulated Other Comprehensive Income (Losses) | Treasury Stock | Total |
|---|---|---|---|---|---|---|---|---|
| Balance at December 31, 2001 | $ – | $ 87 | $20,456 | $ 1,997,931 | $ (174,874) | $(15,092) | $ (40,741) | $ 1,787,778 |
| Exercise of options | – | 2 | (443) | 16,170 | – | – | – | 15,729 |
| Proceeds from equity offering | – | 8 | – | 202,891 | – | – | – | 202,899 |
| Dividends declared – preferred | – | – | – | 330 | (36,908) | – | – | (36,578) |
| Dividends declared – common | – | – | – | – | (231,257) | – | – | (231,257) |
| Restricted stock units granted to employees | – | – | – | 19,048 | – | – | – | 19,048 |
| Options granted to employees | – | – | 309 | – | – | – | – | 309 |
| High performance units sold to employees | 1,359 | – | – | – | – | – | – | 1,359 |
| Contributions from significant shareholder | – | – | – | 506 | – | – | – | 506 |
| Issuance of stock – DRIP plan | – | 1 | – | 44,426 | – | – | – | 44,427 |
| Purchase of treasury shares | – | – | – | 334 | – | – | (7,315) | (6,981) |
| Net income for the period | – | – | – | – | 215,270 | – | – | 215,270 |
| Change in accumulated other comprehensive income (losses) | – | – | – | – | – | 12,791 | – | 12,791 |
| Balance at December 31, 2002 | $ 1,359 | $ 98 | $20,322 | $ 2,281,636 | $ (227,769) | $ (2,301) | $ (48,056) | $ 2,025,300 |
| Exercise of options | – | 1 | 373 | 27,754 | – | – | – | 28,128 |
| Net proceeds from preferred offering/exchange | – | – | – | 87,900 | – | – | – | 87,909 |
| Proceeds from equity offering | – | 5 | – | 190,931 | – | – | – | 190,936 |
| Dividends declared – preferred | – | – | – | 195 | (36,908) | – | – | (36,713) |
| Dividends declared – common | – | – | – | – | (267,785) | – | – | (267,785) |
| Dividends declared – HPU's | – | – | – | – | (2,144) | – | – | (2,144) |
| Restricted stock units granted to employees | – | – | – | 1,339 | – | – | – | 1,339 |
| Options granted to employees | – | – | – | 82 | – | – | – | 82 |
| High performance units sold to employees | 3,772 | – | – | – | – | – | – | 3,772 |
| Issuance of stock – DRIP/Stock purchase plan | – | 3 | – | 88,935 | – | – | – | 88,938 |
| Net income for the period | – | – | – | – | 292,157 | – | – | 292,157 |
| Change in accumulated other comprehensive income (losses) | – | – | – | – | – | 3,309 | – | 3,309 |
| Balance at December 31, 2003 | $ 5,131 | $ 107 | $20,695 | $ 2,678,772 | $ (242,449) | $ 1,008 | $ (48,056) | $ 2,415,228 |
| Exercise of options and warrants | – | 4 | (14,237) | 41,501 | – | – | – | 27,268 |
| Net proceeds from preferred offering/exchange | – | – | – | 202,743 | – | – | – | 202,751 |
| Proceeds from equity offering | – | – | – | (155,959) | – | – | – | (155,965) |
| Dividends declared – preferred | – | – | – | – | (51,340) | – | – | (51,340) |
| Dividends declared – common | – | – | – | – | (310,744) | – | – | (310,744) |
| Dividends declared – HPU's | – | – | – | – | (5,011) | – | – | (5,011) |
| Restricted stock units granted to employees | – | – | – | 53,351 | – | – | – | 53,351 |
| High performance units sold to employees | 2,697 | – | – | – | – | – | – | 2,697 |
| Issuance of stock – DRIP/Stock purchase plan | – | – | – | 17,719 | – | – | – | 17,719 |
| Contribution from significant shareholder | – | – | – | 1,935 | – | – | – | 1,935 |
| Net income for the period | – | – | – | – | 260,447 | – | – | 260,447 |
| Change in accumulated other comprehensive income (losses) | – | – | – | – | – | (3,094) | – | (3,094) |
| **Balance at December 31, 2004** | **$7,828** | **$111** | **$6,458** | **$2,840,062** | **$(349,097)** | **$ (2,086)** | **$(48,056)** | **$2,455,242** |

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| For the Years Ended December 31, | 2004 | 2003 | 2002 |
|---|---|---|---|
| | | (In thousands) | |
| **Cash flows from operating activities:** | | | |
| Net income | **$ 260,447** | $ 292,157 | $ 215,270 |
| Adjustments to reconcile net income to cash flows provided by operating activities: | | | |
| Minority interest in consolidated entities | **716** | 249 | 162 |
| Non-cash expense for stock-based compensation | **54,403** | 3,781 | 18,059 |
| Depreciation and amortization | **64,541** | 50,626 | 42,579 |
| Depreciation and amortization from discontinued operations | **3,942** | 5,453 | 5,462 |
| Amortization of deferred financing costs | **30,189** | 27,180 | 23,460 |
| Amortization of discounts/premiums, deferred interest and costs on lending investments | **(59,466)** | (54,799) | (33,086) |
| Discounts, loan fees and deferred interest received | **40,373** | 36,063 | 36,714 |
| Equity in earnings (loss) from joint ventures and unconsolidated subsidiaries | **(2,909)** | 4,284 | (1,222) |
| Distributions from operations of joint ventures | **5,840** | 2,839 | 5,802 |
| Loss on early extinguishment of debt | **13,144** | – | 12,166 |
| Deferred operating lease income receivable | **(18,075)** | (15,366) | (15,265) |
| Gain from discontinued operations | **(43,375)** | (5,167) | (717) |
| Provision for loan losses | **9,000** | 7,500 | 8,250 |
| Change in investments in and advances to joint ventures and unconsolidated subsidiaries | **–** | (2,877) | (6,598) |
| Changes in assets and liabilities: | | | |
| Changes in accrued interest and operating lease income receivable | **(1,018)** | (647) | 3,809 |
| Changes in deferred expenses and other assets | **21,599** | (20,690) | 1,763 |
| Changes in accounts payable, accrued expenses and other liabilities | **(16,219)** | 7,676 | 32,185 |
| Cash flows from operating activities | **363,132** | 338,262 | 348,793 |
| **Cash flows from investing activities:** | | | |
| New investment originations | **(2,058,732)** | (2,086,890) | (1,812,993) |
| Add-on fundings under existing loan commitments | **(255,321)** | (46,164) | (21,619) |
| Net proceeds from sale of corporate tenant lease assets | **279,575** | 47,569 | 3,702 |
| Net proceeds from lease termination payments | **–** | – | 17,500 |
| Repayments of and principal collections on loans and other lending investments | **1,591,015** | 1,119,743 | 671,965 |
| Investments in and advances to unconsolidated joint ventures | **–** | – | (127) |
| Capital improvements for build-to-suit projects | **–** | – | (1,064) |
| Capital improvement projects on corporate tenant lease assets | **(7,124)** | (3,487) | (2,277) |
| Other capital expenditures on corporate tenant lease assets | **(14,846)** | (5,125) | (4,157) |
| Cash flows from investing activities | **(465,433)** | (974,354) | (1,149,070) |

(continued)

## CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

| For the Years Ended December 31, | 2004 | 2003 | 2002 |
|---|---|---|---|
| | | (In thousands) | |
| **Cash flows from financing activities:** | | | |
| Borrowings under secured revolving credit facilities | **$ 2,680,416** | $ 1,643,552 | $ 2,496,200 |
| Repayments under secured revolving credit facilities | **(3,298,421)** | (2,220,715) | (2,122,994) |
| Borrowings under unsecured revolving credit facilities | **3,945,500** | 130,000 | – |
| Repayments under unsecured revolving credit facilities | **(3,235,500)** | – | – |
| Borrowings under term loans | **160,181** | 233,000 | 115,099 |
| Repayments under term loans | **(403,231)** | (107,723) | (18,279) |
| Borrowings under unsecured bond offerings | **1,032,442** | 526,966 | – |
| Repayments under unsecured notes | **(110,000)** | – | – |
| Borrowings under secured bond offerings | **–** | 645,822 | 885,079 |
| Repayments under secured bond offerings | **(378,400)** | (210,876) | (475,679) |
| Borrowings under other debt obligations | **–** | 25,251 | 1,094 |
| Repayments under other debt obligations | **(10,148)** | (7,064) | (1,668) |
| Contribution from minority interest partner | **3,340** | 2,522 | – |
| Changes in restricted cash held in connection with debt obligations | **18,757** | (17,454) | (22,359) |
| Prepayment penalty on early extinguishment of debt | **(9,769)** | – | (3,950) |
| Payments for deferred financing costs | **(13,131)** | (35,609) | (45,702) |
| Distributions to minority interest in consolidated entities | **(1,054)** | (159) | (231) |
| Net proceeds from preferred offering/exchange | **203,048** | 87,909 | – |
| Redemption of preferred stock | **(165,000)** | – | – |
| Common dividends paid | **(310,744)** | (267,785) | (231,257) |
| Preferred dividends paid | **(41,908)** | (36,713) | (36,578) |
| Dividends on HPUs | **(5,011)** | (2,144) | – |
| HPUs issued | **2,697** | 3,772 | 1,359 |
| Purchase of treasury stock | **–** | – | (6,981) |
| Proceeds from equity offering | **–** | 190,936 | 202,899 |
| Contribution from significant shareholder | **1,935** | – | 506 |
| Proceeds from exercise of options and issuance of DRIP/Stock purchase shares | **44,634** | 116,760 | 63,983 |
| Cash flows from financing activities | **110,633** | 700,248 | 800,541 |
| Increase in cash and cash equivalents | **8,332** | 64,156 | 264 |
| Cash and cash equivalents at beginning of period | **80,090** | 15,934 | 15,670 |
| Cash and cash equivalents at end of period | **$ 88,422** | $ 80,090 | $ 15,934 |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid during the period for interest, net of amount capitalized | **$ 191,205** | $ 165,757 | $ 157,618 |

The accompanying notes are an integral part of the 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 provides custom-tailored financing to high-end private and corporate owners of real estate, including senior and junior mortgage debt, senior and mezzanine corporate capital, and corporate net lease financing. 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 primary product lines include:

- **Structured Finance.** The Company provides senior and subordinated loans that typically range in size from $20 million to $100 million. These loans may be either fixed or variable rate and are structured to meet the specific financing needs of the borrowers, including the acquisition or financing of large, quality real estate. The Company offers borrowers a wide range of structured finance options, including first mortgages, second mortgages, partnership loans, participating debt and interim facilities. The Company's structured finance transactions have maturities generally ranging from three to ten years. As of December 31, 2004, based on gross carrying values, the Company's structured finance assets represented 25% of its assets.
- **Portfolio Finance.** The Company provides funding to regional and national borrowers who own multiple facilities in geographically diverse portfolios. Loans are cross-collateralized to give the Company the benefit of all available collateral and underwritten to recognize inherent portfolio diversification. Property types include multifamily, suburban office, hotels and other property types where individual property values are less than $20 million on average. Loan terms are structured to meet the specific requirements of the borrower and typically range in size from $25 million to $150 million. The Company's portfolio finance transactions have maturities generally ranging from three to ten years. As of December 31, 2004, based on gross carrying values, the Company's portfolio finance assets represented 15% of its assets.
- **Corporate Finance.** The Company provides senior and subordinated capital to corporations engaged in real estate or real estate-related businesses. Financings may be either secured or unsecured and typically range in size from $20 million to $150 million. The Company's corporate finance transactions have maturities generally ranging from five to ten years. As of December 31, 2004, based on gross carrying values, the Company's corporate finance assets represented 10% of its assets.
- **Loan Acquisition.** The Company acquires whole loans and loan participations which present attractive risk-reward opportunities. Loans are generally acquired at a small discount to the principal balance outstanding. Loan acquisitions typically range in size from $5 million to $100 million and are collateralized by all major property types. The Company's loan acquisition transactions have maturities generally ranging from three to ten years. As of December 31, 2004, based on gross carrying values, the Company's loan acquisition assets represented 6% of its assets.
- **Corporate Tenant Leasing.** The Company provides capital to corporations and borrowers who control facilities leased to single creditworthy customers. The Company's net leased assets are generally mission-critical headquarters or distribution facilities that are subject to long-term leases with public companies, many of which are rated corporate credits and which provide for all expenses at the facility to be paid by the corporate customer on a triple net lease basis. Corporate tenant lease ("CTL") transactions have terms generally ranging from ten to 20 years and typically range in size from $20 million to $150 million. As of December 31, 2004, based on gross carrying values, the Company's CTL assets (including investments in and advances to joint ventures and unconsolidated subsidiaries and assets held for sale) represented 44% of its assets.

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.
- 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 approximately $1.1 billion of assets to the Company's predecessor in exchange for a controlling interest in that company. Since that time, the Company has grown by originating new lending and leasing transactions, as well as through corporate acquisitions.

Specifically, in September 1998, the Company acquired the loan origination and servicing business of a major insurance company, and in December 1998, the Company acquired the mortgage and mezzanine loan portfolio of its largest private competitor. Additionally, in November 1999, the Company acquired TriNet Corporate Realty Trust, Inc. ("TriNet" or the "Leasing Subsidiary"), then the largest publicly-traded company specializing in corporate sale/leaseback transactions for office and industrial facilities (the "TriNet Acquisition"). The TriNet Acquisition was structured as a stock-for-stock merger of TriNet with a subsidiary of the Company.

Concurrent with the TriNet Acquisition, the Company also 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 shares were traded on the American Stock Exchange.

## Note 2 – Basis of Presentation

The accompanying audited Consolidated Financial Statements have been prepared in conformity with 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 ("FIN 46") (see Note 6).

Certain other investments in partnerships or joint ventures 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.

## 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, other lending investments-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 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 40.0 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 life of the facility for facility improvements.

CTL assets to be disposed of are reported at the lower of their carrying amount or 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. In management's opinion, CTL assets to be held and used are not carried at amounts in excess of their estimated recoverable amounts.

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 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 "Deferred expenses and other assets" on the Company's Consolidated Balance Sheets.

The value of above-market or below-market in-place leases are amortized to expense 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.

**Capitalized interest** – The Company capitalizes interest costs incurred during the construction period on qualified build-to-suit projects for corporate tenants, including investments in joint ventures accounted for under the equity method. No interest was capitalized during the 12 months ended December 31, 2004 and 2003.

**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.

**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 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" in 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 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 termsis recorded as "Deferred operating lease income receivable" on the Company's Consolidated Balance Sheets.

**Provision 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 provisions, 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 according to the contractual terms of 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 provision 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 secured by real estate assets or are corporate lending arrangements to entities with significant rental real estate operations (e.g., an unsecured loan to a company which operates residential apartments or retail, industrial or office facilities as rental real estate). 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 preclusions as to

how much senior and/or secured debt the customer may borrow ahead of the Company's position.

**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.

**Accounting for 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 by Statement of Financial Accounting Standards No. 137 "Accounting for Derivative Instruments and Hedging Activity – Deferral of the Effective Date of FASB 133," Statement of Financial Accounting Standards No. 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities – an Amendment of FASB Statement 133" and Statement of Financial Accounting Standards No. 149 "Amendment of Statement 133 on Derivative Instrument and Hedging Activities," 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: (1) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment; (2) a hedge of the exposure to variable cash flows of a forecasted transaction; or (3) in certain circumstances, a hedge of a foreign currency exposure.

**Accounting for the 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 in the Company's Consolidated Statements of Operations.

**Reclassification of extraordinary loss on early extinguishment of debt** – In accordance with the Statement of Financial Accounting Standards No. 145 ("SFAS No. 145"), "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections," the Company can no longer aggregate the gains and losses from the early extinguishment of debt and, if material, classify them as an extraordinary item. The Company is not prohibited from classifying such gains and losses as extraordinary items, so long as they meet the criteria in paragraph 20 of Accounting Principles Board Opinion No. 30 ("APB 30"), "Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions"; however, due to the nature of the Company's operations, such treatment may not be available to the Company. Any gains or losses on early extinguishments of debt that were previously classified as extraordinary items in prior periods presented that do not meet the criteria in APB 30 for classification as an extraordinary item are reclassified to income from continuing operations.

**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. iStar Operating Inc. ("iStar Operating") and TriNet Management Operating Company, Inc. ("TMOC"), the Company's taxable REIT subsidiaries, 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 iStar Operating and TMOC. Accordingly, except for the Company's taxable REIT subsidiaries, no current or deferred taxes are provided for in the Consolidated Financial Statements. During the third quarter 2003, TMOC was liquidated. See Note 6 for a detailed discussion on the ownership structure and operations of iStar Operating and TMOC.

**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.

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

**New accounting standards** – 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 FASB No. 123R using one of three transition methods: (1) the modified prospective method; (2) a variation of the modified prospective method; or (3) the modified retrospective method. The provisions of this statement are effective for interim and annual periods beginning after June 15, 2005, however, in the third quarter 2002, in anticipation of this new literature, the Company adopted the second transition method (with retroactive application of fair-value accounting to the beginning of the calendar year), which did not have a significant financial impact on the Company's Consolidated Financial Statements.

In December 2003, the SEC issued Staff Accounting Bulletin No. 104 ("SAB 104"), "Revenue Recognition" which supercedes SAB 101, "Revenue Recognition in Financial Statements." SAB 104's primary purpose is to rescind the accounting guidance contained in SAB 101 related to multiple element revenue arrangements, superceded as a result of the issuance of EITF 00-21. The Company adopted the provisions of this statement immediately, as required, and it did not have a significant impact on the Company's Consolidated Financial Statements.

EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables," issued during the third quarter of 2003, provides guidance on revenue recognition for revenues derived from a single contract that contain multiple products or services. EITF 00-21 also provides additional requirements to determine when these revenues may be recorded separately for accounting purposes. The Company adopted EITF 00-21 on July 1, 2003, as required, and it did not have a significant impact on the Company's Consolidated Financial Statements.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150 ("SFAS No. 150"), "Accounting for Certain Financial Instruments With Characteristics of Both Liabilities and Equity." This standard requires issuers to classify as liabilities the following three types of freestanding financial instruments: (1) mandatorily redeemable financial instruments; (2) obligations to repurchase the issuer's equity shares by transferring assets; and (3) certain obligations to issue a variable number of shares. The FASB recently issued FASB Staff Position ("FSP") 150-3, which defers the provisions of paragraphs 9 and 10 of SFAS No. 150 indefinitely as they apply to mandatorily redeemable noncontrolling interests associated with finite-lived entities. The Company adopted the provisions of this statement, as required, on July 1, 2003, and it did not have a significant financial impact on the Company's Consolidated Financial Statements.

In January 2003, the FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities," an interpretation of ARB 51. FIN 46 provides guidance on identifying entities for which control is achieved through means other than through voting rights (a "variable interest entity" or "VIE"), and how to determine when and which business enterprise should consolidate a VIE. In addition, FIN 46 requires that both the primary beneficiary and all other enterprises with a significant variable interest in a VIE make additional disclosures. The transitional disclosure requirements took effect immediately and were required for all financial statements initially issued or modified after January 31, 2003. Immediate consolidation is required for VIEs entered into or modified after February 1, 2003 in which the Company is deemed the primary beneficiary. For VIEs in which the Company entered into prior to February 1, 2003, FIN 46 was deferred to the quarter ended March 31, 2004. In December 2003, the FASB issued a revised FIN 46 that modifies and clarifies various aspects of the original Interpretation. FIN 46 applies when either: (1) the equity investors (if any) lack one or more of the essential characteristics of controlling financial interest; (2) the equity investment at risk is insufficient to finance that entity's activities without additional subordinated financial support; or (3) the equity investors have voting rights that are not proportionate to their economic interest. The adoption of the additional consolidation provisions of FIN 46 did not have a material impact on the Company's Consolidated Financial Statements (see Note 6).

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148 ("SFAS No. 148"), "Accounting for Stock-Based Compensation – Transition and Disclosure," an amendment of FASB Statement No. 123 ("SFAS No. 123"). This statement provides alternative transition methods for a voluntary change to the fair value basis of accounting for stock-based employee compensation. However, this Statement does not permit the use of the original SFAS No. 123 prospective method of transition for changes to the fair value-based method made in fiscal years beginning after December 15, 2003. In addition, this Statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation, description of transition method utilized and the effect of the method used on reported results. The Company adopted SFAS No. 148 with retroactive application to grants made subsequent to January 1, 2002 with no material effect on the Company's Consolidated Financial Statements.

SFAS No. 148 disclosure requirements, including the effect on net income and earnings per share if the fair value-based method had been applied to all outstanding and unvested stock awards in each period, are presented below (in thousands except per share amounts):

| For the Years Ended December 31, | 2004 Basic EPS | 2003 Basic EPS | 2002 Basic EPS |
|---|---|---|---|
| Net income allocable to common shareholders and HPU holders, as reported[1] | **$209,107** | $255,249 | $178,362 |
| Total stock-based compensation expense determined under fair value-based method for all awards, net of related tax effects | **–** | (96) | (188) |
| Pro forma net income allocable to common shareholders and HPU holders | **$209,107** | $255,153 | $178,174 |
| Earnings per share: | | | |
| Basic – as reported[2] | **$ 1.87** | $ 2.52 | $ 1.98 |
| Basic – pro forma[2] | **1.87** | 2.52 | 1.98 |
| Diluted – as reported[3][4] | **$ 1.83** | $ 2.43 | $ 1.93 |
| Diluted – pro forma[3][4] | **1.83** | 2.43 | 1.92 |

**Explanatory Notes:**

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

(2) For the 12 months ended December 31, 2004, 2003 and 2002, excludes $3,314, $2,066 and $0 of net income allocable to HPU holders, respectively.

(3) For the 12 months ended December 31, 2004, 2003 and 2002, excludes $3,265, $1,994 and $0 of net income allocable to HPU holders, respectively.

(4) For the 12 months ended December 31, 2004, 2003 and 2002, includes $3, $167 and $0 of joint venture income, respectively.

In November 2002, the FASB issued FASB Interpretation No. 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," an interpretation of Statement of Financial Accounting Standards No. 5 ("SFAS No. 5"), "Accounting for Contingencies," Statement of Financial Accounting Standards No. 57, "Related Party Disclosures," Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments" and rescinds FASB Interpretation No. 34, "Disclosure of Indirect Guarantees of Indebtedness of Others, an Interpretation of SFAS No. 5." It requires that, upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under that guarantee regardless if the Company receives separately identifiable consideration (e.g., a premium). The disclosure requirements became effective December 31, 2002. The adoption of FIN 45 did not have a material impact on the Company's Consolidated Financial Statements.

In September 2002, the FASB issued Statement of Financial Accounting Standards No. 147 ("SFAS No. 147"), "Acquisitions of Certain Financial Institutions," an amendment of FASB Statements No. 72 and 144 and FASB Interpretation No. 9. SFAS No. 147 provides guidance on the accounting for the acquisitions of financial institutions, except those acquisitions between two or more mutual enterprises. SFAS No. 147 removes acquisitions of financial institutions from the scope of both FASB No. 72, "Accounting for Certain Acquisitions of Banking or Thrift Institutions," and FASB Interpretation No. 9, Applying APB Opinions No. 16 and 17, "When a Savings and Loan Association or a Similar Institution Is Acquired in a Business Combination Accounted for by the Purchase Method," and requires that those transactions be accounted for in accordance with SFAS No. 141 and SFAS No. 142. SFAS No. 147 also amends SFAS No. 144 to include in its scope long-term, customer-relationship intangible assets of financial institutions such as depositor-relationship and borrower-relationship intangible assets and credit cardholder intangible assets. The Company adopted the provisions of this statement, as required, on October 1, 2002, and it did not have a significant financial impact on the Company's Consolidated Financial Statements.

In June 2002, the FASB issued Statement of Financial Accounting Standards No. 146 ("SFAS No. 146"), "Accounting for Exit or Disposal Activities," to address significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for pursuant to the guidance that the Emerging Issues Task Force ("EITF") has set forth in EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The scope of SFAS No. 146 also includes: (1) costs related to terminating a contract that is not a capital lease; and (2) termination benefits received by employees involuntarily terminated under the terms of a one-time benefit arrangement that is not an on-going benefit arrangement or an individual deferred-compensation contract. The Company adopted the provisions of SFAS 146 on December 31, 2002, as required, and it did not have a material effect on the Company's Consolidated Financial Statements.

**Note 4 – Loans and Other Lending Investments**

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

| Type of Investment | Underlying Property Type | Number of Borrowers In Class | Principal Balances Outstanding | Carrying Value as of December 31, 2004 | Carrying Value as of December 31, 2003 | Effective Maturity Dates | Contractual Interest Payment Rates[2][3] | Contractual Interest Accrual Rates[2][3] | Principal Amortization | Participation Features |
|---|---|---|---|---|---|---|---|---|---|---|
| Senior Mortgages[4] | Office/Residential/ Retail/Industrial, R&D/ Conference Center/ Mixed Use/Hotel/ Entertainment, Leisure/Other | 48 | $2,373,178 | **$2,334,662** | $2,106,791 | 2005 to 2022 | Fixed: 7.03% to 18.20% Variable: LIBOR + 2.90% to LIBOR + 7.50% | Fixed: 7.03% to 18.20% Variable: LIBOR + 2.90% to LIBOR + 7.50% | Yes[5] | Yes[6] |
| Subordinate Mortgages | Office/Residential/ Retail/Mixed Use/Hotel | 20 | 578,525 | **579,322** | 550,572 | 2005 to 2013 | Fixed: 7.00% to 18.00% Variable: LIBOR + 4.00% to LIBOR + 7.02% | Fixed: 7.32% to 18.00% Variable: LIBOR + 4.00% to LIBOR + 7.02% | Yes[5] | No |
| Corporate/ Partnership Loans[7] | Office/Residential/ Retail/Industrial, R&D/ Mixed Use/Hotel/ Entertainment, Leisure/Other | 28 | 944,530 | **912,756** | 710,469 | 2005 to 2013 | Fixed: 6.00% to 15.00% Variable: LIBOR + 2.50% to LIBOR + 9.25% | Fixed: 7.33% to 17.50% Variable: LIBOR + 2.50% to LIBOR + 9.25% | Yes[5] | Yes[6] |
| Other Lending Investments – Loans | Office/Mixed Use/ Other | 3 | 4,261 | **4,036** | 23,767 | 2005 to 2008 | Fixed: 9.00% | Fixed: 9.00% | No | Yes[6] |
| Other Lending Investments – Securities[8] | Industrial, R&D/ Entertainment, Leisure/Other | 7 | 158,383 | **157,849** | 344,511 | 2005 to 2013 | Fixed: 8.27% to 10.00% Variable: LIBOR + 2.82% to LIBOR + 5.00% | Fixed: 8.27% to 10.00% Variable: LIBOR + 2.82% to LIBOR + 5.00% | Yes[5] | No |
| Gross Carrying Value | | | | **$3,988,625** | $3,736,110 | | | | | |
| Provision for Loan Losses | | | | **(42,436)** | (33,436) | | | | | |
| Total, Net | | | | **$3,946,189** | $3,702,674 | | | | | |

**Explanatory Notes:**

(1) Details (other than carrying values) are for loans outstanding as of December 31, 2004.

(2) Substantially all variable-rate loans are based on 30-day LIBOR and reprice monthly. The 30-day LIBOR on December 31, 2004 was 2.40%. As of December 31, 2004, four loans with a combined carrying value of $73.0 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 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) As of December 31, 2004, the Company has 47 loans and other lending investments with LIBOR floors ranging from 1.00% to 3.00%.

(4) Includes a participation interest in a first mortgage.

(5) The loans require fixed payments of principal and interest resulting in partial principal amortization over the term of the loan with the remaining principal due at maturity.

(6) 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.

(7) Includes one unsecured loan with a carrying value of $7.5 million as of December 31, 2004.

(8) Generally consists of term preferred stock or debt interests that are specifically originated or structured to meet customer financing requirements and the Company's investment criteria. These investments do not typically consist of securities purchased in the open market or as part of broadly-distributed offerings.

During the 12 months ended December 31, 2004 and 2003, respectively, the Company and its affiliated ventures originated or acquired an aggregate of approximately $1,596.4 million and $1,735.4 million in loans and other lending investments, funded $255.3 million and $46.1 million under existing loan commitments, and received principal repayments of $1,591.0 million and $1,120.0 million.

As of December 31, 2004, the Company had 25 loans with unfunded commitments. The total unfunded commitment amount was approximately $678.9 million, of which $202.5 million was discretionary and $476.4 million was non-discretionary.

A portion of the Company's loans and other lending investments are pledged as collateral under either the iStar Asset Receivables secured notes, the secured revolving credit facilities or secured term loans (see Note 7 for a description of the Company's secured and unsecured debt).

The Company has reflected provisions for loan losses of approximately $9.0 million, $7.5 million and $8.3 million in its results of operations during the 12 months ended December 31, 2004, 2003 and 2002, respectively. 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. During the 12 months ended December 31, 2003, the Company took a $3.3 million direct impairment on a $30.4 million partnership loan lowering the book value of the asset to $27.1 million. In August 2003, the borrower stopped making its debt service payments due to insufficient cash flow caused by vacancies at the property. After taking the impairment charge management believes there is adequate collateral to support the book value of the asset as of December 31, 2004.

Changes in the Company's provision for loan losses were as follows:

| | |
|---|---|
| **Provision for loan losses, December 31, 2001** | $ 21,000 |
| Additional provision for loan losses | 8,250 |
| **Provision for loan losses, December 31, 2002** | 29,250 |
| Additional provision for loan losses | 7,500 |
| Impairment on loans | (3,314) |
| **Provision for loan losses, December 31, 2003** | $ 33,436 |
| Additional provision for loan losses | 9,000 |
| **Provision for loan losses, December 31, 2004** | **$42,436** |

## Note 5 – Corporate Tenant Lease Assets

During the 12 months ended December 31, 2004 and 2003, respectively, the Company acquired an aggregate of approximately $513.0 million (which includes the Company's acquisition of the remaining interest in its ACRE Simon, LLC joint venture – See Note 6) and $351.4 million in CTL assets and disposed of CTL assets for net proceeds of approximately $279.6 million and $47.6 million. In relation to the CTL assets acquired during the 12 months ended December 31, 2004, the Company allocated approximately $18.4 million of purchase costs to intangible assets based on their estimated fair values (see Note 3). As of December 31, 2004 and 2003, the Company had unamortized purchase related intangible assets of approximately $41.2 million and $24.9 million, respectively, and included these in "Deferred expenses and other assets" on the Company's Consolidated Balance Sheets.

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

| | December 31, 2004 | December 31, 2003 |
|---|---|---|
| Facilities and improvements | **$2,431,649** | $2,210,592 |
| Land and land improvements | **672,238** | 468,708 |
| Direct financing lease | **–** | 35,472 |
| Less: accumulated depreciation | **(226,845)** | (178,887) |
| Corporate tenant lease assets, net | **$2,877,042** | $2,535,885 |

The Company's CTL assets are leased to customers with initial term expiration dates from 2005 to 2026. Future operating lease payments under non-cancelable leases, excluding customer reimbursements of expenses, in effect at December 31, 2004, are approximately as follows (in thousands):

| Year | Amount |
|---|---|
| 2005 | $ 281,266 |
| 2006 | 271,697 |
| 2007 | 248,539 |
| 2008 | 238,848 |
| 2009 | 234,397 |
| Thereafter | 2,079,328 |

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 12 months ended December 31, 2004, 2003 and 2002. 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 12 months ended December 31, 2004, 2003 and 2002 were approximately $31.1 million, $27.1 million and $25.5 million, respectively, and are included as a reduction of "Operating costs – corporate tenant lease assets" on the Company's Consolidated Statements of Operations.

The Company is subject to expansion option agreements with two existing customers which could require the Company to fund and to construct up to 161,000 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.

In addition, the Company has $32.8 million of non-discretionary unfunded commitments related to two existing customers. These commitments generally fall into two categories: (1) pre-approved capital improvement projects; and (2) new or additional construction costs. Currently, the Company has committed $18.1 million in pre-approved capital improvement projects and $14.7 million in new construction costs. Upon funding the Company would receive additional operating lease income from the customer.

During the 12 months ended December 31, 2004, 2003 and 2002, the Company sold 22 CTL assets (to six different buyers), nine CTL assets and one CTL asset for net proceeds of approximately $279.6 million, $47.6 million and $3.7 million, and net realized gains of approximately $43.4 million, $5.2 million and $595,000, respectively.

As of December 31, 2003, there was one CTL asset with a book value of $24.8 million classified as "Asset held for sale" on the Company's Consolidated Balance Sheets. During the first quarter 2004, this CTL asset was reclassified as held for use.

On September 30, 2002, one of the Company's customers exercised an option to terminate its lease on 50.00% of the land leased from the Company. In connection with this termination, the Company realized $17.5 million in cash lease termination payments, offset by a $17.4 million impairment charge in connection with the termination, resulting in a net gain of approximately $123,000. In the fourth quarter of 2002, the customer completed a recapitalization transaction that significantly enhanced its credit. In connection with this recapitalization, the Company agreed to amend the customer's lease, effective October 1, 2002. In the lease amendment, the Company received $12.5 million in cash as prepaid lease payments and the customer agreed to fixed minimum increases on future lease payments. In exchange, the Company agreed to reduce the customer's lease obligations for a period not to exceed nine quarters. Following the reduction period, the customer was required to make additional lease payments over a ten-year period sufficient to reimburse the Company for a portion of the temporary reduction in lease payments. However, due to increased liquidity, the customer has prepaid all additional lease payments related to the reduction period as of December 31, 2004. These lease payments total approximately $1.8 million and are included in "Accounts payable, accrued expenses and other liabilities" on the Company's Consolidated Balance Sheets.

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, Unconsolidated Subsidiaries and Minority Interest

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

The Company's ownership percentages, its investments in and advances to unconsolidated joint ventures and subsidiaries, the Company's pro rata share of its ventures' third-party, non-recourse debt as of December 31, 2004 and its respective income (loss) for the year ended December 31, 2004 are presented below (in thousands):

| | Ownership % | Equity Investment | JV Income (Loss) for the Year Ended December 31, 2004 | Pro Rata Share of Third-Party Non-Recourse Debt | Third-Party Debt: Interest Rate | Third-Party Debt: Scheduled Maturity Date |
|---|---|---|---|---|---|---|
| **Unconsolidated Joint Ventures:** | | | | | | |
| ACRE Simon | 20.00% | $ – | **$ (190)** | $ – | N/A | N/A |
| CTC | 50.00% | 5,663 | **3,025** | – | N/A | N/A |
| Sunnyvale | 44.70% | – | **74** | – | N/A | N/A |
| Total | | $5,663 | **$2,909** | $ – | | |

**Investments in and advances to unconsolidated joint ventures:** At December 31, 2004, the Company had an 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 December 31, 2004, the venture held one facility. The Company's investment in this joint venture at December 31, 2004 was $5.7 million. The joint venture's carrying value for the one facility owned at December 31, 2004 was $17.9 million. The joint venture had total assets of $19.7 million and total liabilities of $66,000 as of December 31, 2004 and net income of $6.3 million for the year ended December 31, 2004. 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.

On November 23, 2004, the Company acquired the remaining 80.00% share of its joint venture partner's interest in the ACRE Simon, LLC joint venture. The total net purchase price was $40.1 million of which $14.6 million was paid in cash and $25.5 million reflected the assumption of the joint venture partner's share of the debt of the partnership. The Company now owns 100.00% of this joint venture and therefore, as of November 23, 2004, consolidates it for financial statement purposes.

On September 27, 2004, CTC Associates I L.P., a wholly-owned subsidiary of the Company's CTC joint venture, sold its interest in five buildings to a third-party investor and the mortgage lender accepted the proceeds in full satisfaction of the obligation. This transaction resulted in a net loss of approximately $950,000 allocable to the Company.

On March 30, 2004, CTC Associates II L.P., a wholly-owned subsidiary of the Company's CTC joint venture, conveyed its interest in two buildings and the related property to the mortgage lender in exchange for satisfaction of the entity's obligations of the related loan. Prior to the conveyance of the buildings, early lease terminations resulted in one-time income allocable to the Company of approximately $3.5 million during the first quarter of 2004.

On March 31, 2004, the Company began accounting for its 44.70% interest in TriNet Sunnyvale Partners, L.P. ("Sunnyvale") as a VIE (see Note 3) 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. Therefore, the

Company consolidates this partnership for financial statement reporting purposes. Prior to its consolidation, the Company accounted for this joint venture under the equity method for financial statement reporting purposes and it was presented in "Investments in and advances to joint ventures and unconsolidated subsidiaries," on the Company's Consolidated Balance Sheets and earnings from the joint venture were included in "Equity in earnings (loss) from joint ventures and unconsolidated subsidiaries" in the Company's Consolidated Statements of Operations.

On July 2, 2002, the Company paid approximately $27.9 million in cash to the former member of TriNet Milpitas Associates ("Milpitas") joint venture in exchange for its 50.00% ownership interest. Pursuant to the terms of the joint venture agreement, the former external member had the right to convert its interest into 984,476 shares of Common Stock of the Company at any time during the period February 1, 2002 through January 31, 2003. On May 2, 2002, the former Milpitas external member exercised this right. Upon the external member's exercise of its conversion right, the Company had the option to acquire the partner's interest for cash, instead of shares, for a payment equal to the value of 984,476 shares of Common Stock multiplied by the ten-day average closing stock price as of the transaction date. The Company made such election and, as of July 2, 2002, owns 100.00% of Milpitas, and therefore consolidates these assets for accounting purposes. The Company accounted for the acquisition of the external interest using the purchase method.

On April 1, 2002, the former Sierra Land Ventures ("Sierra") joint venture partner assigned its 50.00% ownership interest in Sierra to a wholly-owned subsidiary of the Company. There was no cash or shares exchanged in this transaction. As of April 1, 2002, the Company owns 100.00% of the CTL asset previously held by Sierra and therefore consolidates this asset for accounting purposes.

**Investments in and advances to unconsolidated subsidiaries:** The Company has an investment in iStar Operating, a taxable REIT subsidiary that, through a wholly-owned subsidiary, services the Company's loans and certain loan portfolios owned by third parties. The Company owns all of the non-voting preferred stock and a 95.00% economic interest in iStar Operating. The common shareholder, an entity controlled by a former director of the Company, is the owner of all the voting common stock and a 5.00% economic interest in iStar Operating. As of December 31, 2004, there have never been any distributions to the common shareholder, nor does the Company expect to make any in the future. At any time, the Company has the right to acquire all of the common stock of iStar Operating at fair market value, which the Company believes to be nominal.

iStar Operating has elected to be treated as a taxable REIT subsidiary for purposes of maintaining compliance with the REIT provisions of the Code and prior to July 1, 2003 was accounted for under the equity method for financial statement reporting purposes and was presented in "Investments in and advances to joint ventures and unconsolidated subsidiaries" on the Company's Consolidated Balance Sheets. As of July 1, 2003, the Company consolidates this entity as a VIE (see Note 3) with no material impact. Prior to its consolidation, the Company charged an allocated portion of its general overhead expenses to iStar Operating based on the number of employees at iStar Operating as a percentage of the Company's total employees. These general overhead expenses were in addition to the direct general and administrative costs of iStar Operating. As of December 31, 2004, iStar Operating had no debt obligations.

In addition, the Company had an investment in TMOC, an entity originally formed to make a $2.0 million investment in the convertible debt securities of a real estate company which trades on the Mexican Stock Exchange. This investment was made by TriNet prior to its acquisition by the Company in 1999. On June 30, 2003, the $2.0 million investment was fully repaid and during the third quarter 2003, the entity was liquidated.

**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.

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 was capitalized with initial contributions of $9,500 (0.50%) from AutoStar Realty GP LLC (the "GP") and $1.9 million (99.50%) from 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. At December 31, 2004, the venture held 25 net leased facilities. The venture's carrying value for the 25 facilities owned at December 31, 2004 was $170.4 million. The venture had total assets of $173.5 million and total liabilities of $121.7 million as of December 31, 2004 and net income of $1.9 million for the period ended December 31, 2004.

As discussed above, on March 31, 2004, the Company began accounting for its 44.70% interest in the Sunnyvale joint venture as a VIE and therefore 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 September 29, 2003 the Company acquired a 96.00% interest in iStar Harborside LLC, an infinite life partnership, with the external partner holding the remaining 4.00% interest. 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.

The Company also holds a 98.00% interest in TriNet Property Partners, L.P with the external partners holding the remaining 2.00% interest. As of August 1999, the external partners have the option to convert their partnership interest into cash; however, the Company may elect to deliver 72,819 shares of Common Stock in lieu of cash. 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.

**Note 7 – Debt Obligations**

As of December 31, 2004 and 2003 the Company has debt obligations under various arrangements with financial institutions as follows (in thousands):

| | Maximum Amount Available | Carrying Value as of December 31, 2004 | Carrying Value as of December 31, 2003 | Stated Interest Rates[(1)] | Scheduled Maturity Date |
|---|---|---|---|---|---|
| **Secured revolving credit facilities:** | | | | | |
| Line of credit | $ 250,000 | **$ –** | $ 88,640 | LIBOR + 1.50% – 2.05% | March 2005 |
| Line of credit | 700,000 | **67,775** | 310,364 | LIBOR + 1.40% – 2.15% | January 2007[(2)] |
| Line of credit | 350,000 | **10,811** | 117,211 | LIBOR + 1.50% – 2.25% | August 2006[(2)] |
| Line of credit | 500,000 | **–** | 180,376 | LIBOR + 1.50% – 2.25% | September 2005 |
| **Unsecured revolving credit facilities:** | | | | | |
| Line of credit[(3)] | 1,250,000 | **840,000** | – | LIBOR + 0.875% | April 2008 |
| Line of credit | – | **–** | 130,000 | LIBOR + 2.125% | July 2004 |
| Total revolving credit facilities | $3,050,000 | **$918,586** | $ 826,591 | | |
| **Secured term loans:** | | | | | |
| Secured by CTL asset | | **76,670** | 77,938 | 6.55% | December 2005 |
| Secured by CTL asset | | **136,512** | 140,440 | 7.44% | April 2009 |
| Secured by CTL asset | | **135,000** | 135,000 | LIBOR + 1.75% | October 2008 |
| Secured by CTL assets | | **–** | 193,000 | LIBOR + 1.85% | July 2006 |
| Secured by CTL assets | | **148,600** | 92,876 | 6.80% – 8.80% | Various through 2026[(4)] |
| Secured by corporate bond investments | | **129,446** | – | LIBOR + 1.05% – 1.50% | January 2006 |
| Secured by corporate lending investment | | **60,180** | 60,874 | 6.41% | January 2013 |
| Secured by corporate lending investment | | **–** | 60,000 | LIBOR + 2.50% | June 2004 |
| Secured by corporate lending investment | | **–** | 48,000 | LIBOR + 2.125% | July 2008 |
| Total term loans | | **686,408** | 808,128 | | |
| Less: debt (discount)/premium | | **7,065** | (128) | | |
| Total secured term loans | | **693,473** | 808,000 | | |
| **iStar Asset Receivables secured notes:** | | | | | |
| STARs Series 2002-1: | | | | | |
| Class A1 | | **–** | 40,011 | LIBOR + 0.26% | June 2004[(5)] |
| Class A2 | | **202,052** | 381,296 | LIBOR + 0.38% | December 2009[(5)] |
| Class B | | **39,955** | 39,955 | LIBOR + 0.65% | April 2011[(5)] |
| Class C | | **26,637** | 26,637 | LIBOR + 0.75% | May 2011[(5)] |
| Class D | | **21,310** | 21,310 | LIBOR + 0.85% | January 2012[(5)] |
| Class E | | **42,619** | 42,619 | LIBOR + 1.235% | January 2012[(5)] |
| Class F | | **26,637** | 26,637 | LIBOR + 1.335% | January 2012[(5)] |
| Class G | | **21,309** | 21,309 | LIBOR + 1.435% | January 2012[(5)] |
| Class H | | **26,637** | 26,637 | 6.35% | January 2012[(5)] |
| Class J | | **26,637** | 26,637 | 6.35% | May 2012[(5)] |
| Class K | | **26,637** | 26,637 | 6.35% | May 2012[(5)] |
| Total STARs Series 2002-1 | | **460,430** | 679,685 | | |
| Less: debt discount | | **(3,734)** | (4,090) | | |
| STARs Series 2003-1: | | | | | |
| Class A1 | | **113,309** | 235,808 | LIBOR + 0.25% | October 2005[(6)] |
| Class A2 | | **225,227** | 248,206 | LIBOR + 0.35% | August 2010[(6)] |
| Class B | | **16,744** | 18,452 | LIBOR + 0.55% | July 2011[(6)] |
| Class C | | **18,418** | 20,297 | LIBOR + 0.65% | April 2012[(6)] |
| Class D | | **11,720** | 12,916 | LIBOR + 0.75% | October 2012[(6)] |
| Class E | | **13,395** | 14,762 | LIBOR + 1.05% | May 2013[(6)] |
| Class F | | **13,395** | 14,762 | LIBOR + 1.10% | June 2013[(6)] |
| Class G | | **11,720** | 12,916 | LIBOR + 1.25% | June 2013[(6)] |
| Class H | | **11,721** | 12,916 | 4.97% | June 2013[(6)] |
| Class J | | **13,394** | 14,761 | 5.07% | June 2013[(6)] |
| Class K | | **23,441** | 25,833 | 5.56% | June 2013[(6)] |
| Total STARS Series 2003-1 | | **472,484** | 631,629 | | |
| Total iStar Asset Receivables secured notes | | **$929,180** | $1,307,224 | | |

| | Carrying Value as of | | Stated | Scheduled |
|---|---|---|---|---|
| | **December 31, 2004** | **December 31, 2003** | **Interest Rates[1]** | **Maturity Date** |
| **Unsecured notes:** | | | | |
| LIBOR + 1.25% Senior Notes | **$ 200,000** | $ – | LIBOR + 1.25% | March 2007 |
| 4.875% Senior Notes | **350,000** | – | 4.875% | January 2009 |
| 5.125% Senior Notes | **250,000** | – | 5.125% | April 2011 |
| 5.70% Senior Notes | **250,000** | – | 5.70% | March 2014 |
| 6.00% Senior Notes | **350,000** | 350,000 | 6.00% | December 2010 |
| 6.50% Senior Notes | **150,000** | 150,000 | 6.50% | December 2013 |
| 7.00% Senior Notes | **185,000** | 185,000 | 7.00% | March 2008 |
| 7.70% Notes[7][8] | **100,000** | 100,000 | 7.70% | July 2017 |
| 7.95% Notes[7][8] | **50,000** | 50,000 | 7.95% | May 2006 |
| 8.75% Notes | **240,000** | 350,000 | 8.75% | August 2008 |
| Total unsecured notes | **2,125,000** | 1,185,000 | | |
| Less: debt discount | **(56,913)** | (47,921) | | |
| Plus: impact of pay-floating swap agreements[9] | **(3,652)** | 690 | | |
| Total unsecured notes | **2,064,435** | 1,137,769 | | |
| **Other debt obligations** | **–** | 34,148 | Various | Various |
| **Total debt obligations** | **$4,605,674** | $4,113,732 | | |

**Explanatory Notes:**

(1) Substantially all variable-rate debt obligations are based on 30-day LIBOR and reprice monthly. The 30-day LIBOR rate on December 31, 2004 was 2.40%.

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

(3) On October 5, 2004 the interest rate and facility fees were reduced to LIBOR + 0.875% (from LIBOR + 1.00%) and 17.5 basis points, (from 25 basis points), due to an upgrade in the Company's senior unsecured debt rating to investment grade by S&P. On December 17, 2004 the commitment on this facility was increased to $1,250.0 million and the accordion feature was amended to increase the facility to $1.5 billion in the future if necessary. As of December 31, 2004, $7.6 million of the maximum amount available under this facility is utilized for two letters of credit. Maturity date reflects a one-year extension at the Company's option.

(4) On November 23, 2004, the Company purchased the remaining interest in the ACRE Simon joint venture from the former ACRE Simon external member for $40.1 million. Upon purchase of the interest, the ACRE Simon joint venture became fully consolidated for accounting purposes and approximately $31.8 million of secured term debt was reflected on the Company's Consolidated Balance Sheets. On December 9, 2004, the Company repaid one of the term loans with a balance of $9.8 million and an original maturity date of June 2005.

(5) Principal payments on these bonds are a function of the principal repayments on loan or CTL assets which collateralize these obligations. The dates indicated above represent the expected date on which the final payment would occur for such class based on the assumptions that the loans which collateralize the obligations are not voluntarily prepaid, the loans are paid on their effective maturity dates and no extensions of the effective maturity dates of any of the loans are granted. The final maturity date for the underlying indenture on class A1 is May 28, 2017 and the final maturity date for classes A2, B, C, D, E, F, G, H, J and K is May 28, 2020.

(6) Principal payments on these bonds are a function of the principal repayments on loan or CTL assets which collateralize these obligations. The dates indicated above represent the expected date on which the final payment would occur for such class based on the assumptions that the loans which collateralize the obligations are not voluntarily prepaid, the loans are paid on their effective maturity dates and no extensions of the effective maturity dates of any of the loans are granted. The final maturity date for the underlying indenture is August 28, 2022.

(7) The Notes are callable by the Company at any time for an amount equal to the total of principal outstanding, accrued interest and the applicable make-whole prepayment premium. On March 1, 2005, the 7.70% Notes were exchanged for 5.70% Series B Senior Notes due 2014 (see Note 17 for further discussion).

(8) These obligations were assumed as part of the acquisition of TriNet. As part of the accounting for the purchase, these fixed-rate obligations were considered to have stated interest rates which were below the then-prevailing market rates at which the Leasing Subsidiary could issue new debt obligations and, accordingly, the Company ascribed a market discount to each obligation. Such discounts are amortized as an adjustment to interest expense using the effective interest method over the related term of the obligations. As adjusted, the effective annual interest rates on these obligations were 9.51% and 9.04% for the 7.70% Notes and 7.95% Notes, respectively.

(9) On January 15, 2004, the Company entered into four pay-floating interest rate swaps struck at 3.678%, 3.713%, 3.686% and 3.684% with notional amounts of $105.0 million, $100.0 million, $100.0 million and $45.0 million, respectively, and maturing on January 15, 2009. On December 17, 2003, the Company entered into three pay-floating interest rate swaps struck at 4.381%, 4.345% and 4.29% in the notional amounts of $200.0 million, $100.0 million and $50.0 million, respectively. On November 27, 2002, the Company entered into two pay-floating interest rate swaps struck at 3.8775% and 3.81% in the notional amounts of $100.0 million and $50.0 million, respectively. These swaps are intended to mitigate the risk of changes in the fair value of $350.0 million of five-year Senior Notes, $350.0 million of seven-year Senior Notes and $150.0 million of ten-year Senior Notes, respectively, attributable to changes in LIBOR. For accounting purposes, quarterly the Company adjusts the value of the swap to its fair value and adjusts the carrying amount of the hedged liability by an offsetting amount.

The Company's primary source of short-term funds is a $1,250.0 million unsecured revolving credit facility. Under the facility the Company is required to meet certain financial covenants. As of December 31, 2004, there is approximately $402.4 million available to draw under the facility. In addition, the Company has four secured revolving credit facilities of which availability is based on percentage borrowing base calculations. Certain debt obligations, including the unsecured and secured lines of credit, contain covenants. These covenants 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 December 31, 2004, the Company believes it is in compliance with all financial and non-financial covenants on its debt obligations.

Capital Markets Activity – During the 12 months ended December 31, 2004, the Company issued $850.0 million aggregate principal amount of

fixed-rate Senior Notes bearing interest at annual rates ranging from 4.875% to 5.70% and maturing between 2009 and 2014 and $200.0 million of variable-rate Senior Notes bearing interest at an annual rate of three-month LIBOR + 1.25% and maturing 2007. The proceeds from these transactions were used to repay secured indebtedness and to fund new investment activity. In addition, the Company redeemed $110.0 million aggregate principal amount of its outstanding 8.75% Senior Notes due 2008 at a price of 108.75% of par. In connection with this redemption, the Company recognized a charge to income of $11.5 million included in "Loss on early extinguishment of debt" on the Company's Consolidated Statements of Operations.

During the 12 months ended December 31, 2003, the Company issued $535.0 million aggregate principal amount of fixed-rate Senior Notes bearing interest at annual rates ranging from 6.00% to 7.00% and maturing between 2008 and 2013. In addition, the Company retired the 6.75% Dealer Remarketable Securities of its Leasing Subsidiary by exchanging those securities for newly issued $150.0 million 7.00% Senior Notes due March 2008.

**Unsecured/Secured Credit Facilities Activity** – On July 20, 2004, one of the Company's $500.0 million secured facilities was amended to reduce the maximum amount available to $350.0 million, to extend the final maturity to August 2005 and to reduce the stated interest rate on first mortgage collateral to LIBOR + 1.50%.

On April 19, 2004, the Company completed a new $850.0 million unsecured revolving credit facility with 19 banks and financial institutions. The new facility has a three-year initial term with a one-year extension at the Company's option. The facility bears interest, based upon the Company's current credit ratings, at a rate of LIBOR + 0.875% and a 17.5 basis point annual facility fee decreased from LIBOR + 1.00% and 25 basis points, respectively, due to an upgrade in the Company's senior unsecured debt rating to investment grade by S&P. On December 17, 2004, the commitment on this facility was increased to $1,250.0 million and the accordion feature was amended to increase the facility to $1.5 billion in the future if necessary. This new facility replaced a $300.0 million unsecured credit facility with a scheduled maturity of July 2004.

On March 12, 2004, one of the Company's $700.0 million secured facilities was amended to reduce the maximum amount available to $250.0 million, to shorten the maturity to March 2005 and to reduce the stated interest rate on first mortgages and CTL assets to LIBOR + 1.50% and on subordinate and mezzanine lending investments to LIBOR + 2.05%.

On January 13, 2004, the Company closed $200.0 million of term financing that is secured by certain corporate bond investments and other lending securities. A number of these investments were previously financed under existing credit facilities. The new facility bears interest at LIBOR + 1.05% – 1.50% and has a final maturity date of January 2006.

On January 27, 2003, the Company extended the maturity on one of its $700.0 million secured facilities to January 2007, which includes a one-year "term-out" at the Company's option.

On September 30, 2002, the Company closed a $500.0 million secured revolving credit facility with a leading financial institution. The facility had a three-year term and bears interest at LIBOR + 1.50% to 2.25%, depending upon the collateral contributed to the borrowing base. The facility accepts a broad range of structured finance and CTL assets and has a final maturity of September 2005. On November 4, 2003, this facility was amended to include subordinate and mezzanine lending investments as collateral at stated interest rates of LIBOR + 2.15% – 2.25%.

**Other Financing Activity** – During the 12 months ended December 31, 2004, the Company purchased the remaining interest in the ACRE Simon joint venture from the former ACRE Simon external member for $40.1 million. Upon purchase of the interest, the ACRE Simon joint venture became fully consolidated for accounting purposes and approximately $31.8 million of secured term debt is reflected on the Company's Consolidated Balance Sheets. The term loans bear interest at rates of 7.61% to 8.43% and mature between 2005 and 2011. In addition, the Company repaid a total of $314.6 million in term loan financing, $9.8 million of which was part of the ACRE Simon acquisition.

During the 12 months ended December 31, 2003, the Company closed an aggregate of $233.0 million in secured term debt bearing interest at rates ranging from LIBOR + 0.60% – 2.125% and maturing between 2003 to 2008. In addition, the Company repaid $125.0 million of term loan financing, $50.0 million of which had been closed during the same year.

In addition, during the 12 months ended December 31, 2003, a wholly-owned subsidiary of the Company issued iStar Asset Receivables ("STARs"), Series 2003-1, the Company's proprietary match funding program, consisting of $645.8 million of investment-grade bonds secured by the subsidiary's structured finance and CTL assets, which had an aggregate outstanding carrying value of approximately $738.1 million at inception. Principal payments received on the assets will be utilized to repay the most senior class of the bonds then outstanding. The maturity of the bonds match funds the maturity of the underlying assets financed under the program. The weighted average interest rate on the bonds, on an all-floating rate basis, was approximately LIBOR + 0.47% at inception. For accounting purposes, this transaction was treated as a secured financing: the underlying assets and STARs liabilities remained on the Company's Consolidated Balance Sheets, and no gain on sale was recognized.

During the 12 months ended December 31, 2002, the Company purchased the remaining interest in the Milpitas joint venture from the Milpitas external member for $27.9 million. Upon purchase of the interest, the Milpitas joint venture became fully consolidated for accounting purposes and approximately $79.1 million of secured term debt is reflected on the Company's Consolidated Balance Sheets. This term loan bears interest at 6.55% and matures in 2005. In addition, the Company closed a $61.5 million term loan financing with a leading institution to fund a portion of an $82.1 million CTL investment. The none-recourse loan is fixed rate and bears interest at 6.412%, matures in 2012 and amortizes over a 30-year schedule.

In addition, during the 12 months ended December 31, 2002, the Company repaid the then remaining $446.2 million of bonds outstanding under its STARs, Series 2000-1 financing. Simultaneously, a wholly-owned subsidiary of the Company issued STARs, Series 2002-1, consisting of $885.1 million of investment-grade bonds secured by the subsidiary's structured finance and CTL assets, which had an aggregate outstanding carrying value of approximately $1.1 billion at inception. Principal payments received on the assets will be utilized to repay the most senior class of the bonds then outstanding. The maturity of the bonds match funds the maturity of the underlying assets financed under the program. The weighted average interest rate on the bonds, on an all-floating rate basis, was approximately LIBOR + 0.56% at inception. For accounting purposes, this transaction was treated as a secured financing: the underlying assets and STARs liabilities remained on the Company's Consolidated Balance Sheets, and no gain on sale was recognized.

During the 12 months ended December 31, 2004, 2003 and 2002 the Company incurred an aggregate net loss on early extinguishment of debt of approximately $13.1 million, $0 and $12.2 million, respectively, as a result of the early retirement of certain debt obligations.

As of December 31, 2004, future expected/scheduled maturities of outstanding long-term debt obligations are as follows (in thousands)[1]:

| | |
|---|---|
| 2005 | $ 189,979 |
| 2006 | 190,257 |
| 2007 | 270,493 |
| 2008 | 1,400,000 |
| 2009 | 706,251 |
| Thereafter | 1,905,928 |
| Total principal maturities | 4,662,908 |
| Net unamortized debt discounts | (53,582) |
| Impact of pay-floating swap agreement | (3,652) |
| Total debt obligations | $4,605,674 |

**Explanatory Note:**

(1) Assumes exercise of extensions to the extent such extensions are at the Company's option.

## Note 8 – Shareholders' Equity

The Company's charter provides for the issuance of up to 200.0 million shares of Common Stock, par value $0.001 per share, and 30.0 million shares of preferred stock. The Company has 4.0 million shares of 8.00% Series D Cumulative Redeemable Preferred Stock, 5.6 million shares of 7.875% Series E Cumulative Redeemable Preferred Stock, 4.0 million shares of 7.80% Series F Cumulative Redeemable Preferred Stock, 3.2 million shares of 7.65% Series G Cumulative Redeemable Preferred Stock and 5.0 million shares of 7.50% Series I Cumulative Redeemable Preferred Stock. The Series D, E, F, G, and I Cumulative Redeemable Preferred Stock are redeemable without premium at the option of the Company at their respective liquidation preferences beginning on October 8, 2002, July 18, 2008, September 29, 2008, December 19, 2008 and March 1, 2009, respectively.

In February 2004, the Company redeemed 2.0 million outstanding shares of its 9.375% Series B Cumulative Redeemable Preferred Stock and 1.3 million outstanding shares of its 9.20% Series C Cumulative Redeemable Preferred Stock. The redemption price was $25.00 per share, plus accrued and unpaid dividends to the redemption date of $0.46 and $0.45 for the Series B and C Preferred Stock, respectively. In connection with this redemption, the Company recognized a charge to net income allocable to common shareholders and HPU holders of approximately $9.0 million included in "Preferred dividend requirements" on the Company's Consolidated Statements of Operations.

In February 2004, the Company completed an underwritten public offering of 5.0 million shares of its 7.50% Series I Cumulative Redeemable Preferred Stock, having a liquidation preference of $25.00 per share and a redemption date beginning March 1, 2009. The Company used the net proceeds from the offering of $121.0 million to redeem approximately $110.0 million aggregate principal amount of its outstanding 8.75% Senior Notes due 2008 at a price of 108.75% of their principal amount plus accrued interest to the redemption date.

In January 2004, the Company completed a private placement of 3.3 million shares of its Series H Variable Rate Cumulative Redeemable Preferred Stock, having a liquidation preference of $25.00 per share and redeemable at par at any time from the purchase date through the first four months. The Company specifically used the proceeds from this offering to redeem the Series B and C Cumulative Redeemable Preferred Stock on February 23, 2004. On January 27, 2004, the Company redeemed all Series H Preferred Stock using excess liquidity from its secured credit facilities.

In December 2003, the Company completed an underwritten public offering of 5.0 million primary shares of the Company's Common Stock. The Company received approximately $191.1 million from the offering and used these proceeds to repay a portion of secured indebtedness.

In December 2003, the Company redeemed 1.6 million shares of the Company's 9.50% Series A Cumulative Redeemable Preferred Stock, having a liquidation preference of $50.00 per share by exchanging those securities for newly issued 3.2 million shares of 7.65% Series G Cumulative Redeemable Preferred Stock, having a liquidation preference of $25.00 per share and a redemption date beginning on December 19, 2008. Immediately following this transaction the Company no longer had any Series A Preferred Stock outstanding. The Company did not receive any cash proceeds from the offering.

In September 2003, the Company completed an underwritten public offering of 4.0 million shares of its 7.80% Series F Cumulative Redeemable Preferred Stock, having a liquidation preference of $25.00 per share and a redemption date beginning on September 29, 2008. The Company used the proceeds from the offering to repay a portion of secured indebtedness.

In July 2003, the Company redeemed 2.8 million shares of the Company's 9.50% Series A Cumulative Redeemable Preferred Stock, having a liquidation preference of $50.00 per share by exchanging those securities for newly issued 5.6 million shares of 7.875% Series E Cumulative Redeemable Preferred Stock, having a liquidation preference of $25.00 per share and a redemption date beginning on July 18, 2008. The Company did not receive any cash proceeds from the offering.

On November 14, 2002, the Company completed an underwritten public offering of 8.0 million primary shares of the Company's Common Stock. The Company received approximately $202.9 million from the offering and used these proceeds to repay a portion of secured indebtedness.

On December 15, 1998, the Company issued warrants to acquire 6.1 million shares of Common Stock, as adjusted for dilution, at $34.35 per share. The warrants were exercisable on or after December 15, 1999 at a price of $34.35 per share and expired on December 15, 2005. On April 8, 2004, all 6.1 million warrants were exercised on a net basis and the Company subsequently issued approximately 1.1 million shares.

DRIP/Stock Purchase Plan – The Company maintains a dividend reinvestment and direct stock purchase plan. Under the dividend reinvestment component of the plan, the Company's shareholders may purchase additional shares of Common Stock without payment of brokerage commissions

or service charges by automatically reinvesting all or a portion of their Common Stock cash dividends. Under the direct stock purchase component of the plan, the Company's shareholders and new investors may purchase shares of Common Stock directly from the Company without payment of brokerage commissions or service charges. All purchases of shares in excess of $10,000 per month pursuant to the direct purchase component are at the Company's sole discretion. Shares issued under the plan may reflect a discount of up to 3.00% from the prevailing market price of the Company's Common Stock. The Company is authorized to issue up to 8.0 million shares of Common Stock pursuant to the dividend reinvestment and direct stock purchase plan. During the 12 months ended December 31, 2004 and 2003, the Company issued a total of approximately 427,000 and 2.6 million shares of its Common Stock, respectively, through the direct stock purchase component of the plan. Net proceeds during the 12 months ended December 31, 2004 and 2003, were approximately $17.6 million and $89.1 million, respectively. There are approximately 3.1 million shares available for issuance under the plan as of December 31, 2004.

**Stock Repurchase Program** – The Board of Directors approved, and the Company has implemented, a stock repurchase program under which the Company is authorized to repurchase up to 5.0 million shares of its Common Stock from time to time, primarily using proceeds from the disposition of assets or loan repayments and excess cash flow from operations, but also using borrowings under its credit facilities if the Company determines that it is advantageous to do so. As of December 31, 2004, the Company had repurchased a total of approximately 2.3 million shares at an aggregate cost of approximately $40.7 million. The Company has not repurchased any shares under the stock repurchase program since November 2000.

## Note 9 – Risk Management and Use of Financial Instruments

**Risk management** – In the normal course of its ongoing business operations, the Company encounters economic risk. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or different bases, than its interest-earning assets. Credit risk is the risk of default on the Company's lending investments that results from a property's, borrower's or corporate tenant's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of loans due to changes in interest rates or other market factors, including the rate of prepayments of principal and the value of the collateral underlying loans and the valuation of CTL facilities held by the Company.

**Use of derivative financial instruments** – The Company's use of derivative financial instruments is primarily limited to the utilization of interest rate agreements or other instruments to manage interest rate risk exposure. The principal objective of such arrangements is to minimize the risks and/or costs associated with the Company's operating and financial structure as well as to hedge specific anticipated transactions. The counterparties to these contractual arrangements are major financial institutions with which the Company and its affiliates may also have other financial relationships. The Company is potentially exposed to credit loss in the event of non-performance by these counterparties. However, because of their high credit ratings, the Company does not anticipate that any of the counterparties will fail to meet their obligations. The Company does not use derivative instruments to hedge credit/market risk or for speculative purposes.

The Company has entered into the following cash flow and fair value hedges that are outstanding as of December 31, 2004. All hedges are currently effective and no ineffectiveness exists. The net value (liability) associated with these hedges is reflected on the Company's Consolidated Balance Sheets (in thousands).

| Type of Hedge | Notional Amount | Strike Price or Swap Rate | Trade Date | Maturity Date | Estimated Value at December 31, 2004 |
|---|---|---|---|---|---|
| Pay-Fixed Swap | $125,000 | 2.885% | 1/23/03 | 6/25/06 | **$ 544** |
| Pay-Fixed Swap | 125,000 | 2.838% | 2/11/03 | 6/25/06 | **632** |
| Pay-Fixed Swap | 67,000 | 4.659% | 12/09/04 | 3/31/15 | **217** |
| Pay-Fixed Swap | 67,000 | 4.659% | 12/09/04 | 3/31/15 | **217** |
| Pay-Fixed Swap | 66,000 | 4.660% | 12/09/04 | 3/31/15 | **208** |
| Pay-Floating Swap | 200,000 | 4.381% | 12/17/03 | 12/15/10 | **(55)** |
| Pay-Floating Swap | 105,000 | 3.678% | 1/15/04 | 1/15/09 | **(1,339)** |
| Pay-Floating Swap | 100,000 | 4.345% | 12/17/03 | 12/15/10 | **(219)** |
| Pay-Floating Swap | 100,000 | 3.878% | 11/27/02 | 8/15/08 | **1,030** |
| Pay-Floating Swap | 100,000 | 3.713% | 1/15/04 | 1/15/09 | **(1,128)** |
| Pay-Floating Swap | 100,000 | 3.686% | 1/15/04 | 1/15/09 | **(1,239)** |
| Pay-Floating Swap | 50,000 | 3.810% | 11/27/02 | 8/15/08 | **389** |
| Pay-Floating Swap | 50,000 | 4.290% | 12/17/03 | 12/15/10 | **(256)** |
| Pay-Floating Swap | 45,000 | 3.684% | 1/15/04 | 1/15/09 | **(562)** |
| LIBOR Cap | 345,000 | 8.000% | 5/22/02 | 5/28/14 | **4,465** |
| LIBOR Cap | 135,000 | 6.000% | 9/29/03 | 10/15/06 | **19** |
| Total Estimated Value | | | | | **$ 2,923** |

Between January 1, 2003 and December 31, 2004, the Company also had outstanding the following cash flow hedges that have expired or been settled (in thousands):

| Type of Hedge | Notional Amount | Strike Price or Swap Rate | Trade Date | Maturity Date |
|---|---|---|---|---|
| Pay-Fixed Swap | $235,000 | 1.135% | 3/11/04 | 9/15/04 |
| Pay-Fixed Swap | 200,000 | 1.144% | 3/11/04 | 9/15/04 |
| Pay-Fixed Swap | 200,000 | 1.144% | 3/11/04 | 9/15/04 |
| Pay-Fixed Swap | 125,000 | 7.058% | 6/15/00 | 6/25/03 |
| Pay-Fixed Swap | 125,000 | 7.055% | 6/15/00 | 6/25/03 |
| Pay-Fixed Swap | 100,000 | 4.139% | 9/29/03 | 1/2/11 |
| Pay-Fixed Swap | 100,000 | 4.643% | 9/29/03 | 1/2/14 |
| Pay-Fixed Swap | 100,000 | 4.484% | 1/16/04 | 5/1/14 |
| Pay-Fixed Swap | 75,000 | 5.580% | 11/4/99[(1)] | 12/1/04 |
| Pay-Fixed Swap | 50,000 | 4.502% | 1/16/04 | 5/1/14 |
| Pay-Fixed Swap | 50,000 | 4.500% | 1/16/04 | 5/1/14 |
| LIBOR Cap | 75,000 | 7.750% | 11/4/99[(1)] | 12/1/04 |
| LIBOR Cap | 35,000 | 7.750% | 11/4/99[(1)] | 12/1/04 |

**Explanatory Note:**

(1) Acquired in connection with the TriNet Acquisition (see Note 1).

On December 9, 2004, the Company entered into three forward-starting swaps all with ten-year terms and rates of 4.659%, 4.659% and 4.660% and notional amounts of $67.0 million, $67.0 million and $66.0 million, respectively, and are being used to lock-in swap rates related to a portion of planned future corporate unsecured fixed-rate bond issuances. These three swaps were settled on March 1, 2005 in connection with the Company's issuance of $700.0 million of seven-year Senior Notes (see Note 17).

On March 11, 2004, the Company entered into three pay-fixed interest rate swaps all with six-month terms, rates of 1.135%, 1.144% and 1.144% and notional amounts of $235.0 million, $200.0 million and $200.0 million, respectively. These three swaps matured on September 15, 2004.

On January 16, 2004, the Company entered into three forward-starting swaps all with ten-year terms and rates of 4.484%, 4.502% and 4.500% and notional amounts of $100.0 million, $50.0 million and $50.0 million, respectively, and were used to lock-in swap rates related to a portion of planned future corporate unsecured fixed-rate bond issuances. These three swaps were settled in connection with the Company's issuance of $250.0 million of ten-year Senior Notes in March 2004.

On January 15, 2004, in connection with the Company's fixed-rate corporate bonds, the Company entered into four pay-floating interest rate swaps struck at 3.678%, 3.713%, 3.686% and 3.684% with notional amounts of $105.0 million, $100.0 million, $100.0 million and $45.0 million, respectively, and maturing on January 15, 2009. The Company pays six-month LIBOR and receives the stated fixed rate in return. These swaps mitigate the risk of changes in the fair value of $350.0 million of five-year Senior Notes attributable to changes in LIBOR. For accounting purposes, the difference between the fixed rate received and the LIBOR rate paid on the notional amount of the swap is recorded as "Interest expense" on the Company's Consolidated Statements of Operations. In addition, the Company adjusts the value of the swap to its fair value and adjusts the carrying amount of the hedged liability by an offsetting amount on a quarterly basis.

During 2003, the Company entered into two 90-day forward-starting swaps each having a $100.0 million notional amount. These pay-fixed swaps which were effective in September 2003, had rates of 4.139% and 4.643%, had seven-year and ten-year terms, respectively, and were used to lock in swap rates related to a portion of planned future corporate unsecured fixed-rate bond issuances. These two swaps were settled in connection with the Company's issuance of $350.0 million of seven-year Senior Notes and $150.0 million of ten-year Senior Notes. In addition, effective in September 2003, the Company entered into a $135.0 million cap with a rate of 6.00% to hedge the Company's current outstanding floating-rate debt. This cap has a three-year term. Further, the Company entered into two $125.0 million forward-starting swaps in the first quarter 2003 that became effective in June 2003. These forward-starting swaps replaced the two $125.0 million pay-fixed swaps that expired in June 2003. The two new pay-fixed swaps have a three-year term and expire on June 25, 2006.

In addition, in connection with a portion of the Company's fixed-rate corporate bonds, the Company entered into three pay-floating interest rate swaps in December 2003 struck at 4.381%, 4.345% and 4.290% with notional amounts of $200.0 million, $100.0 million and $50.0 million,

respectively, and maturing on December 15, 2010 and also entered into two pay-floating interest rate swaps in November 2002 struck at 3.8775% and 3.810% with notional amounts of $100.0 million and $50.0 million, respectively, and maturing on August 15, 2008. The Company pays six-month LIBOR on the swaps entered into in December 2003 and one-month LIBOR on the swaps entered into in November 2002 and receives the stated fixed rate in return. These swaps mitigate the risk of changes in the fair value of $350.0 million of seven-year Senior Notes and $150.0 million of ten-year Senior Notes attributable to changes in LIBOR. For accounting purposes, the difference between the fixed rate received and the LIBOR rate paid on the notional amount of the swap is recorded as "Interest expense" on the Company's Consolidated Statements of Operations. In addition, the Company adjusts the value of the swap to its fair value and adjusts the carrying amount of the hedged liability by an offsetting amount on a quarterly basis.

In connection with STARs, Series 2003-1 in May 2003, the Company entered into a LIBOR interest rate cap struck at 6.95% in the notional amount of $270.6 million, and simultaneously sold a LIBOR interest rate cap with the same terms. Since these instruments do not change the Company's net interest rate risk exposure, they do not qualify as hedges and changes in their respective values are charged to earnings. As the terms of these arrangements are substantially the same, the effects of a revaluation of these two instruments substantially offset one another.

In connection with STARs, Series 2002-1 in May 2002, the Company entered into a LIBOR interest rate cap struck at 8.00% in the notional amount of $345.0 million. The Company utilizes the provisions of SFAS No. 133 with respect to such instruments. SFAS No. 133 provides that the up-front fees paid on option-based products such as caps should be expensed into earnings based on the allocation of the premium to the affected periods as if the agreement were a series of "caplets." These allocated premiums are then reflected as a charge to income (as part of interest expense) in the affected period. On May 28, 2002, in connection with the STARs, Series 2002-1 transaction, the Company paid a premium of $13.7 million for this interest rate cap. Using the "caplet" methodology discussed above, amortization of the cap premium is dependent upon the actual value of the caplets at inception.

During the year ended December 31, 1999, the Company refinanced its $125.0 million term loan maturing March 15, 1999 with a $155.4 million term loan maturing March 5, 2009. The term loan bears interest at 7.44% per annum, payable monthly, and amortizes over an approximately 22-year schedule. The term loan represented forecasted transactions for which the Company had previously entered into U.S. Treasury-based hedging transactions. The net $3.4 million cost of the settlement of such hedges has been deferred and is being amortized as an increase to the effective financing cost of the term loan over its effective ten-year term.

**Credit risk concentrations** – Concentrations of credit risks arise when a number of borrowers or customers related to the Company's investments are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations, including those to the Company, to be similarly affected by changes in economic conditions. The Company regularly monitors various segments of its portfolio to assess potential concentrations of credit risks. Management believes the current portfolio is reasonably well diversified and does not contain any unusual concentration of credit risks.

Substantially all of the Company's CTL assets (including those held by joint ventures) and loans and other lending investments are collateralized by facilities located in the United States, with significant concentrations (i.e., greater than 10.00%) as of December 31, 2004 in California (19.49%). As of December 31, 2004, the Company's investments also contain greater than 10.00% concentrations in the following asset types: office-CTL (23.13%), industrial (16.17%), office-lending (12.43%) and entertainment/leisure (10.71%).

The Company underwrites the credit of prospective borrowers and customers and often requires them to provide some form of credit support such as corporate guarantees, letters of credit and/or cash security deposits. Although the Company's loans and other lending investments and corporate customer lease assets are geographically diverse and the borrowers and customers operate in a variety of industries, to the extent the Company has a significant concentration of interest or operating lease revenues from any single borrower or customer, the inability of that borrower or customer to make its payment could have an adverse effect on the Company. As of December 31, 2004, the Company's five largest borrowers or corporate customers collectively accounted for approximately 15.08% of the Company's aggregate annualized interest and operating lease revenue of which no single customer accounts for more than 4.45%.

## Note 10 – Stock-Based Compensation Plans and Employee Benefits

The Company's 1996 Long-Term Incentive Plan (the "Plan") is designed to provide incentive compensation for officers, other key employees and directors of the Company. The Plan provides for awards of stock options and shares of restricted stock and other performance awards. The maximum number of shares of Common Stock available for awards under the Plan is 9.00% of the outstanding shares of Common Stock, calculated on a fully diluted basis, from time to time, provided that the number of shares of Common Stock reserved for grants of options designated as incentive stock options is 5.0 million, subject to certain antidilution provisions in the Plan. All awards under the Plan, other than automatic awards to non-employee directors, are at the discretion of the Board of Directors or a committee of the Board of Directors. At December 31, 2004, a total of approximately 10.1 million shares of Common Stock were available for awards under the Plan, of which options to purchase approximately 1.3 million shares of Common Stock were outstanding and approximately 411,000 shares of restricted stock were outstanding. A total of approximately 914,000 shares remain available for awards under the Plan as of December 31, 2004.

Changes in options outstanding during each of the fiscal 2002, 2003 and 2004 are as follows:

| | Number of Shares | | | Weighted |
|---|---|---|---|---|
| | | Non-Employee | | Average |
| | Employees | Directors | Other | Strike Price |
| **Options outstanding, December 31, 2001** | 3,645,058 | 583,532 | 896,676 | $18.98 |
| Granted in 2002 | – | 80,000 | – | $27.83 |
| Exercised in 2002 | (488,674) | (190,650) | (164,683) | $18.63 |
| Forfeited in 2002 | (16,907) | (4,600) | – | $24.87 |
| **Options outstanding, December 31, 2002** | 3,139,477 | 468,282 | 731,993 | $18.77 |
| Granted in 2003 | 15,500 | – | – | $14.72 |
| Exercised in 2003 | (843,624) | (235,746) | (389,594) | $18.99 |
| Forfeited in 2003 | (2,300) | (13,850) | – | $26.14 |
| Transferred in 2003[(1)] | – | (63,692) | 63,692 | $27.15 |
| **Options outstanding, December 31, 2003** | 2,309,053 | 154,994 | 406,091 | $18.59 |
| Granted in 2004 | **–** | **–** | **–** | **–** |
| Exercised in 2004 | **(1,316,070)** | **(36,600)** | **(98,527)** | **$19.23** |
| Forfeited in 2004 | **(83,730)** | **(14,600)** | **–** | **$17.14** |
| **Options outstanding, December 31, 2004** | **909,253** | **103,794** | **307,564** | **$17.99** |

**Explanatory Note:**

(1) Transfer of shares due to the down-size of Board of Directors on June 2, 2003.

The following table summarizes information concerning outstanding and exercisable options as of December 31, 2004:

| | Options Outstanding | | Options Exercisable |
|---|---|---|---|
| Exercise Price | Options Outstanding | Remaining Contractual Life | Currently Exercisable |
| $14.72 | 486,214 | 4.12 | 475,881 |
| $16.88 | 406,461 | 5.01 | 406,461 |
| $17.38 | 16,667 | 5.21 | 16,667 |
| $19.69 | 231,783 | 6.00 | 231,783 |
| $20.94 | 25,000 | 5.68 | 25,000 |
| $24.13 | 6,900 | 0.42 | 6,900 |
| $24.94 | 40,000 | 6.38 | 40,000 |
| $26.09 | 13,800 | 1.41 | 13,800 |
| $26.97 | 2,000 | 6.45 | 2,000 |
| $27.00 | 25,000 | 6.48 | 25,000 |
| $28.54 | 3,396 | 3.34 | 3,396 |
| $29.82 | 58,296 | 7.41 | 58,296 |
| $55.39 | 5,094 | 4.42 | 5,094 |
| | 1,320,611 | 4.98 | 1,310,278 |

In the third quarter 2002 (with retroactive application to the beginning of the calendar year), the Company adopted the fair value method for accounting for options issued to employees or directors, as allowed under Statement of Financial Accounting Standards No. 123 ("SFAS No. 123"), "Accounting for Stock-Based Compensation." 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 will be amortized over the related remaining vesting terms to individual employees as additional compensation. There were 15,500 options issued during the year ended December 31, 2003 with a strike price of $14.72.

If the Company's compensation costs had been determined using the fair value method of accounting for stock options issued under the Plan to employees and directors prescribed by SFAS No. 123 prior to 2002, the Company's net income for the fiscal years ended December 31, 2004, 2003 and 2002, would have been reduced on a pro forma basis by approximately $0, $96,000 and $188,000 respectively. This would not have significantly impacted the Company's earnings per share

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| Expected life (in years) | **N/A** | 5 | 5 |
| Risk-free interest rate | **N/A** | 3.13% | 4.38% |
| Volatility | **N/A** | 17.64% | 16.23% |
| Dividend yield | **N/A** | 9.57% | 8.45% |
| Weighted average grant date fair value | **N/A** | $5.26 | $1.38 |

Future charges may be taken to the extent of additional option grants, which are at the discretion of the Board of Directors.

During the year ended December 31, 2004, the Company granted 36,205 restricted shares to employees that vest proportionately over three years on the anniversary date of the initial grant of which 34,280 remain outstanding. In addition, in connection with the Chief Executive Officer's employment agreement 236,167 restricted shares were issued on March 31, 2004 (see detailed information below).

During the year ended December 31, 2003, the Company granted 40,600 restricted shares to employees that vest proportionately over three years on the anniversary date of the initial grant of which 21,604 remain outstanding as of December 31, 2004.

During the year ended December 31, 2002, the Company granted 199,350 restricted shares to employees. Of these shares, 44,350 will vest proportionately over three years on the anniversary date of the initial grant. Of the 44,350 shares granted, 10,030 remain outstanding as of December 31, 2004. The balance of 155,000 restricted shares granted to several employees vested on March 31, 2004 due to the satisfaction of the following circumstances: (1) the employee remained employed until that date; and (2) the 60-day average closing price of the Company's Common Stock equaled or exceeded a set floor price as of such date. The market price of the stock was $42.30 on March 31, 2004; therefore, the Company incurred a one-time charge to earnings of approximately $6.7 million (the fair market value of the 155,000 shares at $42.30 per share plus the Company's share of taxes). During the year ended December 31, 2002, the Company also granted 208,980 restricted shares to its Chief Financial Officer (see detailed information below).

For accounting purposes, the Company measures compensation costs for these shares, not including the contingently issuable shares, as of the date of the 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. Such amounts appear on the Company's Consolidated Statements of Operations in "General and administrative – stock-based compensation expense."

During the year ended December 31, 2004, the Company entered into a three-year employment agreement with its new President. This initial three-year term, and any subsequent one-year renewal term, will automatically be extended for an additional year, unless earlier terminated by prior notice from the Company or the President. Under the agreement, the President receives an annual base salary of $350,000, subject to an annual review for upward (but not downward) adjustment. Beginning with the fiscal year ending December 31, 2005, he will receive a target bonus of $650,000, subject to annual review for upward adjustment. For the year ended 2004, the President received a target bonus of $650,000, but prorated to reflect the portion of the year during which he was employed. In addition, the President purchased a 20.00% interest in both the Company's 2005 and 2006 high performance unit program for directors and executive officers. The President will also have the option to buy 25.00%, 30.00% and 35.00% in the Company's 2007, 2008, and 2009 high performance unit program for directors and executive officers. The President shall also receive an allocation of 25.00% of the interests in the Company's proposed New Business Crossed Incentive Compensation Program, which is a program that is intended to provide incentive compensation based upon the performance of new business lines to be identified by the Company.

During the year ended December 31, 2002, the Company entered into a three-year employment agreement with its new Chief Financial Officer. Under the agreement, the Chief Financial Officer receives an annual base salary of $225,000. She may also receive a bonus, which is targeted to be $325,000, subject to an annual review for upward or downward adjustment. In addition, the Company granted the Chief Financial Officer 108,980 contingently vested restricted stock awards. These awards become vested on December 31, 2005 if the executive's employment with the Company has not terminated before such date. Dividends will be paid on the restricted shares as dividends are paid on shares of the Company's Common Stock. These dividends are accounted for in a manner consistent with the Company's Common Stock dividends, as a reduction to retained earnings. For accounting purposes, the Company is currently taking a total charge of approximately $3.0 million related to the restricted stock awards, which is being amortized over the period from November 6, 2002 through December 31, 2005. This charge is reflected on the Company's Consolidated Statements of Operations in "General and administrative – stock-based compensation."

Further, the Company granted the Chief Financial Officer 100,000 restricted shares which became fully-vested on January 31, 2004 as a result of the Company achieving a 53.28% total shareholder rate of return (dividends since November 6, 2002 plus share price appreciation from January 2, 2003). The Company incurred a one-time charge to earnings during the three months ended March 31, 2004 of approximately $4.1 million (the fair market value of the 100,000 shares at $40.02 per share plus the Company's share of taxes). For accounting purposes, the employment arrangement described above was treated as a contingent, variable plan until January 31, 2004.

On February 11, 2004, the Company entered into a new employment agreement with its Chief Executive Officer which took effect upon the expiration of the old agreement. The new agreement has an initial term of three years and provides for the following compensation:

- an annual salary of $1.0 million;
- a potential annual cash incentive award of up to $5.0 million if performance goals set by the Compensation Committee of the Board of Directors in consultation with the Chief Executive Officer are met; and
- a one-time award of Common Stock with a value of $10.0 million at March 31, 2004 (based upon the trailing 20-day average closing price of the Common Stock); the award was fully-vested when granted and dividends will be paid on the shares from the date of grant, but the shares cannot be sold for five years unless the price of the Common Stock during the 12 months ending March 31 of each year increases by at least 15.00%, in which case the sale restrictions on 25.00% of the shares awarded will lapse in respect to each 12-month period. In connection with this award the Company recorded a $10.1 million charge in "General and administrative – stock-based compensation expense" on the Company's Consolidated Statements of Operations. The Chief Executive Officer notified the Company that subsequent to this award he contributed an equivalent number of shares to a newly established charitable foundation.

In addition, the Chief Executive Officer purchased an 80.00% interest in the Company's 2006 high performance unit program for directors and executive officers. This performance program was approved by the Company's shareholders in 2003 and is described in detail in the Company's 2003 annual proxy statement. The purchase price paid by the Chief Executive Officer was based upon a valuation prepared by an independent investment-banking firm. The interests purchased by the Chief Executive Officer will have no value to him unless the Company achieves total shareholder returns in excess of those achieved by peer group indices, all as more fully described in the Company's 2003 annual proxy statement.

The February 2004 employment agreement with the Company's Chief Executive Officer replaced a prior employment agreement dated March 30, 2001 that expired at the end of its term. The compensation awarded to the Company's Chief Executive Officer under this prior agreement included a grant of 2.0 million unvested phantom shares. The phantom shares vested on a contingent basis in installments of 350,000 shares, 650,000 shares, 600,000 shares and 400,000 shares when the average closing price of the Company's Common Stock achieved performance targets of $25.00, $30.00, $34.00 and $37.00, respectively, which were set at the commencement of the agreement in March 2001. The phantom shares became fully-vested at the expiration of the term of the agreement on March 30, 2004. The market price of the Common Stock on March 30, 2004 was $42.40 and the Company incurred a one-time charge to earnings during the three months ended March 31, 2004 of approximately $86.0 million (the fair market value of the 2.0 million shares at $42.40 per share plus the Company's share of taxes).

Upon the phantom share units becoming fully-vested, the Company delivered to the executive 728,552 shares of Common Stock and $53.9 million of cash, the total of which is equal to the fair market value of the 2.0 million shares of Common Stock multiplied by the closing stock price of $42.40 on March 30, 2004. Prior to March 30, 2004, the executive received dividends on shares that were contingently vested and were not forfeited under the terms of the agreement, when the Company declared and paid dividends on its Common Stock. Because no shares had been issued prior to March 30, 2004, dividends received on these phantom shares were reflected as compensation expense by the Company. For accounting purposes, this arrangement was treated as a contingent, variable plan and no additional compensation expense was recognized until the shares became irrevocably vested on March 30, 2004, at which time the Company reflected a charge equal to the fair value of the shares irrevocably vested.

In addition, during the year ended December 31, 2001, the Company entered into a three-year employment agreement with its former President. Under the agreement, in lieu of salary and bonus, the Company granted the executive 500,000 restricted shares. These shares became fully-vested on September 30, 2002 as a result of the Company achieving a 60.00% total shareholder rate of return (dividends plus share price appreciation) since January 1, 2001. Upon the restricted shares becoming fully-vested, the Company withheld 250,000 of such shares from the executive to cover the tax obligations associated with the vesting of such shares. These shares are reflected as "Treasury stock", at a cost of approximately $7.4 million, on the Company's Consolidated Statements of Changes in Shareholders' Equity. For accounting purposes, the employment arrangement described above was treated as a contingent, variable plan until the April 29, 2002 contingent vesting date. The Company incurred a total charge of approximately $15.0 million related to the vesting of the shares, recognized ratably over the period from April 29, 2002 through September 30, 2002. The executive received dividends on the share grant from the date of the agreement as and when the Company declared and paid dividends on its Common Stock. For financial statement purposes, such dividends were accounted for in a manner consistent with the Company's normal Common Stock dividends, as a reduction to retained earnings.

Certain affiliates of Starwood Opportunity Fund IV, LP ("SOFI IV") and the Company's Chief Executive Officer previously agreed to reimburse the Company for the value of restricted shares awarded to the former President in excess of 350,000 shares, net of tax benefits realized by the Company or its shareholders on account of compensation expense deductions. The reimbursement obligation arose once the restricted share award became fully-vested on September 30, 2002. The Company's Chief Executive Officer fulfilled his reimbursement obligation through the delivery of shares of the Company's Common Stock owned by him. As of March 31, 2004, the SOFI IV affiliates fulfilled their obligation through the payment of approximately $2.4 million in cash. These reimbursement payments are reflected as "Additional paid-in capital" on the Company's Consolidated Balance Sheets, and not as an offset to the charge referenced above.

**High Performance Unit Program**

In May 2002, the Company's shareholders approved the iStar Financial High Performance Unit ("HPU") Program. The program, as more fully described in the Company's annual proxy statement dated April 8, 2002, is a performance-based employee compensation plan that only has material value to the participants if the Company provides superior returns to its shareholders. The program entitles the employee participants ("HPU holders") to receive distributions in the nature of Common Stock dividends if the total rate of return on the Company's Common Stock (share price appreciation plus dividends) exceeds certain performance levels.

Initially, there were three plans within the program: the 2002 plan, the 2003 plan, and the 2004 plan. Each plan has 5,000 shares of High Performance Common Stock associated with it. Each share of High Performance Common Stock carries 0.25 votes per share.

For these three plans, the Company's performance is measured over a one-, two-, or three-year valuation period, beginning on January 1, 2002 and ending on December 31, 2002, December 31, 2003 and December 31, 2004, respectively. The end of the valuation period (i.e., the "valuation date") will be accelerated if there is a change in control of the Company. The High Performance Common Stock has a nominal value unless the total rate of shareholder return for the relevant valuation period exceeds the greater of: (1) 10.00%, 20.00%, or 30.00% for the 2002 plan, the 2003 plan and the 2004 plan, respectively; and (2) a weighted industry index total rate of return consisting of equal weightings of the Russell 1000 Financial Index and the Morgan Stanley REIT Index for the relevant period.

If the total rate of return on the Company's Common Stock exceeds the threshold performance levels for a particular plan, then distributions will be paid on the shares of High Performance Common Stock related to that plan in the same amounts and at the same times as distributions are paid on a number of shares of the Company's Common Stock equal to the following: 7.50% of the Company's excess total rate of return (over the higher of the two threshold performance levels) multiplied by the weighted average market value of the Company's common equity capitalization during the measurement period, all as divided by the average closing price of a share of the Company's Common Stock for the 20 trading days immediately preceding the applicable valuation date.

If the total rate of return on the Company's Common Stock does not exceed the threshold performance levels for a particular plan, then the

shares of High Performance Common Stock related to that plan will have only nominal value. In this event, each of the 5,000 shares will be entitled to dividends equal to 0.01 times the dividend paid on a share of Common Stock, if and when dividends are declared on the Common Stock.

Regardless of how much the Company's total rate of return exceeds the threshold performance levels, the dilutive impact to the Company's shareholders resulting from distributions on High Performance Common Stock in each plan is limited to the equivalent of 1.00% of the average monthly number of fully diluted shares of the Company's Common Stock outstanding during the valuation period.

The employee participants have purchased their interests in High Performance Common Stock through a limited liability company at purchase prices approved by the Company's Board of Directors. The Company's Board of Directors has established the prices of the High Performance Common Stock based upon, among other things, an independent valuation from a major securities firm. The aggregate initial purchase prices were set on June 25, 2002 and were approximately $2.8 million, $1.8 million and $1.4 million for the 2002, 2003 and 2004 plans, respectively. No employee is permitted to exchange his or her interest in the LLC for shares of High Performance Common Stock prior to the applicable valuation date.

The total shareholder return for the valuation period under the 2002 plan was 21.94%, which exceeded both the fixed performance threshold of 10.00% and the industry index return of (5.83%). As a result of this superior performance, the participants in the 2002 plan are entitled to receive distributions equivalent to the amount of dividends payable on 819,254 shares of the Company's Common Stock, as and when such dividends are paid. Such dividend payments began with the first quarter 2003 dividend. The Company will pay dividends on the 2002 plan shares in the same amount per equivalent share and on the same distribution dates that shares of the Company's Common Stock are paid. The Company has the right, but not the obligation, to repurchase at cost 50.00% of the interests earned by an employee in the 2002 plan if the employee breaches certain non-competition, non-solicitation and confidentiality covenants through January 1, 2005.

The total shareholder return for the valuation period under the 2003 plan was 78.29%, which exceeded the fixed performance threshold of 20.00% and the industry index return of 24.66%. The plan was fully funded and was limited to 1.00% of the average monthly number of fully diluted shares of the Company's Common Stock during the valuation period. As a result of the Company's superior performance, the participants in the 2003 plan are entitled to receive distributions equivalent to the amount of dividends payable on 987,149 shares of the Company's Common Stock, as and when such dividends are paid. Such dividend payments began with the first quarter 2004 dividend. The Company will pay dividends on the 2003 plan shares in the same amount per equivalent share and on the same distribution dates that shares of the Company's Common Stock are paid.

The total shareholder return for the valuation period under the 2004 plan was 115.47%, which exceeded the fixed performance threshold of 30.00% and the industry index return of 55.05%. The plan was fully funded and was limited to 1.00% of the average monthly number of fully diluted shares of the Company's Common Stock during the valuation period. As a result of the Company's superior performance, the participants in the 2004 plan are entitled to receive distributions equivalent to the amount of dividends payable on 1,031,875 shares of the Company's Common Stock, as and when such dividends are paid. Such dividend payments will begin with the first quarter 2005 dividend. The Company will pay dividends on the 2004 plan shares in the same amount per equivalent share and on the same distribution dates that shares of the Company's Common Stock are paid.

A new 2005 plan has been established with a three-year valuation period ending December 31, 2005. Awards under the 2005 plan were approved on January 14, 2003. The 2005 plan has 5,000 shares of High Performance Common Stock with an aggregate initial purchase price of $617,000. As of December 31, 2004 the Company has received a net contribution of $586,000 under this plan. The purchase price of the High Performance Common Stock was established by the Company's Board of Directors based upon, among other things, an independent valuation from a major securities firm. The provisions of the 2005 plan are substantially the same as the prior plans.

A new 2006 plan has been established with a three-year valuation period ending December 31, 2006. Awards under the 2006 plan were approved on January 23, 2004. The 2006 plan had 5,000 shares of High Performance Common Stock with an aggregate initial purchase price of $715,000. As of December 31, 2004 the Company has received a net contribution of $687,000 under this plan. The purchase price of the High Performance Common Stock was established by the Company's Board of Directors based upon, among other things, an independent valuation from a major securities firm. The provisions of the 2006 plan are substantially the same as the prior plans.

A new 2007 plan has been established with a three-year valuation period ending December 31, 2007. Awards under the 2007 plan were approved in January 2005. The 2007 plan had 5,000 shares of High Performance Common Stock with an aggregate initial purchase price of $643,000. The purchase price of the High Performance Common Stock was established by the Company's Board of Directors based upon, among other things, an independent valuation from a major securities firm. The provisions of the 2007 plan are substantially the same as the prior plans.

The additional equity from the issuance of the High Performance Common Stock is recorded as a separate class of stock and included within shareholders' equity on the Company's Consolidated Balance Sheets. Net income allocable to common shareholders will be reduced by the HPU holders' share of dividends paid and undistributed earnings, if any.

**401(k) Plan**

Effective November 4, 1999, the Company implemented a savings and retirement plan (the "401(k) Plan"), which is a voluntary, defined contribution plan. All employees are eligible to participate in the 401(k) Plan following completion of three months of continuous service with the Company. Each participant may contribute on a pretax basis up to the maximum percentage of compensation and dollar amount permissible under Section 402(g) of the Internal Revenue Code not to exceed the limits of Code Sections 401(k), 404 and 415. At the discretion of the Board of Directors, the Company may make matching contributions on the participant's behalf of up to 50.00% of the first 10.00% of the participant's annual compensation. The Company made gross contributions of approximately $523,000, $424,000 and $356,000 for the 12 months ended December 31, 2004, 2003 and 2002, respectively.

## Note 11 – Earnings Per Share

The following table presents a reconciliation of the numerators and denominators of the basic and diluted EPS calculations for the years ended December 31, 2004, 2003 and 2002, respectively (in thousands, except per share data):

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| Numerator: | | | |
| Income from continuing operations | **$198,953** | $264,817 | $191,608 |
| Preferred dividend requirements | **(51,340)** | (36,908) | (36,908) |
| Income allocable to common shareholders and HPU holders before income from discontinued operations and gain from discontinued operations[1] | **147,613** | 227,909 | 154,700 |
| Income from discontinued operations | **18,119** | 22,173 | 22,945 |
| Gain from discontinued operations | **43,375** | 5,167 | 717 |
| Net income allocable to common shareholders and HPU holders[1] | **$209,107** | $255,249 | $178,362 |
| Denominator: | | | |
| Weighted average common shares outstanding for basic earnings per common share | **110,205** | 100,314 | 89,886 |
| Add: effect of assumed shares issued under treasury stock method for stock options, restricted shares and warrants | **1,322** | 1,897 | 1,645 |
| Add: effect of contingent shares | **639** | 1,667 | 1,118 |
| Add: effect of joint venture shares | **298** | 223 | – |
| Weighted average common shares outstanding for diluted earnings per common share | **112,464** | 104,101 | 92,649 |
| Basic earnings per common share: | | | |
| Income allocable to common shareholders before income from discontinued operations and gain from discontinued operations[2] | **$ 1.31** | $ 2.25 | $ 1.72 |
| Income from discontinued operations | **0.17** | 0.22 | 0.25 |
| Gain from discontinued operations | **0.39** | 0.05 | 0.01 |
| Net income allocable to common shareholders[2] | **$ 1.87** | $ 2.52 | $ 1.98 |
| Diluted earnings per common share: | | | |
| Income allocable to common shareholders before income from discontinued operations and gain from discontinued operations[3][4] | **$ 1.28** | $ 2.17 | $ 1.67 |
| Income from discontinued operations | **0.16** | 0.21 | 0.25 |
| Gain from discontinued operations | **0.39** | 0.05 | 0.01 |
| Net income allocable to common shareholders[3][4] | **$ 1.83** | $ 2.43 | $ 1.93 |

**Explanatory Notes:**

(1) HPU holders are Company employees who purchased high performance common stock units under the Company's High Performance Unit Program.
(2) For the 12 months ended December 31, 2004, 2003 and 2002, excludes $3,314, $2,066 and $0 of net income allocable to HPU holders, respectively.
(3) For the 12 months ended December 31, 2004, 2003 and 2002, excludes $3,265, $1,994 and $0 of net income allocable to HPU holders diluted, respectively.
(4) For the 12 months ended December 31, 2004, 2003 and 2002, includes $3, $167 and $0 of joint venture income, respectively.

For the years ended December 31 2004, 2003, and 2002 the following shares were antidilutive:

| For the Years Ended December 31, | 2004 | 2003 | 2002 |
|---|---|---|---|
| Stock options | **5,000** | 5,000 | 167,000 |
| Joint venture shares | **73,000** | – | 371,000 |
| Warrants | **–** | – | 6,100,000 |

## Note 12 – Comprehensive Income

Statement of Financial Accounting Standards No. 130 ("SFAS No. 130"), "Reporting Comprehensive Income" requires that all components of comprehensive income shall be reported in the financial statements in the period in which they are recognized. Furthermore, a total amount for comprehensive income shall be displayed in the financial statements. Total comprehensive income was $257.4 million, $295.5 million and $228.1 million

for the 12 months ended December 31, 2004, 2003 and 2002, respectively. The primary components of comprehensive income, other than net income, consist of amounts attributable to the adoption and continued application of SFAS No. 133 to the Company's cash flow hedges and changes in the fair value of the Company's available-for-sale investments.

| For the Years Ended December 31, | 2004 | 2003 | 2002 |
|---|---|---|---|
| | | (In thousands) | |
| Net income | **$260,447** | $292,157 | $215,270 |
| Other comprehensive income: | | | |
| Reclassification of gains on securities into earnings upon realization | **(6,743)** | (12,031) | – |
| Reclassification of gains/ losses on qualifying cash flow hedges into earnings | **6,212** | 12,601 | 16,299 |
| Unrealized gains on available-for-sale investments | **2,075** | 8,103 | 7,601 |
| Unrealized losses on cash flow hedges | **(4,638)** | (5,364) | (11,109) |
| Comprehensive income | **$257,353** | $295,466 | $228,061 |

Unrealized gains on available-for-sale investments and cash flow hedges are recorded as adjustments to shareholders' equity through "Accumulated other comprehensive income (losses)" on the Company's Consolidated Balance Sheets and are not included in net income unless realized.

As of December 31, 2004 and 2003, accumulated other comprehensive income (losses) reflected in the Company's shareholders' equity is comprised of the following (in thousands):

| As of December 31, | 2004 | 2003 |
|---|---|---|
| Unrealized gains on available-for-sale investments | **$ 4,694** | $ 9,362 |
| Unrealized losses on cash flow hedges | **(6,780)** | (8,354) |
| Accumulated other comprehensive income (losses) | **$(2,086)** | $ 1,008 |

Over time, the unrealized gains and losses held in other comprehensive income will be reclassified to earnings in the same period(s) in which the hedged items are recognized in earnings. The current balance held in other comprehensive income is expected to be reclassified to earnings over the lives of the current hedging instruments, or for the realized losses on forecasted debt transactions, over the related term of the debt obligation, as applicable. The Company expects that $3.0 million will be reclassified into earnings as an increase in interest expense over the next 12 months.

**Note 13 – Dividends**

In order to maintain its election to qualify as a REIT, the Company must currently distribute, at a minimum, an amount equal to 90.00% of its taxable income and must distribute 100.00% of its taxable income to avoid paying corporate federal income taxes. The Company anticipates it will distribute all of its taxable income to its shareholders. Because taxable income differs from cash flow from operations due to non-cash revenues and expenses (such as depreciation), 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.

For the year ended December 31, 2004, total dividends declared by the Company aggregated $310.7 million, or $2.79 per share on Common Stock consisting of quarterly dividends of $0.6975 which were declared on April 1, 2004, July 1, 2004, October 1, 2004 and December 1, 2004. For tax reporting purposes, the 2004 dividends were classified as 49.15% ($1.3713) ordinary income, 2.20% ($0.0613) 15.00% capital gain, 7.45% ($0.0278) 25.00% Section 1250 capital gain and 41.20% ($1.1496) return of capital for those shareholders who held shares of the Company for the entire year. The Company also declared and paid dividends aggregating $8.0 million, $11.0 million, $7.8 million, $6.1 million and $7.4 million, respectively, on its Series D, E, F, G and I preferred stock, respectively, during the 12 months ended December 31, 2004.

In connection with the redemption of the Series H preferred stock on January 27, 2004 the Company paid a dividend of $87,656 representing unpaid dividends of $0.49 per share for the 5 days the preferred stock was outstanding.

In connection with the redemption of the Series B preferred stock on February 23, 2004 the Company paid a final dividend of $920,000 representing unpaid dividends of $0.46 per share for the 70 days from the prior dividend payment on December 15, 2003. Upon redemption, the Company recognized a charge to net income allocable to common shareholders and HPU holders of $5.5 million included in "Preferred dividend requirements" on the Company's Consolidated Statements of Operations.

In connection with the redemption of the Series C preferred stock on February 23, 2004 the Company paid a final dividend of $585,000 representing unpaid dividends of $0.45 per share for the 70 days from the prior dividend payment on December 15, 2003. Upon redemption, the Company recognized a charge to net income allocable to common shareholders and HPU holders of $3.5 million included in "Preferred dividend requirements" on the Company's Consolidated Statements of Operations.

Holders of shares of the Series D preferred stock are entitled to receive, when and as declared by the Board of Directors, out of funds legally available for the payment of dividends, cumulative preferential cash dividends at the rate of 8.00% per annum of the $25.00 liquidation preference, equivalent to a fixed annual rate of $2.00 per share. 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 Series D 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.

Holders of shares of the Series E preferred stock are entitled to receive, when and as declared by the Board of Directors, out of funds legally available for the payment of dividends, cumulative preferential cash dividends at the rate of 7.875% per annum of the $25.00 liquidation preference, equivalent to a fixed annual rate of $1.97 per share. The remaining terms relating to dividends of the Series E preferred stock are substantially identical to the terms of the Series D preferred stock described above.

Holders of shares of the Series F preferred stock are entitled to receive, when and as declared by the Board of Directors, out of funds legally available for the payment of dividends, cumulative preferential cash dividends at the rate of 7.80% per annum of the $25.00 liquidation preference, equivalent to a fixed annual rate of $1.95 per share. The remaining terms relating to dividends of the Series F preferred stock are substantially identical to the terms of the Series D preferred stock described above.

Holders of shares of the Series G preferred stock are entitled to receive, when and as declared by the Board of Directors, out of funds legally available for the payment of dividends, cumulative preferential cash dividends at the rate of 7.65% per annum of the $25.00 liquidation preference, equivalent to a fixed annual rate of $1.91 per share. The remaining terms relating to dividends of the Series G preferred stock are substantially identical to the terms of the Series D preferred stock described above.

Holders of the Series I preferred stock are entitled to receive, when and as declared by the Board of Directors, out of funds legally available for the payment of dividends, cumulative preferential cash dividends at the rate of 7.50% per annum of the $25.00 liquidation preference, equivalent to a fixed annual rate of $1.88 per share. The remaining terms relating to dividends of the Series I preferred stock are substantially identical to the terms of the Series D preferred stock described above.

The 2002, 2003 and 2004 High Performance Unit Program reached their valuation dates on December 31, 2002, 2003 and 2004, respectively. Based on the Company's 2002, 2003 and 2004 total rate of return, the participants are entitled to receive dividends on 819,254 shares, 987,149 shares and 1,031,875 shares, respectively, of the Company's Common Stock. The Company will pay dividends on these units in the same amount per equivalent share and on the same distribution dates as shares of the Company's Common Stock. Such dividend payments for the 2002 plan began with the first quarter 2003 dividend, such dividends for the 2003 plan began with the first quarter 2004 dividend and such dividends for the 2004 plan will begin with the first quarter 2005 dividend. All dividends to HPU holders will reduce net income allocable to common shareholders when paid. Additionally, net income allocable to common shareholders will be reduced by the HPU holders' share of undistributed earnings, if any.

The exact amount of future quarterly dividends to common shareholders will be determined by the Board of Directors based on the Company's actual and expected operations for the fiscal year and the Company's overall liquidity position.

## Note 14 – Fair Values of Financial Instruments

SFAS No. 107, "Disclosures About Fair Value of Financial Instruments" ("SFAS No. 107"), requires the disclosure of the estimated fair values of financial instruments. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Quoted market prices, if available, are utilized as estimates of the fair values of financial instruments. Because no quoted market prices exist for a significant part of the Company's financial instruments, the fair values of such instruments have been derived based on management's assumptions, the amount and timing of future cash flows and estimated discount rates. The estimation methods for individual classifications of financial instruments are described more fully below. Different assumptions could significantly affect these estimates. Accordingly, the net realizable values could be materially different from the estimates presented below. The provisions of SFAS No. 107 do not require the disclosure of the fair value of non-financial instruments, including intangible assets or the Company's CTL assets.

In addition, the estimates are only indicative of the value of individual financial instruments and should not be considered an indication of the fair value of the Company as an operating business.

**Short-term financial instruments** – The carrying values of short-term financial instruments including cash and cash equivalents and short-term investments approximate the fair values of these instruments. These financial instruments generally expose the Company to limited credit risk and have no stated maturities, or have an average maturity of less than 90 days and carry interest rates which approximate market.

**Loans and other lending investments** – For the Company's interests in loans and other lending investments, the fair values were estimated by discounting the future contractual cash flows (excluding participation interests in the sale or refinancing proceeds of the underlying collateral) using estimated current market rates at which similar loans would be made to borrowers with similar credit ratings for the same remaining maturities.

**Marketable securities** – Securities held for investment, securities available for sale, loans held for sale, trading account instruments, long-term debt and trust preferred securities traded actively in the secondary market have been valued using quoted market prices.

**Other financial instruments** – The carrying value of other financial instruments including, restricted cash, accrued interest receivable, accounts payable, accrued expenses and other liabilities approximate the fair values of the instruments.

**Debt obligations** – A portion of the Company's existing debt obligations bear interest at fixed margins over LIBOR. Such margins may be higher or lower than those at which the Company could currently replace the related financing arrangements. Other obligations of the Company bear interest at fixed rates, which may differ from prevailing market interest rates. As a result, the fair values of the Company's debt obligations were estimated by discounting current debt balances from December 31, 2004 and 2003 to maturity using estimated current market rates at which the Company could enter into similar financing arrangements.

**Interest rate protection agreements** – The fair value of interest rate protection agreements such as interest rate caps, floors, collars and swaps used for hedging purposes (see Note 9) is the estimated amount the Company would receive or pay to terminate these agreements at the reporting date, taking into account current interest rates and current creditworthiness of the respective counterparties.

The book and fair values of financial instruments as of December 31, 2004 and 2003 were (in thousands):

| | 2004 | | 2003 | |
|---|---|---|---|---|
| | Book Value | Fair Value | Book Value | Fair Value |
| **Financial assets:** | | | | |
| Loans and other lending investments | **$3,988,625** | **$4,272,749** | $3,736,110 | $3,978,715 |
| Marketable securities | **9,494** | **9,494** | 20,265 | 20,265 |
| Provision for loan losses | **(42,436)** | **(42,436)** | (33,436) | (33,436) |
| **Financial liabilities:** | | | | |
| Debt obligations | **4,605,674** | **4,805,055** | 4,113,732 | 4,253,279 |
| Interest rate protection agreements | **2,923** | **2,923** | 6,506 | 6,506 |

## Note 15 – Segment Reporting

Statement of Financial Accounting Standard No. 131 ("SFAS No. 131") establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected financial information about operating segments in interim financial reports issued to shareholders.

The Company has two reportable segments: Real Estate Lending and Corporate Tenant Leasing. The Company does not have any foreign operations. The accounting policies of the segments are the same as those described in Note 3. The Company has no single customer that accounts for more than 3.85% of annualized total revenues (see Note 9 for other information regarding concentrations of credit risk).

The Company evaluates performance based on the following financial measures for each segment:

| | Real Estate Lending | Corporate Tenant Leasing | Corporate/ Other[1] | Company Total |
|---|---|---|---|---|
| | | (In thousands) | | |
| **2004:** | | | | |
| Total revenues[2]: | **$ 399,669** | **$ 291,942** | **$ 2,813** | **$ 694,424** |
| Equity in earnings (loss) from joint ventures and unconsolidated subsidiaries: | **–** | **2,909** | **–** | **2,909** |
| Total operating and interest expense[3]: | **57,673** | **140,933** | **299,058** | **497,664** |
| Net operating income[4]: | **341,996** | **153,918** | **(296,245)** | **199,669** |
| Total long-lived assets[5]: | **3,946,189** | **2,877,042** | **N/A** | **6,823,231** |
| Total assets: | **4,022,729** | **3,068,242** | **129,266** | **7,220,237** |
| **2003:** | | | | |
| Total revenues[2]: | $ 338,566 | $ 234,303 | $ 242 | $ 573,111 |
| Equity in earnings (loss) from joint ventures and unconsolidated subsidiaries: | – | (2,019) | (2,265) | (4,284) |
| Total operating and interest expense[3]: | 90,648 | 114,387 | 98,726 | 303,761 |
| Net operating income[4]: | 247,918 | 117,897 | (100,749) | 265,066 |
| Total long-lived assets[5]: | 3,702,674 | 2,535,885 | N/A | 6,238,559 |
| Total assets: | 3,810,679 | 2,729,716 | 120,195 | 6,660,590 |
| **2002:** | | | | |
| Total revenues[2]: | $ 279,157 | $ 214,824 | $ (324) | $ 493,657 |
| Equity in earnings (loss) from joint ventures and unconsolidated subsidiaries: | – | 5,081 | (3,859) | 1,222 |
| Total operating and interest expense[3]: | 94,273 | 92,903 | 115,933 | 303,109 |
| Net operating income[4]: | 184,884 | 127,002 | (120,116) | 191,770 |
| Total long-lived assets[5]: | 3,050,342 | 2,291,805 | N/A | 5,342,147 |
| Total assets: | 3,126,219 | 2,442,087 | 43,391 | 5,611,697 |

**Explanatory Notes:**

(1) Corporate and Other represents all corporate level items, including general and administrative expenses and any intercompany eliminations necessary to reconcile to the consolidated Company totals. This caption also includes the Company's servicing business, which is not considered a material separate segment.

(2) Total revenues represents all revenues earned during the period from the assets in each segment. Revenue from the Real Estate Lending business primarily represents interest income and revenue from the Corporate Tenant Leasing business primarily represents operating lease income.

(3) Total operating and interest expense represents provision for loan losses and loss on early extinguishment of debt for the Real Estate Lending business and operating costs on CTL assets for the Corporate Tenant Leasing business, as well as interest expense specifically related to each segment. Interest expense on unsecured notes, general and administrative expense and general and administrative-stock-based compensation is included in Corporate and Other for all periods. Depreciation and amortization of $64.5 million, $50.6 million and $42.6 million for the years ended December 31, 2004, 2003 and 2002, respectively, are included in the amounts presented above.

(4) Net operating income represents income before minority interest, income (loss) from discontinued operations and gain from discontinued operations.

(5) Total long-lived assets is comprised of Loans and other lending investments, net and Corporate tenant lease assets, net, for each respective segment.

## Note 16 – Quarterly Financial Information (Unaudited)

The following table sets forth the selected quarterly financial data for the Company (in thousands, except per share amounts).

| | Quarter Ended | | | |
|---|---|---|---|---|
| | December 31, | September 30, | June 30, | March 31, |
| **2004:** | | | | |
| Revenue | **$186,387** | **$173,262** | **$173,751** | **$161,024** |
| Net income (loss) | **127,442** | **85,102** | **83,019** | **(35,116)** |
| Net income (loss) allocable to common shares | **114,997** | **73,331** | **71,276** | **(53,811)** |
| Net income (loss) per common share – basic | **$ 1.03** | **$ 0.66** | **$ 0.64** | **$ (0.50)** |
| Weighted average common shares outstanding – basic | **111,402** | **111,230** | **110,695** | **107,468** |
| **2003:** | | | | |
| Revenue | $ 155,806 | $ 143,582 | $ 139,858 | $ 133,865 |
| Net income | 79,580 | 74,878 | 69,746 | 67,953 |
| Net income allocable to common shares | 68,835 | 66,082 | 60,025 | 58,241 |
| Net income per common share – basic | $ 0.67 | $ 0.66 | $ 0.60 | $ 0.59 |
| Weighted average common shares outstanding – basic | 102,603 | 100,687 | 99,445 | 98,472 |

## Note 17 – Subsequent Events

**Acquisition of Falcon Financial** – On January 20, 2005, the Company signed a definitive agreement to acquire Falcon Financial Investment Trust, an independent finance company dedicated to providing long-term capital to automotive dealers throughout the United States. 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 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 97.7% of Falcon Financial's issued and outstanding shares, had been tendered and not withdrawn. On March 3, 2005, the Company completed a 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 were converted into the right to receive $7.50 per share, without interest and the Company acquired 100% ownership of Falcon Financial.

**Acquisition of Substantial Minority Interest in Oak Hill Advisors** – On February 15, 2005, the Company signed a definitive agreement to make a substantial minority investment in Oak Hill Advisors, a premier asset management firm that focuses on corporate credit-oriented investment strategies for institutional investors. The Company agreed to issue approximately $49 million of its shares of Common Stock to the selling partners as part of the consideration for this investment. In addition, the Company agreed to appoint one of the selling partners to its Board of Directors. The Company expects to account for this transaction under the equity method. The transaction is expected to close in the first half of 2005.

**Investment in Acquisition of LNR Property Corporation** – The Company provided debt and equity to Blackacre/Cerberus Capital Management, L.P. and senior executives of LNR Property Corporation in connection with their acquisition and subsequent privatization of LNR Property Corporation. LNR is a diversified company that owns a portfolio of operating real estate assets, development properties and real estate securities, and is the largest special servicer in the CMBS market.

**TriNet Bond Exchange** – On March 1, 2005, the Company exchanged its TriNet 7.70% Senior Notes due 2017 for iStar Financial 5.70% Series B Senior Notes due 2014 in accordance with the exchange offer and consent solicitation issued on January 25, 2005. For each $1,000 principal amount of TriNet Notes tendered, holders received approximately $1,171 principal amount of iStar Notes. A total of $117.0 million aggregate principal amount of iStar Notes were issued. The iStar Notes issued in the exchange offer form part of the series of iStar Financial 5.70% Series B Notes due 2014 issued on March 9, 2004.

**Capital Market and Hedging Transactions** – On March 1, 2005, the Company issued $700.0 million of fixed rate 5.15% Senior Notes due 2012 and $400.0 million of Senior Floating Rate Notes due 2008 which will bear interest equal to three-month LIBOR + 0.39%. The Company used the proceeds to repay outstanding balances on its revolving credit facilities. In connection with the $700.0 million seven-year bond issuance the Company settled three forward-starting swaps that were entered into in December 2004.

## COMMON STOCK PRICE AND DIVIDENDS (UNAUDITED)

The high and low sales prices per share of Common Stock are set forth below for the periods indicated.

| Quarter Ended | High | Low |
|---|---|---|
| **2003** | | |
| March 31, 2003 | $ 29.90 | $ 27.05 |
| June 30, 2003 | $ 36.60 | $ 29.68 |
| September 30, 2003 | $ 38.95 | $ 35.00 |
| December 31, 2003 | $ 40.00 | $ 37.25 |
| **2004** | | |
| March 31, 2004 | **$42.95** | **$38.60** |
| June 30, 2004 | **$42.75** | **$34.50** |
| September 30, 2004 | **$41.23** | **$37.03** |
| December 31, 2004 | **$45.57** | **$41.32** |

On March 1, 2005, the closing sale price of the Common Stock as reported by the NYSE was $42.75. The Company had 3,236 holders of record of Common Stock as of March 1, 2005.

The following table sets forth the dividends paid or declared by the Company on its Common Stock:

| Quarter Ended | Shareholder Record Date | Dividend/Share |
|---|---|---|
| **2003**[1] | | |
| March 31, 2003 | April 15, 2003 | $ 0.6625 |
| June 30, 2003 | July 15, 2003 | $ 0.6625 |
| September 30, 2003 | October 15, 2003 | $ 0.6625 |
| December 31, 2003 | December 15, 2003 | $ 0.6625 |
| **2004**[2] | | |
| March 31, 2004 | April 15, 2004 | **$0.6975** |
| June 30, 2004 | July 15, 2004 | **$0.6975** |
| September 30, 2004 | October 15, 2004 | **$0.6975** |
| December 31, 2004 | December 15, 2004 | **$0.6975** |

**Explanatory Notes:**

(1) For tax reporting purposes, the 2003 dividends were classified as 68.90% ($1.8258) ordinary income, 2.46% ($0.0651) 20.00% capital gain, 1.90% ($0.0503) 15.00% capital gain (post May 5, 2003), 2.67% ($0.0709) 25.00% Section 1250 capital gain and 24.08% ($0.6380) return of capital for those shareholders who held shares of the Company for the entire year.

(2) For tax reporting purposes, the 2004 dividends were classified as 49.15% ($1.3713) ordinary income, 2.20% ($0.0613) 15.00% capital gain, 7.45% ($0.0278) 25.00% Section 1250 capital gain and 41.20% ($1.1496) return of capital for those shareholders who held shares of the Company for the entire year.

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## DIRECTORS

Jay Sugarman [3]
Chairman and
Chief Executive Officer,
iStar Financial Inc.

Willis Andersen, Jr. [1] [4]
Principal,
REIT Consulting Services

Robert W. Holman, Jr. [3]
Chairman and
Chief Executive Officer,
National Warehouse
Investment Company

Robin Josephs [1] [2]
President,
Ropasada, LLC

John G. McDonald [2] [4]
Stanford Investors Professor,
Stanford University
Graduate School of Business

George R. Puskar [3] [4]
Former Chairman and
Chief Executive Officer,
Equitable Real Estate
Investment Management

Jeffrey A. Weber [1] [2]
President,
York Capital Management, LP

[1] Audit Committee
[2] Compensation Committee
[3] Investment Committee
[4] Nominating and Governance Committee

## OFFICERS

Jay Sugarman
Chairman and
Chief Executive Officer

Jay S. Nydick
President

Catherine D. Rice
Chief Financial Officer

Timothy J. O'Connor
Executive Vice President and
Chief Operating Officer

Nina B. Matis
Executive Vice President and
General Counsel

Barbara Rubin
President – iStar Asset Services

## EXECUTIVE VICE PRESIDENTS

Daniel S. Abrams
Steven R. Blomquist
Roger M. Cozzi
Chase S. Curtis, Jr.
Jeffrey R. Digel
R. Michael Dorsch III
Barclay G. Jones III
H. Cabot Lodge III
Michelle M. MacKay
Andrew C. Richardson

## SENIOR VICE PRESIDENTS

Jeffrey N. Brown
Philip S. Burke
James D. Burns
Geoffrey M. Dugan
Peter K. Kofoed
John F. Kubicko
Elizabeth B. Smith
Erich J. Stiger
Colette J. Tretola
Cynthia M. Tucker

## HEADQUARTERS

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## EMPLOYEES

As of March 14, 2005, the Company had 167 employees.

## INDEPENDENT AUDITORS

PricewaterhouseCoopers LLP
New York, NY

## REGISTRAR AND TRANSFER AGENT

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P.O. Box 43069
Providence, RI 02940-3069
tel: (800) 756-8200
http://www.equiserve.com

## DIVIDEND REINVESTMENT AND DIRECT STOCK PURCHASE PLAN

Registered shareholders may reinvest dividends and may also purchase stock directly from the Company through the Company's Dividend Reinvestment and Direct Stock Purchase Plan. For more information, please call the Transfer Agent or the Company's Investor Relations Department.

## ANNUAL MEETING OF SHAREHOLDERS

May 25, 2005, 9:00 a.m. ET
Harvard Club of New York City
35 West 44 Street
New York, NY 10036

## INVESTOR INFORMATION SERVICES

iStar Financial is a listed company on the New York Stock Exchange and is traded under the ticker "SFI". The Company has submitted a Section 12(a) CEO Certification to the NYSE last year. In addition, the Company has filed with the SEC the CEO/CFO certification required under Section 302 of the Sarbanes-Oxley Act as an exhibit to our most recently filed Form 10-K.

For help with questions about the Company, or to receive additional corporate information, please contact:

## INVESTOR RELATIONS DEPARTMENT

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