# iStar Financial Annual Report **2011**

MELBOURNE, FL
MEMPHIS, TN
METAIRIE, LA
MIAMI BEACH, FL
MIAMI, FL
MILPITAS, CA
MILTON, CANADA
MILWAUKEE, WI
MOBILE, AL
MONROE, NY
MONTEGO BAY, JAMAICA
MONTEREY, CA
MOSELEY, VA
MT. LAUREL, NJ
N. MIAMI BEACH, FL
NAPLES, FL
NATIONAL CITY, CA
NEW YORK, NY
NEWARK, NJ
NEWBURY PARK, CA
NORTH HOLLYWOOD, CA
NORTH MIAMI, FL
OAKLAND, CA
OCEAN CITY, MD
OLATHE, KS
ORLANDO, FL
PALATINE, IL
PARK CITY, UT
PARSIPPANY, NJ
PEMBROKE PINES, FL
PHILADELPHIA, PA
PORTLAND, OR
PUNTA CANA, DOMINICAN REPUBLIC
RANSON, WV
RENO, NV
RICHARDSON, TX
RICHMOND HILL, CANADA
RICHMOND, CA
RIO RANCHO, NM
RIVERSIDE, CA
ROCHESTER, MN
ROSEMONT, IL
SAN ANTONIO, TX
SAN BERNARDINO, CA
SAN DIEGO, CA
SAN FRANCISCO, CA
SAN JOSE, CA
SAN PEDRO, CA
SANDY, UT
SANTA CLARITA, CA
SARASOTA, FL
SAVANNAH, GA
SCOTTSDALE, AZ
SEATTLE, WA
SEYMOUR, IN
SOUTH BEND, IN
SOUTH HOLLAND, IL
SPOKANE, WA
SPRINGFIELD, NJ
ST. AUGUSTINE, FL
ST. PETERSBURG, FL
STRONGSVILLE, OH
SUN VALLEY, ID
SUNNY ISLES, FL
SUNNYVALE, CA
SYRACUSE, NY
TACOMA, WA
TARRYTOWN, NY
TEMPE, AZ
THOUSAND OAKS, CA
TRENTON, NJ
UNITED KINGDOM
UNTERSCHLEISSHEIM, GERMANY
VACAVILLE, CA
WAIPAHU, HI
WALNUT CREEK, CA
WARRINGTON, PA
WASHINGTON, DC
WEST END, GRAND BAHAMAS ISLAND
WEST HOLLYWOOD, CA
WEST PALM BEACH, FL
WESTBOROUGH, MA
WINDSOR, CANADA

167,381
180,879
315,157
62,220
221,184
39,848
404,996
16,000
66,968
51,049
75,489
75,489
104,836
74,849
38,534
51,514
156,806
80,357
115,849
444,362
236,000
68,950
50,978
957,354
355,060
1,005,332
483,896
100,000
200,000
206,900
241,927
179,327
59,256
307,224
229,888
114,247
35,210
49,700
60,891
155,211
1,259,348

36,622
POTENTIAL FOR 88,000 HOMES
AND 7,000 MIDRISES
KEYS
MORE THAN 160,000
S.F. OF MIXED-USE
REAL ESTATE
9.8%
YIELD RETURN
ASSETS IN
STATES
23

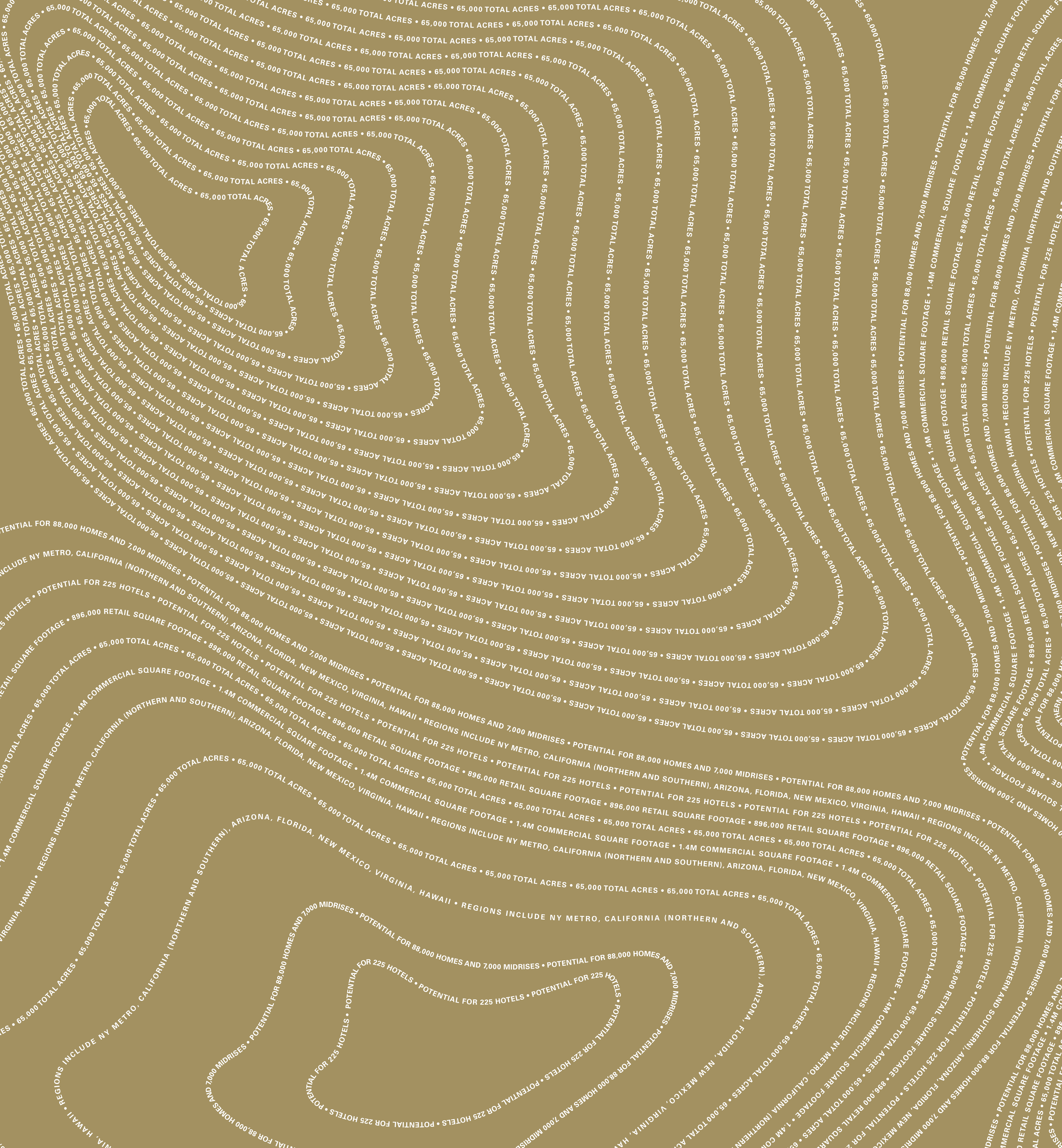
To Our Valued Investors,

2011 was another year of hard-won progress. Beginning with our $3 billion secured financing in the first quarter, and ending with significant year-over-year reductions in overall debt, lower corporate leverage levels, and reduced NPL balances and reserve costs, we saw real improvements on many fronts.

Despite this progress, challenges remain, and our share price has only recently recovered to levels achieved at the beginning of last year. Having recently closed on a new $880 million financing to put away a majority of 2012 debt maturities, we believe we have successfully cleared a path to begin exploring ways to access additional capital and to begin increasing our investment activity from the small but highly profitable base we have established over the past 24 months. There is no question we retain a valuable platform that can execute on a wide range of investment opportunities in the current market environment. With your support, we will work diligently to be in a position to capture those opportunities in the coming years.

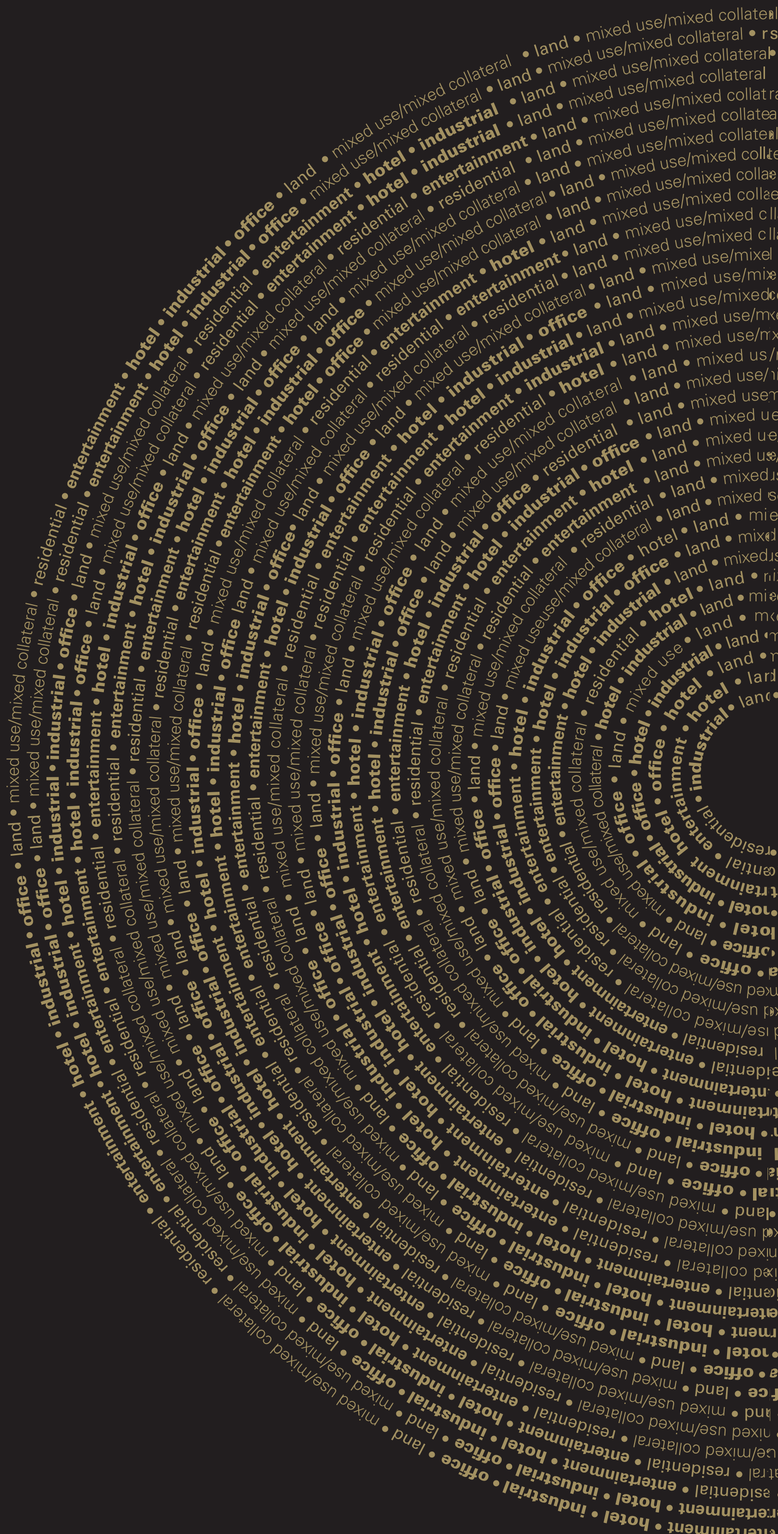
Jay Sugarman
Chairman and Chief Executive Officer

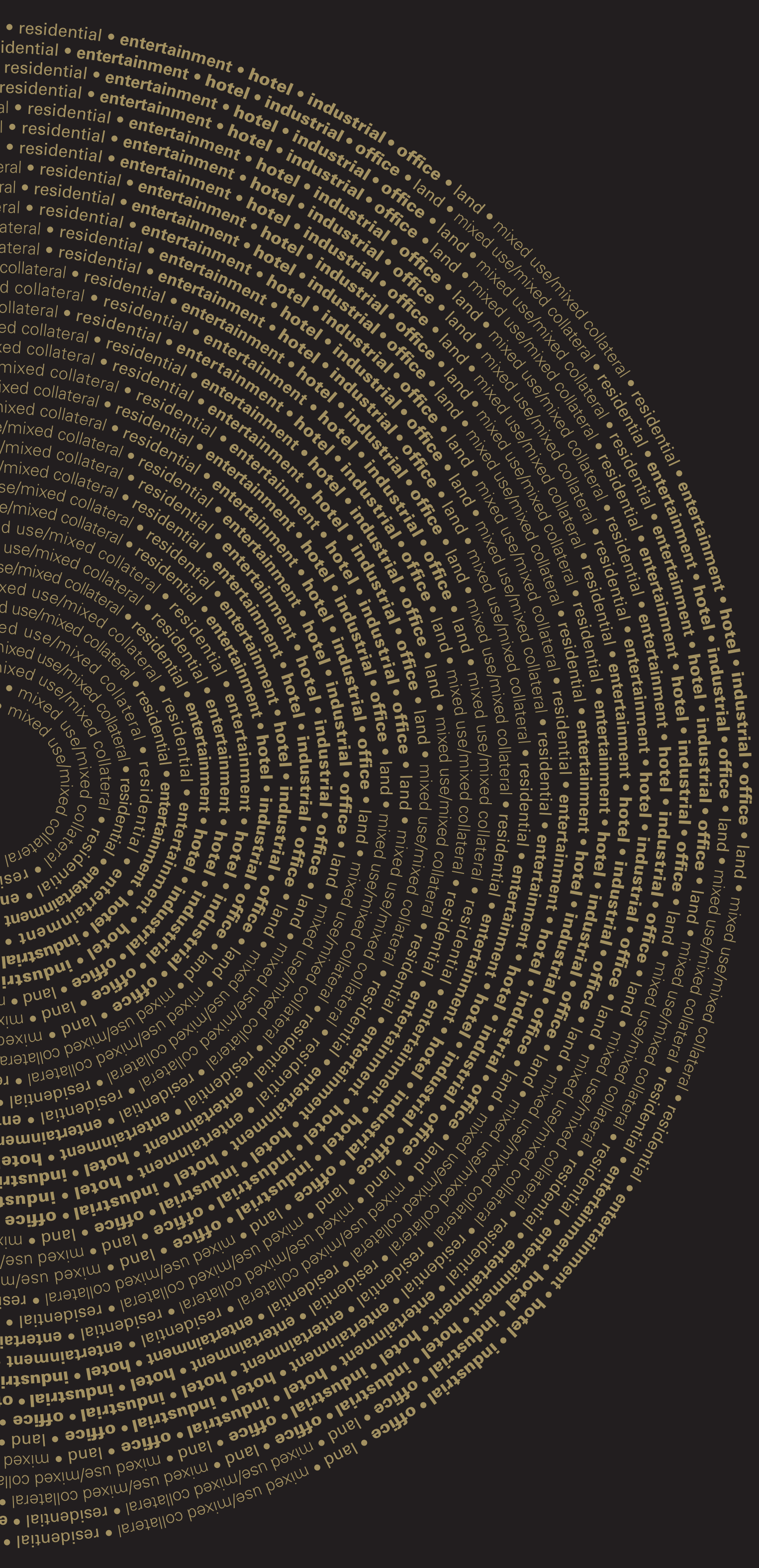
506,805 SF


65,000 TOTAL ACRES
POTENTIAL FOR 88,000 HOMES AND 7,000 MIDRISES
POTENTIAL FOR 225 HOTELS
896,000 RETAIL SQUARE FOOTAGE
1.4M COMMERCIAL SQUARE FOOTAGE
REGIONS INCLUDE NY METRO, CALIFORNIA (NORTHERN AND SOUTHERN), ARIZONA, FLORIDA, NEW MEXICO, VIRGINIA, HAWAII

# PERFORMING LOANS, NET LEASE ASSETS, STRATEGIC INVESTMENTS

Representing approximately $4.3 billion in assets, our performing loans, net lease assets and strategic investments all performed well in 2011. Performing loans generated $191 million in interest income, our net lease assets generated $165 million in rental income and our strategic investments generated $95 million in investment income. We will look to continue to find attractive opportunities in these areas that add to shareholder value.



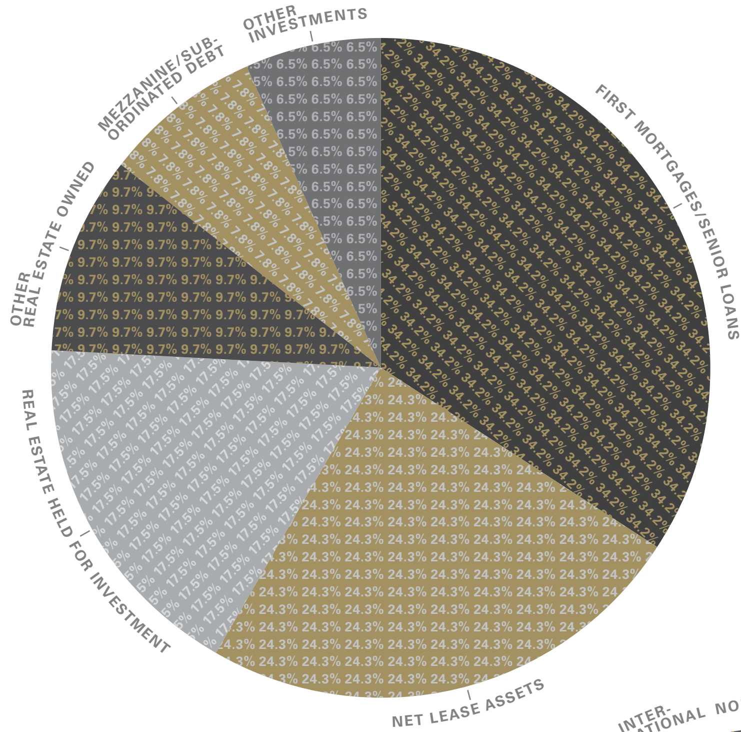



# NPLs, REOs AND DEVELOPMENT ASSETS

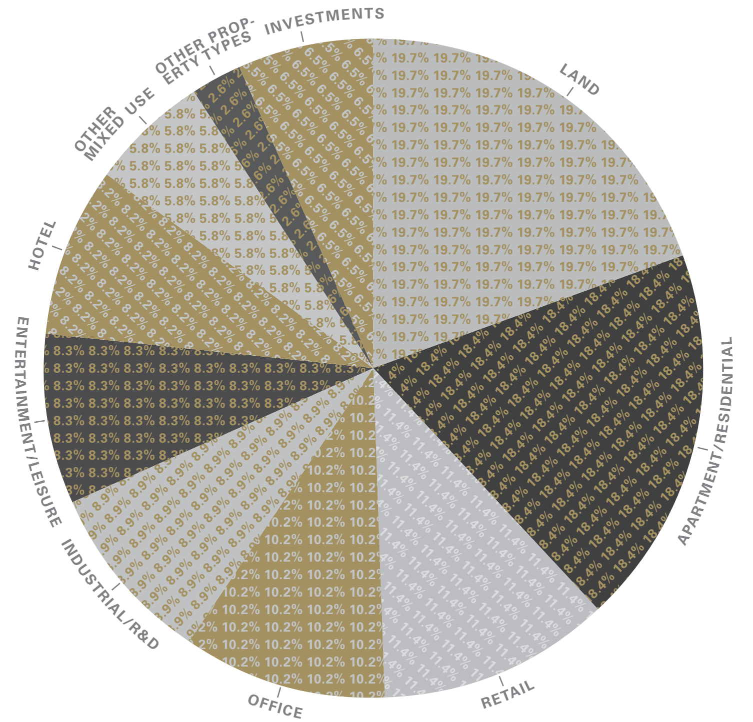
Representing approximately $2.7 billion in assets, our NPL and owned real estate portfolio, including our land development platform, will likely continue to be a cash and earnings drain on the company for the coming year. In 2011, we invested over $90 million in transitioning, repositioning and stabilizing this side of the portfolio and will continue to work to maximize the value of assets in this category. With capital flowing into the United States and into many of the sectors represented in our portfolio, we believe our strategy is the right one for the long term and will prove to be a profitable one for the Company.

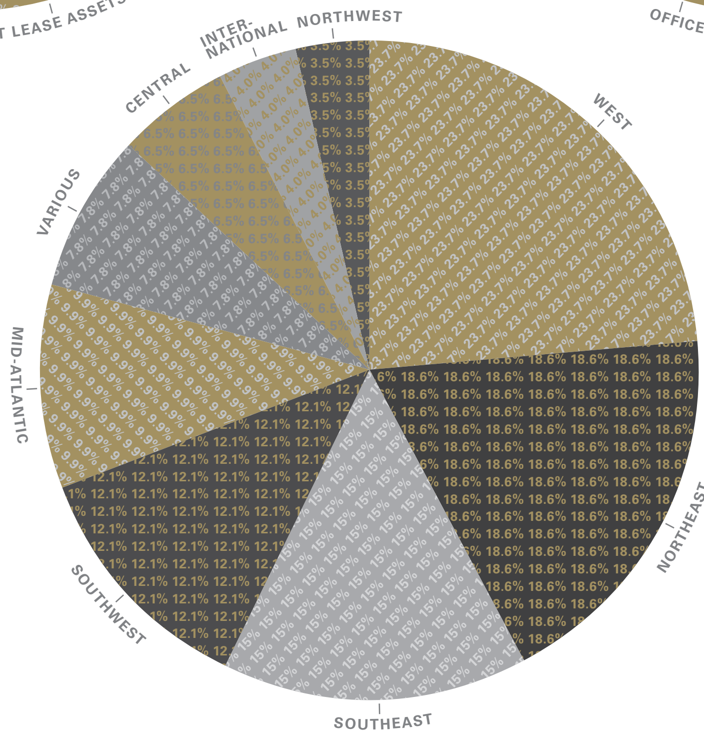
# OVER 47 MILLION SQ. FEET OF REAL ESTATE

## ASSET TYPE




## PROPERTY TYPE

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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 2011 presentation.

| For the Years Ended December 31, | | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|---|
| (In thousands, except per share data and ratios) | | | | | | |
| **Operating Data:** | | | | | | |
| Interest income | | **$ 226,871** | $ 364,094 | $ 557,809 | $ 947,661 | $ 998,008 |
| Operating lease income | | **165,040** | 164,681 | 175,225 | 176,429 | 173,265 |
| Other income | | **40,878** | 40,943 | 25,953 | 97,742 | 99,682 |
| Total revenue | | **432,789** | 569,718 | 758,987 | 1,221,832 | 1,270,955 |
| Interest expense | | **344,788** | 314,868 | 413,091 | 617,529 | 609,512 |
| Operating costs – net lease assets | | **18,439** | 14,566 | 15,799 | 15,096 | 17,947 |
| Operating costs – REHI and OREO | | **77,282** | 64,694 | 40,866 | 9,288 | 445 |
| Depreciation and amortization | | **62,619** | 61,663 | 61,643 | 59,017 | 49,222 |
| General and administrative | | **105,039** | 109,526 | 124,152 | 138,164 | 146,678 |
| Provision for loan losses | | **46,412** | 331,487 | 1,255,357 | 1,029,322 | 185,000 |
| Impairment of assets | | **22,368** | 16,319 | 126,885 | 334,830 | 144,184 |
| Other expense | | **11,070** | 16,055 | 62,329 | 14,582 | 11,352 |
| Total costs and expenses | | **688,017** | 929,178 | 2,100,122 | 2,217,828 | 1,164,340 |
| Income (loss) before earnings from equity method investments and other items | | **(255,228)** | (359,460) | (1,341,135) | (995,996) | 106,615 |
| Gain on early extinguishment of debt, net | | **101,466** | 108,923 | 547,349 | 393,131 | 225 |
| Gain on sale of joint venture interest | | **–** | – | – | 280,219 | – |
| Earnings from equity method investments | | **95,091** | 51,908 | 5,298 | 6,535 | 29,626 |
| Income (loss) from continuing operations before income taxes | | **(58,671)** | (198,629) | (788,488) | (316,111) | 136,466 |
| Income tax (expense) benefit | | **4,719** | (7,023) | (4,141) | (10,175) | (6,972) |
| Income (loss) from continuing operations | | **(53,952)** | (205,652) | (792,629) | (326,286) | 129,494 |
| Income (loss) from discontinued operations | | **(2,572)** | 15,476 | 10,356 | 53,061 | 99,276 |
| Gain from discontinued operations | | **25,110** | 270,382 | 12,426 | 91,458 | 7,832 |
| Income from sales of residential property | | **5,721** | – | – | – | – |
| Net income (loss) | | **(25,693)** | 80,206 | (769,847) | (181,767) | 236,602 |
| Net (income) loss attributable to noncontrolling interests | | **3,629** | (523) | 1,071 | 991 | 816 |
| Gain attributable to noncontrolling interests | | **–** | – | – | (22,249) | – |
| Net income (loss) attributable to iStar Financial Inc. | | **(22,064)** | 79,683 | (768,776) | (203,025) | 237,418 |
| Preferred dividends | | **(42,320)** | (42,320) | (42,320) | (42,320) | (42,320) |
| Net (income) loss allocable to HPU holders and Participating Security holders[1] | | **1,997** | (1,084) | 22,526 | 2,855 | (7,739) |
| Net income (loss) allocable to common shareholders | | **$ (62,387)** | $ 36,279 | $ (788,570) | $ (242,490) | $ 187,359 |
| Per common share data[2]: | | | | | | |
| Income (loss) attributable to iStar Financial Inc. | Basic | **$ (0.94)** | $ (2.58) | $ (8.10) | $ (2.91) | $ 0.65 |
| from continuing operations: | Diluted[3] | **$ (0.94)** | $ (2.58) | $ (8.10) | $ (2.91) | $ 0.65 |
| Net income (loss) attributable | Basic | **$ (0.70)** | $ 0.39 | $ (7.88) | $ (1.85) | $ 1.48 |
| to iStar Financial Inc.: | Diluted[3] | **$ (0.70)** | $ 0.39 | $ (7.88) | $ (1.85) | $ 1.47 |
| Per HPU share data[2]: | | | | | | |
| Income (loss) attributable to iStar Financial Inc. | Basic | **$ (179.73)** | $ (490.67) | $ (1,543.67) | $ (548.73) | $ 123.20 |
| from continuing operations: | Diluted[3] | **$ (179.73)** | $ (490.67) | $ (1,543.67) | $ (548.73) | $ 122.67 |
| Net income (loss) attributable | Basic | **$ (133.13)** | $ 72.27 | $ (1,501.73) | $ (349.87) | $ 279.53 |
| to iStar Financial Inc.: | Diluted[3] | **$ (133.13)** | $ 72.27 | $ (1,501.73) | $ (349.87) | $ 278.07 |
| Dividends declared per common share[4] | | **–** | – | – | $ 1.74 | $ 3.60 |
| **Supplemental Data:** | | | | | | |
| Adjusted EBITDA[6][7] | | **$ 376,464** | $ 768,815 | $ 686,267 | $1,592,422 | $ 1,318,833 |
| Ratio of Adjusted EBITDA to interest expense and preferred dividends[5][6] | | **1.0x** | 2.0x | 1.3x | 2.2x | 2.0x |
| Ratio of earnings to fixed charges[7][8] | | **–** | – | – | – | 1.2x |
| Ratio of earnings to fixed charges and preferred dividends[8] | | **–** | – | – | – | 1.2x |
| Weighted average common shares outstanding – basic | | **88,688** | 93,244 | 100,071 | 131,153 | 126,801 |
| Weighted average common shares outstanding – diluted | | **88,688** | 93,244 | 100,071 | 131,153 | 127,542 |
| Weighted average HPU shares outstanding – basic and diluted | | **15** | 15 | 15 | 15 | 15 |
| Cash flows from: | | | | | | |
| Operating activities | | **$ (31,785)** | $ (47,396) | $ 77,795 | $ 418,529 | $ 561,337 |
| Investing activities | | **$ 1,471,429** | $ 3,738,823 | $ 724,702 | $ (27,943) | $(4,745,080) |
| Financing activities | | **$(1,587,683)** | $(3,411,194) | $(1,074,402) | $ 1,444 | $ 4,182,299 |

| As of December 31, | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| (In thousands) | | | | | |
| **Balance Sheet Data:** | | | | | |
| Loans and other lending investments, net | **$2,860,762** | $4,587,352 | $ 7,661,562 | $10,586,644 | $10,949,354 |
| Net lease assets, net | **$1,702,764** | $1,784,509 | $ 2,885,896 | $ 3,044,811 | $ 3,309,866 |
| Real estate held-for-investment, net | **$1,228,134** | $ 833,060 | $ 422,664 | $ – | $ – |
| Other real estate owned | **$ 677,458** | $ 746,081 | $ 839,141 | $ 242,505 | $ – |
| Total assets | **$7,517,837** | $9,174,514 | $12,810,575 | $15,296,748 | $15,848,298 |
| Debt obligations, net | **$5,837,540** | $7,345,433 | $10,894,903 | $12,486,404 | $12,363,044 |
| Total equity | **$1,573,604** | $1,694,659 | $ 1,656,118 | $ 2,446,662 | $ 2,972,170 |

**Explanatory Notes:**

(1) HPU holders are current and former Company employees who purchased high performance common stock units under the Company's High Performance Unit Program. Participating Security holders are Company employees and directors who hold unvested restricted stock units and common stock equivalents granted under the Company's Long Term Incentive Plans.

(2) See Note 14 of the Notes to Consolidated Financial Statements.

(3) For the year ended December 31, 2007, net income used to calculate earnings per diluted common share and HPU share includes joint venture income of $85.

(4) The Company has not declared or paid a common dividend since the quarter ended June 30, 2008. In December of 2007, the Company declared a special $0.25 common dividend, in addition to its regular quarterly dividends, due to higher taxable income generated as a result of the Company's acquisition of Fremont CRE.

(5) Adjusted EBITDA should be examined in conjunction with net income (loss) as shown in the Company's Consolidated Statements of Operations. Adjusted EBITDA should not be considered as an alternative to net income (loss) (determined in accordance with GAAP) as an indicator of 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 Adjusted EBITDA indicative of funds available to fund the Company's cash needs or available for distribution to shareholders. Rather, Adjusted EBITDA is an additional measure for the Company to use to analyze how its business is performing. In addition, in calculating its ratio of Adjusted EBITDA to interest expense and preferred stock dividends, the Company makes adjustments for impairments of assets and provisions for loan losses because they are significant non-cash items and the Company believes that investors may find it useful to consider the Company's coverage of its interest and preferred dividend payments without the effect of these non-cash items, as an additional measure to earnings to fixed charges. It should be noted that the Company's manner of calculating Adjusted EBITDA may differ from the calculations of similarly-titled measures by other companies.

(6) Adjusted EBITDA is calculated as net income (loss) plus the sum of interest expense, income taxes, depreciation and amortization, provision for loan losses, impairment of assets, stock-based compensation expense and less the gain on early extinguishment of debt, net.

| For the Years Ended December 31, | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| (In thousands) | | | | | |
| Net Income (loss) | **$ (25,693)** | $ 80,206 | $ (769,847) | $ (181,767) | $ 236,602 |
| Add: Interest expense[1] | **345,914** | 346,500 | 481,116 | 666,706 | 629,272 |
| Add: Income tax expense (benefit) | **(4,719)** | 7,023 | 4,141 | 10,175 | 6,972 |
| Add: Depreciation and amortization[2] | **63,928** | 70,786 | 98,238 | 102,745 | 99,427 |
| Add: Provision for loan losses | **46,412** | 331,487 | 1,255,357 | 1,029,322 | 185,000 |
| Add: Impairment of assets[3] | **22,386** | 22,381 | 141,018 | 334,830 | 144,184 |
| Add: Stock-based compensation expense | **29,702** | 19,355 | 23,593 | 23,542 | 17,601 |
| Less: Gain on early extinguishment of debt, net | **$(101,466)** | $(108,923) | $ (547,349) | $ (393,131) | $ (225) |
| Adjusted EBITDA[4] | **$ 376,464** | $ 768,815 | $ 686,267 | $1,592,422 | $1,318,833 |

**Explanatory Notes:**

(1) For the years ended December 31, 2011, 2010, 2009, 2008 and 2007, interest expense includes $1,126, $31,632, $68,025, $49,177 and $19,760, respectively, of interest expense reclassified to discontinued operations.

(2) For the years ended December 31, 2011, 2010, 2009, 2008 and 2007, depreciation and amortization includes $1,309, $9,122, $37,645, $42,426 and $45,145, respectively, of depreciation and amortization reclassified to discontinued operations.

(3) For the years ended December 31, 2011, 2010 and 2009, impairment of assets includes $18, $6,063 and $14,133, of impairment of assets reclassified to discontinued operations.

(4) Prior period presentation has been restated to conform to current period presentation.

(7) This ratio of earnings to fixed charges is calculated in accordance with SEC Regulation S-K Item 503. The Company's unsecured debt securities have a fixed charge coverage covenant which is calculated differently in accordance with the terms of the agreements.

(8) For the years ended December 31, 2011, 2010, 2009 and 2008, earnings were not sufficient to cover fixed charges by $68,784, $218,353, $757,283 and $276,951, respectively, and earnings were not sufficient to cover fixed charges and preferred dividends by $111,104, $260,673, $799,603 and $319,271, respectively.

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

This discussion summarizes the significant factors affecting our consolidated operating results, financial condition and liquidity during the three-year period ended December 31, 2011. This discussion should be read in conjunction with our consolidated financial statements and related notes for the three-year period ended December 31, 2011 included elsewhere in this Annual Report. These historical financial statements may not be indicative of our future performance. We reclassified certain items in our consolidated financial statements of prior years to conform to our current year's presentation.

## Introduction

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

The lending portfolio is primarily comprised of senior and mezzanine real estate loans that typically range in size from $20 million to $150 million and have original terms generally ranging from three to ten years. These loans may be either fixed-rate (based on the U.S. Treasury rate plus a spread) or variable-rate (based on LIBOR plus a spread) and are structured to meet the specific financing needs of borrowers. Our portfolio also includes senior and subordinated loans to corporations, particularly those engaged in real estate or real estate related businesses. These financings may be either secured or unsecured, typically range in size from $20 million to $150 million and have initial maturities generally ranging from three to ten years. Our loan portfolio includes whole loans, loan participations and debt securities.

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

Our real estate investment portfolio includes real estate held-for-investment ("REHI") and other real estate owned ("OREO") properties primarily acquired through foreclosure or through deed-in-lieu of foreclosure in full or partial satisfaction of non-performing loans. Through the infusion of capital and/or intensive asset management, we generally seek to reposition and redevelop these assets with the objective of maximizing their value. We have developed significant expertise in the ownership and repositioning of multifamily, condominium, master planned and development properties.

Our primary sources of revenues are interest income, which is the interest that borrowers pay on loans, and operating lease income, which is the rent that corporate customers pay to lease our properties. We primarily generate income through the "spread" or "margin," which is the difference between the revenues generated from loans and leases and interest expense and the cost of net lease operations. Going forward, we also expect to earn income from our other real estate investments. Income from real estate investments may include operating revenues as well as income from sales of properties either in bulk or through unit sales. This income will be reduced by holding costs while the real estate investments are redeveloped, repositioned and eventually sold.

## Executive Overview

The recent economic recession adversely affected our business, resulting in significant provisions for loan losses and impairments, increasing amounts of non-performing loans, higher financing costs and an inability to access the unsecured debt markets. During the recession and continuing through 2011, we focused on resolving non-performing assets, generating liquidity, retiring debt, decreasing leverage and preserving shareholder value. In furtherance of these objectives, in 2011 we completed $2.96 billion of secured debt refinancing transactions, which enabled us to meet our debt maturities and improve our debt maturity profile, though at a higher cost of capital. In addition, we generated $1.74 billion of liquidity from the portfolio and used the proceeds primarily to retire debt and reduce leverage. We made meaningful progress in resolving problem assets, primarily evidenced by reductions in our non-performing loans and a significantly lower provision for loan losses. While we continue to incur significant costs repositioning and developing our OREO/REHI assets, we believe that these investments should enhance the value of these assets and improve our ultimate returns. Additionally, we maintained book value per common share, which increased slightly from the prior year. In the coming year we intend to continue to focus on preserving shareholder value by resolving non-performing assets, strengthening the balance sheet through reduced leverage and better alignment of our asset and liability profile, and investing in our OREO/REHI portfolio.

For the year ended December 31, 2011, we recorded a net loss of $22.1 million. Although this was a decrease from $79.6 million of net income in 2010, the results in 2010 included $270.4 million in gains primarily related to the sale of a large net lease asset portfolio as compared to $25.1 million of such gains in the current year. The provision for loan losses decreased to $46.4 million in 2011 from $331.5 million in 2010, which resulted primarily from a reduction in non-performing loans. Our 2011 results also benefited from a $43.2 million increase in income from equity method investments, due primarily to the sale of our interest in Oak Hill Advisors and a full year of earnings from our investment in LNR, and the redemption of a series of senior secured notes, which resulted in a one-time gain of $109.0 million.

During the year, non-performing loans decreased to $771.2 million as of December 31, 2011, compared to $1.35 billion at December 31, 2010. In some cases these loans were sold or modified and in many cases we took possession of properties serving as collateral for these loans through foreclosure or deed-in-lieu of foreclosure. These foreclosed assets constitute the majority of our real estate investment portfolio, which has increased to $1.91 billion as of December 31, 2011, from $1.58 billion at the end of 2010. The overall increase in this portfolio was driven primarily by new REHI assets that we took title to during the year, offset by net reductions in OREO due to asset sales. We generally seek to reposition and redevelop assets within this portfolio through the infusion of capital and/or intensive asset management, with the objective of maximizing their value. While we work on repositioning and redeveloping these assets, we expect to continue to incur significant costs. These costs, net of REHI revenues, totaled $42.0 million in 2011 and $41.5 million in 2010.

During the year ended December 31, 2011, we generated a total of $1.74 billion in proceeds from our portfolio, comprised of $1.21 billion in loan principal repayments and $534.6 million from asset sales. These proceeds were used in part to reduce our debt obligations by $1.51 billion. In March 2011, we entered into a $2.95 billion senior secured credit facility and used the proceeds to repay approximately $2.62 billion of outstanding borrowings under our existing secured credit facilities, which were due to mature in June 2011 and June 2012, and approximately $300.0 million of unsecured debt. Additionally, we funded a total of $216.3 million in new and pre-existing investments. The new investments we made in 2011 were primarily sourced from our existing portfolio. We believe that making additional investments in assets within our portfolio may present more attractive risk-adjusted return opportunities than are otherwise available in the market, due to our existing relationships with the customers and knowledge of the assets.

As of December 31, 2011, we had approximately $1.60 billion of debt maturing and minimum required amortization payments due on or before December 31, 2012. Of this amount, $211.6 million represents the minimum amortization payable by December 31, 2012 under the Secured Credit Facility, which is collateralized by assets with a carrying value of $3.08 billion. We expect to use proceeds from repayments and sales of the pledged collateral to meet these amortization payments. The remaining $1.38 billion of maturities represent unsecured debt that is scheduled to mature during 2012, including $263.5 million in March, $336.5 million in June and $784.8 million in October.

As of December 31, 2011, we had unrestricted cash of $356.8 million and other unencumbered assets with a carrying value of $3.69 billion. Our capital sources to meet our unsecured debt maturities in the coming year will primarily include debt refinancings, proceeds from asset sales and loan repayments from borrowers, and may include equity capital raising transactions. We believe that proceeds from these activities will be sufficient to meet our obligations during the remainder of the year; however, the timing and amounts of proceeds from expected asset repayments and sales, and our ability to consummate debt refinancing and equity capital raising transactions are subject to factors outside of our control and cannot be predicted with certainty. As discussed further in "Liquidity and Capital Resources" below, our plans are dynamic and we may adjust our plans in response to changes in our expectations and changes in market conditions.

On February 28, 2012, we announced the launch of a syndication of up to $900.0 million in new senior secured credit facilities. We expect the facilities to be comprised of two tranches, maturing in 2016 and 2017, with differing interest rates. Outstanding borrowings under the facilities will be collateralized by a pool of diversified collateral, including loans, net lease assets and other real estate assets. The proceeds from the new credit facilities will be used to refinance our 2012 unsecured debt maturities. We are in the process of syndicating the new facilities and there can be no assurance that we will be successful in our efforts to complete the syndication.

## Results of Operations for the Year Ended December 31, 2011 compared to the Year Ended December 31, 2010

| | 2011 | 2010 | $ Change | % Change |
|---|---|---|---|---|
| (In thousands) | | | | |
| Interest income | **$226,871** | $364,094 | $(137,223) | (38)% |
| Operating lease income | **165,040** | 164,681 | 359 | –% |
| Other income | **40,878** | 40,943 | (65) | –% |
| Total revenue | **432,789** | 569,718 | (136,929) | (24)% |
| Interest expense | **344,788** | 314,868 | 29,920 | 10% |
| Operating costs – net lease assets | **18,439** | 14,566 | 3,873 | 27% |
| Operating costs – REHI and OREO | **77,282** | 64,694 | 12,588 | 19% |
| Depreciation and amortization | **62,619** | 61,663 | 956 | 2% |
| General and administrative | **105,039** | 109,526 | (4,487) | (4)% |
| Provision for loan losses | **46,412** | 331,487 | (285,075) | (86)% |
| Impairment of assets | **22,368** | 16,319 | 6,049 | 37% |
| Other expense | **11,070** | 16,055 | (4,985) | (31)% |
| Total costs and expenses | **688,017** | 929,178 | (241,161) | (26)% |
| Gain on early extinguishment of debt, net | **101,466** | 108,923 | (7,457) | (7)% |
| Earnings from equity method investments | **95,091** | 51,908 | 43,183 | 83% |
| Income tax (expense) benefit | **4,719** | (7,023) | 11,742 | >(100)% |
| Income (loss) from discontinued operations | **(2,572)** | 15,476 | (18,048) | >(100)% |
| Gain from discontinued operations | **25,110** | 270,382 | (245,272) | (91)% |
| Income from sales of residential property | **5,721** | – | 5,721 | 100% |
| Net income (loss) | **$ (25,693)** | $ 80,206 | $(105,899) | >(100)% |

**Revenue** – The decrease in interest income is primarily due to a decline in the average balance of performing loans to $2.58 billion for the year ended December 31, 2011 from $3.92 billion for the year ended December 31, 2010. The decrease in performing loans was primarily due to loan repayments and sales as well as performing loans moving to non-performing status (see Risk Management below). For the year ended December 31, 2011, performing loans generated a weighted average effective yield of 7.20% as compared to 7.85% in 2010. The decrease was partially offset by $26.3 million of interest income recorded during the year ended December 31, 2011, related to certain non-performing loans that were resolved, including interest not previously recorded due to the loans being on non-accrual status.

Within our other income, revenue from REHI assets increased to $35.3 million in 2011 from $23.1 million in 2010 due to additional REHI assets acquired during the last 12 months. During the year ended December 31, 2011, we received title to properties in full or partial satisfaction of non-performing loans of which $396.2 million were classified as REHI. This increase in other income was almost entirely offset by lower loan prepayment fees received in the current year.

**Costs and expenses** – Our total costs and expenses were impacted most significantly by lower provisions for loan losses. The decline in our provisions for loan losses primarily resulted from fewer loans moving to non-performing status and a lower overall balance of non-performing loans during the year ended December 31, 2011 as compared to 2010. Additionally, repayments and sales of performing loans resulted in a lower portfolio balance leading to a reduction in the required general loan loss reserve. (See Risk Management below.)

General and administrative expenses decreased primarily due to lower payroll and employee related costs from both staffing reductions and reduced annual cash compensation offset by additional stock-based compensation expense resulting from the modification of our December 19, 2008 restricted stock units. See Note 13 of the Notes to Consolidated Financial Statements for further details on the modification of the December 19, 2008 awards. Excluding stock-based compensation expense, general and administrative expense declined by $14.8 million or 16.5% from the prior year.

Other expense decreased during the year primarily due to lower legal fees and other unreimbursed expenses incurred relating to loans in our portfolio.

Offsetting these declines in expenses was an increase in interest expense. Interest expense increased primarily due to higher interest rates on our Secured Credit Facility entered into during 2011, partially offset by lower average outstanding borrowings. Our weighted average effective cost of debt increased to 5.24% for the year ended December 31, 2011 as compared to 3.73% during 2010. The average outstanding balance of our debt declined to $6.51 billion for the year ended December 31, 2011 from $9.16 billion for the year ended December 31, 2010.

Operating costs for REHI and OREO were greater in 2011 than in 2010 due to an increase in the number of properties held in the current year. The increase in operating costs for net lease assets was primarily due to an increase in bad debt expense and lease expirations, offset by new lease commencements.

Impairments of assets for the year ended December 31, 2011 primarily consisted of $20.8 million of impairments on OREO assets. For the year ended December 31, 2010, impairment of assets primarily included $19.1 million of impairments on OREO assets. Impairments in both periods were due to changes in market conditions.

**Gain on early extinguishment of debt, net –** During the year ended December 31, 2011, we fully redeemed our $312.3 million remaining principal amount of 10% senior secured notes due June 2014, which resulted in a $109.0 million gain on early extinguishment of debt. This was offset by losses on extinguishment of debt related to the acceleration of unamortized deferred fees and debt discount resulting from accelerated repayments of our secured credit facilities, including the Tranche A-1 facility.

During the same period in 2010, we retired $633.0 million par value of our senior secured and unsecured notes and we redeemed $282.3 million of senior secured notes. Together, these transactions resulted in an aggregate gain on early extinguishment of debt of $131.0 million. These gains were offset by $22.1 million of losses resulting from the acceleration of unamortized deferred fees and debt discount in connection with the prepayments of our $1.0 billion First Priority Credit Agreement, which was due to mature in 2012, and our $947.9 million non-recourse secured term loan and another secured term loan that were collateralized by net lease assets we sold during the period.

**Earnings from equity method investments –** The increase in earnings from equity method investments was primarily attributable to the sale of our interests in Oak Hill Advisors, L.P. and related entities as well as a full year of earnings from our investment in LNR. In October 2011, we sold a substantial portion of our interests in Oak Hill Advisors, L.P. and related entities and recorded a pre-tax gain of $30.3 million. Prior to the sale in October of 2011, we recorded $8.5 million of earnings from our investments in the Oak Hill entities that were sold during the year ended December 31, 2011. We also recorded a full year of earnings from our investment in LNR, which was $52.1 million higher than our partial year earnings in the prior year when the investment was made. During the year ended December 31, 2011, our share of earnings from LNR included $19.2 million of nonrecurring income from the settlement of tax liabilities. These increases in earnings were partially offset by losses and lower returns recorded by certain of our strategic investments, primarily due to weaker market performance as compared to 2010.

**Income tax (expense) benefit –** The income tax benefit recorded during the year ended December 31, 2011 was comprised of $13.7 million of deferred tax benefit offset by $9.0 million of current tax expense related to taxable income generated by assets held in our taxable REIT subsidiaries ("TRS"). TRS entities generated income subject to tax of $75.8 million for the year ended December 31, 2011, including the gain on the sale of our investment in Oak Hill Advisors, L.P. This income was offset by the utilization of net operating loss carryforwards of $54.8 million which reduced our current tax expense by $20.0 million, to $9.0 million for the year. The $13.7 million non-cash deferred tax benefit was due to the reversal of a deferred tax liability related to a difference in investment basis for our Oak Hill investments that were sold in October of 2011.

**Discontinued operations –** During the year ended December 31, 2011, we sold net lease assets with an aggregate carrying value of $34.4 million resulting in a net gain of $2.9 million. In 2011, we also resolved a contingent obligation related to the 2010 portfolio sale of 32 net lease assets, resulting in a gain of $22.2 million (see Note 6 of the Notes to Consolidated Financial Statements). During the same period in 2010, we sold net lease assets, including a portfolio of 32 net lease assets, and recognized an aggregate initial gain of $270.4 million.

Income (loss) from discontinued operations includes operating results from net lease assets sold prior to December 31, 2011. We sold net lease assets with an aggregate carrying value of $34.4 million during 2011 compared to $1.17 billion during 2010, which included the sale of a portfolio of 32 net lease assets.

**Income from sales of residential property –** During the year ended December 31, 2011, we also sold OREO assets with a carrying value of $176.5 million. A portion of these were sales of residential property units from which we recorded income of $5.7 million.

## Results of Operations for the Year Ended December 31, 2010 compared to the Year Ended December 31, 2009

| (in thousands) | 2010 | 2009 | $ Change | % Change |
|---|---|---|---|---|
| Interest income | $364,094 | $ 557,809 | $ (193,715) | (35)% |
| Operating lease income | 164,681 | 175,225 | (10,544) | (6)% |
| Other income | 40,943 | 25,953 | 14,990 | 58% |
| Total revenue | 569,718 | 758,987 | (189,269) | (25)% |
| Interest expense | 314,868 | 413,091 | (98,223) | (24)% |
| Operating costs – net lease assets | 14,566 | 15,799 | (1,233) | (8)% |
| Operating costs – REHI and OREO | 64,694 | 40,866 | 23,828 | 58% |
| Depreciation and amortization | 61,663 | 61,643 | 20 | –% |
| General and administrative | 109,526 | 124,152 | (14,626) | (12)% |
| Provision for loan losses | 331,487 | 1,255,357 | (923,870) | (74)% |
| Impairment of assets | 16,319 | 126,885 | (110,566) | (87)% |
| Other expense | 16,055 | 62,329 | (46,274) | (74)% |
| Total costs and expenses | 929,178 | 2,100,122 | (1,170,944) | (56)% |
| Gain on early extinguishment of debt, net | 108,923 | 547,349 | (438,426) | (80)% |
| Earnings from equity method investments | 51,908 | 5,298 | 46,610 | >100% |
| Income tax (expense) benefit | (7,023) | (4,141) | (2,882) | 70% |
| Income (loss) from discontinued operations | 15,476 | 10,356 | 5,120 | 49% |
| Gain from discontinued operations | 270,382 | 12,426 | 257,956 | >100% |
| Net income (loss) | $ 80,206 | $ (769,847) | $ 850,053 | >100% |

**Revenue** – The decrease in interest income is primarily a result of a decline in the balance of performing loans to $3.37 billion at December 31, 2010 from $4.91 billion at December 31, 2009. The decline in performing loans was primarily driven by loan repayments and note sales as well as loans moving to non-performing status. (See Risk Management below).

Operating lease income from net lease assets decreased primarily due to a slight decrease in tenant occupancy rates and lower rent received as a result of lease restructurings.

Offsetting these declines in revenue was an increase in other income primarily driven by an increase in operating revenue from REHI assets and loan prepayment fees received. Revenue from REHI assets increased to $23.1 million in 2010 from $5.8 million in 2009 due to the increase in real estate assets held-for-investment.

**Costs and expenses** – Total costs and expenses decreased primarily due to lower provisions for loan losses. The decline in our provision for loan losses was primarily due to fewer loans moving to non-performing status during the year ended December 31, 2010 as compared to the same period in 2009. The decrease in loans moving to non-performing status during the year can be attributed to a smaller overall loan portfolio and improving economic conditions and credit environment. Additionally, loan repayments and sales have led to a smaller performing loan asset base, which has resulted in a reduction in the required general loan loss reserve. (See Risk Management below.)

Impairment of assets for the year ended December 31, 2010 primarily consisted of $19.1 million of impairments on OREO assets. Asset impairments in 2009 were significantly higher due to declining real estate values and distressed economic conditions. These impairments included $78.6 million of impairments on OREO assets, $19.1 on net lease assets, $12.6 million on investment securities and $12.2 million on equity investments.

Interest expense decreased primarily due to the repayment and retirement of debt during the last 12 months as well as the exchange of senior unsecured notes for new second-lien senior secured notes completed in May 2009. The average outstanding balance of our debt declined to $9.16 billion at December 31, 2010 from $11.66 billion at December 31, 2009. In addition, the weighted average interest rate on outstanding debt decreased to 3.73% for the year ended December 31, 2010 from 4.07% during the same period in 2009 primarily due to the repayment of higher rate debt obligations.

Other expense was lower primarily due to a $42.4 million charge incurred in 2009 pursuant to a settlement agreement under which we terminated a long-term lease for new headquarters space and settled all disputes with the landlord.

The decrease in general and administrative expense was primarily due to $5.9 million of rent expense incurred during the year ended December 31, 2009 relating to a lease for new headquarters space which was terminated in May 2009. Stock-based compensation expense also declined by $4.2 million primarily due to amortization of newer stock awards with lower values than those granted in prior years.

The increase in operating costs for REHI and OREO was primarily due to the increase in the number of assets held during 2010 as compared to in 2009.

**Gain on early extinguishment of debt, net –** During 2010, we retired $633.0 million par value of our senior secured and unsecured notes and we redeemed $282.3 million of senior secured notes. Together, these transactions resulted in an aggregate gain on early extinguishment of debt of $131.0 million. These gains were offset by $22.1 million associated with accelerating the unamortized deferred financing costs and other costs incurred in connection with the prepayments of our $1.00 billion First Priority Credit Agreement, which was due to mature in June 2012, and our $947.9 million non-recourse secured term loan and another secured term loan that were each collateralized by net lease assets we sold during the period.

During 2009, we retired $1.31 billion par value of our senior unsecured notes at discounts to par and recognized $439.4 million in gain on early extinguishment of debt. Additionally, we completed our secured note exchange transactions and purchased $12.5 million of our outstanding senior floating rates notes in a cash tender offer, which resulted in an aggregate net gain on early extinguishment of debt of $107.9 million.

**Earnings from equity method investments –** The increase in earnings from equity method investments was primarily attributable to better overall market performance that affected our strategic investments in 2010 as compared to 2009. In addition, during 2009 we recorded a $9.4 million non-cash out of period charge to recognize losses from an equity method investment as a result of additional depreciation expense that should have been recorded at the equity method entity in prior periods.

**Discontinued operations –** During the year ended December 31, 2010, we sold net lease assets, including a portfolio of 32 net lease assets, and recognized aggregate gains of $270.4 million. During the year ended December 31, 2009, we sold four net lease assets and recognized aggregate gains of $12.4 million.

Income (loss) from discontinued operations includes the operating results from those net lease assets sold during the period. Income (loss) from discontinued operations in 2009 included the net income from net lease assets sold offset by $14.4 million of impairments on those sold assets.

## Adjusted EBITDA

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

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

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

| For the Years Ended December 31, | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| (In thousands) | | | | | |
| Adjusted EBITDA | | | | | |
| Net income (loss) | **$ (25,693)** | $ 80,206 | $ (769,847) | $ (181,767) | $ 236,602 |
| Add: Interest expense[1] | **345,914** | 346,500 | 481,116 | 666,706 | 629,272 |
| Add: Income tax expense (benefit) | **(4,719)** | 7,023 | 4,141 | 10,175 | 6,972 |
| Add: Depreciation and amortization[2] | **63,928** | 70,786 | 98,238 | 102,745 | 99,427 |
| Add: Provision for loan losses | **46,412** | 331,487 | 1,255,357 | 1,029,322 | 185,000 |
| Add: Impairment of assets[3] | **22,386** | 22,381 | 141,018 | 334,830 | 144,184 |
| Add: Stock-based compensation expense | **29,702** | 19,355 | 23,593 | 23,542 | 17,601 |
| Less: (Gain) loss on early extinguishment of debt, net | **(101,466)** | (108,923) | (547,349) | (393,131) | (225) |
| Adjusted EBITDA[4] | **$ 376,464** | $ 768,815 | $ 686,267 | $1,592,422 | $1,318,833 |

**Explanatory Notes:**

(1) For the years ended December 31, 2011, 2010, 2009, 2008 and 2007, interest expense includes $1,126, $31,632, $68,025, $49,177 and $19,760, respectively, of interest expense reclassified to discontinued operations.

(2) For the years ended December 31, 2011, 2010, 2009, 2008 and 2007, depreciation and amortization includes $1,309, $9,122, $37,645, $42,426 and $45,145, respectively, of depreciation and amortization reclassified to discontinued operations.

(3) For the years ended December 31, 2011, 2010 and 2009, impairment of assets includes $18, $6,063 and $14,133, of impairment of assets reclassified to discontinued operations.

(4) Prior period presentation has been restated to conform to current period presentation.

## Risk Management

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

| As of December 31, | 2011 | 2010 |
|---|---|---|
| **Non-performing loans** | | |
| Carrying value[1] | **$771,196** | $1,351,410 |
| As a percentage of total carrying value of loans | **27.1%** | 29.6% |
| **Watch list loans** | | |
| Carrying value | **$136,006** | $ 190,553 |
| As a percentage of total carrying value of loans | **4.8%** | 4.2% |
| **Reserve for loan losses** | | |
| Total reserve for loan losses | **$646,624** | $ 814,625 |
| As a percentage of total loans before loan loss reserves | **18.5%** | 15.1% |
| Non-performing loan asset-specific reserves for loan losses | **$557,129** | $ 667,779 |
| As a percentage of gross carrying value of non-performing loans | **41.9%** | 33.1% |

**Explanatory Note:**

(1) As of December 31, 2011 and 2010, carrying values of non-performing loans are net of asset-specific reserves for loan losses of $557.1 million and $667.8 million, respectively.

**Non-Performing Loans –** We designate loans as non-performing at such time as: (1) the loan becomes 90 days delinquent; (2) the loan has a maturity default; or (3) management determines it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan. All non-performing loans are placed on non-accrual status and income is only recognized in certain cases upon actual cash receipt. As of December 31, 2011, we had non-performing loans with an aggregate carrying value of $771.2 million. Our non-performing loans decreased during the year ended December 31, 2011, primarily due to transfers of non-performing loans to REHI and OREO as well as sales and repayments.

**Watch List Loans –** During our quarterly loan portfolio assessments, loans are put on the watch list if deteriorating performance indicates they warrant a higher degree of monitoring and senior management attention. As of December 31, 2011, we had loans on the watch list (excluding non-performing loans) with an aggregate carrying value of $136.0 million.

**Reserve for Loan Losses –** The reserve for loan losses was $646.6 million as of December 31, 2011, or 18.5% of the gross carrying value of total loans, compared to $814.6 million or 15.1% at December 31, 2010. The change in the balance of the reserve was the result of $46.4 million of provisioning for loan losses, reduced by $214.4 million of charge-offs during the year ended December 31, 2011. Due to the continued volatility of the commercial real estate market, the process of estimating collateral values and reserves continues to require us to use significant judgment. We currently believe there is adequate collateral and reserves to support the carrying values of the loans.

The reserve for loan losses includes an asset-specific component and a formula-based component. An asset-specific reserve is established for an impaired loan when the estimated fair value of the loan's collateral less costs to sell is lower than the carrying value of the loan. As of December 31, 2011, asset-specific reserves decreased to $573.1 million compared to $694.4 million at December 31, 2010, primarily due to charge-offs on assets that were sold or transferred to REHI and OREO. The decrease was partially offset by impairments on new non-performing loans.

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

The general reserve was $73.5 million or 3.4% of the gross carrying value of performing loans as of December 31, 2011, compared to $120.2 million or 3.6% of the gross carrying value of performing loans at December 31, 2010. The decrease in the balance of the general reserve was primarily due to the decrease in performing loans outstanding to $2.16 billion as of December 31, 2011 from $3.37 billion as of December 31, 2010. The reduction in general reserves as a percentage of performing loans outstanding was primarily attributable to an improvement in the weighted average risk ratings of performing loans outstanding to 3.29 at the end of the current period compared to 3.51 as of December 31, 2010.

**Real Estate Held-for-Investment, net and Other Real Estate Owned –** REHI and OREO consist of properties acquired through foreclosure or by deed-in-lieu of foreclosure in full or partial satisfaction of non-performing loans. Properties are designated as REHI or OREO depending on our strategic plan to realize the maximum value from the collateral received. When we intend to hold, operate or develop the property for a period of at least 12 months, assets are classified as REHI, and when we intend to market these properties for sale in the near term, assets are classified as OREO. As of December 31, 2011 we had $1.23 billion of assets classified as REHI and $677.5 million as OREO. During the year ended December 31, 2011, we recorded impairment charges of $20.8 million on OREO assets due to changing market conditions. The continued volatility of the commercial real estate market requires us to use significant judgment in estimating fair values of REHI and OREO properties at the time of transfer and thereafter when events or circumstances indicate there may be a potential impairment. Additionally, we will continue to incur holding and operating costs related to REHI and OREO assets while they are being marketed for sale or redeveloped and repositioned. The aggregate net operating and holding costs for REHI and OREO assets was $42.0 million for the year ended December 31, 2011.

**Risk concentrations –** As of December 31, 2011, our total investment portfolio was comprised of the following property/collateral types ($ in thousands)[(1)]:

| Property/Collateral Types | Performing Loans | Net Lease Assets | Non-performing Loans | REHI | OREO | Total | % of Total |
|---|---|---|---|---|---|---|---|
| Land | $ 206,550 | $ 56,014 | $211,164 | $ 782,766 | $119,004 | $1,375,498 | 19.7% |
| Apartment/Residential | 549,471 | – | 292,740 | 41,076 | 402,983 | 1,286,270 | 18.4% |
| Retail | 356,823 | 158,762 | 68,483 | 154,406 | 58,379 | 796,853 | 11.4% |
| Office | 116,527 | 490,106 | 36,901 | 71,148 | 2,616 | 717,298 | 10.2% |
| Industrial/R&D | 87,853 | 478,322 | 7,836 | 48,789 | 1,100 | 623,900 | 8.9% |
| Entertainment/Leisure | 78,231 | 424,794 | 79,581 | – | 479 | 583,085 | 8.3% |
| Hotel | 352,777 | 94,766 | 68,270 | 42,285 | 16,049 | 574,147 | 8.2% |
| Mixed Use/Mixed Collateral | 238,943 | – | – | 87,664 | 76,848 | 403,455 | 5.8% |
| Other property types | 175,891 | – | 6,221 | – | – | 182,112 | 2.6% |
| Other Investments | – | – | – | – | – | 457,835 | 6.5% |
| Total | $2,163,066 | $1,702,764 | $771,196 | $1,228,134 | $677,458 | $7,000,453 | 100.0% |

**Explanatory Note:**

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

As of December 31, 2011, our total investment portfolio had the following characteristics by geographical region ($ in thousands):

**Explanatory Note:**

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

Concentrations of credit risks arise when a number of borrowers or customers related to our 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 us, to be similarly affected by changes in economic conditions. We monitor various segments of our portfolio to assess potential concentrations of credit risks. We believe the current portfolio is reasonably well diversified and does not contain any significant concentration of credit risks.

Substantially all of our net lease, REHI and OREO assets, as well as assets collateralizing our loans and other lending investments are located in the United States, with California 15.3% and Florida 11.0% representing the only significant concentrations (greater than 10.0%) as of December 31, 2011. Our portfolio contains significant concentrations in the following asset types as of December 31, 2011: land 19.7%, apartment/residential 18.4%, retail 11.4% and office 10.2%.

We underwrite the credit of prospective borrowers and customers and often require them to provide some form of credit support such as corporate guarantees, letters of credit and/or cash security deposits. Although our loans and other lending investments, net lease, REHI and OREO assets are geographically diverse and the borrowers and customers operate in a variety of industries, to the extent we have 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 us. As of December 31, 2011, our five largest borrowers or tenants of net lease assets collectively accounted for approximately 22.4% of our aggregate annualized interest and operating lease revenue, of which no single customer accounts for more than 8.0%.

## Liquidity and Capital Resources

In March 2011, we entered into a $2.95 billion senior secured credit facility and used the proceeds to repay $2.62 billion of outstanding borrowings under existing secured credit facilities, which were due to mature in June 2011 and 2012, and approximately $300.0 million of unsecured debt. During the year ended December 31, 2011, we generated a total of $1.74 billion in proceeds from our portfolio, including $1.21 billion in loan principal repayments and $534.6 million from asset sales. With these proceeds, we have reduced our outstanding debt obligations to $5.84 billion as of December 31, 2011 from $7.35 billion at the prior year end. This includes repayments of $538.4 million, as of December 31, 2011, on the A-1 Tranche of the senior secured credit facility which exceeds the $450.0 million minimum amortization requirement due to be paid on or before June 30, 2012 and leaves $211.6 million to be paid on or before December 31, 2012. During the year, we repurchased 12.3 million shares of common stock for $78.5 million. In addition, we funded a total of $216.3 million of investments and paid preferred dividends totaling $42.3 million during the year ended December 31, 2011.

As of December 31, 2011, we had approximately $1.60 billion of debt maturing and minimum required amortization payments due on or before December 31, 2012. Of this amount, $211.6 million represents the minimum amortization payable by December 31, 2012 under the Secured Credit Facility, which is collateralized by assets with a carrying value of $3.08 billion. We expect to use proceeds from repayments and sales of the pledged collateral to meet these amortization payments. The remaining $1.38 billion of maturing debt represents unsecured debt that is scheduled to mature during 2012 as follows ($ in thousands):

| Maturity Date | Amount Due |
|---|---|
| March 2012 | $263,466 |
| June 2012 | $336,495 |
| October 2012 | $784,750 |

As of December 31, 2011, we had unrestricted cash of $356.8 million and other unencumbered assets with a carrying value of $3.69 billion. Our capital sources to meet our unsecured debt maturities in the coming year will primarily include debt refinancings, proceeds from asset sales and loan repayments from borrowers, and may include equity capital raising transactions. We have identified unencumbered assets with a carrying value of approximately $1.5 billion that we will use either as collateral for secured refinancings or will sell strategically during the year ending December 31, 2012. We currently expect that the majority of such asset sales would occur during the second half of 2012. Based upon the dynamic nature of our assets and our liquidity plan and the time frame in which we need to generate liquidity, the specific assets, nature of the transactions, timing and amount of asset sales and refinancing transactions could vary. We may also encounter difficulty in finding buyers of assets or executing capital raising strategies on acceptable terms in a timely manner, which could impact our ability to make scheduled repayments on our outstanding debt. However, given our unencumbered assets base and current market conditions, we believe that we have several options that can be reasonably and timely executed to enable us to repay our debt obligations during 2012 as they come due.

The timing and amounts of proceeds from expected asset repayments and sales, and our ability to consummate debt refinancing and equity capital raising transactions are subject to factors outside our control and cannot be predicted with certainty. Our plans are dynamic and we may adjust our plans in response to changes in our expectations and changes in market conditions. In addition, although there were early signs of improvement in the commercial real estate and credit markets beginning in 2010 and in 2011, such markets remain volatile and it is not possible for us to predict whether these trends will continue in the future or quantify the impact of these or other trends on our financial results. If we fail to repay our obligations as they become due, it would be an event of default under the relevant debt instruments, which could result in a cross-default and acceleration of our other outstanding debt obligations, all of which would have a material adverse effect on our business.

**Contractual Obligations –** The following table outlines the contractual obligations related to our long-term debt agreements and operating lease obligations as of December 31, 2011 (see Note 9 of the Notes to Consolidated Financial Statements).

| | Principal and Interest Payments Due by Period | | | | | |
|---|---|---|---|---|---|---|
| | Total | Less Than 1 Year | 2-3 Years[1] | 4-5 Years | 6-10 Years | After 10 Years |
| (In thousands) | | | | | | |
| **Long-Term Debt Obligations:** | | | | | | |
| Secured credit facilities | $2,411,580 | $ 211,580 | $2,200,000 | $ – | $ – | $ – |
| Unsecured notes | 2,041,010 | 356,310 | 1,217,810 | 367,168 | 99,722 | – |
| Convertible notes | 784,750 | 784,750 | – | – | – | – |
| Unsecured revolving credit facilities | 243,650 | 243,650 | – | – | – | – |
| Secured term loans | 293,193 | – | 105,063 | – | 161,912 | 26,218 |
| Other debt obligations | 100,000 | – | – | – | – | 100,000 |
| Total principal maturities | 5,874,183 | 1,596,290 | 3,522,873 | 367,168 | 261,634 | 126,218 |
| **Interest Payable**[2] | 762,427 | 303,586 | 320,940 | 60,685 | 46,537 | 30,679 |
| **Operating Lease Obligations** | 37,017 | 5,522 | 9,439 | 8,665 | 13,391 | – |
| Total[3] | $6,673,627 | $1,905,398 | $3,853,252 | $436,518 | $321,562 | $156,897 |

**Explanatory Notes:**

(1) Future long-term debt obligations due during the years ending December 31, 2013 and 2014 are $1.97 billion and $1.55 billion, respectively.

(2) All variable-rate debt assumes a 30-day LIBOR rate of 0.30% (the 30-day LIBOR rate at December 30, 2011).

(3) We also have issued letters of credit totaling $12.7 million in connection with six of our investments. See Unfunded Commitments below, for a discussion of certain unfunded commitments related to our lending and net lease businesses.

**Secured Credit Facility –** In March 2011, we entered into a new $2.95 billion Secured Credit Facility comprised of a $1.50 billion term loan facility bearing interest at a rate of LIBOR plus 3.75% and maturing in June 2013 (the "Tranche A-1 Facility") and a $1.45 billion term loan facility bearing interest at a rate of LIBOR plus 5.75% maturing in June 2014 (the "Tranche A-2 Facility"), together the "Secured Credit Facility." Both tranches include a LIBOR floor of 1.25%. The Tranche A-1 Facility and Tranche A-2 Facility were issued at discounts to par of 1.0% and 1.5%, respectively. Proceeds from the Secured Credit Facility were used to fully repay the $1.67 billion and $0.9 billion outstanding under

our secured credit facilities, which were due to mature in June 2011 and June 2012, respectively, and to repay $175.0 million of our unsecured credit facilities due in June 2011. The remaining proceeds were used to repay other unsecured debt maturing in the first half of 2011.

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

During the year ended December 31, 2011, we used proceeds from principal repayments and sales of collateral to repay $538.4 million of the Tranche A-1 Facility. These repayments exceeded the $450.0 million cumulative amortization required to be paid by June 30, 2012, leaving $211.6 million to be paid on or before December 31, 2012. Repayments of the facility prior to scheduled amortization dates have resulted in losses on early extinguishment of debt of $12.0 million for the year ended December 31, 2011, related to the acceleration of discounts and unamortized deferred financing fees on the portion of the facility that was repaid.

During the year ended December 31, 2011, we received $9.1 million pursuant to an agreement with a holder of our previously outstanding secured credit facilities. The amount effectively reduced the par value that was repaid to the debtholder and was accounted for under ASC 470-60, resulting in $3.7 million being recognized during the year ended December 31, 2011, as a gain on extinguishment of debt. As the same lender participated in the new Secured Credit Facility, the remaining amount was recorded as a premium to that facility and will serve to reduce a portion of future interest expense as it is amortized through its maturity.

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

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

In March 2011, we refinanced the $47.7 million outstanding principal balance of a maturing secured term loan. In addition, during June 2011, we entered into an additional $4.6 million secured term loan. These loans bear interest at LIBOR + 4.50%, mature in 2014 and are cross-collateralized by the same net lease assets. Simultaneously with the financings, we entered into interest rate swaps to exchange the variable rates on the notes for fixed interest rates (see Note 12 of the Notes to Consolidated Financial Statements).

**Secured Notes –** In January 2011, we fully redeemed the $312.3 million remaining principal balance of our 10% 2014 Notes and recorded a gain on early extinguishment of debt of $109.0 million primarily related to the recognition of the deferred gain premiums that resulted from the exchange.

**Unsecured Notes –** During the year ended December 31, 2011, we repaid, upon maturity, the $170.4 million outstanding principal balance of our 5.65% senior unsecured notes, the $96.9 million outstanding principal balance of our 5.125% senior unsecured notes and the $107.8 million outstanding principal balance of our 5.80% senior unsecured notes. In addition, during the year ended December 31, 2011, we repurchased $97.2 million par value of our senior unsecured notes with various maturities ranging from September 2011 to October 2012. In connection with these repurchases, we recorded an aggregate gain on early extinguishment of debt of $0.8 million for the year ended December 31, 2011.

**Unencumbered/Encumbered Assets –** As of December 31, 2011, we had unencumbered assets, including cash, with a gross carrying value of $4.68 billion, gross of $707.3 million of accumulated depreciation and loan loss reserves, and encumbered assets with a carrying value of $3.53 billion. The carrying value of our encumbered assets by asset type is as follows ($ in thousands):

| As of December 31, | 2011 | 2010 |
|---|---|---|
| Loans and other lending investments, net | **$1,786,449** | $2,832,184 |
| Net lease assets, net | **1,173,978** | 1,021,783 |
| REHI, net | **359,597** | 28,376 |
| OREO | **177,005** | 232,150 |
| Other investments | **37,957** | – |
| Total | **$3,534,986** | $4,114,493 |

**Debt Covenants –** Our outstanding unsecured debt securities contain corporate level covenants that include a covenant to maintain a ratio of unencumbered assets to unsecured indebtedness of at least 1.2x and a restriction on debt incurrence based upon the effect of the debt incurrence on our fixed charge coverage. If any of our covenants are breached and not cured within applicable cure periods, the breach could result in acceleration of our debt securities unless a waiver or modification is agreed upon with the requisite percentage of the bondholders. While we expect that our ability to incur new indebtedness under the fixed charge coverage ratio will be limited for the foreseeable future, we will continue to be permitted to incur indebtedness for the purpose of refinancing existing indebtedness and for other permitted purposes under the indentures.

Our Secured Credit Facility contains certain covenants, including covenants relating to collateral coverage, dividend payments, restrictions on fundamental changes, transactions with affiliates, matters relating to the liens granted to the lenders and the delivery of information to the lenders. In particular, we are required to maintain collateral

coverage of 1.25x outstanding borrowings. In addition, for so long as we maintain our qualification as a REIT, the Secured Credit Facility permits us to distribute 100% of our REIT taxable income on an annual basis. We may not pay common dividends if we cease to qualify as a REIT.

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

**Derivatives –** Our use of derivative financial instruments is primarily limited to the utilization of interest rate hedges or other instruments to manage interest rate risk exposure and foreign exchange hedges to manage our risk to changes in foreign currencies. The principal objectives of such hedges are to minimize the risks and/or costs associated with our operating and financial structure and to manage our exposure to foreign exchange rate movements. As a result of the repayment of our secured credit facilities in March 2011 a portion of our multi-currency borrowing capacity was extinguished. Accordingly, upon repayment of the facilities we simultaneously entered into foreign currency hedges to manage our exposure on foreign denominated investment assets. See Note 12 of the Notes to Consolidated Financial Statements.

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

**Unfunded Commitments –** We generally fund construction and development loans and build-outs of space in net lease assets over a period of time if and when the borrowers and tenants meet established milestones and other performance criteria. We refer to these arrangements as Performance-Based Commitments. In addition, we sometimes establish a maximum amount of additional funding which we will make available to a borrower or tenant for an expansion or addition to a project if we approve of the expansion or addition in our sole discretion. We refer to these arrangements as Discretionary Fundings. Finally, we have committed to invest capital in several real estate funds and other ventures. These arrangements are referred to as Strategic Investments. As of December 31, 2011, the maximum amounts of the fundings we may make under each category, assuming all performance hurdles and milestones are met under the Performance-Based Commitments, that we approve all Discretionary Fundings and that 100% of our capital committed to Strategic Investments is drawn down, are as follows (in thousands):

| | Loans | Net Lease Assets | Strategic Investments | Total |
|---|---|---|---|---|
| Performance-Based Commitments | $ 53,266 | $14,054 | $ – | $ 67,320 |
| Discretionary Fundings | 128,029 | – | – | 128,029 |
| Other | – | – | 24,340 | 24,340 |
| Total | $181,295 | $14,054 | $24,340 | $219,689 |

**Transactions with Related Parties –** In October 2011, we sold a substantial portion of our interests in Oak Hill Advisors, L.P. and related entities for $183.7 million of net cash proceeds, which resulted in a net gain of $30.3 million. Additionally, prior to the sale we recorded $8.5 million of earnings from these investments for the year ended December 31, 2011. Both the gain and earnings are included in "Earnings from equity method investments" on our Consolidated Statements of Operations. The transaction was completed in part through sales of interests to unrelated third parties and in part through redemption of interests by principals of Oak Hill Advisors, L.P., including Glenn R. August. Mr. August serves as a member of our Board of Directors and is also the president and senior partner of Oak Hill Advisors, L.P. In conjunction with the sale of our interests in Oak Hill Advisors, L.P., we retained interests in our share of certain unearned incentive fees of various funds. These fees are contingent on the future performance of the funds and we will recognize income related to these fees if and when the amounts are realized.

As of December 31, 2011, we had investments in noncontrolling interests of Oak Hill funds, which were not included in the sale, with a carrying value of $58.7 million. Mr. August holds an investment in these same entities. We recorded equity in earnings from these investments of $1.5 million for the year ended December 31, 2011.

We have an equity interest of approximately 24% in LNR Property Corporation ("LNR") and two of our executive officers serve on LNR's board of managers. During the year ended December 31, 2010, we executed the discounted payoff of a $25.0 million principal value loan with LNR for which we received proceeds of $24.5 million in full repayment.

**Stock Repurchase Program –** On August 8, 2011, our Board of Directors approved a stock repurchase program that authorized the repurchase of up to $65.0 million of our Common Stock from time to time in open market and privately negotiated purchases, including pursuant to one or more trading plans. When aggregated with the $14.1 million remaining authorization from previous repurchase programs, we had $79.1 million of our Common Stock available for repurchases during the year ended December 31, 2011.

During the year ended December 31, 2011, we repurchased 12.3 million shares of our outstanding Common Stock for approximately $78.5 million, at an average cost of $6.43 per share, and repurchases were recorded at cost. As of December 31, 2011, we had $0.6 million of Common Stock available to repurchase under our Board authorized stock repurchase programs.

## Critical Accounting Estimates

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

During 2011, management reviewed and evaluated these critical accounting estimates and believes they are appropriate. Our significant accounting policies are described in Note 3 of the Notes to Consolidated Financial Statements. The following is a summary of accounting policies that require more significant management estimates and judgments:

**Reserve for Loan Losses –** The reserve for loan losses reflects management's estimate of loan losses inherent in the loan portfolio as of the balance sheet date. The reserve is increased through the "Provision for loan losses" on our Consolidated Statements of Operations and is decreased by charge-offs when losses are confirmed through the receipt of assets such as cash in a pre-foreclosure sale or via ownership control of the underlying collateral in full satisfaction of the loan upon foreclosure or when significant collection efforts have ceased. We have determined we have one portfolio segment, represented by commercial real estate lending, whereby we utilize a uniform process for determining our reserves for loan losses. The reserve for loan losses includes a general, formula-based component and an asset-specific component.

The general reserve component covers performing loans and reserves for loan losses are recorded when (i) available information as of each balance sheet date indicates that it is probable a loss has occurred in the portfolio and (ii) the amount of the loss can be reasonably estimated. The formula-based general reserve is derived from estimated principal default probabilities and loss severities applied to groups of loans based upon risk ratings assigned to loans with similar risk characteristics during our quarterly loan portfolio assessment. During this assessment, we perform a comprehensive analysis of our loan portfolio and assign risk ratings to loans that incorporate management's current judgments about their credit quality based on all known and relevant internal and external factors that may affect collectability. We consider, among other things, payment status, lien position, borrower financial resources and investment in collateral, collateral type, project economics and geographical location as well as national and regional economic factors. This methodology results in loans being segmented by risk classification into risk rating categories that are associated with estimated probabilities of default and principal loss. Ratings range from "1" to "5" with "1" representing the lowest risk of loss and "5" representing the highest risk of loss. We estimate loss rates based on historical realized losses experienced within our portfolio and take into account current economic conditions affecting the commercial real estate market when establishing appropriate time frames to evaluate loss experience.

The asset-specific reserve component relates to reserves for losses on impaired loans. We consider a loan to be impaired when, based upon current information and events, we believe that it is probable that we will be unable to collect all amounts due under the contractual terms of the loan agreement. This assessment is made on a loan-by-loan basis each quarter based on such factors as payment status, lien position, borrower financial resources and investment in collateral, collateral type, project economics and geographical location as well as national and regional economic factors. A reserve is established for an impaired loan when the present value of payments expected to be received, observable market prices, or the estimated fair value of the collateral (for loans that are dependent on the collateral for repayment) is lower than the carrying value of that loan.

Substantially all of our impaired loans are collateral dependent and impairment is measured using the estimated fair value of collateral, less costs to sell. We generally use the income approach through internally developed valuation models to estimate the fair value of the collateral for such loans. In more limited cases, we obtain external "as is" appraisals for loan collateral, generally when third party participations exist. Valuations are performed or obtained at the time a loan is determined to be impaired and designated non-performing, and they are updated if circumstances indicate that a significant change in value has occurred. In limited cases, appraised values may be discounted when real estate markets rapidly deteriorate.

A loan is also considered impaired if its terms are modified in a troubled debt restructuring ("TDR"). A TDR occurs when we grant a concession and the debtor is experiencing financial difficulties. Impairments on TDR loans are generally measured based on the present value of expected future cash flows discounted at the effective interest rate of the original loan.

The provisions for loan losses for the years ended December 31, 2011, 2010 and 2009 were $46.4 million, $331.5 million and $1.26 billion, respectively. The total reserve for loan losses at December 31, 2011 and 2010, included asset specific reserves of $573.1 million and $694.4 million, respectively, and general reserves of $73.5 million and $120.2 million, respectively.

**Impairment of Available-for-Sale and Held-to-Maturity Debt Securities –** For held-to-maturity and available-for-sale debt securities held in "Loans and other lending investments, net" management evaluates whether the asset is other-than-temporarily impaired when the fair market value is below carrying value. We consider debt securities other-than-temporarily impaired if (1) we have the intent to sell the security, (2) it is more likely than not that we will be required to sell the security before recovery, or (3) we do not expect to recover the entire amortized cost basis of the security. If it is determined that an other-than-temporary impairment exists, the portion related to credit losses, where we do not expect to recover our entire amortized cost basis, will be recognized as an "Impairment of assets" on our Consolidated Statements of Operations. If we do not intend to sell the security and it is more likely than not that we will not be required to sell the security, but the security has suffered a credit loss, the impairment charge will be separated. The credit loss component of the impairment will be recorded as an

"Impairment of assets" on our Consolidated Statements of Operations, and the remainder will be recorded in "Accumulated other comprehensive income (loss)" on our Consolidated Balance Sheets.

During the year ended December 31, 2009, we determined that unrealized credit related losses on certain held-to-maturity and available-for-sale debt securities were other-than-temporary and recorded impairment charges totaling $11.7 million, in "Impairment of assets" on the Consolidated Statements of Operations.

**Real Estate Held-for-Investment, Net and Other Real Estate Owned –** REHI and OREO consist of properties acquired through foreclosure or by deed-in-lieu of foreclosure in full or partial satisfaction of non-performing loans. Properties are designated as REHI or OREO depending on our strategic plan to realize the maximum value from the collateral received. When we intend to hold, operate or develop the property for a period of at least 12 months, assets are classified as REHI, and when we intend to market these properties for sale in the near term, assets are classified as OREO.

REHI assets are initially recorded at their estimated fair value. The excess of the carrying value of the loan over the fair value of the property is charged-off against the reserve for loan losses when title to the property is obtained. Upon acquisition, tangible and intangible assets and liabilities acquired are recorded at their estimated fair values. We consider REHI assets to be long-lived and periodically review them for impairment in value whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Impairment of REHI assets is measured in the same manner as long-lived assets as described below.

OREO assets are recorded at the estimated fair value less costs to sell. The excess of the carrying value of the loan over the fair value of the property less estimated costs to sell is charged-off against the reserve for loan losses when title to the property is obtained.

We review the recoverability of an OREO asset's carrying value when events or circumstances indicate a potential impairment of a property's value. If impairment exists a loss is recorded to the extent that the carrying value exceeds the estimated fair value of the property less cost to sell.

During the years ended December 31, 2011, 2010 and 2009, we received titles to properties in satisfaction of senior mortgage loans with cumulative gross carrying values of $617.8 million, $1.41 billion and $1.88 billion, respectively, for which those properties had served as collateral, and recorded charge-offs totaling $115.3 million, $631.9 million and $573.6 million, respectively, related to these loans. Subsequent to taking title to the properties, we determined certain OREO assets were impaired due to changing market conditions, and recorded impairment charges of $20.8 million, $19.1 million and $78.6 million during the years ended December 31, 2011, 2010 and 2009, respectively.

**Long-Lived Assets Impairment Test –** Net lease assets to be disposed of are reported at the lower of their carrying amount or estimated fair value less costs to sell and are included in "Assets held for sale" on our Consolidated Balance Sheets. The difference between the estimated fair value less costs to sell and the carrying value will be recorded as an impairment charge and included in "Income (loss) from discontinued operations" on the Consolidated Statements of Operations. Once the asset is classified as held for sale, depreciation expense is no longer recorded and historical operating results are reclassified to "Income (loss) from discontinued operations" on the Consolidated Statements of Operations.

We periodically review long-lived assets to be held and used for impairment in value whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. A held for use long-lived asset's value is impaired only if management's estimate of the aggregate future cash flows (undiscounted and without interest charges) to be generated by the asset (taking into account the anticipated holding period of the asset) is less than the carrying value. Such estimate of cash flows considers factors such as expected future operating income, trends and prospects, as well as the effects of demand, competition and other economic factors. To the extent impairment has occurred, the loss will be measured as the excess of the carrying amount of the property over the fair value of the asset and reflected as an adjustment to the basis of the asset. Impairments of net lease and REHI assets are recorded in "Impairment of assets," on our Consolidated Statements of Operations.

During the years ended December 31, 2010 and 2009, we recorded impairment charges on net lease assets of $6.1 million and $33.5 million, respectively, due to changes in market conditions, of which $6.1 million and $14.1 million, respectively, were included in "Income (loss) from discontinued operations."

**Identified Intangible Assets and Goodwill –** We record intangible assets acquired at their estimated fair values separate and apart from goodwill. We determine whether such intangible assets have finite or indefinite lives. As of December 31, 2011, all such acquired intangible assets have finite lives. We amortize finite lived intangible assets based on the period over which the assets are expected to contribute directly or indirectly to the future cash flows of the business acquired. We review finite lived intangible assets for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. If we determine the carrying value of an intangible asset is not recoverable we will record an impairment charge to the extent its carrying value exceeds its estimated fair value. Impairments of intangibles are recorded in "Impairment of assets" on our Consolidated Statements of Operations.

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

**Valuation of Deferred Tax Assets –** Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, as well as operating loss and tax credit carryforwards. We evaluate the realizability of our deferred tax assets and recognize a valuation allowance if, based on the available evidence, both positive and negative, it is more likely than not that some portion or all of our deferred tax assets will not be realized. When evaluating the realizability of our deferred tax assets, we consider, among other matters, estimates of expected future taxable income, nature of current and cumulative losses, existing and projected book/tax differences, tax planning strategies available, and the general and industry specific economic outlook. This realizability analysis is inherently subjective, as it requires us to forecast our business and general economic environment in future periods. Changes in estimate of deferred tax asset realizability, if any are included in "Income tax (expense) benefit" on the Consolidated Statements of Operations.

Based on our assessment of all factors, we determined that a valuation allowance of $50.9 million was required on our deferred tax assets as of December 31, 2011.

**Consolidation – Variable Interest Entities –** We evaluate our investments and other contractual arrangements to determine if our interests constitute variable interests in a variable interest entity ("VIE") and if we are the primary beneficiary. There is a significant amount of judgment required to determine if an entity is considered a VIE and if we are the primary beneficiary. We first perform a qualitative analysis, which requires certain subjective decisions regarding our assessment, including, but not limited to, which interests create or absorb variability, contractual terms, the key decision making powers, either impact on the VIE's economic performance and related party relationships. An iterative quantitative analysis is required if our qualitative analysis proves inconclusive as to whether the entity is a VIE or we are the primary beneficiary and consolidation is required.

**Fair Value of Assets and Liabilities –** The degree of management judgment involved in determining the fair value of assets and liabilities is dependent upon the availability of quoted market prices or observable market parameters. For financial and nonfinancial assets and liabilities that trade actively and have quoted market prices or observable market parameters, there is minimal subjectivity involved in measuring fair value. When observable market prices and parameters are not fully available, management judgment is necessary to estimate fair value. In addition, changes in market conditions may reduce the availability of quoted prices or observable data. For example, reduced liquidity in the capital markets or changes in secondary market activities could result in observable market inputs becoming unavailable. Therefore, when market data is not available, we would use valuation techniques requiring more management judgment to estimate the appropriate fair value measurement.

See Note 16 of the Notes to Consolidated Financial Statements for a complete discussion on how we determine fair value of financial and non-financial assets and financial liabilities and the related measurement techniques and estimates involved.

### New Accounting Pronouncements

For a discussion of the impact of new accounting pronouncements on our financial condition or results of operations, see Note 3 of the Notes to 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 our business plan, the primary market risk to which we are exposed is interest rate risk. Our operating results will depend in part on the difference between the interest and related income earned on our assets and the interest expense incurred in connection with our interest-bearing liabilities. Changes in the general level of interest rates prevailing in the financial markets will affect the spread between our interest-earning assets and interest-bearing liabilities subject to the impact of interest rate floors and caps, as well as the amounts of floating rate assets and liabilities. Any significant compression of the spreads between interest-earning assets and interest-bearing liabilities could have a material adverse effect on us.

In the event of a significant rising interest rate environment or further economic downturn, defaults could increase and cause us to incur additional credit losses which would adversely affect our liquidity and operating results. Such delinquencies or defaults would likely have an adverse effect on the spreads between interest-earning assets and interest-bearing liabilities. In addition, an increase in interest rates could, among other things, reduce the value of our fixed-rate interest-bearing assets and our ability to realize gains from the sale of such assets.

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 our control. We monitor the spreads between our interest-earning assets and interest-bearing liabilities and may implement hedging strategies to limit the effects of changes in interest rates on our operations, including engaging in interest rate swaps and other interest rate-related derivative contracts. Such strategies are designed to reduce our exposure, on specific transactions or on a portfolio basis, to changes in cash flows as a result of interest rate movements in the market. We do not enter into derivative contracts for speculative purposes or as a hedge against changes in our credit risk or the credit risk of our borrowers.

While a REIT may utilize derivative instruments to hedge interest rate risk on its liabilities incurred to acquire or carry real estate assets without generating non-qualifying income, use of derivatives for other purposes will generate non-qualified income for REIT income test purposes. This includes hedging asset related risks such as credit, foreign exchange and prepayment or interest rate exposure on our loan assets. As a result our ability to hedge these types of risks is limited. There can be no assurance that our profitability will not be adversely affected during any period as a result of changing interest rates.

The following table quantifies the potential changes in net investment income should interest rates increase by 50 or 100 basis points and decrease by 10 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 and earnings from equity method investments, less interest expense and operating costs on net lease assets for the year ended December 31, 2011. The base interest rate scenario assumes the one-month LIBOR rate of 0.30% as of December 31, 2011. Actual results could differ significantly from those estimated in the table.

**Estimated Percentage Change in Net Investment Income**

| Change in Interest Rates | Net Investment Income[1] |
|---|---|
| –10 Basis Points[1] | 0.02% |
| Base Interest Rate | –% |
| +50 Basis Points | (0.09)% |
| +100 Basis Points | (1.00)% |

**Explanatory Note:**

(1) We have a net variable-rate debt exposure resulting in an increase in net investment income when rates decrease and a decrease in net investment income when rates increase. In addition, interest rate floors on certain of our loan assets further increase net investment income as rates decrease and decrease net investment income when rates increase. As of December 31, 2011, $400.7 million of our floating rate loans has a weighted average interest rate floor of 3.16% and $2.39 billion of our floating rate debt has a weighted average interest rate floor of 1.25%.

## MANAGEMENT'S REPORT ON INTERNAL CONTROL 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 management's assessment under the framework in *Internal Control – Integrated Framework*, management has concluded that its internal control over financial reporting was effective as of December 31, 2011.

The Company's internal control over financial reporting as of December 31, 2011, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears on page 27.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of changes in equity and of cash flows present fairly, in all material respects, the financial position of iStar Financial Inc. and its subsidiaries (collectively, the 'Company') at December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

The Company has approximately $1.6 billion of debt maturing in 2012. As further described in Note 10, the Company's capital sources to meet its debt maturities are expected to primarily include debt refinancings, proceeds from asset sales and loan repayments from borrowers and may include equity capital raising transactions.

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
February 29, 2012

## CONSOLIDATED BALANCE SHEETS

| As of December 31, | 2011 | 2010 |
|---|---|---|
| (In thousands, except per share data) | | |
| **Assets** | | |
| Loans and other lending investments, net | **$ 2,860,762** | $ 4,587,352 |
| Net lease assets, net | **1,702,764** | 1,784,509 |
| Real estate held-for-investment, net | **1,228,134** | 833,060 |
| Other real estate owned | **677,458** | 746,081 |
| Other investments | **457,835** | 532,358 |
| Cash and cash equivalents | **356,826** | 504,865 |
| Restricted cash | **32,630** | 13,784 |
| Accrued interest and operating lease income receivable, net | **16,878** | 24,408 |
| Deferred operating lease income receivable | **72,074** | 62,569 |
| Deferred expenses and other assets, net | **112,476** | 85,528 |
| Total assets | **$ 7,517,837** | $ 9,174,514 |
| **Liabilities and Equity** | | |
| Liabilities: | | |
| Accounts payable, accrued expenses and other liabilities | **$ 106,693** | $ 134,422 |
| Debt obligations, net | **5,837,540** | 7,345,433 |
| Total liabilities | **5,944,233** | 7,479,855 |
| Commitments and contingencies | **–** | – |
| Equity: | | |
| iStar Financial Inc. shareholders' equity: | | |
| Preferred Stock Series D, E, F, G and I, liquidation preference $25.00 per share (see Note 11) | **22** | 22 |
| High Performance Units | **9,800** | 9,800 |
| Common Stock, $0.001 par value, 200,000 shares authorized, 140,028 issued and 81,920 outstanding at December 31, 2011 and 138,189 issued and 92,336 outstanding at December 31, 2010 | **140** | 138 |
| Additional paid-in capital | **3,834,460** | 3,809,071 |
| Retained earnings (deficit) | **(2,078,397)** | (2,014,013) |
| Accumulated other comprehensive income (loss) (see Note 15) | **(328)** | 1,609 |
| Treasury stock, at cost, $0.001 par value, 58,108 shares at December 31, 2011 and 45,853 shares at December 31, 2010 | **(237,341)** | (158,492) |
| Total iStar Financial Inc. shareholders' equity | **1,528,356** | 1,648,135 |
| Noncontrolling interests | **45,248** | 46,524 |
| Total equity | **1,573,604** | 1,694,659 |
| Total liabilities and equity | **$ 7,517,837** | $ 9,174,514 |

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

## CONSOLIDATED STATEMENTS OF OPERATIONS

| For the Years Ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| (In thousands, except per share data) | | | |
| **Revenue:** | | | |
| Interest income | **$ 226,871** | $ 364,094 | $ 557,809 |
| Operating lease income | **165,040** | 164,681 | 175,225 |
| Other income | **40,878** | 40,943 | 25,953 |
| Total revenue | **432,789** | 569,718 | 758,987 |
| **Costs and expenses:** | | | |
| Interest expense | **344,788** | 314,868 | 413,091 |
| Operating costs – net lease assets | **18,439** | 14,566 | 15,799 |
| Operating costs – REHI and OREO | **77,282** | 64,694 | 40,866 |
| Depreciation and amortization | **62,619** | 61,663 | 61,643 |
| General and administrative | **105,039** | 109,526 | 124,152 |
| Provision for loan losses | **46,412** | 331,487 | 1,255,357 |
| Impairment of assets | **22,368** | 16,319 | 126,885 |
| Other expense | **11,070** | 16,055 | 62,329 |
| Total costs and expenses | **688,017** | 929,178 | 2,100,122 |
| Income (loss) before earnings from equity method investments and other items | **(255,228)** | (359,460) | (1,341,135) |
| Gain on early extinguishment of debt, net | **101,466** | 108,923 | 547,349 |
| Earnings from equity method investments | **95,091** | 51,908 | 5,298 |
| Income (loss) from continuing operations before income taxes | **(58,671)** | (198,629) | (788,488) |
| Income tax (expense) benefit | **4,719** | (7,023) | (4,141) |
| Income (loss) from continuing operations[1] | **(53,952)** | (205,652) | (792,629) |
| Income (loss) from discontinued operations | **(2,572)** | 15,476 | 10,356 |
| Gain from discontinued operations | **25,110** | 270,382 | 12,426 |
| Income from sales of residential property | **5,721** | – | – |
| Net income (loss) | **(25,693)** | 80,206 | (769,847) |
| Net (income) loss attributable to noncontrolling interests | **3,629** | (523) | 1,071 |
| Net income (loss) attributable to iStar Financial Inc. | **(22,064)** | 79,683 | (768,776) |
| Preferred dividends | **(42,320)** | (42,320) | (42,320) |
| Net (income) loss allocable to HPU holders and Participating Security holders[2][3] | **1,997** | (1,084) | 22,526 |
| Net income (loss) allocable to common shareholders | **$ (62,387)** | $ 36,279 | $ (788,570) |
| **Per common share data[1]:** | | | |
| Income (loss) attributable to iStar Financial Inc. from continuing operations: | | | |
| Basic and diluted | **$ (0.94)** | $ (2.58) | $ (8.10) |
| Net income (loss) attributable to iStar Financial Inc.: | | | |
| Basic and diluted | **$ (0.70)** | $ 0.39 | $ (7.88) |
| Weighted average number of common shares – basic and diluted | **88,688** | 93,244 | 100,071 |
| **Per HPU share data[1][2]:** | | | |
| Income (loss) attributable to iStar Financial Inc. from continuing operations: | | | |
| Basic and Diluted | **$ (179.73)** | $ (490.67) | $ (1,543.67) |
| Net income (loss) attributable to iStar Financial Inc.: | | | |
| Basic and Diluted | **$ (133.13)** | $ 72.27 | $ (1,501.73) |
| Weighted average number of HPU shares – basic and diluted | **15** | 15 | 15 |

**Explanatory Notes:**

(1) Income (loss) from continuing operations attributable to iStar Financial for the years ended December 31, 2011, 2010 and 2009 was $(50,323), $(206,175) and $(791,558), respectively. See Note 14 for details on the calculation of earnings per share.

(2) HPU holders are current and former Company employees who purchased high performance common stock units under the Company's High Performance Unit Program (see Note 11).

(3) Participating Security holders are Company employees and directors who hold unvested restricted stock units and common stock equivalents granted under the Company's Long Term Incentive Plans (see Notes 13 and 14).

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

| For the Years Ended December 31, 2011, 2010 and 2009 | iStar Financial Inc. Shareholders' Equity | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Preferred Stock[1] | HPUs | Common Stock at Par | Additional Paid-In Capital | Retained Earnings (Deficit) | Accumulated Other Comprehensive Income (Loss) | Treasury Stock at Cost | Noncon-trolling Interests | Total Equity |
| (In thousands) | | | | | | | | | |
| Balance at December 31, 2008 | $22 | $9,800 | $137 | $3,768,772 | $(1,240,280) | $ 1,707 | $(121,159) | $27,663 | $2,446,662 |
| Dividends declared – preferred | – | – | – | – | (42,320) | – | – | – | (42,320) |
| Repurchase of stock | – | – | – | – | – | – | (29,857) | – | (29,857) |
| Restricted stock unit amortization, net | – | – | 1 | 23,200 | – | – | – | – | 23,201 |
| Net loss for the period[2] | – | – | – | – | (768,776) | – | – | (1,065) | (769,841) |
| Contributions from noncontrolling interests | – | – | – | – | – | – | – | 26,487 | 26,487 |
| Distributions to noncontrolling interests | – | – | – | – | – | – | – | (2,652) | (2,652) |
| Change in accumulated other comprehensive income (loss) | – | – | – | – | – | 4,438 | – | – | 4,438 |
| Balance at December 31, 2009 | $22 | $9,800 | $138 | $3,791,972 | $(2,051,376) | $ 6,145 | $(151,016) | $50,433 | $1,656,118 |
| Dividends declared – preferred | – | – | – | – | (42,320) | – | – | – | (42,320) |
| Repurchase of stock | – | – | – | – | – | – | (7,476) | – | (7,476) |
| Restricted stock unit amortization, net | – | – | – | 17,099 | – | – | – | – | 17,099 |
| Net income for the period[2] | – | – | – | – | 79,683 | – | – | 534 | 80,217 |
| Contributions from noncontrolling interests | – | – | – | – | – | – | – | 159 | 159 |
| Distributions to noncontrolling interests | – | – | – | – | – | – | – | (4,602) | (4,602) |
| Change in accumulated other comprehensive income (loss) | – | – | – | – | – | (4,536) | – | – | (4,536) |
| Balance at December 31, 2010 | $22 | $9,800 | $138 | $3,809,071 | $(2,014,013) | $ 1,609 | $(158,492) | $46,524 | $1,694,659 |
| Dividends declared – preferred | – | – | – | – | (42,320) | – | – | – | (42,320) |
| Restricted stock unit amortization, net | – | – | 2 | 25,389 | – | – | – | – | 25,391 |
| Net loss for the period[2] | – | – | – | – | (22,064) | – | – | (3,603) | (25,667) |
| Change in accumulated other comprehensive income (loss) | – | – | – | – | – | (1,937) | – | – | (1,937) |
| Repurchase of stock | – | – | – | – | – | – | (78,849) | – | (78,849) |
| Contributions from noncontrolling interests | – | – | – | – | – | – | – | 3,917 | 3,917 |
| Distributions to noncontrolling interests | – | – | – | – | – | – | – | (1,590) | (1,590) |
| **Balance at December 31, 2011** | **$22** | **$9,800** | **$140** | **$3,834,460** | **$(2,078,397)** | **$ (328)** | **$(237,341)** | **$45,248** | **$1,573,604** |

**Explanatory Notes:**

(1) See Note 11 for details on the Company's Cumulative Redeemable Preferred Stock.

(2) For the years ended December 31, 2011, 2010 and 2009, net income (loss) shown above excludes $(26), $(11) and $(6), respectively, of net income (loss) attributable to redeemable noncontrolling interests.

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| For the Years Ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| (In thousands) | | | |
| **Cash flows from operating activities:** | | | |
| Net income (loss) | $ (25,693) | $ 80,206 | $ (769,847) |
| Adjustments to reconcile net income (loss) to cash flows from operating activities: | | | |
| Provision for loan losses | 46,412 | 331,487 | 1,255,357 |
| Impairment of assets | 22,386 | 22,403 | 141,018 |
| Depreciation and amortization | 63,928 | 70,770 | 99,287 |
| Non-cash expense for stock-based compensation | 29,702 | 19,355 | 23,592 |
| Amortization of discounts/premiums and deferred financing costs on debt | 32,345 | (18,926) | (12,025) |
| Amortization of discounts/premiums and deferred interest on lending investments | (62,194) | (102,261) | (117,527) |
| Discounts, loan fees and deferred interest received | 3,933 | 9,587 | 11,921 |
| Earnings from equity method investments | (95,091) | (51,908) | (5,298) |
| Distributions from operations of equity method investments | 85,766 | 32,651 | 27,973 |
| Deferred operating lease income | (9,390) | (9,976) | (13,926) |
| Deferred income taxes | (13,729) | 4,473 | 3,772 |
| Income from sales of residential property | (5,721) | – | – |
| Gain from discontinued operations | (25,110) | (270,382) | (12,426) |
| Gain on early extinguishment of debt, net | (97,742) | (110,075) | (547,349) |
| Other non-cash adjustments | (3,886) | (3,451) | (4,928) |
| Changes in assets and liabilities: | | | |
| Changes in accrued interest and operating lease income receivable, net | 4,793 | 14,259 | 31,767 |
| Changes in deferred expenses and other assets, net | 10,580 | (1,781) | 7,659 |
| Changes in accounts payable, accrued expenses and other liabilities | 6,926 | (63,827) | (41,225) |
| Cash flows from operating activities | $ (31,785) | $ (47,396) | $ 77,795 |
| **Cash flows from investing activities:** | | | |
| New investment originations | $ (20,000) | $ (100,000) | $ – |
| Fundings under existing loan commitments | (89,895) | (356,329) | (1,224,593) |
| Repayments of and principal collections on loans | 1,206,461 | 1,519,653 | 951,202 |
| Purchase of securities | – | – | (31,535) |
| Net proceeds from sales of loans | 95,859 | 700,098 | 720,770 |
| Net proceeds from sales of net lease assets | 37,343 | 1,362,983 | 64,566 |
| Net proceeds from sales of other real estate owned | 178,587 | 460,198 | 270,621 |
| Net proceeds from repayments and sales of securities | – | 213,344 | 27,060 |
| Contributions to unconsolidated entities | (41,820) | (23,520) | (34,272) |
| Distributions from and proceeds from sales of unconsolidated entities | 188,467 | 11,441 | 9,459 |
| Capital expenditures on net lease assets | (12,174) | (14,031) | (14,891) |
| Capital expenditures on REHI and OREO | (51,995) | (28,832) | (11,056) |
| Changes in restricted cash held in connection with investing activities | (20,042) | (2,068) | (1,519) |
| Other investing activities, net | 638 | (4,114) | (1,110) |
| Cash flows from investing activities | $1,471,429 | $3,738,823 | $ 724,702 |

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

(continued)

## CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

| For the Years Ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| (In thousands) | | | |
| **Cash flows from financing activities:** | | | |
| Borrowings under secured credit facilities | **$ 2,913,250** | $ 36,294 | $ 39,530 |
| Repayments under secured credit facilities | **(1,495,354)** | (36,812) | (361,704) |
| Borrowings under unsecured credit facilities | **–** | 499 | 95,211 |
| Repayments under unsecured credit facilities | **(506,600)** | – | (10,094) |
| Borrowings under secured term loans | **124,575** | – | 1,000,000 |
| Repayments under secured term loans | **(1,684,231)** | (2,132,899) | (318,431) |
| Repayments under unsecured notes | **(375,127)** | (374,249) | (628,366) |
| Repurchases and redemptions of secured and unsecured notes | **(408,690)** | (855,833) | (885,055) |
| Payments for deferred financing costs | **(35,545)** | – | (51,801) |
| Preferred dividends paid | **(42,320)** | (42,320) | (42,320) |
| Purchase of treasury stock | **(78,849)** | (7,476) | (29,857) |
| Changes in restricted cash held in connection with debt obligations | **199** | 12,064 | 121,116 |
| Other financing activity | **1,009** | (10,462) | (2,631) |
| Cash flows from financing activities | **(1,587,683)** | (3,411,194) | (1,074,402) |
| Changes in cash and cash equivalents | **(148,039)** | 280,233 | (271,905) |
| Cash and cash equivalents at beginning of period | **504,865** | 224,632 | 496,537 |
| Cash and cash equivalents at end of period | **$ 356,826** | $ 504,865 | $ 224,632 |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid during the period for interest, net of amount capitalized | **$ 322,601** | $ 376,473 | $ 531,858 |

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

## Note 1 – Business and Organization

**Business –** iStar Financial Inc., or the "Company," is a fully-integrated finance and investment company focused on the commercial real estate industry. The Company provides custom-tailored investment capital to high-end private and corporate owners of real estate and invests directly across a range of real estate sectors. The Company, which is taxed as a real estate investment trust, or "REIT," has invested more than $35 billion over the the past two decades. The Company's three primary business segments are lending, net leasing and real estate investment. See Note 10 for discussion of business risks and uncertainties, including the impact of recent economic conditions on the Company and the Company's liquidity and capital resources.

**Organization –** The Company began its business in 1993 through private investment funds and became publicly traded in 1998. Since that time, the Company has grown through the origination of new lending and leasing transactions, as well as through corporate acquisitions.

## Note 2 – Basis of Presentation and Principles of Consolidation

**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 preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

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

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

**Consolidated VIEs –** The Company consolidates OHA Strategic Credit Fund Parallel I, L.P. ("OHA SCF"), which was created to invest in distressed and undervalued loans, bonds, equities and other investments. As of December 31, 2011 and 2010, OHA SCF had $56.9 million and $45.7 million, respectively, of total assets, no debt, and $0.1 million of noncontrolling interests. The investments held by this entity are presented in "Other investments" on the Company's Consolidated Balance Sheets. As of December 31, 2011, the Company had a total unfunded commitment of $16.9 million to this entity.

The Company also consolidates Madison Deutsche Andau Holdings, LP ("Madison DA"), which was created to invest in mortgage loans collateralized by real estate in Europe. As of December 31, 2011 and 2010, Madison DA had $37.4 million and $58.0 million, respectively, of total assets, no debt, and $5.4 million and $8.6 million of noncontrolling interests, respectively. The investments held by this entity are presented in "Loans and other lending investments, net" on the Company's Consolidated Balance Sheets.

**Unconsolidated VIEs –** The Company determined that as of December 31, 2011, 28 of its other investments were in VIEs where it is not the primary beneficiary and accordingly the VIEs have not been consolidated in the Company's Consolidated Financial Statements. As of December 31, 2011, the Company's maximum exposure to loss from these investments does not exceed the sum of the $220.2 million carrying value of the investments and $7.4 million of related unfunded commitments.

## Note 3 – Summary of Significant Accounting Policies

**Loans and other lending investments, net –** Loans and other lending investments, net includes the following investments: senior mortgages, subordinate mortgages, corporate/partnership loans and other lending investments-securities. Management considers nearly all of its loans and debt securities to be held-for-investment or held-to-maturity, although certain investments may be classified as held-for-sale or available-for-sale.

Loans classified as held-for-investment or held-to-maturity are reported at their outstanding unpaid principal balance, and include unamortized acquisition premiums or discounts and unamortized deferred loan costs or fees. These loans also include accrued and paid-in-kind interest and accrued exit fees that the Company determines are probable of being collected. Debt securities classified as available-for-sale are reported at fair value with unrealized gains and losses included in "Accumulated other comprehensive income (loss)" on the Company's Consolidated Balance Sheets.

Loans and other lending investments designated for sale are classified as held for sale and are carried at lower of amortized historical cost or fair value. The amount by which carrying value exceeds fair value is recorded as a valuation allowance. Subsequent changes in the valuation allowance are included in the determination of net income (loss) in the period in which the change occurs.

For held-to-maturity and available-for-sale debt securities held in "Loans and other lending investments, net," management evaluates whether the asset is other-than-temporarily impaired when the fair market value is below carrying value. The Company considers debt securities other-than-temporarily impaired if (1) the Company has the intent to sell the security, (2) it is more likely than not that it will be required to sell the security before recovery, or (3) it does not expect to recover the entire amortized cost basis of the security. If it is determined that an other-than-temporary impairment exists, the portion related to credit losses, where the Company does not expect to recover its entire amortized cost basis, will be recognized as an "Impairment of assets" on the Company's Consolidated Statements of Operations. If the Company does not intend to sell the security and it is more likely than not that the entity will not be required to sell the security, but the security has suffered a credit loss, the impairment charge will be separated. The credit loss component of the impairment will be recorded as

an "Impairment of assets" on the Company's Consolidated Statements of Operations, and the remainder will be recorded in "Accumulated other comprehensive income (loss)" on the Company's Consolidated Balance Sheets.

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

Net lease assets to be disposed of are reported at the lower of their carrying amount or estimated fair value less costs to sell and are included in "Assets held for sale" on the Company's Consolidated Balance Sheets. If the estimated fair value less costs to sell is less than the carrying value, the difference will be recorded as an impairment charge and included in "Income (loss) from discontinued operations" on the Company's Consolidated Statements of Operations. Once an asset is classified as held for sale, depreciation expense is no longer recorded and historical operating results are reclassified to "Income (loss) from discontinued operations" on the Company's Consolidated Statements of Operations.

The Company periodically reviews long-lived assets to be held and used for impairment in value whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. The value of a long-lived asset held for use is impaired only if management's estimate of the aggregate future cash flows (undiscounted and without interest charges) to be generated by the asset (taking into account the anticipated holding period of the asset) is less than the carrying value. Such estimate of cash flows considers factors such as expected future operating income, trends and prospects, as well as the effects of demand, competition and other economic factors. To the extent impairment has occurred, the loss will be measured as the excess of the carrying amount of the property over the fair value of the asset and reflected as an adjustment to the basis of the asset. Impairments of net lease assets that are not held for sale are recorded in "Impairment of assets," on the Company's Consolidated Statements of Operations.

The Company accounts for its acquisition of facilities by allocating the purchase price to the tangible and intangible assets and liabilities acquired based on their estimated fair values. The value of the tangible assets, consisting of land, buildings, building improvements and tenant improvements is determined as if these assets are vacant. Intangible assets may include the value of above-market or below-market, in-place leases and the value of customer relationships, which are each recorded at their relative estimated fair values.

The capitalized above-market (or below-market) lease value is amortized as a reduction of (or, increase to) operating lease income over the remaining non-cancelable term of each lease plus any renewal periods with fixed rental terms that are considered to be below-market. The Company also generally engages in sale/leaseback transactions and typically executes leases with the occupant simultaneously with the purchase of the net lease asset at market-rate rents. As such, no above-market or below-market lease value is ascribed to these transactions.

**Real estate held-for-investment, net –** Real estate held-for-investment, net ("REHI") consists of properties acquired through foreclosure or through deed-in-lieu of foreclosure in full or partial satisfaction of non-performing loans that the Company intends to hold, operate or develop for a period of at least 12 months. REHI assets are initially recorded at their estimated fair value. The excess of the carrying value of the loan over the estimated fair value of the property acquired is charged-off against the reserve for loan losses when title to the property is obtained. Additionally, upon acquisition of a property, tangible and intangible assets and liabilities acquired are recorded at their estimated fair values and depreciation is computed, all in the same manners as described in "Net lease assets and depreciation" above.

Subsequent to acquisition, qualified development and construction costs, including interest and certain other carrying costs incurred during the construction and/or renovation periods are capitalized and charged to operations through depreciation over the asset's estimated useful life. The Company ceases capitalization on the portions substantially completed and capitalizes only those costs associated with the portions under development.

The Company considers REHI assets to be long-lived and periodically reviews them for impairment in value whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. The Company measures impairments for REHI assets in the same manner as net lease assets, as described in "Net lease assets and depreciation" above. Impairments of REHI assets are recorded in "Impairment of assets," on the Company's Consolidated Statements of Operations.

Operating revenues related to REHI assets are recorded as "Other income" and expenses are included in "Operating costs – REHI and OREO," on the Company's Consolidated Statements of Operations.

**Other real estate owned –** OREO consists of properties acquired through foreclosure or by deed-in-lieu of foreclosure in full or partial satisfaction of non-performing loans that the Company intends to market for sale in the near term. OREO is recorded at the estimated fair value less costs to sell. The excess of the carrying value of the loan over the estimated fair value of the property less costs to sell is charged-off against the reserve for loan losses when title to the property is obtained. Net revenues and costs of holding the property are recorded as "Operating costs – REHI and OREO" in the Company's Consolidated Statements of Operations. Significant property improvements may be capitalized to the extent that the carrying value of the property does not exceed its estimated fair value less costs to sell.

The Company reviews the recoverability of an OREO asset's carrying value when events or circumstances indicate a potential impairment of a property's value. If impairment exists, a loss is recorded to the extent that the carrying value exceeds the estimated fair value of the property less costs to sell. These impairments are recorded in "Impairment of assets" on the Company's Consolidated Statements of Operations.

Profits on sales of residential properties are recognized upon closing of the sale when all conditions for full profit recognition have been met. The Company uses the relative sales value method to allocate costs to individual residential properties. Profits on sales of residential properties are included in "Income from sales of residential property" on the Consolidated Statements of Operations.

**Equity and cost method investments –** Purchased equity interests are accounted for pursuant to the equity method of accounting if the Company can significantly influence the operating and financial policies of an investee. This is generally presumed to exist when ownership interest is between 20% and 50% of a corporation, or greater than 5% of a limited partnership or limited liability company. The Company's periodic share of earnings and losses in equity method investees is included in "Earnings from equity method investments" on the Consolidated Statements of Operations. When the Company's ownership position is too small to provide such influence, the cost method is used to account for the equity interest. Equity and cost method investments are included in "Other investments" on the Company's Consolidated Balance Sheets.

The Company periodically reviews equity method investments for impairment in value whenever events or changes in circumstances indicate that the carrying amount of such investments may not be recoverable. The Company will record an impairment charge to the extent that the estimated fair value of an investment is less than its carrying value and the Company determines the impairment is other-than-temporary. Impairment charges are recorded in "Impairment of assets" on the Company's Consolidated Statements of Operations.

**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 under certain of the Company's debt obligations, lending investments, OREO, leasing and derivative transactions.

**Consolidation – Variable interest entities –** The Company evaluated its investments and other contractual arrangements to determine if they constitute variable interests in a VIE. A VIE is an entity where a controlling financial interest is achieved through means other than voting rights. A VIE is consolidated by the primary beneficiary, which is the party that has the power to direct matters that most significantly impact the activities of the VIE and has the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. This overall consolidation assessment includes a review of, among other factors, which interests create or absorb variability, contractual terms, the key decision making powers, their impact on the VIE's economic performance, and related party relationships. Where qualitative assessment is not conclusive, the Company performs a quantitative analysis. The Company reassesses its evaluation of the primary beneficiary of a VIE on an ongoing basis and assesses its evaluation of an entity as a VIE upon certain reconsideration events.

The Company has investments in certain funds that meet the deferral criteria in Accounting Standards Update ("ASU") 2010-10 and will continue to assess consolidation of these entities under the overall guidance on the consolidation of VIEs in Accounting Standards Codification ("ASC") 810-10. The consolidation evaluation is similar to the process noted above, except that the primary beneficiary is the party that will receive a majority of the VIE's anticipated losses, a majority of the VIE's expected residual returns, or both. In addition, for entities that meet the deferral criteria, the Company reassesses its initial evaluation of the primary beneficiary and whether an entity is a VIE upon the occurrence of certain reconsideration events.

**Deferred expenses –** Deferred expenses include leasing costs and financing fees. Leasing costs include brokerage, legal and other costs which are amortized over the life of the respective leases. External fees and costs incurred to obtain long-term financing have been deferred and are amortized over the term of the respective borrowing using the effective interest method or the straight line method, as appropriate. Amortization of leasing costs and deferred financing fees are included in "Depreciation and amortization" and "Interest expense," respectively, on the Company's Consolidated Statements of Operations.

**Identified intangible assets and goodwill –** Upon the acquisition of a business, the Company records intangible assets acquired at their estimated fair values separate and apart from goodwill. The Company determines whether such intangible assets have finite or indefinite lives. As of December 31, 2011, all such intangible assets acquired by the Company have finite lives. The Company amortizes finite lived intangible assets based on the period over which the assets are expected to contribute directly or indirectly to the future cash flows of the business acquired. The Company reviews finite lived intangible assets for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. If the Company determines the carrying value of an intangible asset is not recoverable it will record an impairment charge to the extent its carrying value exceeds its estimated fair value. Impairments of intangible assets are recorded in "Impairment of assets" on the Company's Consolidated Statements of Operations.

As of December 31, 2011 and 2010, the Company had $53.6 million and $42.8 million, respectively, of unamortized finite lived intangible assets primarily related to the prior acquisition of net lease assets and REHI. The total amortization expense for these intangible assets was $11.0 million, $9.0 million and $12.2 million for the years ended December 31, 2011, 2010 and 2009, respectively. The estimated aggregate amortization costs for each of the five succeeding fiscal years are as follows ($ in thousands):

| | |
|---|---|
| 2012 | $ 7,807 |
| 2013 | 6,172 |
| 2014 | 5,720 |
| 2015 | 5,476 |
| 2016 | 5,395 |
| Total | $30,570 |

The excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired (including identified intangible assets) and liabilities assumed is recorded as goodwill. Goodwill is not amortized but is tested for impairment on an annual basis, or more frequently if events or changes in circumstances indicate that

the asset might be impaired. The impairment test is done at a level of reporting referred to as a reporting unit. If the fair value of the reporting unit is less than its carrying value, an impairment loss is recorded to the extent that the fair value of the goodwill within the reporting unit is less than its carrying value. Fair values for goodwill and other finite lived intangible assets are determined using the market approach, income approach or cost approach, as appropriate.

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

*Loans and other lending investments:* Interest income on loans and other lending investments is recognized on an accrual basis using the interest method.

On occasion, the Company may acquire loans at premiums or discounts. These discounts and premiums in addition to any deferred costs or fees, are typically amortized over the contractual term of the loan using the interest method. Exit fees are also recognized over the lives of the related loans as a yield adjustment, if management believes it is probable that such amounts will be received. If loans with premiums, discounts, loan origination or exit fees are prepaid, the Company immediately recognizes the unamortized portion, which is included in "Other income" on the Company's Consolidated Statements of Operations.

The Company considers a loan to be non-performing and places loans on non-accrual status at such time as: (1) the loan becomes 90 days delinquent; (2) the loan has a maturity default; or (3) management determines it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan. While on non-accrual status, based on the Company's judgment as to collectability of principal, loans are either accounted for on a cash basis, where interest income is recognized only upon actual receipt of cash, or on a cost-recovery basis, where all cash receipts reduce a loan's carrying value. Non-accrual loans are returned to accrual status when a loan has become contractually current.

Certain 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 interest income only upon receipt of cash.

The Company holds certain loans initially acquired at a discount, for which it was probable, at acquisition, that all contractually required payments would not be received. The Company does not have a reasonable expectation about the timing and amount of cash flows expected to be collected on these loans and recognizes income when cash is received or applies cash to reduce the carrying value of the loans. As of December 31, 2011 and 2010, these loans had cumulative principal balances of $74.5 million and $93.6 million, respectively, and cumulative carrying values of $59.6 million and $75.9 million, respectively.

*Leasing investments:* The Company's leases have all been determined to be operating leases based on an analysis performed in accordance with ASC 840. Operating lease revenue is recognized on the straight-line method of accounting, generally from the later of the date the lessee takes possession of the space and it is ready for its intended use 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 periodic difference between lease revenue recognized under this method and contractual lease payment terms is recorded as "Deferred operating lease income receivable," on the Company's Consolidated Balance Sheets.

**Reserve for loan losses –** The reserve for loan losses reflects management's estimate of loan losses inherent in the loan portfolio as of the balance sheet date. The reserve is increased through the "Provision for loan losses" on the Company's Consolidated Statements of Operations and is decreased by charge-offs when losses are confirmed through the receipt of assets such as cash in a pre-foreclosure sale or via ownership control of the underlying collateral in full satisfaction of the loan upon foreclosure or when significant collection efforts have ceased. The Company has determined it has one portfolio segment, represented by commercial real estate lending, whereby it utilizes a uniform process for determining its reserve for loan losses. The reserve for loan losses includes a general, formula-based component and an asset-specific component.

The general reserve component covers performing loans and reserves for loan losses are recorded when (i) available information as of each balance sheet date indicates that it is probable a loss has occurred in the portfolio and (ii) the amount of the loss can be reasonably estimated. The formula-based general reserve is derived from estimated principal default probabilities and loss severities applied to groups of loans based upon risk ratings assigned to loans with similar risk characteristics during the Company's quarterly loan portfolio assessment. During this assessment, the Company performs a comprehensive analysis of its loan portfolio and assigns risk ratings to loans that incorporate management's current judgments about their credit quality based on all known and relevant internal and external factors that may affect collectability. The Company considers, among other things, payment status, lien position, borrower financial resources and investment in collateral, collateral type, project economics and geographical location as well as national and regional economic factors. This methodology results in loans being segmented by risk classification into risk rating categories that are associated with estimated probabilities of default and principal loss. Ratings range from "1" to "5" with "1" representing the lowest risk of loss and "5" representing the highest risk of loss. The Company estimates loss rates based on historical realized losses experienced within its portfolio and takes into account current economic conditions affecting the commercial real estate market when establishing appropriate time frames to evaluate loss experience.

The asset-specific reserve component relates to reserves for losses on impaired loans. The Company considers a loan to be impaired when, based upon current information and events, it believes that it is probable that the Company will be unable to collect all amounts due

under the contractual terms of the loan agreement. This assessment is made on a loan-by-loan basis each quarter based on such factors as payment status, lien position, borrower financial resources and investment in collateral, collateral type, project economics and geographical location as well as national and regional economic factors. A reserve is established for an impaired loan when the present value of payments expected to be received, observable market prices, or the estimated fair value of the collateral (for loans that are dependent on the collateral for repayment) is lower than the carrying value of that loan.

Substantially all of the Company's impaired loans are collateral dependent and impairment is measured using the estimated fair value of collateral, less costs to sell. The Company generally uses the income approach through internally developed valuation models to estimate the fair value of the collateral for such loans. In more limited cases, the Company obtains external "as is" appraisals for loan collateral, generally when third party participations exist. Valuations are performed or obtained at the time a loan is determined to be impaired and designated non-performing, and they are updated if circumstances indicate that a significant change in value has occurred. In limited cases, appraised values may be discounted when real estate markets rapidly deteriorate.

A loan is also considered impaired if its terms are modified in a troubled debt restructuring ("TDR"). A TDR occurs when the Company has granted a concession and the debtor is experiencing financial difficulties. Impairments on TDR loans are generally measured based on the present value of expected future cash flows discounted at the effective interest rate of the original loan.

**Allowance for doubtful accounts –** The allowance for doubtful accounts reflects management's estimate of losses inherent in the accrued operating lease income receivable and deferred operating lease income receivable balances as of the balance sheet date and incorporates an asset-specific component, as well as a general, formula-based reserve based on management's evaluation of the credit risks associated with these receivables. At December 31, 2011 and 2010, the total allowance for doubtful accounts was $3.7 million and $1.4 million, respectively.

**Derivative instruments and hedging activity –** The Company recognizes derivatives as either assets or liabilities on the Company's Consolidated Balance Sheets at fair value. If certain conditions are met, a derivative may be specifically designated as a hedge of the exposure to changes in the fair value of a recognized asset or liability, a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability.

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

**Stock-based compensation –** Compensation cost for stock-based awards is measured on the grant date and adjusted over the period of the employees' services to reflect (i) actual forfeitures and (ii) the outcome of awards with performance or service conditions through the requisite service period. The Company recognizes compensation cost for performance-based awards if and when the Company concludes that it is probable that the performance condition will be achieved. Compensation cost for market condition-based awards is determined using a Monte Carlo model to simulate a range of possible future stock prices for the Company's Common Stock, which is reflected in the grant date fair value. All compensation cost for market-condition based awards in which the service conditions are met is recognized regardless of whether the market condition is satisfied. Compensation costs are recognized ratably over the applicable vesting/service period and recorded in "General and administrative" on the Company's Consolidated Statements of Operations.

**Disposal of long-lived assets –** The results of operations from net lease assets that were sold or held for sale in the current and prior periods are classified as "Income (loss) 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 net lease assets are classified as "Gain from discontinued operations" on the Company's Consolidated Statements of Operations.

**Income taxes –** The Company has elected to be qualified and taxed as a REIT under section 856 through 860 of the Internal Revenue Code of 1986, as amended (the "Code"). 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 and certain specific reserve amounts that the Company deems to be uncollectable. These deductions allow the Company to shelter a portion of its operating cash flow from its dividend payout requirement under federal tax laws. In addition, the Company has made foreclosure elections for certain properties acquired through foreclosure which allows the Company to operate these properties within the REIT but subjects them to certain tax obligations. The carrying value of assets with foreclosure elections as of December 31, 2011 is $1.38 billion. The Company intends to operate in a manner consistent with and to elect to be treated as a REIT for tax purposes. As of December 31, 2010, the Company had $153.7 million of net operating loss carryforwards at the corporate REIT level, which can generally be used to offset both ordinary and capital taxable income in future years and will expire through 2030 if unused. The amount of net operating loss carryforwards as of December 31, 2011 will be subject to finalization of the 2011 tax returns. The Company recognizes interest expense and penalties related to uncertain tax positions, if any, as "Income tax (expense) benefit" on the Company's Consolidated Statements of Operations.

The Company can participate in certain activities from which it was previously precluded in order to maintain its qualification as a REIT, as long as these activities are conducted in entities which elect to be treated as taxable subsidiaries under the Code, subject to certain limitations. As such, the Company, through its taxable REIT subsidiaries ("TRSs"), is engaged in various real estate related opportunities, including but not limited to managing various investments in equity affiliates, including Oak Hill Advisors, L.P. and LNR, and managing activities related to certain foreclosed assets. As of December 31, 2011, $770.7 million of the Company's assets were owned by TRS entities.

The Company's TRS entities are not consolidated for federal income tax purposes and are taxed as corporations. For financial reporting purposes, current and deferred taxes are provided for on the portion of earnings recognized by the Company with respect to its interest in TRS entities. The following represents the Company's TRS income tax expense ($ in thousands):

| For the Years Ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| Current tax expense | **$ 9,010** | $2,550 | $ 369 |
| Deferred tax expense (benefit)[1] | **(13,729)** | 4,473 | 3,772 |
| Total income tax expense (benefit) | **$ (4,719)** | $7,023 | $4,141 |

**Explanatory Note:**

(1) During the year ended December 31, 2011, the Company sold its investment in Oak Hill Advisors L.P. (see Note 7) and recognized a deferred tax benefit resulting from the reversal of a deferred tax liability associated with the investment. See the table at the right for the Company's deferred tax assets and liabilities as of December 31, 2011 and 2010.

During the year ended December 31, 2011, the Company's TRS entities had income subject to tax of $75.8 million which was offset by $54.8 million of net operating loss carryforwards, generating current tax expense of $9.0 million. The Company's TRS taxable income for the year ended December 31, 2011 included the gain on the Company's sale of its investment in Oak Hill Advisors L.P. (see Note 7). The Company's utilization of net operating loss carryforwards of $54.8 million offset this taxable income and reduced current tax expense by approximately $20.0 million. The Company also had TRS entities which generated $36.9 million of aggregate taxable losses during the year ended December 31, 2011. Total cash paid for taxes for the years ended December 31, 2011, 2010 and 2009, was $8.5 million, $7.3 million and $2.9 million, respectively.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, as well as operating loss and tax credit carryforwards. The Company evaluates the realizability of its deferred tax assets and recognizes a valuation allowance if, based on the available evidence, both positive and negative, it is more likely than not that some portion or all of its deferred tax assets will not be realized. When evaluating the realizability of its deferred tax assets, the Company considers, among other matters, estimates of expected future taxable income, nature of current and cumulative losses, existing and projected book/tax differences, tax planning strategies available, and the general and industry specific economic outlook. This realizability analysis is inherently subjective, as it requires the Company to forecast its business and general economic environment in future periods. Based on an assessment of all factors, including historical losses and continued volatility of the activities within the TRS entities, it was determined that valuation allowances of $50.9 million and $29.9 million were required on the net deferred tax assets as of December 31, 2011 and 2010, respectively. Changes in estimate of deferred tax asset realizability, if any are included in "Income tax (expense) benefit" on the Consolidated Statements of Operations.

Deferred tax assets and liabilities of the Company's TRS entities were as follows ($ in thousands):

| As of December 31, | 2011 | 2010 |
|---|---|---|
| Deferred tax assets[1] | **$ 53,625** | $ 29,921 |
| Deferred tax liabilities[2] | **(2,736)** | (13,729) |
| Valuation allowance | **(50,889)** | (29,921) |
| Net deferred tax assets (liabilities) | **$ –** | $(13,729) |

**Explanatory Notes:**

(1) Deferred tax assets primarily include net operating loss carryforwards of $22.8 million and $21.5 million as of December 31, 2011 and 2010, respectively, as well as real estate asset basis differences of $30.8 million and $8.4 million as of December 31, 2011 and 2010, respectively.

(2) Deferred tax liabilities are primarily comprised of basis differences in equity investments. During the year ended December 31, 2011, the Company sold its investment in Oak Hill Advisors L.P. (see Note 7) and recognized the deferred tax benefit associated with the reversal of this deferred liability.

**Earnings per share –** The Company uses the two-class method in calculating EPS when it issues securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the Company when, and if, the Company declares dividends on its common stock. Vested HPU shares are entitled to dividends of the Company when dividends are declared. Basic earnings per share ("Basic EPS") for the Company's Common Stock and HPU shares are computed by dividing net income allocable to common shareholders and HPU holders by the weighted average number of shares of Common Stock and HPU shares outstanding for the period, respectively. Diluted earnings per share ("Diluted EPS") is calculated similarly, however, it reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, where such exercise or conversion would result in a lower earnings per share amount.

Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are deemed a ("Participating Security") and are included in the computation of earnings per share pursuant to the two-class method. The Company's unvested restricted stock units with rights to dividends and common stock equivalents issued under its Long-Term Incentive Plans are considered participating securities and have been included in the two-class method when calculating EPS.

## New Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2011-05, "Presentation of Comprehensive Income," which requires entities to (1) present net income and other comprehensive income in either a single continuous statement or in two separate, but consecutive, statements of net income and other comprehensive income and (2) present reclassification of other comprehensive income on the

face of the income statement. In December 2011, the FASB issued ASU 2011-12, "Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05," which deferred the requirements of entities to present reclassification of other comprehensive income on the face of the income statement. Both standards are effective in interim and fiscal years beginning after December 15, 2011 and should be applied retrospectively. The Company will adopt this ASU for the reporting period ending March 31, 2012, as required.

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

In April 2011, the FASB issued ASU 2011-02, "A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring," which provides additional guidance to creditors for determining whether a loan modification is a troubled debt restructuring ("TDR"). The guidance provides additional considerations in determining whether a creditor has granted a concession and adds factors for creditors to consider in determining whether a debtor is experiencing financial difficulties. This ASU was effective for the first interim or annual period beginning on or after June 15, 2011 with retrospective application for loan modifications that have occurred from January 1, 2011. Loan modifications that qualify as TDRs are considered impaired and will be measured and recorded prospectively in the period of adoption. The Company adopted the standard in the period ended September 30, 2011, as required. As a result of this adoption, the Company reassessed all restructurings that occurred on or after January 1, 2011 for identification as troubled debt restructurings. As of September 30, 2011, the Company had a recorded investment of $50.9 million in loans for which the allowance for credit losses was previously measured under a general allowance for credit losses methodology and became specifically reviewed for impairment as a result of adoption of this ASU. Based on an evaluation of potential losses at September 30, 2011, no specific reserves were required for these loans. See Note 4 for additional troubled debt restructuring disclosures.

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

### Note 4 – Loans and Other Lending Investments, net

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

| As of December 31, | 2011 | 2010 |
|---|---|---|
| **Type of Investment**[1] | | |
| Senior mortgages | **$2,801,213** | $4,390,770 |
| Subordinate mortgages | **211,491** | 305,245 |
| Corporate/Partnership loans | **478,892** | 689,535 |
| Total gross carrying value of loans[2] | **3,491,596** | 5,385,550 |
| Reserves for loan losses | **(646,624)** | (814,625) |
| Total carrying value of loans | **2,844,972** | 4,570,925 |
| Other lending investments – securities | **15,790** | 16,427 |
| Total loans and other lending investments, net | **$2,860,762** | $4,587,352 |

**Explanatory Notes:**

(1) Loans and other lending investments are presented net of unearned income, unamortized discounts and premiums and net unamortized deferred fees and costs. In total, these amounts represented a net discount of $101.7 million and $62.7 million as of December 31, 2011 and 2010, respectively.

(2) The Company's recorded investment in loans as of December 31, 2011 and 2010 was $3.50 billion and $5.41 billion, respectively, which consists of total gross carrying value of loans plus accrued interest of $13.3 million and $21.3 million, for the same two periods, respectively.

During the year ended December 31, 2011, the Company originated $20.0 million in loans and other lending investments, funded $89.9 million under existing loan commitments and received principal repayments of $1.21 billion. During the same period, the Company sold loans with a total carrying value of $144.9 million, for which it recognized charge-offs of $25.0 million.

During the year ended December 31, 2011, the Company received title to properties in full or partial satisfaction of non-performing mortgage loans with a gross carrying value of $617.8 million, for which the properties had served as collateral, and recorded charge-offs totaling $115.3 million related to these loans. These properties were recorded as real estate held-for-investment ("REHI") or other real estate owned ("OREO") on the Company's Consolidated Balance Sheets (see Note 5). In addition, during the same period, the Company received equity in an entity that took title to a property in satisfaction of a non-performing mortgage for which the property had served as collateral. The Company held a participation in the mortgage with a gross carrying value of $74.6 million and charged-off $29.2 million upon receiving the equity interest (see Note 7).

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

| For the Years Ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| **Reserve for loan losses at beginning of period** | **$ 814,625** | $1,417,949 | $ 976,788 |
| Provision for loan losses | **46,412** | 331,487 | 1,255,357 |
| Charge-offs | **(214,413)** | (934,811) | (814,196) |
| **Reserve for loan losses at end of period** | **$ 646,624** | $ 814,625 | $1,417,949 |

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

| | Individually Evaluated for Impairment | Collectively Evaluated for Impairment | Loans Acquired with Deteriorated Credit Quality | Total |
|---|---|---|---|---|
| **As of December 31, 2011:** | | | | |
| Loans | **$1,525,337** | **$1,919,876** | **$ 59,648** | **$3,504,861** |
| Less: Reserve for loan losses | **(554,131)** | **(73,500)** | **(18,993)** | **(646,624)** |
| Total | **$ 971,206** | **$1,846,376** | **$ 40,655** | **$2,858,237** |
| **As of December 31, 2010:** | | | | |
| Loans | $2,296,599 | $3,034,310 | $ 75,907 | $5,406,816 |
| Less: Reserve for loan losses | (692,610) | (120,200) | (1,815) | (814,625) |
| Total | $1,603,989 | $2,914,110 | $ 74,092 | $4,592,191 |

**Credit Characteristics** – As part of the Company's process for monitoring the credit quality of its loans, it performs a quarterly loan portfolio assessment and assigns risk ratings to each of its performing loans. This process is discussed in more detail in "Reserve for loan losses" in Note 3. As of December 31, 2011, the Company's recorded investment in loans, presented by class and by credit quality, as indicated by risk rating, was as follows ($ in thousands):

| | As of | | | |
|---|---|---|---|---|
| | December 31, 2011 | | December 31, 2010 | |
| | Performing Loans | Weighted Average Risk Ratings | Performing Loans | Weighted Average Risk Ratings |
| Senior mortgages | **$1,514,016** | **3.19** | $2,394,270 | 3.48 |
| Subordinate mortgages | **190,342** | **3.36** | 307,509 | 3.20 |
| Corporate/Partnership loans | **472,178** | **3.61** | 685,848 | 3.76 |
| Total | **$2,176,536** | **3.29** | $3,387,627 | 3.51 |

As of December 31, 2011, the Company's recorded investment in loans, aged by payment status and presented by class, were as follows ($ in thousands):

| | Current | Less Than and Equal to 90 Days [1] | Greater Than 90 Days [1] | Total Past Due | Total |
|---|---|---|---|---|---|
| Senior mortgages | $1,721,653 | $ – | $1,086,913 | $1,086,913 | $2,808,566 |
| Subordinate mortgages | 190,342 | 22,481 | – | 22,481 | 212,823 |
| Corporate/Partnership loans | 472,178 | – | 11,294 | 11,294 | 483,472 |
| Total | $2,384,173 | $22,481 | $1,098,207 | $1,120,688 | $3,504,861 |

**Explanatory Note:**

(1) All loans with payments more than 90 days past due are classified as non-performing and are on non-accrual status. In addition, a loan with a recorded investment of $22.5 million that was less than 90 days delinquent is classified as non-performing.

**Impaired Loans –** The Company's recorded investment in impaired loans, presented by class, were as follows ($ in thousands)[1]:

| | As of | | | | | |
|---|---|---|---|---|---|---|
| | December 31, 2011 | | | December 31, 2010 | | |
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| **With no related allowance recorded:** | | | | | | |
| Senior mortgages | $ 219,488 | $ 218,612 | $ – | $ 404,861 | $ 404,126 | $ – |
| Corporate/Partnership loans | 10,110 | 10,160 | – | 10,110 | 10,160 | – |
| Subtotal | $ 229,598 | $ 228,772 | $ – | $ 414,971 | $ 414,286 | $ – |
| **With an allowance recorded:** | | | | | | |
| Senior mortgages | $1,268,962 | $1,263,195 | $(540,670) | $1,834,008 | $1,825,150 | $(683,948) |
| Subordinate mortgages | 22,480 | 22,558 | (22,480) | – | – | – |
| Corporate/Partnership loans | 62,591 | 62,845 | (9,974) | 64,465 | 64,919 | (10,477) |
| Subtotal | $1,354,033 | $1,348,598 | $(573,124) | $1,898,473 | $1,890,069 | $(694,425) |
| **Total:** | | | | | | |
| Senior mortgages | $1,488,450 | $1,481,807 | $(540,670) | $2,238,869 | $2,229,276 | $(683,948) |
| Subordinate mortgages | 22,480 | 22,558 | (22,480) | – | – | – |
| Corporate/Partnership loans | 72,701 | 73,005 | (9,974) | 74,575 | 75,079 | (10,477) |
| Total | $1,583,631 | $1,577,370 | $(573,124) | $2,313,444 | $2,304,355 | $(694,425) |

**Explanatory Note:**

(1) All of the Company's non-accrual loans are considered impaired and included in the table above. In addition, as of December 31, 2011 and 2010, certain loans modified through troubled debt restructurings with a recorded investment of $255.3 million and $294.3 million, respectively, are also included as impaired loans in accordance with GAAP although they are performing and on accrual status.

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

| | For the Years Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2011 | | 2010 | | 2009 | |
| | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| **With no related allowance recorded:** | | | | | | |
| Senior mortgages | $ 309,079 | $31,799[1] | $ 659,150 | $20,472 | $ 751,011 | $10,115 |
| Subordinate mortgages | – | – | 1,404 | 87 | 2,953 | 396 |
| Corporate/Partnership loans | 10,110 | 680 | 27,526 | 1,868 | 28,953 | – |
| Subtotal | $ 319,189 | $32,479 | $ 688,080 | $22,427 | $ 782,917 | $10,511 |
| **With an allowance recorded:** | | | | | | |
| Senior mortgages | $1,608,486 | $ 7,187 | $2,411,735 | $ 5,183 | $3,340,368 | $ 3,712 |
| Subordinate mortgages | 19,477 | – | 77,125 | 107 | 65,009 | – |
| Corporate/Partnership loans | 66,087 | 332 | 65,118 | – | 100,278 | – |
| Subtotal | $1,694,050 | $ 7,519 | $2,553,978 | $ 5,290 | $3,505,655 | $ 3,712 |
| **Total:** | | | | | | |
| Senior mortgages | $1,917,565 | $38,986 | $3,070,885 | $25,655 | $4,091,379 | $13,827 |
| Subordinate mortgages | 19,477 | – | 78,529 | 194 | 67,962 | 396 |
| Corporate/Partnership loans | 76,197 | 1,012 | 92,644 | 1,868 | 129,231 | – |
| Total | $2,013,239 | $39,998 | $3,242,058 | $27,717 | $4,288,572 | $14,223 |

**Explanatory Note:**

(1) Amount includes interest income of $26.3 million related to the resolution of certain non-performing loans. Interest income was not previously recorded as the loans were on non-accrual status.

**Troubled Debt Restructurings –** During the year ended December 31, 2011, the Company modified loans that were determined to be troubled debt restructurings. The recorded investment in these loans was impacted by the modifications as follows, presented by class ($ in thousands):

| | For the Year Ended December 31, 2011 | | |
|---|---|---|---|
| | Number of Loans | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Senior mortgages | 7 | $191,158 | $190,893 |

Loans that defaulted during the year ended December 31, 2011, that were modified as troubled debt restructurings within the previous 12 months, were as follows ($ in thousands):

| | For the Year Ended December 31, 2011 | |
|---|---|---|
| | Number of Loans | Outstanding Recorded Investment |
| Senior mortgages | 1 | $28,005 |

During the year ended December 31, 2011, the Company restructured seven loans that were considered troubled debt restructurings. The Company reduced the rate on three of these loans with a combined recorded investment of $105.7 million, from a combined weighted average rate of 8.3% to 4.7% and extended the loans with a new weighted average maturity of 1.4 years, with conditional extension options in certain cases dependent on pay down hurdles. The Company extended a discounted payoff option on one loan that is currently classified as non-performing and extended the term of the three remaining loans with the interest rates unchanged. In addition, as of December 31, 2011, the Company had $6.1 million of unfunded commitments on modified loans considered troubled debt restructurings.

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

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

## Note 5 – Real Estate Held-for-Investment, net and Other Real Estate Owned

During the year ended December 31, 2011, the Company received title to properties with an aggregate estimated fair value at the time of foreclosure of $502.5 million, in full or partial satisfaction of non-performing mortgage loans for which those properties had served as collateral. Of these, properties with a value of $396.2 million were classified as REHI and $106.3 million were classified as OREO, based on management's current intention to either hold the properties over a longer period or to market them for sale in the near term.

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

| As of December 31, | 2011 | 2010 |
|---|---|---|
| Land held-for-investment and development | **$ 701,547** | $606,083 |
| Operating property | | |
| Land | **143,411** | 69,807 |
| Buildings and improvements | **400,203** | 165,025 |
| Less: accumulated depreciation and amortization | **(17,027)** | (7,855) |
| Real estate held-for-investment, net | **$1,228,134** | $833,060 |

The Company records REHI operating income in "Other income" and REHI operating expenses in "Operating costs – REHI and OREO," on the Company's Consolidated Statements of Operations, as follows ($ in thousands):

| For the Years Ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| REHI operating income | **$35,331** | $23,103 | $ 5,822 |
| REHI operating expenses | **$45,885** | $31,646 | $12,455 |

**Other Real Estate Owned –** During the year ended December 31, 2011, the Company sold OREO assets with a carrying value of $176.5 million. A portion of these were sales of residential property units from which the Company recorded income of $5.7 million. For the years ended December 31, 2011, 2010 and 2009, the Company recorded net impairment charges to OREO properties totaling $20.8 million, $19.1 million and $78.6 million, respectively, and recorded net expenses related to holding costs for OREO properties of $31.4 million, $33.0 million, $28.4 million, respectively.

**Note 6 – Net Lease Assets, net**

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

| As of December 31, | 2011 | 2010 |
|---|---|---|
| Facilities and improvements | **$1,601,477** | $1,651,998 |
| Land and land improvements | **447,603** | 454,925 |
| Less: accumulated depreciation | **(346,316)** | (322,414) |
| Net lease assets, net | **$1,702,764** | $1,784,509 |

During the year ended December 31, 2011, the Company sold net lease assets with carrying values of $34.4 million, resulting in a net gain of $2.9 million.

During the year ended December 31, 2010, the Company completed the sale of a portfolio of 32 net lease assets to a single purchaser for a gross purchase price of $1.35 billion that resulted in a net gain of $250.3 million. The aggregate carrying value of the portfolio of assets was $1.05 billion. At the time of sale, the Company had reduced its gain on sale and recorded a liability based upon certain contingent obligations, which have now been fully resolved. Upon resolution of this liability in 2011, the Company realized $22.2 million of the gain previously deferred and recorded the gain in "Gain from discontinued operations" on the Company's Consolidated Statements of Operations for the year ended December 31, 2011. See Note 9 for additional details on the repayment of the debt collateralized by these assets. As part of the purchaser's financing for the transaction, the Company provided the purchaser with $105.6 million of mezzanine loans, which were subsequently paid down to $26.5 million as of December 31, 2011.

Summarized financial information for discontinued operations related to the sale of the portfolio of 32 net lease assets is as follows ($ in thousands):

| For the Years Ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| Total revenues | **$ –** | $55,559 | $114,575 |
| Income (loss) from discontinued operations | **$(2,301)** | $15,580 | $ 9,966 |

In addition to the sale of the portfolio of assets noted above, during the year ended December 31, 2010, the Company sold net lease assets with carrying values of $119.7 million, which resulted in gains of $20.1 million. For the year ended December 31, 2010, the Company recorded impairment charges on net lease assets of $6.1 million, all of which was included in "Income (loss) from discontinued operations" on the Company's Consolidated Statements of Operations.

During the year ended December 31, 2009 the Company sold net lease assets with carrying values of $52.1 million, which resulted in gains of $12.4 million. In addition, for the year ended December 31, 2009, the Company recorded impairment charges on net lease assets of $33.5 million of which $14.1 million was included in "Income (loss) from discontinued operations" on the Company's Consolidated Statements of Operations.

The Company receives reimbursements from customers for certain facility operating expenses including common area costs, insurance and real estate taxes. Customer expense reimbursements for the years ended December 31, 2011, 2010 and 2009 were $23.4 million, $29.8 million and $36.4 million, respectively. Of these amounts, $23.4 million, $23.6 million and $24.5 million, respectively, were included as a reduction of "Operating costs – net lease assets," and the remainder was included in "Income (loss) from discontinued operations" on the Company's Consolidated Statements of Operations.

**Future Minimum Operating Lease Payments –** Future minimum operating lease payments under non-cancelable leases, excluding customer reimbursements of expenses, in effect at December 31, 2011, are as follows ($ in thousands):

| Year | |
|---|---|
| 2012 | $149,937 |
| 2013 | $149,244 |
| 2014 | $151,188 |
| 2015 | $151,714 |
| 2016 | $148,792 |

## Note 7 – Other Investments

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

| | Carrying value as of December 31, | | Equity in earnings for the Years Ended December 31, | | |
|---|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 | 2009 |
| LNR | **$159,764** | $122,176 | **$53,861** | $ 1,797 | $ – |
| Madison Funds | **103,305** | 92,265 | **3,641** | 9,717 | (5,620) |
| Oak Hill Funds | **56,817** | 48,613 | **1,918** | 11,613 | 2,078 |
| REHI Investments | **52,803** | – | **(7,839)** | – | – |
| Oak Hill Advisors | **–** | 173,231 | **38,361** | 22,439 | 20,588 |
| Other equity method investments | **73,146** | 85,938 | **5,149** | 6,342 | (11,748) |
| Total equity method investments | **$445,835** | $522,223 | **$95,091** | $51,908 | $ 5,298 |
| Other | **12,000** | 10,135 | | | |
| Total other investments | **$457,835** | $532,358 | | | |

Equity Method Investments

**LNR –** On July 29, 2010, the Company acquired an ownership interest of approximately 24% in LNR Property Corporation ("LNR"). LNR is a servicer and special servicer of commercial mortgage loans and CMBS and a diversified real estate investment, finance and management company. In the transaction, the Company and a group of investors, including other creditors of LNR, acquired 100% of the common stock of LNR in exchange for cash and the extinguishment of existing senior notes of LNR's parent holding company (the "Holdco Notes"). The Company contributed $100.0 million aggregate principal amount of Holdco Notes and $100.0 million in cash in exchange for an equity interest of $120.0 million. During the year ended December 31, 2010, the Company executed the discounted payoff of a separate $25.0 million principal value loan with LNR for which it received proceeds of $24.5 million in full repayment.

Below is a summary of LNR's latest available financial information ($ in thousands)(1)(2):

| | For the Year Ended September 30, 2011 | For the Period July 29, 2010 to September 30, 2010 |
|---|---|---|
| **Income Statement** | | |
| Total revenue(2) | $327,032 | $40,022 |
| Income tax expense (benefit) | $ (76,558) | $ 685 |
| Net income attributable to LNR | $225,190 | $ 7,495 |
| iStar's ownership percentage | 24% | 24% |
| iStar's equity in earnings | $ 53,861 | $ 1,797 |

| As of September 30, | 2011 | 2010 |
|---|---|---|
| **Balance Sheet** | | |
| Total assets(2) | $1,288,923 | $1,270,912 |
| Total debt(2) | $ 469,631 | $ 515,495 |
| Total liabilities(2) | $ 576,835 | $ 724,311 |
| Noncontrolling interests | $ 39,940 | $ 37,092 |
| LNR Property LLC equity | $ 672,147 | $ 509,510 |
| iStar's ownership percentage | 24% | 24% |
| iStar's equity investment in LNR | $ 159,764 | $ 122,176 |

| | For the Year Ended September 30, 2011 | For the Period July 29, 2010 to September 30, 2010 |
|---|---|---|
| **Cash Flows** | | |
| Operating cash flows | $170,703 | $22,568 |
| Cash flows from investing and financing (excluding distributions) | $ (4,102) | $ (3,272) |
| Net cash flows (excluding distributions) | $166,601 | $19,296 |
| Cash distributions | $ 73,916 | $ – |
| iStar's ownership percentage | 24% | 24% |
| Cash distributions received by iStar | $ 17,722 | $ – |

**Explanatory Notes:**

(1) The Company records its investment in LNR on a one quarter lag, therefore, amounts in the Company's financial statements for the year ended December 31, 2011 are based on balances and results from LNR for the year ended September 30, 2011.

(2) LNR consolidates certain commercial mortgage-backed securities and collateralized debt obligation trusts that are considered VIEs (and for which it is the primary beneficiary), that have been excluded from the amounts presented above. As of September 30, 2011 and 2010, the assets of these trusts which aggregate approximately $126.66 billion and $142.39 billion, respectively, are the sole source of repayment of the related liabilities, which aggregate approximately $126.64 billion and $141.99 billion, respectively, which are non-recourse to LNR and its equity holders, including the Company. In addition, total revenue presented above includes $119.0 million and $16.8 million for the periods ended September 30, 2011 and 2010, respectively, of servicing fee revenue that is eliminated upon consolidation of the VIE's. This income is then added back through consolidation as an adjustment to income allocable to noncontrolling entities and has no net impact on Net Income attributable to LNR.

**Madison Funds –** As of December 31, 2011, the Company owned a 29.52% interest in Madison International Real Estate Fund II, LP, a 32.92% interest in Madison International Real Estate Fund III, LP and a 29.52% interest in Madison GP1 Investors, LP (collectively, the "Madison Funds"). The Madison Funds invest in ownership positions of entities that own real estate assets. The Company has determined that all of these entities are variable interest entities and that an external member is the primary beneficiary.

**Oak Hill Funds –** As of December 31, 2011, the Company owned a 10.43% interest in Oak Hill Credit Opportunities Fund, L.P. ("OHCOF"), a 5.92% interest in OHA Strategic Credit Master Fund, L.P. ("OHSCF"), and a 9.88% interest in Oak Hill Credit Partners II, Limited ("OHCP II") (collectively, the "Oak Hill Funds"). The Oak Hill Funds were formed to acquire and manage a diverse portfolio of assets, investing in distressed, stressed and undervalued loans, bonds, equities and other investments. The Company appointed to its Board of Directors a member that holds an investment in the Oak Hill Funds. As such Oak Hill is a related party of the Company.

**REHI Investments –** As of December 31, 2011, the Company owned 33% and 31% equity interests in two separate entities that received titles to properties previously serving as collateral for loan investments of the Company.

**Oak Hill Advisors –** In October 2011, the Company sold a substantial portion of its interests in Oak Hill Advisors, L.P. and related entities for $183.7 million of net cash proceeds, which resulted in a net gain of $30.3 million that was recorded in "Earnings from equity method investments" on the Company's Consolidated Statements of Operations. The transaction was completed in part through sales of interests to unrelated third parties and in part through redemption of interests by the principals of Oak Hill Advisors, L.P., including Glenn R. August. Mr. August serves as a member of the Company's Board of Directors and is also the president and senior partner of Oak Hill Advisors, L.P. In conjunction with the sale of its interests in Oak Hill Advisors, L.P., the Company retained interests in its share of certain unearned incentive fees of various funds. These fees are contingent on the future performance of the funds and the Company will recognize income related to these fees if and when the amounts are realized.

**Other Equity Method Investments –** The Company also had smaller investments in several other entities that were accounted for under the equity method where the Company has ownership interests up to 50.0%. Several of these investments are in real estate related funds or other strategic investment opportunities within niche markets.

During the years ended December 31, 2010 and 2009, the Company recognized impairment charges on certain of its equity method investments of $1.2 million and $4.7 million, respectively. In addition, during the year ended December 31, 2009, the Company recorded a non-cash out-of-period charge of $9.4 million to recognize additional losses from an equity method investment as a result of additional depreciation expense that should have been recorded at the equity method entity. This adjustment was recorded as a reduction to "Other investments" on the Company's Consolidated Balance Sheets and a decrease to "Earnings from equity method investments," on the Company's Consolidated Statements of Operations. The Company concluded that the amount of losses that should have been recorded in periods beginning in July 2007 were not material to any of its previously issued financial statements. The Company also concluded that the cumulative out-of-period charge was not material to the fiscal year in which it has been recorded. As such, the charge was recorded in the Company's Consolidated Statements of Operations for the year ended December 31, 2009, rather than restating prior periods.

**Summarized Financial Information –** The following table presents the investee level summarized financial information of the Company's equity method investments, excluding LNR ($ in thousands):

| For the years ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| **Income Statements** | | | |
| Revenues | **$198,340** | $590,265 | $129,814 |
| Net income (loss) attributable to parent entities | **$ 97,066** | $342,661 | $ (12,237) |

| As of December 31, | 2011 | 2010 |
|---|---|---|
| **Balance Sheets** | | |
| Total assets | **$3,079,736** | $4,486,974 |
| Total liabilities | **$ 197,246** | $1,236,116 |
| Noncontrolling interests | **$ 4,139** | $ 107,422 |
| Total equity | **$2,878,351** | $3,143,436 |

## Note 8 – Other Assets and Other Liabilities

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

| As of December 31, | 2011 | 2010 |
|---|---|---|
| Deferred financing fees, net[1] | $ 21,443 | $ 5,527 |
| Other receivables | 17,273 | 13,521 |
| Net lease in-place lease intangibles, net[2] | 17,013 | 24,469 |
| Leasing costs, net[3] | 12,423 | 8,267 |
| Corporate furniture, fixtures and equipment, net[4] | 9,034 | 11,016 |
| Prepaid expenses | 5,441 | 5,265 |
| Other assets | 29,849 | 17,463 |
| Deferred expenses and other assets, net | $112,476 | $85,528 |

**Explanatory Notes:**

(1) During the year ended December 31, 2011, in connection with the Secured Credit Facility, the Company recorded deferred financing fees of $33.3 million (see Note 9). Accumulated amortization of deferred financing fees was $13.3 million and $21.1 million as of December 31, 2011 and 2010, respectively.

(2) Represents unamortized finite lived intangible assets related to the prior acquisition of net lease assets. Accumulated amortization on net lease intangibles was $33.4 million and $26.6 million as of December 31, 2011 and 2010, respectively. Amortization expense related to these assets was $6.8 million, $6.4 million and $9.6 million for the years ended December 31, 2011, 2010 and 2009, respectively.

(3) Accumulated amortization on leasing costs was $5.5 million and $5.3 million as of December 31, 2011 and 2010, respectively.

(4) Accumulated depreciation on corporate furniture, fixtures and equipment was $8.1 million and $7.2 million as of December 31, 2011 and 2010, respectively.

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

| As of December 31, | 2011 | 2010 |
|---|---|---|
| Accrued expenses | $ 36,332 | $ 19,800 |
| Accrued interest payable | 30,122 | 38,143 |
| Security deposits and other investment deposits | 12,192 | 2,874 |
| Unearned operating lease income | 9,077 | 10,423 |
| Property taxes payable | 6,495 | 5,880 |
| Deferred tax liabilities | – | 13,729 |
| Other liabilities | 12,475 | 43,573 |
| Accounts payable, accrued expenses and other liabilities | $106,693 | $134,422 |

## Note 9 – Debt Obligations, net

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

| | Carrying Value as of December 31, | | Stated | Scheduled |
|---|---|---|---|---|
| | 2011 | 2010 | Interest Rates | Maturity Date |
| **Secured credit facilities:** | | | | |
| Tranche A-1 Facility | **$ 961,580** | $ – | LIBOR + 3.75%[1] | June 2013 |
| Tranche A-2 Facility | **1,450,000** | – | LIBOR + 5.75%[1] | June 2014 |
| Line of credit | **–** | 618,883 | LIBOR + 1.50% | June 2011 |
| Line of credit | **–** | 334,180 | LIBOR + 1.50% | June 2012 |
| **Secured term loans:** | | | | |
| Collateralized by loans, net lease, REHI and OREO assets | **–** | 1,055,000 | LIBOR + 1.50% | June 2011 |
| Collateralized by loans, net lease, REHI and OREO assets | **–** | 612,222 | LIBOR + 1.50% | June 2012 |
| Collateralized by net lease assets | **293,192** | 190,223 | 5.05% - 7.68% | Various through 2026 |
| Total secured credit facilities and term loans | **2,704,772** | 2,810,508 | | |
| **Unsecured credit facilities:** | | | | |
| Line of credit | **–** | 501,405 | LIBOR + 0.85% | June 2011 |
| Line of credit | **243,650** | 243,819 | LIBOR + 0.85% | June 2012 |
| Total unsecured credit facilities | **243,650** | 745,224 | | |
| **Secured notes:** | | | | |
| 10.0% senior notes | **–** | 312,329 | 10.0% | June 2014 |
| **Unsecured notes:** | | | | |
| 5.80% senior notes | **–** | 107,766 | 5.80% | March 2011 |
| 5.125% senior notes | **–** | 96,916 | 5.125% | April 2011 |
| 5.65% senior notes | **–** | 196,593 | 5.65% | September 2011 |
| 5.15% senior notes | **263,466** | 322,006 | 5.15% | March 2012 |
| 5.50% senior notes | **92,845** | 102,345 | 5.50% | June 2012 |
| LIBOR + 0.50% senior convertible notes[2] | **784,750** | 787,750 | LIBOR + 0.50% | October 2012 |
| 8.625% senior notes | **501,701** | 501,701 | 8.625% | June 2013 |
| 5.95% senior notes | **448,453** | 448,453 | 5.95% | October 2013 |
| 6.5% senior notes | **67,055** | 67,055 | 6.5% | December 2013 |
| 5.70% senior notes | **200,601** | 200,601 | 5.70% | March 2014 |
| 6.05% senior notes | **105,765** | 105,765 | 6.05% | April 2015 |
| 5.875% senior notes | **261,403** | 261,403 | 5.875% | March 2016 |
| 5.85% senior notes | **99,722** | 99,722 | 5.85% | March 2017 |
| Total unsecured notes | **2,825,761** | 3,298,076 | | |
| **Other debt obligations:** | | | | |
| Other debt obligations | **100,000** | 100,000 | LIBOR + 1.5% | October 2035 |
| **Total debt obligations** | **5,874,183** | 7,266,137 | | |
| Debt premiums/(discounts), net[2][3] | **(36,643)** | 79,296 | | |
| **Total debt obligations, net** | **$5,837,540** | $7,345,433 | | |

**Explanatory Notes:**

(1) These loans each have a LIBOR floor of 1.25%. As of December 31, 2011, inclusive of the floors, the Tranche A-1 Facility and Tranche A-2 Facility loans incurred interest at a rate of 5.00% and 7.00%, respectively.

(2) The Company's convertible senior floating rate notes due October 2012 ("Convertible Notes") are convertible at the option of the holders, into 22.2 shares per $1,000 principal amount of Convertible Notes, on or after August 15, 2012, or prior to that date if (1) the price of the Company's Common Stock trades above 130% of the conversion price for a specified duration, (2) the trading price of the Convertible Notes is below a certain threshold, subject to specified exceptions, (3) the Convertible Notes have been called for redemption, or (4) specified corporate transactions have occurred. None of the conversion triggers have been met as of December 31, 2011. As of December 31, 2011, the outstanding principal balance of the Company's senior convertible notes was $784.8 million, the unamortized discount was $10.3 million and the net carrying amount of the liability was $774.5 million. As of December 31, 2011, the carrying value of the additional paid-in-capital, or equity component of the convertible notes, was $37.4 million. For the years ended December 31, 2011, 2010 and 2009, the Company recognized interest expense on the convertible notes of $18.0 million, $17.5 million and $21.0 million, respectively, of which $11.6 million, $10.8 million and $10.0 million, respectively, related to the amortization of the debt discount.

(3) As of December 31, 2011, includes unamortized original issue debt discounts of $22.5 million associated with the Secured Credit Facility completed in March 2011.

**Future Scheduled Maturities –** As of December 31, 2011, future scheduled maturities of outstanding long-term debt obligations, net are as follows ($ in thousands)(1):

| | |
|---|---|
| 2012 | $1,596,290 |
| 2013 | 1,971,049 |
| 2014 | 1,551,824 |
| 2015 | 105,765 |
| 2016 | 261,403 |
| Thereafter | 387,852 |
| Total principal maturities | 5,874,183 |
| Unamortized debt discounts, net | (36,643) |
| Total long-term debt obligations, net | $5,837,540 |

**Explanatory Note:**

(1) Includes minimum required amortization payments on the Secured Credit Facility.

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

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

During the year ended December 31, 2011, the Company used proceeds from principal repayments and sales of collateral to repay $538.4 million of its Tranche A-1 Facility. These repayments exceeded the $450.0 million cumulative amortization required to be paid by June 30, 2012, leaving $211.6 million to be paid on or before December 31, 2012. Repayments of the facility prior to scheduled amortization dates have resulted in losses on early extinguishment of debt of $12.0 million for the year ended December 31, 2011, related to the acceleration of discounts and unamortized deferred financing fees on the portion of the facility that was repaid.

During the year ended December 31, 2011, the Company received $9.1 million pursuant to an agreement with a holder of the Company's previously outstanding secured credit facilities. The amount effectively reduced the par value that was repaid to the debtholder and was accounted for under ASC 470-60, resulting in $3.7 million being recognized during the year ended December 31, 2011, as a gain on extinguishment of debt. As the same lender participated in the new Secured Credit Facility, the remaining amount was recorded as a premium to that facility and will serve to reduce a portion of future interest expense as it is amortized through its maturity.

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

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

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

In 2010, the Company repaid other secured term loans, including a $947.9 million non-recourse loan that was collateralized by the portfolio of net lease assets sold during the period, as well as $153.3 million of other term loans with various maturities. In connection with these repayments, the Company expensed unamortized deferred financing costs and incurred other expenses totaling $22.1 million, which reduced net gain on early extinguishment of debt during the year ended December 31, 2010.

**Secured Notes –** During 2009, the Company completed a series of private offers in which the Company issued $155.3 million and $479.5 million aggregate principal amount of its 8.0% second priority senior secured guaranteed notes due 2011 and 10.0% second priority senior secured guaranteed notes due 2014, respectively, in exchange for $1.01 billion aggregate principal amount of its senior unsecured notes of various series. As a result of these transactions, the Company recognized a $107.9 million gain on early extinguishment of debt, net of closing costs of $11.8 million, during the year ended December 31, 2009, and recorded a deferred gain of $262.7 million which was reflected as premiums to the par value of the new debt.

During 2010, the Company redeemed or repurchased $322.5 million par value of its 2011 and 2014 Notes, generating $71.3 million of gains on early extinguishment of debt.

In January 2011, the Company fully redeemed the $312.3 million remaining principal balance of its 10% 2014 Notes and recorded a gain on early extinguishment of debt of $109.0 million primarily related to the recognition of the deferred gain premiums that resulted from the exchange.

**Unsecured Notes –** During the year ended December 31, 2011, the Company repaid, upon maturity, the $170.4 million outstanding principal balance of its 5.65% senior unsecured notes, the $96.9 million outstanding principal balance of its 5.125% senior unsecured notes and the $107.8 million outstanding principal balance of its 5.80% senior unsecured notes. In addition, the Company repurchased $97.2 million par value of its senior unsecured with various maturities ranging from September 2011 to October 2012. In connection with these repurchases, the Company recorded an aggregate gain on early extinguishment of debt of $0.8 million for the year ended December 31, 2011.

During the year ended December 31, 2010, the Company repurchased $592.8 million par value of senior unsecured notes with various maturities ranging from March 2010 to March 2014 generating $59.7 million in net gains on early extinguishment of debt.

During the year ended December 31, 2009, the Company repurchased $1.31 billion par value of senior unsecured notes with various maturities ranging from January 2009 to March 2017 generating $439.4 million in net gains on early extinguishment of debt.

**Unencumbered/Encumbered Assets –** As of December 31, 2011, the Company had unencumbered assets, including cash, with a gross carrying value of $4.68 billion, gross of $707.3 million of accumulated depreciation and loan loss reserves, and encumbered assets with a carrying value of $3.53 billion. The carrying value of our encumbered assets by asset type is as follows ($ in thousands):

| As of December 31, | 2011 | 2010 |
|---|---|---|
| Loans and other lending investments, net | **$1,786,449** | $2,832,184 |
| Net lease assets, net | **1,173,978** | 1,021,783 |
| REHI, net | **359,597** | 28,376 |
| OREO | **177,005** | 232,150 |
| Other investments | **37,957** | – |
| Total | **$3,534,986** | $4,114,493 |

## Debt Covenants

The Company's outstanding unsecured debt securities contain corporate level covenants that include a covenant to maintain a ratio of unencumbered assets to unsecured indebtedness of at least 1.2x and a restriction on debt incurrence based upon the effect of the debt incurrence on the Company's fixed charge coverage. If any of the Company's covenants is breached and not cured within applicable cure periods, the breach could result in acceleration of its debt securities unless a waiver or modification is agreed upon with the requisite percentage of the bondholders. While the Company expects that its ability to incur new indebtedness under the fixed charge coverage ratio will be limited for the foreseeable future, it will continue to be permitted to incur indebtedness for the purpose of refinancing existing indebtedness and for other permitted purposes under the indentures.

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

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

## Note 10 – Commitments and Contingencies

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

The Company saw signs of an economic recovery during 2010 and 2011, including some improvements in the commercial real estate market and capital markets. These conditions resulted in reduced additions to non-performing loans, reductions in provisions for loan losses and increased levels of liquidity to fund operations. These improving conditions allowed the Company to complete the Secured Credit Facility in March of 2011. While the Company has benefited from improving conditions, volatility within the capital markets and commercial real estate market continues to have an adverse effect on the Company's operations, as primarily evidenced by continuing elevated levels of non-performing assets and higher costs of capital. Further, improvement in the Company's financial condition and operating results and its ability to generate sufficient liquidity are dependent on a sustained economic recovery, which cannot be predicted with certainty.

As of December 31, 2011, the Company had $1.60 billion of debt maturing and minimum required amortization payments due on or before December 31, 2012. Of this amount, $211.6 million represents the minimum amortization payable by December 31, 2012 under the

Secured Credit Facility, which is collateralized by assets with a carrying value of $3.08 billion. The Company expects to use proceeds from repayments and sales of the pledged collateral to meet these amortization payments. The remaining $1.38 billion of maturing debt represents unsecured debt that is scheduled to mature during 2012 as follows ($ in thousands):

| Maturity Date | Amount Due |
|---|---|
| March 2012 | $263,466 |
| June 2012 | $336,495 |
| October 2012 | $784,750 |

As of December 31, 2011, the Company had unrestricted cash of $356.8 million and other unencumbered assets with a carrying value of $3.69 billion. The Company's capital sources to meet its unsecured debt maturities in the coming year will primarily include debt refinancings, proceeds from asset sales and loan repayments from borrowers, and may include equity capital raising transactions. The Company has identified unencumbered assets with a carrying value of approximately $1.5 billion that it will use either as collateral for secured refinancings or will sell strategically during the year ending December 31, 2012. The Company currently expects that the majority of such asset sales would occur during the second half of 2012. Based upon the dynamic nature of the Company's assets and its liquidity plan and the time frame in which the Company needs to generate liquidity, the specific assets, nature of the transactions, timing and amount of asset sales and refinancing transactions could vary. The Company may also encounter difficulty in finding buyers of assets or executing capital raising strategies on acceptable terms in a timely manner, which could impact its ability to make scheduled repayments on its outstanding debt. However, given the Company's unencumbered asset base and current market conditions, the Company believes that it has several options that can be reasonably and timely executed to enable the Company to repay its debt obligations during 2012 as they come due.

The timing and amounts of proceeds from expected asset repayments and sales, and the Company's ability to consummate debt refinancing and equity capital raising transactions are subject to factors outside its control and cannot be predicted with certainty. The Company's plans are dynamic and it may adjust its plans in response to changes in its expectations and changes in market conditions. In addition, although there were early signs of improvement in the commercial real estate and credit markets beginning in 2010 and in 2011, such markets remain volatile and it is not possible for the Company to predict whether these trends will continue in the future or quantify the impact of these or other trends on its financial results. If the Company fails to repay its obligations as they become due, it would be an event of default under the relevant debt instruments, which could result in a cross-default and acceleration of the Company's other outstanding debt obligations, all of which would have a material adverse effect on the Company.

**Unfunded Commitments –** The Company has certain off-balance sheet unfunded commitments. The Company generally funds construction and development loans and build-outs of space in net lease assets over a period of time if and when the borrowers and tenants meet established milestones and other performance criteria. The Company refers to these arrangements as Performance-Based Commitments. In addition, the Company will sometimes establish a maximum amount of additional fundings which it will make available to a borrower or tenant for an expansion or addition to a project if it approves of the expansion or addition at its sole discretion. The Company refers to these arrangements as Discretionary Fundings. Finally, the Company has committed to invest capital in several real estate funds and other ventures. These arrangements are referred to as Strategic Investments. As of December 31, 2011, the maximum amounts of the fundings the Company may make under each category, assuming all performance hurdles and milestones are met under the Performance-Based Commitments, that it will approve all Discretionary Fundings and that 100% of its capital committed to Strategic Investments is drawn down, are as follows ($ in thousands):

| | Loans | Net Lease Assets | Strategic Investments | Total |
|---|---|---|---|---|
| Performance-Based Commitments | $ 53,266 | $14,054 | $ – | $ 67,320 |
| Discretionary Fundings | 128,029 | – | – | 128,029 |
| Other | – | – | 24,340 | 24,340 |
| Total | $181,295 | $14,054 | $24,340 | $219,689 |

**Other Commitments –** Total operating lease expense for the years ended December 31, 2011, 2010 and 2009 were $7.2 million, $7.3 million and $13.3 million, respectively. Future minimum lease obligations under non-cancelable operating leases are as follows ($ in thousands):

| | |
|---|---|
| 2012 | $5,522 |
| 2013 | $4,952 |
| 2014 | $4,487 |
| 2015 | $4,254 |
| 2016 | $4,411 |
| Thereafter | $3,391 |

For the year ended December 31, 2009, the Company recognized a $42.4 million lease termination expense in "Other expense" on the Consolidated Statements of Operations pursuant to a settlement agreement under which the Company terminated a long-term lease for new headquarters space and settled all disputes with the landlord.

The Company also has issued letters of credit totaling $12.7 million in connection with six of its investments.

**Legal Proceedings –** The Company and/or one or more of its subsidiaries is party to various pending litigation matters that are considered ordinary routine litigation incidental to the Company's business as a finance and investment company focused on the commercial real estate industry, including loan foreclosure and foreclosure-related proceedings. The Company discloses certain of its more significant legal proceedings under "Item 3. Legal Proceedings" in its Annual Report on Form 10-K for the year ended December 31, 2011 (Legal Proceedings).

A liability is accrued when it is both (a) probable that a loss with respect to the legal proceeding has occurred and (b) the amount

of loss can be reasonably estimated. The Company evaluates, on a quarterly basis, developments in legal proceedings that could require a liability to be accrued. Based on its current knowledge, and after consultation with legal counsel, the Company believes it is not a party to, nor is any of its properties the subject of, any pending legal proceeding that would have a material adverse effect on the Company's consolidated financial condition.

## Note 11 – 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. As of December 31, 2011, 140.0 million common shares were issued and 81.9 million common shares were outstanding.

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

| | | | Cumulative Preferential Cash Dividends[1][2] | |
|---|---|---|---|---|
| Series | Shares Issued and Outstanding (in thousands) | Par Value | Rate per Annum of the $25.00 Liquidation Preference | Equivalent to Fixed Annual Rate (per share) |
| D | 4,000 | $0.001 | 8.000% | $2.00 |
| E | 5,600 | $0.001 | 7.875% | $1.97 |
| F | 4,000 | $0.001 | 7.8% | $1.95 |
| G | 3,200 | $0.001 | 7.65% | $1.91 |
| I | 5,000 | $0.001 | 7.50% | $1.88 |
| | 21,800 | | | |

**Explanatory Notes:**

(1) Holders of shares of the Series D, E, F, G and I preferred stock are entitled to receive dividends, when and as declared by the Board of Directors, out of funds legally available for the payment of dividends. Dividends are cumulative from the date of original issue and are payable quarterly in arrears on or before the 15th day of each March, June, September and December or, if not a business day, the next succeeding business day. Any dividend payable on the preferred stock for any partial dividend period will be computed on the basis of a 360-day year consisting of twelve 30-day months. Dividends will be payable to holders of record as of the close of business on the first day of the calendar month in which the applicable dividend payment date falls or on another date designated by the Board of Directors of the Company for the payment of dividends that is not more than 30 nor less than ten days prior to the dividend payment date.

(2) The Company declared and paid dividends aggregating $8.0 million, $11.0 million, $7.8 million, $6.1 million and $9.4 million on its Series D, E, F, G, and I preferred stock, respectively, during each of the years ended December 31, 2011 and 2010. There are no dividend arrearages on any of the preferred shares currently outstanding.

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.

### High Performance Unit Program

In May 2002, the Company's shareholders approved the iStar Financial High Performance Unit ("HPU") Program. The program entitled employee participants ("HPU Holders") to receive distributions if the total rate of return on the Company's Common Stock (share price appreciation plus dividends) exceeded certain performance thresholds over a specified valuation period. The Company established seven HPU plans that had valuation periods ending between 2002 and 2008 and the Company has not established any new HPU plans since 2005. HPU Holders purchased their interests in High Performance Common Stock for aggregate initial purchase prices of approximately $2.8 million, $1.8 million, $1.4 million, $0.6 million, $0.7 million, $0.6 million and $0.8 million for the 2002, 2003, 2004, 2005, 2006, 2007 and 2008 plans, respectively.

The 2002, 2003 and 2004 plans all exceeded their performance thresholds and are entitled to receive distributions equivalent to the amount of dividends payable on 819,254 shares, 987,149 shares and 1,031,875 shares, respectively, of the Company's Common Stock as and when such dividends are paid on the Company's Common Stock. Each of these three plans has 5,000 shares of High Performance Common Stock associated with it, which is recorded as a separate class of stock within shareholders' equity on the Company's Consolidated Balance Sheets. High Performance Common Stock carries 0.25 votes per share. Net income allocable to common shareholders is reduced by the HPU holders' share of earnings.

The remaining four plans that had valuation periods which ended in 2005, 2006, 2007 and 2008, did not meet their required performance thresholds and none of the plans were funded. As a result, the Company redeemed the participants' units for approximately $1,700 resulting in the unit holders losing $2.4 million of aggregate contributions.

In addition to these plans, a high performance unit program for executive officers was established with plans having three-year valuation periods which ended December 31, 2005, 2006, 2007 and 2008. The provisions of these plans were substantially the same as the high performance unit programs for employees. The Chief Executive Officer and former President collectively purchased 100% interests

in the Company's 2005, 2006, 2007 and 2008 high performance unit program for senior executive officers for an aggregate purchase price of $1.5 million. These plans did not meet the required performance thresholds and were not funded, resulting in the Chief Executive Officer and former President losing $0.9 million and $0.6 million in total contributions, respectively.

**Dividends** – In order to maintain its election to qualify as a REIT, the Company must currently distribute, at a minimum, an amount equal to 90% of its taxable income, excluding net capital gains, and must distribute 100% of its taxable income (including net capital gains) to avoid paying corporate federal income taxes. The Company has recorded net operating losses and may record net operating losses in the future, which may reduce its taxable income in future periods and lower or eliminate entirely the Company's obligation to pay dividends for such periods in order to maintain its REIT qualification. Because taxable income differs from cash flow from operations due to non-cash revenues and expenses (such as depreciation and certain asset impairments), in certain circumstances, the Company may generate operating cash flow in excess of its dividends or, alternatively, may be required to borrow to make sufficient dividend payments. The Company's Secured Credit Facility permits the Company to distribute 100% of its REIT taxable income on an annual basis, for so long as the Company maintains its qualification as a REIT. The Secured Credit Facility restricts the Company from paying any common dividends if it ceases to qualify as a REIT. The Company did not declare or pay any Common Stock dividends for the years ended December 31, 2011 and 2010.

**Stock Repurchase Program** – On August 8, 2011, the Company's Board of Directors approved a stock repurchase program that authorized the repurchase of up to $65.0 million of its Common Stock from time to time in open market and privately negotiated purchases, including pursuant to one or more trading plans. When aggregated with the $14.1 million remaining authorization from previous repurchase programs, the Company had $79.1 million of its Common Stock available for repurchases during the year ended December 31, 2011.

During the year ended December 31, 2011, the Company repurchased 12.3 million shares of its outstanding Common Stock for approximately $78.5 million, at an average cost of $6.43 per share, and repurchases were recorded at cost. As of December 31, 2011, the Company had $0.6 million of Common Stock available to repurchase under its Board authorized stock repurchase programs.

## Note 12 – Risk Management and Derivatives

### Risk management

In the normal course of its on-going 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 points in time and potentially at different bases, than its interest-earning assets. Credit risk is the risk of default on the Company's lending investments or leases that result from a borrower's or tenant's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of loans and other lending investments 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, the valuation of net lease, REHI and OREO assets by the Company as well as changes in foreign currency exchange rates.

**Risk concentrations** – As of December 31, 2011, the Company's total investment portfolio was comprised of the following property/collateral types ($ in thousands)(1):

| Property/Collateral Types | Performing Loans | Net Lease Assets | Non-performing Loans | REHI | OREO | Total | % of Total |
|---|---|---|---|---|---|---|---|
| Land | $ 206,550 | $ 56,014 | $211,164 | $ 782,766 | $119,004 | $1,375,498 | 19.7% |
| Apartment/Residential | 549,471 | – | 292,740 | 41,076 | 402,983 | 1,286,270 | 18.4% |
| Retail | 356,823 | 158,762 | 68,483 | 154,406 | 58,379 | 796,853 | 11.4% |
| Office | 116,527 | 490,106 | 36,901 | 71,148 | 2,616 | 717,298 | 10.2% |
| Industrial/R&D | 87,853 | 478,322 | 7,836 | 48,789 | 1,100 | 623,900 | 8.9% |
| Entertainment/Leisure | 78,231 | 424,794 | 79,581 | – | 479 | 583,085 | 8.3% |
| Hotel | 352,777 | 94,766 | 68,270 | 42,285 | 16,049 | 574,147 | 8.2% |
| Mixed Use/Mixed Collateral | 238,943 | – | – | 87,664 | 76,848 | 403,455 | 5.8% |
| Other property types | 175,891 | – | 6,221 | – | – | 182,112 | 2.6% |
| Other Investments | – | – | – | – | – | 457,835 | 6.5% |
| Total | $2,163,066 | $1,702,764 | $771,196 | $1,228,134 | $677,458 | $7,000,453 | 100.0% |

**Explanatory Note:**

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

As of December 31, 2011, the Company's total investment portfolio had the following characteristics by geographical region ($ in thousands):

| Geographic Region | Carrying Value[(1)] | % of Total |
|---|---|---|
| West | $1,657,504 | 23.7% |
| Northeast | 1,303,779 | 18.6% |
| Southeast | 1,052,002 | 15.0% |
| Southwest | 847,141 | 12.1% |
| Mid-Atlantic | 694,654 | 9.9% |
| Various | 545,421 | 7.8% |
| Central | 376,338 | 5.4% |
| International | 279,352 | 4.0% |
| Northwest | 244,262 | 3.5% |
| Total | $7,000,453 | 100.0% |

**Explanatory Note:**

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

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 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 significant concentration of credit risks.

Substantially all of the Company's net lease, REHI and OREO assets as well as assets collateralizing its loans and other lending investments are located in the United States, with California 15.3% and Florida 11.0% representing the only significant concentrations (greater than 10.0%) as of December 31, 2011. The Company's portfolio contains significant concentrations in the following asset types as of December 31, 2011: land 19.7%, apartment/residential 18.4%, retail 11.4% and office 10.2%.

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 net 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, 2011, the Company's five largest borrowers or tenants collectively accounted for approximately 22.4% of the Company's aggregate annualized interest and operating lease revenue, of which no single customer accounts for more than 8.0%.

Derivatives

The Company's use of derivative financial instruments is primarily limited to the utilization of interest rate hedges and foreign exchange hedges. The principal objective of such hedges are to minimize the risks and/or costs associated with the Company's operating and financial structure and to manage its exposure to foreign exchange rate movements. Derivatives not designated as hedges are not speculative and are used to manage the Company's exposure to interest rate movements, foreign exchange rate movements, and other identified risks, but may not meet the strict hedge accounting requirements.

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

| | Derivative Assets as of December 31, | | | | Derivative Liabilities as of December 31, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2011 | | 2010 | | 2011 | | 2010 | |
| Derivative | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Foreign exchange contracts | Other Assets | **$–** | Other Assets | $– | Other Liabilities | **$1,342** | Other Liabilities | $223 |
| Cash flow interest rate swap | Other Assets | **–** | Other Assets | – | Other Liabilities | **1,031** | Other Liabilities | – |
| Total | | **$–** | | $– | | **$2,373** | | $223 |

The tables below present the effect of the Company's derivative financial instruments on the Consolidated Statements of Operations for the year ended December 31, 2011 ($ in thousands):

| Derivatives Designated in Hedging Relationships | Location of Gain (Loss) Recognized in Income on Derivative | Amount of Gain (Loss) Recognized in Accumulated Other Comprehensive Income (Effective Portion) | Amount of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Earnings (Effective Portion) | Amount of Gain (Loss) Recognized in Earnings (Ineffective Portion) |
|---|---|---|---|---|
| Cash flow interest rate swap | Accumulated Other Comprehensive Income | $(1,553) | $(526) | N/A |

| Derivatives Not Designated in Hedging Relationships | Location of Gain or (Loss) Recognized in Income on Derivative | Amount of Gain or (Loss) Recognized in Income on Derivative For the Year Ended December 31, 2011 | 2010 | 2009 |
|---|---|---|---|---|
| Foreign Exchange Contracts | Other Expense | **$17,406** | $(1,010) | $738 |

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

The following table presents the Company's foreign currency derivatives outstanding as of December 31, 2011 ($ in thousands):

| Derivative Type | Notional Amount | Notional (USD Equivalent) | Maturity |
|---|---|---|---|
| Sells EUR/Buys USD Forward | €141,500 | $183,126 | March 2012 |
| Sells GBP/Buys USD Forward | £47,960 | $74,380 | March 2012 |
| Sells CAD/Buys USD Forward | CAD 50,641 | $49,728 | March 2012 |

**Qualifying Cash Flow Hedges—**During the year ended December 31, 2011, the Company entered into interest rate swaps to convert its variable rate debt to fixed rate. The following table presents the Company's interest rate swaps outstanding as of December 31, 2011 ($ in thousands):

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

The effective portion of the change in the fair value of these qualifying hedges are recorded in "Accumulated other comprehensive income (loss)" on the Company's Consolidated Balance Sheets. Over the next 12 months, the Company expects that $0.5 million of expense and $0.7 million of income related to the qualifying cash flow hedges and previously terminated cash flow hedges, respectively, will be reclassified from Accumulated other comprehensive income (loss) into earnings.

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

In connection with its foreign currency derivatives, as of December 31, 2011, the Company has posted collateral of $9.6 million, which is included in "Restricted cash" on the Company's Consolidated Balance Sheets.

## Note 13 – Stock-Based Compensation Plans and Employee Benefits

On May 27, 2009, the Company's shareholders approved the Company's 2009 Long-Term Incentive Plan (the "2009 LTIP") which is designed to provide incentive compensation for officers, key employees, directors and advisors of the Company. The 2009 LTIP provides for awards of stock options, shares of restricted stock, phantom shares, restricted stock units, dividend equivalent rights and other share-based performance awards. A maximum of 8,000,000 shares of Common Stock may be awarded under the 2009 LTIP, plus up to an additional 500,000 shares to the extent that a corresponding number of equity awards previously granted under the Company's 1996 Long-Term Incentive Plan expire or are cancelled or forfeited. All awards under the 2009 LTIP are made at the discretion of the Board of Directors or a committee of the Board of Directors.

The Company's 2006 Long-Term Incentive Plan (the "2006 LTIP") is designed to provide equity-based incentive compensation for officers, key employees, directors, consultants and advisers of the Company. The 2006 LTIP provides for awards of stock options, shares of restricted stock, phantom shares, dividend equivalent rights and other share-based performance awards. A maximum of 4,550,000 shares of Common Stock may be subject to awards under the 2006 LTIP provided that the number of shares of Common Stock reserved for grants of options designated as incentive stock options is 1.0 million, subject to certain anti-dilution provisions in the 2006 LTIP. All awards under this Plan are at the discretion of the Board of Directors or a committee of the Board of Directors.

The Company's 2007 Incentive Compensation Plan ("Incentive Plan") was approved and adopted by the Board of Directors in 2007 in order to establish performance goals for selected officers and other key employees and to determine bonuses that will be awarded to those officers and other key employees based on the extent to which they achieve those performance goals. Equity-based awards may be made under the Incentive Plan, subject to the terms of the Company's equity incentive plans.

As of December 31, 2011, an aggregate of 3.7 million shares remain available for awards under the Company's 2006 and 2009 LTIP.

**Stock-Based Compensation –** The Company recorded stock-based compensation expense of $29.7 million, $19.4 million and $23.6 million for the years ended December 31, 2011, 2010 and 2009, respectively in "General and administrative" on the Company's Consolidated Statements of Operations. As of December 31, 2011, there was $23.8 million of total unrecognized compensation cost related to all unvested restricted stock units and the cost is expected to be recognized over a weighted average remaining vesting/service period of 0.95 years.

**Stock Options –** Changes in options outstanding during the year ended December 31, 2011, are as follows (amounts in thousands, except for weighted average strike price):

| | Number of Shares | | | | |
|---|---|---|---|---|---|
| | Employees | Non-Employee Directors | Other | Weighted Average Strike Price | Aggregate Intrinsic Value |
| **Options Outstanding, December 31, 2010** | 59 | 64 | 20 | $24.87 | |
| Forfeited in 2011 | (59) | (30) | (10) | $22.65 | |
| **Options Outstanding, December 31, 2011** | **–** | **34** | **10** | **$29.82** | **$–** |

The following table summarizes information concerning outstanding and exercisable options as of December 31, 2011 (options in thousands):

| Exercise Price | Options Outstanding and Exercisable | Remaining Contractual Life (Years) |
|---|---|---|
| $29.82 | 44 | 0.41 |

The Company has not issued any options since 2003. During the years ended December 31, 2011 and 2010, no options were exercised.

**Restricted Stock Units** – Changes in non-vested restricted stock units during the year ended December 31, 2011 were as follows ($ in thousands, except per share amounts):

| Non-Vested Shares | Number of Shares | Weighted Average Grant Date Fair Value Per Share | Aggregate Intrinsic Value |
|---|---|---|---|
| **Non-vested at December 31, 2010** | 14,333 | $2.89 | |
| Granted | 2,721 | $6.43 | |
| Vested | (2,569) | $4.20 | |
| Forfeited[1] | (4,500) | $2.54 | |
| **Non-vested at December 31, 2011** | **9,985** | **$4.70** | **$52,821** |

**Explanatory Note:**

(1) Includes 2,447 Original Units awarded to unit holders on December 19, 2008, reduced as part of the modification to Amended Units on July 1, 2011 as further described below.

The total fair value of restricted stock units vested during the years ended December 31, 2011, 2010 and 2009 was $15.5 million, $1.7 million and $1.4 million, respectively.

*2011 Activity* – On October 9, 2011, 2,000,000 market-condition based restricted stock units originally granted to the Company's Chairman and Chief Executive Officer on October 9, 2008 and approved by shareholders on May 27, 2009 were canceled as the shareholder return target was not achieved. These units would have cliff vested in one installment on October 9, 2011 only if the total shareholder return on the Company's Common Stock was at least 25% per year (compounded at the end of the three year vesting period, including dividends). Total shareholder return was based on the average NYSE closing prices for the Company's Common Stock for the 20 days prior to: (a) the date of the award on October 9, 2008; and (b) the vesting date. The total shareholder return during the three year period was approximately 83%, which was less than the 95% threshold return established in the award agreement.

On October 7, 2011, the Company granted 2,000,000 service-based restricted stock units to the Company's Chairman and Chief Executive Officer with vesting installments of 40% on October 15, 2011 and 30% each on June 15 of 2013 and 2014. On October 15, 2011, the first installment, of 800,000 units vested and were issued to the Company's Chairman and Chief Executive Officer, net of statutory minimum required tax withholdings. These awards carry dividend equivalent rights that entitle the holder to receive dividend payments prior to vesting, if and when dividends are paid on shares of the Company's Common Stock.

During the year ended December 31, 2011, the Company granted 721,257 service based restricted stock units to employees with original vesting terms ranging from two to three years. Unit holders will receive shares of the Company's Common Stock in the amount of the units granted, net of statutory minimum required tax withholdings, if and when the units vest. As of December 31, 2011, 718,957 of the awards remain outstanding. These awards carry dividend equivalent rights that entitle the holder to receive dividend payments prior to vesting, if and when dividends are paid on shares of the Company's Common Stock.

In July 2011, the Company modified the terms of its then outstanding 8,305,000 market-condition based restricted stock units originally granted to executives and other officers of the Company on December 19, 2008 (the "Original Units"). Under the original terms of these awards, these units would have vested in one installment on January 1, 2012 if the Common Stock had achieved a price of $10.00 or more (average NYSE closing price over 20 consecutive trading days) prior to December 19, 2011 and the employee was thereafter employed on the vesting date. Under the terms of the modification, these restricted stock units provide that if the remaining share price target of $10.00 had not been met before December 19, 2011, a portion of the Original Units (the "Amended Units") become eligible for future vesting if extended service period requirements are met. The number of Amended Units is equal to 75% of the Original Units granted to an employee less, in the case of each executive level employee, the number of restricted stock units granted to the executive in March 2011. The Amended Units will vest ratably on each of January 1, 2012, 2013 and 2014, so long as the employee remains employed by the Company on the vesting dates. Upon vesting of these Units, holders will receive shares of the Company's Common Stock in the amount of the vested Units, net of statutory minimum required tax withholdings. The $10.00 price of the Original Units was not met prior to December 19, 2011. While the share price traded above the $10.00 target prior to December 19, 2011, it did not meet the 20 consecutive trading day requirement. Therefore the adjusted amount of shares outstanding under this plan as of December 31, 2011 was 5,857,638. The modification of these awards resulted in additional non-cash expense of approximately $8.1 million for the year ended December 31, 2011 and the remaining expense will be recognized over the extended service period through January 1, 2014. The incremental expense was measured based on the fair value of the modified awards in excess of the fair value of the original award measured immediately before the terms were modified, based on current assumptions. The estimated expense is based upon a number of assumptions and the actual expense could vary from the estimate if the actual experience regarding, among other things, forfeiture and vesting is different from the assumptions.

1,525,000 restricted stock units awarded to certain officers on October 9, 2008, as special retention incentive, fully vested in one installment on October 9, 2011. These units were issued to certain officers, net of statutory minimum required tax withholdings.

*Other Outstanding Awards* – In addition to the awards noted above, the following awards remained outstanding as of December 31, 2011:

- 1,340,620 service-based restricted stock units granted to employees that represent the right to receive an equivalent number of shares of the Company's Common Stock. Unit holders will receive shares of the Company's Common Stock in the amount of the units granted, net of statutory minimum required tax withholdings, if and when the units vest. These units will cliff vest on February 17, 2012 if the employee is employed by the Company on that date and carry dividend equivalent rights that entitle the holder to receive dividend payments prior to vesting, if and when dividends are paid on shares of the Company's Common Stock.
- 806,518 performance-based restricted stock units granted to the Company's Chairman and Chief Executive Officer that represent the right to receive an equivalent number of shares of the Company's Common Stock. The unit holder will receive shares of the Company's Common Stock in the amount of the units granted, net of statutory minimum required tax withholdings, if and when the units vest. The performance-based units will cliff vest on March 2, 2012 if certain performance and service conditions have been achieved, relating to reductions in the Company's general and administrative expenses, retirement of debt and continued employment. The performance conditions were satisfied during the year ended December 31, 2010, therefore, vesting is now based solely on continued employment through March 2, 2012. Since the performance conditions have been achieved, these units now carry dividend equivalent rights that entitle the holder to receive dividend payments, if and when dividends are paid on shares of the Company's Common Stock.
- 61,330 service-based restricted stock units granted to employees with original vesting terms ranging from three to five years that are entitled to receive dividend payments if and when dividends are paid on shares of the Company's Common Stock.

*Market-condition award assumptions* – The fair values of the market-condition based restricted stock units, were determined by utilizing a Monte Carlo model to simulate a range of possible future stock prices for the Company's Common Stock. The following assumptions were used to estimate the fair value of market-condition based awards:

| Valued as of | July 1, 2011 (1) | May 27, 2009 (2) | May 27, 2009 (3) |
|---|---|---|---|
| Risk-free interest rate | 0.092% | 1.16% | 1.28% |
| Expected stock price volatility | 57.75% | 152.03% | 145.45% |
| Expected annual dividend | – | – | – |

**Explanatory Notes:**

(1) The modified December 19, 2008 market-condition based restricted stock units were measured on July 1, 2011, the date the Company's Board of Directors' approved the modification of the award.

(2) Contingent equity-based restricted stock units awarded on October 9, 2008 were measured on May 27, 2009, the date the Company's shareholders approved the grant of the award.

(3) The units granted on December 19, 2008 were re-measured on May 27, 2009 when they became equity-based awards in accordance with ASC 718-20-55-135 to 138.

**Common Stock Equivalents –** Non-employee directors are awarded common stock equivalents ("CSEs") at the time of the annual shareholders' meeting in consideration for their services on the Company's Board of Directors. The CSEs generally vest at the time of the next annual shareholders meeting and pay dividends in an amount equal to the dividends paid on an equivalent number of shares of the Company's Common Stock from the date of grant, as and when dividends are paid on the Common Stock.

During the year ended December 31, 2011, the Company awarded to Directors 61,160 CSEs with a service vesting period ending in May 2012. These CSEs pay dividends in an amount equal to the dividends paid on the equivalent number of shares of the Company's Common Stock from the date of grant, as and when dividends are paid on the Common Stock. The aggregate grant date fair value of these awards was $0.5 million. As of December 31, 2011, 343,118 CSEs granted to members of the Company's Board of Directors remained outstanding and had an aggregate intrinsic value of $1.8 million.

During 2011, the Company's Board of Directors decided pursuant to the terms of the non-employee directors deferral plan to require settlement of CSEs in shares of the Company's Common Stock, thereby eliminating the cash settlement option. This modification converted these liability-based awards to equity awards and as such, the Company reclassified $2.4 million from "Accounts payable, accrued expenses and other liabilities" to "Additional paid-in capital" on the Company's Consolidated Balance Sheet during the year ended December 31, 2011.

401(k) Plan

The Company has 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% of the first 10% of the participant's annual compensation. The Company made gross contributions of approximately $0.9 million, $1.1 million and $1.3 million for the years ended December 31, 2011, 2010 and 2009, respectively.

## Note 14 – Earnings Per Share

EPS is calculated using the two-class method, which allocates earnings among common stock and participating securities to calculate EPS when an entity's capital structure includes either two or more classes of common stock or common stock and participating securities. HPU holders are current and former Company employees who purchased high performance common stock units under the Company's High Performance Unit (HPU) Program (see Note 11). These HPU units have been treated as a separate class of common stock.

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

| For the Years Ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| Income (loss) from continuing operations | **$(53,952)** | $(205,652) | $(792,629) |
| Net (income) loss attributable to noncontrolling interests | **3,629** | (523) | 1,071 |
| Income from sales of residential property | **5,721** | – | – |
| Preferred dividends | **(42,320)** | (42,320) | (42,320) |
| Income (loss) from continuing operations attributable to iStar Financial Inc. and allocable to common shareholders and HPU holders | **$(86,922)** | $(248,495) | $(833,878) |

| For the Years Ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| **Earnings allocable to common shares:** | | | |
| *Numerator for basic and diluted earnings per share:* | | | |
| Income (loss) from continuing operations attributable to iStar Financial Inc. and allocable to common shareholders | **$(84,226)** | $(241,135) | $ (810,723) |
| Income (loss) from discontinued operations | **(2,492)** | 15,019 | 10,070 |
| Gain from discontinued operations | **24,331** | 262,395 | 12,083 |
| Net income (loss) attributable to iStar Financial Inc. and allocable to common shareholders | **$(62,387)** | $ 36,279 | $ (788,570) |
| *Denominator for basic and diluted earnings per share:* | | | |
| Weighted average common shares outstanding for basic and diluted earnings per common share | **88,688** | 93,244 | 100,071 |
| **Basic and diluted earnings per common share:** | | | |
| Income (loss) from continuing operations attributable to iStar Financial Inc. and allocable to common shareholders | **$ (0.94)** | $ (2.58) | $ (8.10) |
| Income (loss) from discontinued operations | **(0.03)** | 0.16 | 0.10 |
| Gain from discontinued operations | **0.27** | 2.81 | 0.12 |
| Net income (loss) attributable to iStar Financial Inc. and allocable to common shareholders | **$ (0.70)** | $ 0.39 | $ (7.88) |
| **Earnings allocable to High Performance Units:** | | | |
| *Numerator for basic and diluted earnings per HPU share:* | | | |
| Income (loss) from continuing operations attributable to iStar Financial Inc. and allocable to HPU holders | **$ (2,696)** | $ (7,360) | $ (23,155) |
| Income (loss) from discontinued operations | **(80)** | 457 | 286 |
| Gain from discontinued operations | **779** | 7,987 | 343 |
| Net income (loss) attributable to iStar Financial Inc. and allocable to HPU holders | **$ (1,997)** | $ 1,084 | $ (22,526) |
| *Denominator for basic and diluted earnings per HPU share:* | | | |
| Weighted average High Performance Units outstanding for basic and diluted earnings per share | **15** | 15 | 15 |
| **Basic and diluted earnings per HPU share:** | | | |
| Income (loss) from continuing operations attributable to iStar Financial Inc. and allocable to HPU holders | **$(179.73)** | $ (490.67) | $(1,543.67) |
| Income (loss) from discontinued operations | **(5.33)** | 30.47 | 19.07 |
| Gain from discontinued operations | **51.93** | 532.47 | 22.87 |
| Net income (loss) attributable to iStar Financial Inc. and allocable to HPU holders | **$(133.13)** | $ 72.27 | $(1,501.73) |

For the years ended December 31, 2011, 2010 and 2009, the following shares were anti-dilutive ($ in thousands):

| For the Years Ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| Joint venture shares | **298** | 298 | 298 |
| Stock options | **44** | 143 | 520 |

**Note 15 – Comprehensive Income (Loss)**

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

| For the Years Ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| Net income (loss) | **$(25,693)** | $80,206 | $(769,847) |
| Other comprehensive income/(losses): | | | |
| Reclassification of (gains)/losses on available-for-sale securities into earnings upon realization | – | (4,206) | 2,727 |
| Reclassification of (gains)/losses on cash flow hedges into earnings upon realization | **(705)** | (799) | (4,357) |
| Unrealized gains/(losses) on available-for-sale securities | **391** | 445 | 6,515 |
| Unrealized gains/(losses) on cash flow hedges | **(666)** | – | (30) |
| Unrealized gains/(losses) on cumulative translation adjustment | **(957)** | 24 | (416) |
| Comprehensive income (loss) | **$(27,630)** | $75,670 | $(765,408) |
| Net (income) loss attributable to noncontrolling interests | **3,629** | (523) | 1,071 |
| Comprehensive income (loss) attributable to iStar Financial Inc. | **$(24,001)** | $75,147 | $(764,337) |

Unrealized gains/(losses) on available-for-sale securities, cash flow hedges and foreign currency translation adjustments are recorded as adjustments to shareholders' equity through "Accumulated other comprehensive income (loss)" on the Company's Consolidated Balance Sheets and are not included in net income unless realized. As of December 31, 2011 and 2010, accumulated other comprehensive income reflected in the Company's shareholders' equity is comprised of the following ($ in thousands):

| As of December 31, | 2011 | 2010 |
|---|---|---|
| Unrealized gains on available-for-sale securities | **$ 589** | $ 198 |
| Unrealized gains on cash flow hedges | **1,986** | 3,357 |
| Unrealized losses on cumulative translation adjustment | **(2,903)** | (1,946) |
| Accumulated other comprehensive income (loss) | **$ (328)** | $ 1,609 |

**Note 16 – Fair Values**

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

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

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

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

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

The following table summarizes the Company's assets and liabilities recorded at fair value on a recurring and non-recurring basis by the above categories ($ in thousands):

| | | Fair Value Using | | |
|---|---|---|---|---|
| | Total | Quoted market prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| **As of December 31, 2011:** | | | | |
| Recurring basis: | | | | |
| Financial Assets: | | | | |
| Marketable securities – equity securities | **$ 483** | **$483** | **$ –** | **$ –** |
| Financial Liabilities: | | | | |
| Derivative liabilities | **$ 2,373** | **$ –** | **$2,373** | **$ –** |
| Non-recurring basis: | | | | |
| Financial Assets: | | | | |
| Impaired loans | **$271,968** | **$ –** | **$ –** | **$271,968** |
| Non-financial Assets: | | | | |
| Impaired OREO | **$ 43,660** | **$ –** | **$ –** | **$ 43,660** |
| **As of December 31, 2010:** | | | | |
| Recurring basis: | | | | |
| Financial Assets: | | | | |
| Marketable securities – equity securities | $ 699 | $699 | $ – | $ – |
| Financial Liabilities: | | | | |
| Derivative liabilities | $ 223 | $ – | $ 223 | $ – |
| Non-recurring basis: | | | | |
| Financial Assets: | | | | |
| Impaired loans | $616,070 | $ – | $ – | $616,070 |
| Impaired equity method investment | $ 1,535 | $ – | $ – | $ 1,535 |
| Non-financial Assets: | | | | |
| Impaired OREO | $ 54,141 | $ – | $ – | $ 54,141 |

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

The book and estimated fair values of financial instruments were as follows ($ in thousands)[(1)]:

| | As of | | | |
|---|---|---|---|---|
| | December 31, 2011 | | December 31, 2010 | |
| | Book Value | Fair Value | Book Value | Fair Value |
| **Financial assets:** | | | | |
| Loans and other lending investments, net | **$2,860,762** | **$2,786,595** | $4,587,352 | $4,256,663 |
| **Financial liabilities:** | | | | |
| Debt obligations, net | **$5,837,540** | **$5,495,197** | $7,345,433 | $6,767,968 |

**Explanatory Note:**

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



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

**Derivatives –** The Company uses interest rate swaps and foreign currency derivatives to manage its interest rate and foreign currency risk. The valuation of these instruments is determined using discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives,

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

**Securities –** The Company's available-for-sale and impaired held-to-maturity debt and equity securities are actively traded and have been valued using quoted market prices.

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

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

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

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

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

## Note 17 – Segment Reporting

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

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

| | Real Estate Lending | Net Leasing | Real Estate Investment | Corporate/ Other[1] | Company Total |
|---|---|---|---|---|---|
| **2011** | | | | | |
| Total revenue[2] | $ 230,047 | $ 165,040 | $ 35,331 | $ 2,371 | $ 432,789 |
| Earnings (loss) from equity method investments | – | 2,566 | (7,839) | 100,364 | 95,091 |
| Operating costs | (2,866) | (18,439) | (77,282) | (8,204) | (106,791) |
| Interest expense | (159,339) | (83,650) | (79,084) | (22,715) | (344,788) |
| General and administrative[3] | (17,281) | (9,194) | (8,577) | (40,285) | (75,337) |
| Segment profit (loss)[4] | $ 50,561 | $ 56,323 | $ (137,451) | $ 31,531 | $ 964 |
| Other significant non-cash items: | | | | | |
| Provision for loan losses | $ 46,412 | $ – | $ – | $ – | $ 46,412 |
| Impairment of assets | $ – | $ 650 | $ 20,846 | $ 872 | $ 22,368 |
| Depreciation and amortization | $ – | $ 53,460 | $ 7,094 | $ 2,065 | $ 62,619 |
| Capitalized expenditures | $ – | $ 12,174 | $ 51,995 | $ – | $ 64,169 |
| Total assets | $2,892,240 | $1,837,425 | $1,982,420 | $ 805,752 | $ 7,517,837 |
| **2010** | | | | | |
| Total revenue[2] | $ 377,844 | $ 165,831 | $ 23,103 | $ 2,940 | $ 569,718 |
| Earnings from equity method investments | – | 2,522 | – | 49,386 | 51,908 |
| Operating costs | (10,107) | (14,566) | (64,694) | (5,948) | (95,315) |
| Interest expense | (192,010) | (43,902) | (45,574) | (33,382) | (314,868) |
| General and administrative[3] | (28,340) | (11,149) | (6,727) | (43,955) | (90,171) |
| Segment profit (loss)[4] | $ 147,387 | $ 98,736 | $ (93,892) | $ (30,959) | $ 121,272 |
| Other significant non-cash items: | | | | | |
| Provision for loan losses | $ 331,487 | $ – | $ – | $ – | $ 331,487 |
| Impairment of assets | $ – | $ – | $ 19,089 | $ (2,770) | $ 16,319 |
| Depreciation and amortization | $ – | $ 52,635 | $ 5,378 | $ 3,650 | $ 61,663 |
| Capitalized expenditures | $ – | $ 14,031 | $ 28,832 | $ 18 | $ 42,881 |
| Total assets | $4,636,777 | $1,915,164 | $1,594,859 | $1,027,714 | $ 9,174,514 |
| **2009** | | | | | |
| Total revenue[2] | $ 563,849 | $ 172,106 | $ 5,822 | $ 17,210 | $ 758,987 |
| Earnings from equity method investments | – | 2,500 | – | 2,798 | 5,298 |
| Operating costs | (9,734) | (15,799) | (40,866) | (52,595) | (118,994) |
| Interest expense | (324,558) | (42,884) | (18,706) | (26,943) | (413,091) |
| General and administrative[3] | (37,406) | (12,782) | (2,156) | (48,216) | (100,560) |
| Segment profit (loss)[4] | $ 192,151 | $ 103,141 | $ (55,906) | $ (107,746) | $ 131,640 |
| Other significant non-cash items: | | | | | |
| Provision for loan losses | $1,255,357 | $ – | $ – | $ – | $ 1,255,357 |
| Impairment of assets | $ – | $ 23,556 | $ 78,564 | $ 24,765 | $ 126,885 |
| Depreciation and amortization | $ – | $ 54,296 | $ 2,955 | $ 4,392 | $ 61,643 |
| Capitalized expenditures | $ – | $ 14,891 | $ 11,056 | $ 703 | $ 26,650 |
| Total assets | $7,723,280 | $3,149,783 | $1,271,506 | $ 666,006 | $12,810,575 |

**Explanatory Notes:**

(1) Corporate/Other represents all corporate level and unallocated items including any intercompany eliminations necessary to reconcile to consolidated Company totals. This caption also includes the Company's joint venture investments and strategic investments that are not related to the other reportable segments above, including the Company's equity investment in LNR of $159.8 million and $122.2 million, as of December 31, 2011 and 2010, respectively, and the Company's share of equity in earnings from LNR of $53.9 million and $1.8 million, for the years ended December 31, 2011 and 2010, respectively. See Note 7 for further details on the Company's investment in LNR and summarized financial information of LNR.

(2) Total revenue represents all revenue earned during the period related to the assets in each segment. Revenue from the Real Estate Lending segment primarily represents interest income, revenue from the Net Leasing segment primarily represents operating lease income and revenue from Real Estate Investment primarily represents operating revenues from REHI properties.

(3) General and administrative excludes stock-based compensation expense of $29.7 million, $19.4 million and $23.6 million for the years ended December 31, 2011, 2010 and 2009, respectively.

(4) The following is a reconciliation of segment profit (loss) to income (loss) from continuing operations ($ in thousands):

| For the Years Ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| Segment profit (loss) | $ 964 | $ 121,272 | $ 131,640 |
| Less: Provision for loan losses | (46,412) | (331,487) | (1,255,357) |
| Less: Impairment of assets | (22,368) | (16,319) | (126,885) |
| Less: Stock-based compensation expense | (29,702) | (19,355) | (23,592) |
| Less: Depreciation and amortization | (62,619) | (61,663) | (61,643) |
| Add: Income tax (expense) benefit | 4,719 | (7,023) | (4,141) |
| Add: Gain (loss) on early extinguishment of debt, net | 101,466 | 108,923 | 547,349 |
| Income (loss) from continuing operations | $(53,952) | $(205,652) | $ (792,629) |

## Note 18—Quarterly Financial Information (Unaudited)

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

| For the Quarters Ended | December 31, | September 30, | June 30, | March 31, |
|---|---|---|---|---|
| 2011 [(1)]: | | | | |
| Revenue | $ 96,480 | $ 97,360 | $128,442 | $110,507 |
| Net income (loss) | $ (28,915) | $ (54,661) | $ (26,020) | $ 83,902 |
| Earnings per common share data: | | | | |
| Net income (loss) attributable to iStar Financial Inc. | $ (35,202) | $ (62,231) | $ (35,525) | $ 67,420 |
| Basic earnings per share | $ (0.43) | $ (0.71) | $ (0.38) | $ 0.73 |
| Diluted earnings per share | $ (0.43) | $ (0.71) | $ (0.38) | $ 0.71 |
| Weighted average number of common shares – basic | 81,769 | 87,951 | 92,621 | 92,458 |
| Weighted average number of common shares – diluted | 81,769 | 87,951 | 92,621 | 94,609 |
| Earnings per HPU share data: | | | | |
| Net income (loss) attributable to iStar Financial Inc. | $ (1,222) | $ (2,008) | $ (1,089) | $ 2,070 |
| Basic earnings per share | $ (81.47) | $ (133.87) | $ (72.60) | $ 138.00 |
| Diluted earnings per share | $ (81.47) | $ (133.87) | $ (72.60) | $ 135.07 |
| Weighted average number of HPU shares – basic and diluted | 15 | 15 | 15 | 15 |
| 2010 [(2)]: | | | | |
| Revenue | $136,035 | $133,297 | $133,819 | $166,567 |
| Net income (loss) | $ (58,865) | $ (74,632) | $229,851 | $ (16,142) |
| Earnings per common share data: | | | | |
| Net income (loss) attributable to iStar Financial Inc. | $ (67,050) | $ (83,531) | $212,275 | $ (25,408) |
| Basic and diluted earnings per share | $ (0.73) | $ (0.89) | $ 2.27 | $ (0.27) |
| Weighted average number of common shares – basic and diluted | 92,319 | 93,370 | 93,382 | 93,923 |
| Earnings per HPU share data: | | | | |
| Net income (loss) attributable to iStar Financial Inc. | $ (2,061) | $ (2,539) | $ 6,452 | $ (768) |
| Basic and diluted earnings per share | $ (137.40) | $ (169.27) | $ 430.13 | $ (51.20) |
| Weighted average number of HPU shares – basic and diluted | 15 | 15 | 15 | 15 |

**Explanatory Notes:**

(1) During the quarter ended December 31, 2011, the Company sold a substantial portion of its interests in Oak Hill Advisors, L.P. and related entities which resulted in a net gain of $30.3 million (see Note 7). During the quarter ended June 30, 2011, the Company recorded interest income of $26.3 million related to certain non-performing loans that were resolved, including interest not previously recorded due to the loans being on non-accrual status. During the quarter ended March 31, 2011, the Company recorded a gain on early extinguishment of debt of $109.0 million for the redemption of its $312.3 million remaining principal amount of 10% senior secured notes due June 2014.

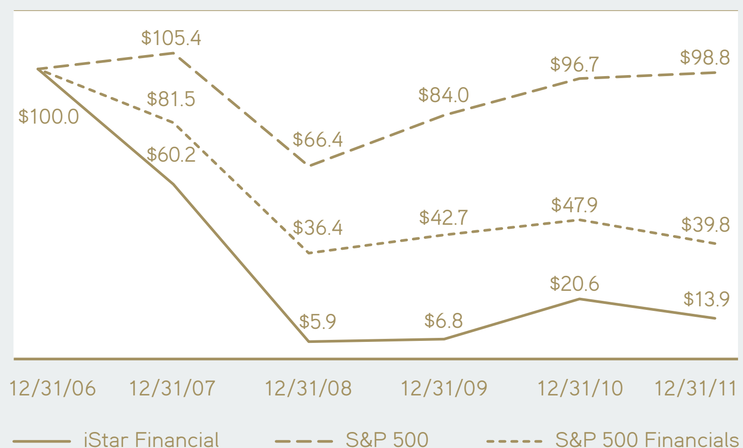
(2) During the quarter ended June 30, 2010, the Company recorded gains from discontinued operations of $250.3 million for the sale of a portfolio of 32 net lease assets (see Note 6).

### Note 19 – Subsequent Events

On February 28, 2012, the Company announced the launch of a syndication of up to $900.0 million in new senior secured credit facilities. The Company expects the facilities to be comprised of two tranches, maturing in 2016 and 2017, with differing interest rates. Outstanding borrowings under the facilities will be collateralized by a pool of diversified collateral, including loans, net lease assets and other real estate assets. The proceeds from the new credit facilities will be used to refinance the Company's 2012 unsecured debt maturities. The Company is in the process of syndicating the new facilities and there can be no assurance that it will be successful in its efforts to complete the syndication.

### Performance Graph

The following graph compares the total cumulative shareholder returns on our Common Stock from December 31, 2006 to December 31, 2011 to that of: (1) the Standard & Poor's 500 Index (the "S&P 500"); and (2) the Standard & Poor's 500 Financials Index (the "S&P 500 Financials"). Our prior comparative index, the Russell 1000 Financial Services Index, was discontinued on October 1, 2010.



## COMMON STOCK PRICE AND DIVIDENDS (UNAUDITED)

The Company's Common Stock trades on the New York Stock Exchange ("NYSE") under the symbol "SFI."

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

| Quarter Ended | High | Low |
|---|---|---|
| **2011** | | |
| December 31, 2011 | **$ 7.18** | **$5.09** |
| September 30, 2011 | **$ 8.41** | **$4.61** |
| June 30, 2011 | **$ 9.62** | **$7.35** |
| March 31, 2011 | **$10.31** | **$7.84** |
| **2010** | | |
| December 31, 2010 | $ 7.82 | $3.06 |
| September 30, 2010 | $ 5.22 | $2.95 |
| June 30, 2010 | $ 7.43 | $4.46 |
| March 31, 2010 | $ 5.06 | $2.53 |

On February 23, 2012, the closing sale price of the Common Stock as reported by the NYSE was $7.01. The Company had 2,569 holders of record of Common Stock as of February 23, 2012.

At December 31, 2011, the Company had five series of preferred stock outstanding: 8.000% Series D Preferred Stock, 7.875% Series E Preferred Stock, 7.8% Series F Preferred Stock, 7.65% Series G Preferred Stock and 7.50% Series I Preferred Stock. Each of the Series D, E, F, G and I preferred stock is publicly traded.

### Dividends

The Board of Directors has not established any minimum distribution level. In order to maintain its qualification as a REIT, the Company intends to pay dividends to its shareholders that, on an annual basis, will represent at least 90% of its taxable income (which may not necessarily equal net income as calculated in accordance with GAAP), determined without regard to the deduction for dividends paid and excluding any net capital gains. The Company has recorded net operating losses and may record net operating losses in the future, which may reduce its taxable income in future periods and lower or eliminate entirely the Company's obligation to pay dividends for such periods in order to maintain its REIT qualification.

Holders of Common Stock, vested High Performance Units and certain unvested restricted stock units and common share equivalents will be entitled to receive distributions if, as and when the Board of Directors authorizes and declares distributions. However, rights to distributions may be subordinated to the rights of holders of preferred stock, when preferred stock is issued and outstanding. In addition, the Company's Secured Credit Facility (see Note 9 of Notes to Consolidated Financial Statements) permits the Company to distribute 100% of its REIT taxable income on an annual basis, for so long as the Company maintains its qualification as a REIT. The Secured Credit Facility restricts the Company from paying any common dividends if it ceases to qualify as a REIT. In any liquidation, dissolution or winding up of the Company, each outstanding share of Common Stock and HPU share equivalent will entitle its holder to a proportionate share of the assets that remain after the Company pays its liabilities and any preferential distributions owed to preferred shareholders.

The Company did not declare or pay dividends on its Common Stock for the years ended December 31, 2011 and 2010. The Company declared and paid dividends aggregating $8.0 million, $11.0 million, $7.8 million, $6.1 million and $9.4 million on its Series D, E, F, G, and I preferred stock, respectively, for each of the years ended December 31, 2011 and 2010. There are no dividend arrearages on any of the preferred shares currently outstanding.

Distributions to shareholders will generally be taxable as ordinary income, although all or a portion of such distributions may be designated by the Company as capital gain or may constitute a tax-free return of capital. The Company annually furnishes to each of its shareholders a statement setting forth the distributions paid during the preceding year and their characterization as ordinary income, capital gain or return of capital.

No assurance can be given as to the amounts or timing of future distributions, as such distributions are subject to the Company's taxable income after giving effect to its net operating loss carryforwards, financial condition, capital requirements, debt covenants, any change in the Company's intention to maintain its REIT qualification and such other factors as the Company's Board of Directors deems relevant. In addition, based upon guidance announced by the Internal Revenue Service, the Company may elect to satisfy some of its 2011 REIT distribution requirements, if any, through qualifying stock dividends.

# DIRECTORS AND OFFICERS

## DIRECTORS

**Jay Sugarman**
Chairman & Chief Executive Officer,
iStar Financial Inc.

**Glenn R. August**
President,
Oak Hill Advisors, L.P.

**Robert W. Holman, Jr.** (1) (2) (4)
Chairman & Chief Executive Officer,
National Warehouse Investment
Company

**Robin Josephs** (1) (2) (4)
Lead Independent Director,
iStar Financial Inc.

**John G. McDonald** (2) (3) (4)
Stanford Investors Professor,
Stanford University Graduate School
of Business

**George R. Puskar** (1) (3)
Former Chairman &
Chief Executive Officer,
Equitable Real Estate
Investment Management

**Dale Anne Reiss** (1) (3)
Senior Consultant,
Global Real Estate Center
Global & Americas Director
of Real Estate, Ernst & Young, LLP
(Retired)

**Barry W. Ridings** (2)
Vice Chairman of
US Investment Banking,
Lazard Freres & Co. LLC

*(1) Audit Committee*
*(2) Compensation Committee*
*(3) Asset Management & Investment Committee*
*(4) Nominating & Governance Committee*

## EXECUTIVE OFFICERS

**Jay Sugarman**
Chairman &
Chief Executive Officer

**Nina B. Matis**
Chief Legal Officer &
Chief Investment Officer

**David M. DiStaso**
Chief Financial Officer

## EXECUTIVE VICE PRESIDENTS

**Chase S. Curtis Jr.**
Credit

**R. Michael Dorsch III**
iStar Land Co.

**Karl Frey**
iStar Land Co.

**Barclay Jones III**
Investments

**Michelle MacKay**
Investments

**Steve Magee**
iStar Land Co.

**Barbara Rubin**
iStar Asset Services, Inc.

**Vernon B. Schwartz**
Investments

# CORPORATE INFORMATION

## HEADQUARTERS

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Fax: 415.391.6259

## EMPLOYEES

As of March 9, 2012,
the Company had 184 employees.

## INDEPENDENT AUDITORS

PricewaterhouseCoopers LLP
New York, NY

## REGISTRAR AND TRANSFER AGENT

Computershare Trust
Company, NA
PO Box 43078
Providence, RI 02940-3078
Tel: 800.756.8200

www.computershare.com

## ANNUAL MEETING OF SHAREHOLDERS

May 31, 2012, 9:00 a.m. ET
Harvard Club of New York City
35 West 44th 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 filed all required Annual Chief Executive Officer Certifications with the NYSE. In addition, the Company has filed with the SEC the certifications of the Chief Executive Officer and Chief Financial Officer required under Section 302 and Section 906 of the Sarbanes-Oxley Act of 2002 as exhibits to our most recently filed Annual Report on Form 10-K. For help with questions about the Company, or to receive additional corporate information, please contact:

## INVESTOR RELATIONS

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Vice President
Investor Relations & Marketing
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New York, NY 10036
Tel: 212.930.9484

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investors@istarfinancial.com

iStar Financial Website:
www.istarfinancial.com

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CLINTON, MD
COLLEGE PARK, GA
COLUMBIA, SC
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DICKSON CITY, PA
DIXMOOR, IL
DRAPER, UT
DUBLIN, OH
DURHAM, NC
EDINA, MN
EDISON, NJ
ELIZABETH, NJ
ELLENVILLE, NY
EMERYVILLE, CA
ESSEX, UNITED KINGDOM
EVERETT, MA
FARMERS BRANCH, TX
FORT LAUDERDALE, FL
FORT WORTH, TX
FOUNTAIN, CO
FREMONT, CA
FRISCO, TX
FT. COLLINS, CO
FT. MEYERS, FL
GAINESVILLE, FL
GERMANY
GLADSTONE, OR
GLENDALE, AZ
GREENVILLE, SC
HAMBURG, NY
HAMILTON, NJ
HARRISBURG, PA
HAWTHORNE, CA
HEMET, CA
HEMPSTEAD, TX
HENDERSON, NV
HIGHLAND PARK, IL
HOLLYWOOD, CA
HOMESTEAD, FL
HONOLULU, HI
HORSEHEADS, NY
HOUSTON, TX
HOWELL, MI
INDIANTOWN, FL
IRVING, TX
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JACKSONVILLE, FL
JENSEN BEACH, FL
JERSEY CITY, NJ
KAILUA-KONA, HI
KAPAA, HI
KAPOLEI, HI
KATY, TX
KEY WEST, FL
KIHEI, HI
KNOXVILLE, TN
KOLOA, HI
KULA, HI
LA PORTE, TX
LAKE CHARLES, LA
LAKE SUCCESS, NY
LANHAM, MD
LARGO, MD
LAS VEGAS, NV
LAUREL, MD
LIHUE, HI
LISLE, IL
LITTLE RIVER, SC
LONDON, ON
LONDON, UNITED KINGDOM
LONG BEACH, CA
LONG BEACH, NY
LONGBOAT KEY, FL
LOS ANGELES, CA
LUTZ, FL
MAMMOTH LAKES, CA
MAMMOTH, CA
MANCHESTER, NH
MARATHON, FL

110,000
84,000
92,000
130,000
70,200
110,000
69,700
50,772
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149,333
180,054
180,696
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3,445,000
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