CAPITALSOURCE ANNUAL INVESTOR CONFERENCE
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CONFERENCE PARTICIPANTS

- John Delaney — CapitalSource
  Chairman and CEO
- Dean Graham — CapitalSource
  President and COO
- Jason Fish — CapitalSource
  Vice Chairman and CIO
- Bryan Corsini — CapitalSource
  Chief Credit Officer
- Keith Reuben — CapitalSource
  Co-President Healthcare and Specialty Finance
- Jim Pieczynski — CapitalSource
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- Michael Szwajkowski — CapitalSource
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- Chris Kelly — CapitalSource
  Managing Director Commercial Real Estate Group
- Joe Kenary — CapitalSource
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- Dan Duffy — CapitalSource
  Managing Director Corporate Lending
- Brian Graham — CapitalSource
  Managing Director Residential Mortgage Investments
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- Henry Coffey — Ferris, Baker Watts
  Analyst
- Don Fandetti — Citigroup
  Analyst
- Joel Houck — Wachovia Securities
  Analyst
- Bob Napoli — Piper Jaffray & Co.
  Analyst

Presentation

John Delaney: Well, that was easy. Let's hope the whole day is that easy. Well, thank you for coming. Is the mike on? Can people hear me? Thank you all for coming, for carving out time from your schedules to come and visit with us here today, and for those on the webcast, welcome. We have, up here and in your book, the agenda for the day, which I won't go through in detail, but you can see where the breaks are and we make adjustments as the day unfolds as appropriate. So let's get started.

Last year around the time of our Investor Conference, actually two days before the Investor Conference, we announced our intention to be treated as a Real Estate Investment Trust effective January 1, 2006. And a lot of work went into that decision, but the one thing that was easy related to that decision was we knew what we had to talk about at our Investor Conference and that was to explain to everyone here why we thought that decision made great sense. And today we'll be touching on why that decision actually has made great sense and, in many ways, it exceeded our expectations. But absent a significant announcement, which we don't have today, we are not announcing our intention to go back to a C-Corp for example, just in case you were wondering, absent a significant announcement determining the content, the Investor Conference is a little more challenging. And so what we will focus on is we really set three standards for ourselves here today.

The first standard is to explain as much as we possibly can about the business and if our package here is any -- or the throw weight of 164 page package is any indication, we've done a reasonably good job there. My only worry is that it might in fact get a little grueling, and if so, I apologize. But, fair warning on that point. T

he second kind of standard we set for ourselves today was to introduce other members of the senior management team to our investors and many familiar faces in the room here today for me, and I'm sure for Jason and for Tom and for increasingly Dean, but there are many people behind the scenes. Fortunately, there are many people behind the scenes who are working very hard and are very talented and are helping to create value at this company, and we wanted to use this conference as an opportunity for you to meet some of them and ask them questions, and get to know the business a little bit from their perspective.

So today we have Keith Reuben and Jim Pieczynski, who are the Co-Presidents of the Healthcare and Specialty Finance business. And Jim Pieczynski actually took the red-eye in tonight to be here for this conference, so if his comments are slurred and garbled, I expect them to be clear and lucid, you'll know why. We also have Chris Kelly, who works with Mike Szwajkowski, whom many of you know, who is the Managing Director in charge of our Commercial Real Estate business. We have Dan Duffy, who is the Managing Director in charge of our syndication efforts and our CLO Asset Management business, who works with Joe Kenary, that most of you know.

And then we also have Brian Graham, who is responsible for our Residential Mortgage Investment business and he promises a very scintillating presentation about how we're taking no risk in the Residential Mortgage business. So Brian, I hope to set the standard high for you there. So that was the second thing we hope to achieve today.

And the third and probably the most important thing we want to achieve today is we'd like you to leave here today sharing the optimism and the enthusiasm that the senior management team and really the Board has for this company. And just, I think most people know this, the management team and the Board own about 40% of the business, so not only is management very much involved in the business but the Board's very much involved in business and deep in the decisions we make. And we have a real sense of, as I said, optimism and enthusiasm about the business. And that's both based on the near-term prospects of the business, which we will spend a fair amount of time discussing today and giving you a lot of detail about why we think the business is very strong right now, and why we think the near-term prospects of this company are excellent.

But we will also spend some time, probably a little less because it's a little less specific, why we think the long-term prospects for this company are terrific. And that's really based on the team we have in place, how the company has been positioned, some of the attributes of the business model and balance sheet and some opportunities we expect to unfold throughout the next several years. And I think if I could make the point pretty simply I'd say we really think this is a singular business and we hope you leave here today with the same impression.

So let me get into it a little bit. Most of you are familiar with the CapitalSource story. There's probably a few new faces in the room today but it's our hope that there's people out in the webcast who this is maybe new to. And so I'm going to spend a few minutes on what I call CapitalSource 101, just a very brief overview of the business before I get into some of the things I want to touch on early this afternoon. CapitalSource, as most of you know, is a commercial finance company and increasingly an asset management business. But the bulk of our activity is commercial finance.

And we focus on middle market borrowers, which we define as people looking to borrow between 5 and $100 million. So we're not focusing on really small companies, nor are we going after kind of large corporate borrowers where we would have less of a competitive advantage relative to investment banks and large commercial banks. It's a true middle market focus, which we will talk about today in some detail as a real strength of the business.

We're organized, as I said, as a real estate investment trust, which is new, we started that January 1 of this year. But we're very different than what most people think of when they think of a REIT. I think that most people view a REIT as something that owns office buildings or shopping centers or something like that, or something principally engaged in owning real estate loans or real estate debt. And while we certainly do that, about half our business is real estate lending in one form or another, and increasingly we're involved in the ownership of real estate from sale leaseback transactions that we do.

About half of our business is balanced with a diverse portfolio of corporate lending businesses, asset based loans, senior secured term loans, things like that. And it's this balance or diversification of the franchise that we think is a great strength of the business and you know it's been referred to as a hybrid REIT or a Super REIT.

But we're really utilizing this REIT structure to optimize the real estate related businesses, but we're still balanced across a lot of different businesses. And this balance is really key, I believe, to the stability of our dividend, which is obviously an important metric of the business, and our ability to grow that dividend and I'm going to talk about that over time.

The platform at this point is very built out, it's large scale. We have over 500 employees in over 20 offices in the United States, including an office in London serving the European marketplace. We had $7.4 billion of kind of core loans that includes our sale leaseback transactions at the end of the second quarter. In addition, we had about $5 million of residential mortgages that we have on our balance sheet to optimize the REIT structure. 1,000 loans, over 600 borrowers, very large diversified kind of granular portfolio at this point.

All of the businesses are showing good growth. The management team is proven. We've worked together for some time, we are often compared to other kind of tax advantaged dividend paying entities, we believe we're the largest and certainly the most diversified of these businesses, which I think is important, and we think we're in a good position to deliver growth and keep the dividend very predictable in the future.

The business is loosely organized around nine divisions and let me go through these quickly. We have a Corporate Finance business and what we mean when we say Corporate Finance is we make senior loans to finance middle market leveraged buyouts. We have a Healthcare Credit business, which is principally engaged in asset based lending to healthcare companies. We have a Healthcare Real Estate business, which provides first mortgage debt and also engages in sale leaseback transactions with healthcare operators, principally nursing homes but also assisted living facilities, independent hospitals.

We have a Commercial Real Estate business, I think most people know what that is. We have a Rediscount Finance business, which is providing senior debt to finance other finance companies, so we're an asset based lender to smaller finance companies it's a really good business for us. We have a Business Credit Services business, which is asset based lending to a wide range of companies. But the common theme is typically a company going through a restructuring or a turnaround so it's really highly structured asset based finance, you need obviously specialized skills to do it, which we have.

We have a Security and Finance business, which is asset based loans to a variety of security related companies. We have some Fee businesses and we hope to have more, particularly in the asset management world. And then we have a business that we call CapitalAnalytics, which we'll keep footing to at different points in the presentation today, which is effective a wholly owned accounting firm. It's really a forensic accounting firm in some ways, it has about 90 CPAs in it at this point and it's engaged by these various businesses to help them do their credit work, to really help and to ensure that these businesses understand the numbers that they're looking at when they make their credit decisions.

And so these businesses operating together have produced, I believe, very good returns for the shareholders, 26% internal rate of return since our initial public offering and 56% since our REIT announcement a year ago. And the REIT announcement has certainly been good for the stock, but in many ways it's even been better for the business and we'll talk about that more today.

To my mind, significant success in financial services is based on two things. The first is execution. It's my judgment that most financial services companies, and CapitalSource is certainly squarely in this camp, are kind of grind it out execution businesses where doing the detail work day in and day out is what's really important. And I think CapitalSource executes at an exceptionally high level and the different members of our management team, who will talk today, will really talk about how they execute against their business plan. It's really critical to the business. That's one component that I think is critical to have significant success in financial services.

The second component is executing against a good business model. Right? And what I wanted to do this afternoon is shine a light on our business model a little bit, because I do believe it's superior and I do believe it's high execution against a superior business model that leads to the singular business that I think we've created here at CapitalSource. And to do that I've broken the business model down into what I call the seven attributes of the business and I'm going to go through each one of them.

Let me say them quickly and then we'll talk about some of them in more detail. We have a broad-based business platform. You've heard me talk about that in the past. We have a true middle market focus, we're a direct origination company, we have a very strong credit culture, I think our financial model is clearly superior, we have a tax efficient structure, that's new, and then we have a dividend that we believe is very stable and has high growth potential, which we'll talk about. So let me drill down into these in a little more depth.

Attribute number one, a broad-based diversified franchise. And I'd like you to focus on this slide a little bit because later in the presentation when I wrap up, which is literally five hours from now if you can believe that. I need to pause there because it takes your breath away for a minute, it certainly does mine, I'm going to talk about why CapitalSource has a bunch of different businesses. And if you were to actually deconstruct the business and value each of them based on kind of normal comparables, you would conclude that unlike what you normally find in financial services where the whole is greater than the sum of the parts, and that's because of all the reasons on this page, at CapitalSource actually right now it seems like the sum of the parts is greater than the whole, which to me is a lot of low hanging fruit actually and we're going to be focusing on that quite a bit.

So why is it good to have a diversified balanced business model? First of all, it allows for more predictable growth. Wouldn't everyone want that? We've seen, in the six years we've had this business, that different businesses have driven our growth. Early on a lot of our growth came from our Corporate Finance business. More recently, it's coming from our Asset Based Real Estate businesses. I'm highly confident in our ability to grow to some predictable degree because we have multiple businesses. Wouldn't you rather have multiple businesses that you can grow at a more predictable pace? Wouldn't you rather have a more diversified franchise when you're in the risk business, which we do. We have no particular concentration by industry or sector, which inherently I think makes the portfolio safer.

Having a diversified franchise allows management to be more disciplined. Full stop. We all like to think we're very, disciplined, that's the nature of what we've all chosen to do at some level. But clearly we're all more disciplined as humans if we have more choices and while I've seen some management teams who run focused businesses really be able to step on the sidelines, I've seen others who run focused businesses who always seem to think the market is good for what they do. And wouldn't you rather have a business where management, it's easier for them to be disciplined, and that's one of the benefits of these diversified franchise.

It's much stronger funding platform, not only should our equity investors appreciate the value of this diversification as it relates to the stability of the dividend, but our debt stakeholders, and certainly there are some in the room here today, care deeply about that. And that I think -- we've seen situations where we've been doing transactions with kind of monoline businesses that are kind of like us and I look our execution on the debt side compared to theirs and it's much better. Stable stream of cash flow, that's somewhat a subsidiary of the points I just made.

Application of best lending practices this is something I think we'll be doing more of. We've noticed across our many businesses some of them do it better than others and we want to make this a real best practices operation in terms of commercial finance. Ability to attract and retain people in economies of scale, again all obvious points. But wouldn't you rather have these in a business as opposed to a monocline business? So I think that's kind of attribute one of why this is a superior business.

And drilling down a little bit on that, you see that we're balanced across our three main businesses which we talk about. We're principally a secured lender but again we're balanced across or diversified across different types of senior loans, reasonably evenly distributed between first mortgages, corporate finance loans and asset based loans. And again, no particular concentration by industry. The one thing that'll jump out with you is the blue section of this slide, which is healthcare. If I were to create a healthcare pie chart you would see multiple sub-industries within healthcare.

So even this part of the slide, which appears concentrated on its face, you have to realize this is a focus of us, we're quite good at it, I believe, and we inherently have diversification within this business. So it's again no particular concentration by any [inaudible].

The second attribute, a true middle market focus. I believe CapitalSource is the only pure play middle market lender and one of the reasons for that is we built it to be that. And we started it six years ago, we had a large capital base and we started with a clean slate so we could really build a business that was just focused on the middle market, which is what we wanted to do. So if people think the middle market is interesting, if they like the growth in the middle market, how dynamic it is and if they want a financial services company that was built to service that market, CapitalSource is that company.

And what does that mean? Well we have what we like to call bulge bracket capabilities applied to the middle market. And what that really means is we're a more sophisticated lender. And a lot of that has to do with the industry focus we have and the sector focus that we have and we apply that enhanced level of sophistication to the middle market and that allows us to compete.

We're a direct origination platform. We much prefer to eat what we cook. We know what's in it, we can get it when we want and we don't have to pay a lot for it and that's a real benefit to a middle market lender. We have an execution focused business model, which I already touched on, and then we have this audit orientation, which is really where CapitalAnalytic comes in and what Bryan will talk about.

I've always had a view that to be successful in middle-market credit you not only have to make good credit decisions, which is actually sometimes not the hard part, but you have to make it based on good information and that can be the hard part. Really figuring out the numbers in these smaller businesses or these more dynamic businesses. And it's not because they're trying to do anything wrong, they're just growing fast and system issues et cetera are very, very common. And so having the people who can get in there and get behind the numbers and really verify them is critical. And all this leads to a business built for the middle market.

Attribute number three, a direct origination platform. I think over time to be successful in lending you have to have one of two things, you either have to control origination or you have to have a really efficient low-cost balance sheet. I'll talk about some of the things we're doing on the efficiency side in a few minutes, and we actually could actually come forth with both of those things, and I think we're making progress in that regard. But we certainly have, I think, the largest and most effective origination platform.

And why is this good? Well you can be more selective, obviously you're looking at more deals, you're going to be more selective. It produces higher yielding opportunities. You get to pick the deals that have superior yields. Despite people's views to the contrary, this is not an efficient market. You see similar credits and you say, "Why is that one 150 basis points wider than the other?" Well, there's lots of reasons, speed, timing, are they good at finding financing, all kinds of things going on so you get a direct origination platform you just take higher yields. Plus you can take lower yielding situations because you control them and structure them around your needs and then sell pieces to other investors and enhance your yield, which is something we're going to talk about today. So that's another benefit of direct origination platform.

It generates more consistent growth, I kind of touched on that, it allows for more favorable deal structures. This is really critical and unless you've been in the lending business, you'll know a loan to a similar credit at 3 times EBITDA compared to another loan, the same business 3 times EBITDA, can be very different based on structure. based on rights that you have, based on relationship with the subordinate capital, whether they be second lead or mezzanine et cetera like that. So if you call origination you structure things, you're not buying in based on books like this from investment banks who have structured them for the benefit of guess who, the issuer. We structure loans for the benefit of ourselves. And then obviously it results in better credit outcomes.

And this origination platform is countrywide, including an office now in Europe, and you can see it continues to produce a larger and larger pipeline. What we've detailed on this slide is our pipeline by quarter. You can see it's growing across the last, I think we have ten quarters here. And then we've also shown our selectivity rate, which is our closing rate, and you can see that's become tighter, which I believe reflects a continued evolution of the credit platform.

Attribute number four, deep credit and investment culture. At the end of the day CapitalSource is a credit shop. If you've spent time in our offices I think that would be your first conclusion. And good credit work to me is about a couple things, one being focus. We don't want to be a generalist. We want to be an expert. Secondly, having good information, I've talked about that, really knowing the numbers you're making your decisions based on. Having good checks and balances, CapitalAnalytics also gives us. Having a good team and engaging in rigorous asset management, we do all of these things.

In terms of focus, all of the industries that are identified on this page we focus on either through a dedicated business, some of the eight businesses, we have nine businesses but one is CapitalAnalytics, some of those eight businesses are focused on of these areas exclusively. But then further within some of our larger businesses we have teams dedicated to these different disciplines. So we don't lead as a generalist, we lead as an expert. And our products are fairly focused. Right now we pretty do much one thing, we provide senior debt to companies that are doing something reasonably complicated, an acquisition, a recap, financing their growth, maybe it's distressed opportunity, et cetera.

That's really all we do. We do it in lots of different industries and the needs may be different, like I said an acquisition or a recap, but these are complicated financings, these are not commodity, there's no equipment leasing in this. We're not in the investment banking business, we're in the business of providing senior debt and doing it really well. And then increasingly we're getting into the asset management business, which is essentially taking all these things I think we do reasonably well and applying to the investors who have an interest in lower returns than we're interested in our balance sheet, doing a certainly better than average job for them. And I think that will drive a lot of growth in the business.

And again CapitalAnalytics, I keep coming back to it, this is really a key asset. Ninety CPAs, it's essentially a forensic accounting firm, it gives us good information and it's a huge check on the system.

No other lender has anything like this, I've been operating with this kind of a resource for some time now most of you know I was involved in a business prior to CapitalSource that was a healthcare lending business and many members of the senior management team worked with me. We had the same thing there and so we've actually been using this model for now, hate to say it, 13 years.

Attribute number five, a superior financial model. I tend to kind of simplify my view of financial services companies when I see them and we have an opportunity to see finance businesses as you'd expect. And I break it down to a couple things, which is what's the return on equity, what's the risk adjusted return on equity of this business? So I look at the return on equity, I look at how risky or how well do I understand what they do, or how well do they understand what they do. And then how much leverage are they putting on top. Right? So if a finance company kind of comes to CapitalSource and says, "You know we have a 10 to 15% ROE and we do these very complicated things, we're buying into complicated structures that the Street is selling us, and we're putting a lot of leverage on it." You're like, "Well, that's not so interesting actually."

What I think is interesting is generating a 20% ROE, doing it with a portfolio of senior secured loans that have been underwritten by us and that start at dollar zero, so there's no inherent leverage in the situation, and running the business with prudent leverage. Again, this is to me first evidence and it's really simple, all the other metrics in financial services to me seem to get to this. And if they don't they're probably not that relevant. What's your ROE, what's your asset quality, how much risk are you taking through leverage? And that's probably one of the reasons why CapitalSource hasn't done many acquisitions, because we think this standard is pretty high. And there may be things over time that beat this standard, but historically we haven't seen it. So again, this is to me first evidence, this is kind of my report card of finance business.

Tax efficient structure, we were a tax payer and now we've become less of a tax payer. Our conversion to a REIT has been very positive in that all of our real estate businesses no longer pay tax. That's not completely true because some of our real estate loans that we made in the past were co-mingled with corporate loans and we're still paying tax on them. But by and large, going forward, all our new real estate loans are now put in a tax free structure within our company and that's made those businesses much more effective and that's been a huge benefit, and we're going to talk about that a lot, later today.

But now we have a tax efficient structure, which gets to this notion I said earlier. If you want to be in the lending businesses, there's two things and if you get them both you've really made it, direct origination and an efficient structure. We've got the direct origination covered. Most of you know that there are lenders out there who have lower cost of debt than do. Right, we're working on that, Tom's done a great job. And we've got some things that we can do that we think can improve that, but then you throw in the tax efficiency and you start saying, "Hey, this is getting pretty good." So this is really important to the business.

And then finally, a stable and growing dividend. Why is our dividend stable? Because we have a diverse collection of businesses. I won't go through why I think that's important again, because I don't want to bore you, but you can tell I think that's important.

A prudent payout ratio, this is something I'll talk about in a second, but you want to have some cushion around that dividend so that you know it's safe. And then you want to have a high quality asset profile so that credit problems. And we're in the credit business, we're in the risk business, we will have credit problems. We've had them, we've worked them out quite successfully, we'll talk about that, I think we're very good at it, but we're in the risk business. But you want to have some measure of safety there so that credit problems don't affect your dividend or your ability to pay. So that's why we will have a stable dividend.

And then in terms of a growing dividend, we think we have ROE enhancement opportunities and we have the ability to retain earnings. Because the one neat thing about our REIT structure is we actually only have to pay out the earnings that come from our real estate activities, so we do have the ability to [inaudible].

Dividend guidance. I think most of you know that we provided guidance after the marked closed yesterday as to what our dividend would be, or what it would be at least for this year and next year. And we said, just so we're clear, we expect to pay dividends of at least $2 per share for 2006 and we expect to pay dividends of at least $2.40 for 2007, which is a 20% growth rate. And we also announced that our payout ratio, which is the dividend off the adjusted earnings if you will, was going to be between 80 and 90%.

Now, let me dwell on the payout ratio for a minute here because last year when I stood here and was explaining the benefits we saw in this REIT election, I was asked a fairly direct question about what's the payout ratio and I said 100% off what was then kind of our adjusted earnings number, which we hadn't quite called it adjusted earnings at the time, but it was our net income adjusted for a certain amount of cash [run]. And I said 100%.

The reason I said 100% was because I had only thought about it for a few days, to be honest with you, and we looked around and we saw that equity REITs generally pay out less because they need to retain money to invest in their properties and lending REITs pay out a high percentage, so we went with 100%. But like most important decisions or most important things in life, sometimes you spend more time on them and you change your mind. And as we thought about this across the year, and we started talking about this a little bit, it made sense to have a more prudent payout ratio.

It made more sense to have a more prudent ratio for two reasons. Number one, the dividend is not something you want to view as likely or something you aspire to, you want your dividend to be something when you say it its really safe. So the best way to do that is put some cushion in. I mean that's the only thing I can figure out.

But more importantly, as this company can increase or lower its payout ratio and retain earnings, we think that's very positive for the business. It lowers our dependence upon the capital markets and it creates an ability for us to retain earnings and have internal growth. And that's where we want to steer this business towards. Continue to grow the dividend, clearly we're projecting very significant growth next year, and continue to grow the dividend in the future but increasingly lower that payout ratio so we can retain earnings. And I think that's very positive for the company and for the shareholders.

So looking forward what's our plan? Well, obviously plan one is to deliver on guidance and we set it out yesterday and we plan on delivering on it. Secondly, grow these businesses. We think we have very good organic growth opportunities in this company, both in the core lending businesses, and you'll hear a lot about that, and in these kind of asset based fee businesses we're working on. Continue to diversify the franchise, again I think that's very valuable and to the extent we see opportunities that fit, meaning high risk adjusted returns, somehow lever into our expertise base may be interesting. So we're going to continue to look at those.

It's not an institutional imperative, but we will to continue to look at things. Maintain focus on credit, obviously that's job one always. Improve operating efficiencies, that's Dean's job so he's going to explain to you how he's going to do that. Nice to be able to kind of pass that over to someone else, all the hard stuff.

And then further broaden and diversify funding sources. This is really important, Tom's going to talk about this, this is Tom's job. And really what we want to do here is some deposit based funding strategy. We think that's really important for the business. We think there's a bunch of different ways of doing it. We tried one, we've been delayed so we'll do some other things, but this will get this company to the point where it already has this huge robust origination capability and then with the REIT structure we have a very efficient tax structure. Our secured debt's coming down very nicely, Tom will talk about that. You mix in some deposit base funding, suddenly you have a company that has a very efficient balance sheet and is a direct originator. And then you're back to that kind of singular business.

And so that's my introductory remarks and with that I want to turn it over to Dean Graham. And then we'll do questions after Dean's section. We're going to kind of spread questions across the day.

Dean Graham: Thanks, John. Good afternoon, everyone. For those of you that don't know me, my name is Dean Graham and I'm the President and Chief Operating Officer of CapitalSource. I joined the company in early 2001 and was the Managing Director of the Healthcare Finance Group and subsequent to that the President of the Healthcare and Specialty Finance Group prior to assuming my current duties on January 1 of this year. For those of you who have been to this conference before and have perhaps seen some of our equity road shows before, I think you'll understand when I say I have the unenviable task of following John Delaney up here at the podium. But in any event, let's begin.

You've just heard John lay out in detail our company strategy and position. This afternoon you will hear from a number of the company's senior executives who will describe our diversified businesses and explain our credit and financial metrics. It is our hope that you will find these presentations both informative and insightful, and that they will reinforce why we think CapitalSource is the leading specialized commercial finance company for middle market borrowers in the United States.

My remarks today will focus on two specific areas of interest. First, the general business environment as it relates to each of our specific business groups, and second, I will review a few important aspects of our overall operations, with a focus on several initiatives John and I are spearheading across the company.

This will be followed by a close look at a few key directional metrics in order to highlight the work which we are undertaking and to provide some color on the progress we are making.

As we walk through the select businesses and operating highlights to follow, I want to emphasize five important CapitalSource themes which will form the basis of my remarks and which will recur throughout many of the presentations to follow this afternoon. First, our nationally broad based origination platform is bully built out and operating efficiently. Second, our fundamental strategy of focusing on attractive defensible high margin niches within the middle market where we can establish a market leading position is proven. Third, all of the diverse sub-markets within the middle market in which we operate have strong growth characteristics and our diversity of product offering allows us to continually and efficiently react to market changes.

Fourth, within the context of our fully functioning proprietary origination machine targeting select defensible niches in the middle market, we remain committed, as we have been since inception, to our core credit principals. We remain committed to our core credit principals in two important respects. First, we remain selective in our deal process and remain focused on quality growth, and second, we continue to invest in loan administration and adhere to its philosophy of active portfolio management. Fifth and finally, because our lending platform is fully built out and scaleable and as we move beyond '06 where we have absorbed REIT election expenses, it is our contention there are further efficiencies to be gained across the operating model.

Let's first discuss the CapitalSource origination platform as it specifically relates to our overall lending strategy. As I mentioned earlier, our direct origination platform is fully built out and we think operating very efficiently. Our origination activities are conducted by our originators and other investment professionals throughout the organization. As of June 30, 2006, CapitalSource had 549 employees of which 390 we consider to be investment professionals involved in some sort of origination activities, conducting business out of 24 offices in the United States and one office in London. This proprietary origination machine has produced $368 billion of deals reviewed since inception and approximately $37 billion of deals reviewed in the second quarter of '06.

Significantly, all this origination, reach and focus is directed specifically to market niches that are underserved by traditional lenders that require heightened domain expertise, that are by their nature less competitive and where we can command higher margins and establish a market leading franchise. By way of example, note the blue circle at the upper right hand corner of the slide depicting several of our diversified businesses. Note also that these businesses are at the higher end of the expertise axis and the higher end of the relative competition axis. As John mentioned in his opening remarks, the company was built to focus on the middle market and the businesses you see here in the CapitalSource zone highlight this theme.

I've touched on the CapitalSource proprietary origination machine as it relates to our focused lending strategy, now I want to dive a little deeper and explore with you the growth opportunities which exist throughout our three lending platforms.

This slide lays out our three lending platforms, Corporate Finance, Healthcare Finance and Specialty Finance and Structured Finance, and highlights the growth potential and competitive market conditions within each target market. Let's begin with Corporate Finance.

In its core lending activities, which is providing senior secured cash flow loans, the Corporate Finance business has remained disciplined in a market increasingly characterized by aggressive competition and increased leverage. Within this framework, Corporate Finance continues to rely on its core competencies, speed, creativity, middle market expertise in media, retail and healthcare and superior execution abilities.

Beyond the core business, Corporate Finance has branched out in new directions by adding a European lending presence and targeting larger sized transactions and managing risk and generating fee income through our extensive syndication capabilities. Both Joe Kenary and Dan Duffy will elaborate on some of these new initiatives further in the program.

Healthcare and Specialty Finance is the largest lending platform in the company. Each of the five businesses in Healthcare and Specialty Finance have consistent to strong growth characteristics and operate in fragmented markets with moderate competition. Let's start with the Healthcare Real Estate Group.

The Healthcare Real Estate Group is one of two principal groups which have been supercharged if you will by our REIT election. Recently adding sale leasebacks to its product mix, the group is by any measure the leading provider of capital to middle market senior housing borrowers in the United States. Growth prospects in this business remain very strong.

The Healthcare Asset Base Group, as many of you know, provides working capital solutions to a broad array of middle market borrowers across the healthcare continuum. Quite simply, we have always been a market leader in this business and we remain so today. Conditions remain very favorable for continued growth in this business.

Our Business Credit Services Group, as John mentioned, provides asset based solutions to our non-healthcare borrowers and is rapidly establishing itself as a smart flexible lender with increasing market share. Our Security Finance business provide solutions to regionally based and national security alarm companies and is the clear market leader in its target market.

The Healthcare and Specialty Finance business has over time had a number of asset management businesses, particularly over the last several years, but our principal asset management activity in this business resides in our FHA/HUD, which processes loan to the Federal government for owners of senior housing. This business continues to enjoy strong growth potential and limited competition. You will hear a great deal more about these individual businesses from Keith Reuben and Jim Pieczynski who are the Co-Presidents of the Healthcare and Specialty Finance business shortly.

Now let's move to Structured Finance. The Real Estate group of Structured Finance, as many of you know, provides a broad array of products and solutions to real estate owners and developers across the United States and is the second principal lending group which has been supercharged by our REIT election. Growth potential in this business, given our REIT election, remains strong even in the face of market competition.

The Rediscount group of Structured Finance provides customized solutions to a broad range of commercial and consumer finance companies. The overall market conditions here remain fragmented and competition is inconsistent. You're going to hear a great deal more about the opportunities in Structured Finance from Michael Szwajkowski who is the President of the Structured Finance business and Chris Kelly who is the Managing Director of our Real Estate business.

Let's pause for a moment and go back over the three themes I have covered so far before we move on. First, our origination platform is complete, second our strategy remains focused on attractive, defensible high margin niches and third, across our diverse lending platform are targeted markets of strong growth characteristics, some of which have been further enabled by our REIT election. Within this framework, let's move on to the fourth theme of my remarks, our strict adherence to our core credit principals.

You're going to hear a great deal more later in the program from Jason Fish and Bryan Corsini about our credit metrics and investment philosophy. My remarks will focus on two of these core credit principals. First, deal selectivity and quality growth, which is highlighted here on the slide before you, and second, continue to invest in loan administration. Let's start with deal selectivity.

As mentioned previously, the CapitalSource proprietary origination machine has produced to 368 billion of deals reviewed since inception and close to 37 billion of deals reviewed in the second quarter of 2006. And yet, despite this tremendous reach into the middle market, our initial screening process, term sheet process and closing process remains disciplined and rigorous, highlighting the fact that we are focused on quality growth.

The second core principal I want to discuss today comes under the category of Active Portfolio Management. In a few minutes, I'm going to provide you with some information suggesting our business as a whole is inherently scaleable and that efficiencies exist throughout our operating model. Loan administration however is an area of our company which is inherently not scaleable, given our credit first orientation. Those of you who are not familiar with loan administration, quite simply, it refers to all the employees and assets of the company that are involved with managing our loans. We have always invested heavily in this area of the company, largely due to our belief that active portfolio management produced better credit outcomes.

The slide before you, depicting number of borrowers per loan administration headcount, highlights this recurrent theme that we have continued to invest in loan administration as our company has grown in size and scope over the last several years. We have continued to make this investment because we fundamentally believe active management produces better credit outcomes.

That concludes the business environment part of my remarks, now I'll turn to a brief discussion of company operations. As the President and Chief Operating Officer, as many of you may expect, I'm very, focused on driving efficiencies and cost savings throughout the organization. These efficiencies largely fall into two categories, first, leveraging the scalability of the organization and second, controlling costs. We will then take a look at various company operational metrics and attempt to show directionally where we are headed.

Let's talk about leveraging the business. Leveraging the inherent scalability of the business and controlling costs includes many things including rigorous attention to headcount growth, continuing to improve cost discipline and best practices across all the lending groups, continuing to find ways to leverage our technology platform and reviewing constantly third-party legal, audit and other company expenses.

With respect to the increasingly complicated issue of employee compensation, we are moving to a more formula based compensation plan tied to more objective measures of employee performance. We are doing this because we believe this is more efficient, that it will better align our superior performers with company goals and it will ensure that our company remains a meritocracy.

No operating overview would be complete without a discussion of certain operating metrics and ratios. As you can see and tell by this slide, from 2003 to 2005 we made steady and substantial progress reducing our overall operating expenses as a percentage of average total commercial assets, with a small uptick in the first quarter of 2006. And I know what some of you may be thinking. You're thinking if that number in 2006 doesn't go down by 2007, I may not be here speaking with you next year at next year's Investor Conference, but rest assured we have an answer for that.

So let's delve into the reasons for the slight uptick in 2006 and discuss why we think in general the operating trend lines are very positive. First and foremost, the uptick in operating expenses in the first half of 2006 was due primarily to the increase in the REIT related expenses in connection with our overall REIT election. If one were to back out legal, audit and other significant REIT related costs, in my estimation you would see a similar downward trend line for the first two quarters of '06 and continuing on into '07. As such, we believe the trend lines will also continue downward throughout '07 and beyond.

Further evidence of the downward trend in operating expenses as a percentage of average assets can be found in the downward trend of compensation as a percentage of average commercial assets. From 2003 to 2005, the percentage declined from 1.35% to 0.95% in 2005 and, given our focus on headcount and compensation, we believe the trend line will continue down again throughout the remainder of '06 and throughout '07.

We have said before and reiterate today that our origination platform is fully built out and operating efficiently. Perhaps no other statistic buttresses this point more than headcount trends. You can see from the slide before you how headcount grew and the platform grew for the build out phase in 2003, 2004 and 2005. As we come to the end of '05 and move through the first two quarters of '06, we begin to see, as we predicted, headcount leveling off dramatically.

We believe this leveling off or slowing of the rate of growth will continue throughout this year and '07 and as such, we will continue to see improvement in our operating ratios going forward.

The last two slides highlighted the downward compensation and headcount trends. To further elucidate the 2006 operating expense ratio, the following slide shows professional fees as a percentage of average assets from 2003 and the first two quarters of 2006. You can see clearly the increase in 2006 due to expenses related to the REIT election, reinforcing why we believe the downward trend lines will continue throughout the remainder and throughout 2007 and beyond.

To sum up the discussion on operations, we have launched a number of significant initiatives to ensure operational efficiencies throughout the organization. The operational trend lines remain on track despite the REIT related uptick in 2006. And third, we believe further operational efficiencies exist going forward.

The key takeaways from my remarks are really only a few. As John has mentioned and I have reiterated, the platform is large, well diversified and positioned for long-term growth. Within that growth, within the context of that large platform, our pipeline remains strong and our deal selectivity remains consistent. I've mentioned our credit first approach and how our core credit principals, we believe, have remained uncompromised. We've laid out a number of initiatives today showing you how we're striving to drive efficiencies throughout the operating platform and all of these add up to the following, that we're highly confident in our ability to continue to deliver superior returns.

Thank you.

QUESTION AND ANSWER SESSION

John Delaney: Okay we'd like to take about ten minutes of questions, just so we can pace ourselves a little bit, and then turn it over to Jason to talk about some of the insights that we have with respect to the business. Yes?

Sameer Gokhale: Hi, Sameer Gokhale, Bear Stearns. I just had a question for Dean, you know you went through some of the areas where you're expecting to get operating efficiencies fairly focused on cost control and headcount, but it just seems like the business overall is fairly labor intensive, specifically if you're thinking about something like CapitalAnalytics and underwriting the loans. Can you give us some specific examples of where you're trying to squeeze out these operating efficiencies? Thanks.

Dean Graham: Sure. Let me answer the question in a couple ways. First why don't I give you an example of why the statement our platform is fully built out leads itself in operational efficiencies. The best example I think I can give you, and you'll hear more about this later, is our Healthcare Real Estate Group.

As I mentioned in my presentation and as you've heard before, the Healthcare Real Estate Group has been enabled by a REIT election. It's been specifically enabled because now

we're offering sale leaseback products to the extent that we were not able to do before. So we're more competitive, we have a better product offering and Jim Pieczynski is going to talk about that in great detail when he gets up.

But to bring it back to your question, and be responsive to your question, the takeaway here with the Healthcare Real Estate Group that you should know is that, while we're offering the sale leaseback product and we're getting tremendous market reception by offering this product, increasing our assets in doing so, we have not had to add any number of personnel. And the reason why that is is the people who want to access the healthcare sale leaseback products are the exact same people who are looking to get loans in the senior housing market. So again we're offering a new product, have increased our reach into that market but have not had to add a significant number at all of new people.

Beyond that, I think you were wondering where else there are efficiencies. I would say to you that, as we've developed some new products in sale leaseback and as the Corporate Finance Group, which you'll hear a little bit more about this afternoon, has reoriented its business to do some larger transactions that rely on syndication. There is some reduced use of a certain amount of our internal resources that's needed for those businesses, just by way of example. So there are several different examples of why we're not having to hire more people to drive growth and some of the moves in reorientation of our businesses internally are actually saving us money.

John, anything to add?

John Delaney: The consistent theme there which we have been saying for some time is that front end scalable, back end, a little bit. Not completely. And then other aspects of the company should be scalable, we haven't done the professional fees, if we just get rid of legal and accounting fees we would look really good. We'd have other problems probably, more significant problems, or at least I would, and we don't want that. But yes, we've always said front end scalable back end not particularly scalable.

Henry?

Henry Coffey: Yes there's a certain blip at least in the last couple of years seems to occur and -- hi, it's Henry Coffey with Ferris, Baker Watts. There's a certain blip that seems to occur every year on the side of, in essence, non-cash compensation tied to the equity program and this year it's getting more aggravated with 123 and other measures. As you go forward, and I guess two questions, is that something that's likely to show up more in June than in any other quarter? And second, as you go forward, are there ways to better manage those costs since they are essentially non-cash?

John Delaney: Yes. Well I think the specific thing that happened in June and, Tom, you need to correct me if I'm wrong here, or Dave perhaps, is that I changed my compensation structure and Jason changed his where we went from receiving cash based compensation to receiving 100% stock based compensation and in my case it was 100% options based compensation.

And that package was structured in really two ways, part of it was stock was issued -- the option was obviously granted at market and they were just straight options as you expect vesting over five years. But the other half of it was performance based where the options are exercised at market but the stock has to achieve a certain level, $32, before they become exercisable. So it's almost like a double trigger, the passage of time plus performance.

And I could spend a lot of time on this, but the accounting dictates that we have to accelerate the expensing of that so even though they're across five years you don't actually expense it across five years, there's some acceleration. And I can't remember the exact percentage, but it was pretty high that was accelerated in the first quarter in which those options were issued.

And the funny thing, and this will kind of I think shed some light on some of the interesting and intricate aspects of accounting, is that performance based options are actually more expensive than the non-performance based options. I'm still trying to figure that out if you have any ideas.

But yes, so it's an odd treatment, so it was accelerated in June when I made this decision to go to stock base compensation. And which I'm very pleased with and I think it's the right decision and it again I think shows very good alignment. But it did cause a blip in stock-based compensation in June.

[Don]?

Unidentified Audience Member: A couple questions, one unrelated, one for John and one for Dean. John --.

John Delaney: Ask Dean the hard one.

Unidentified Audience Member: Okay. I'm going to ask you the hard one actually. It's I guess a philosophical question, there's a trend right now of these mega LBOs and it seems as though at least the early returns are that to attract capital to these mega LBOs people are paying up in terms of spreads. When you look at that, is that ever tempting to you to get involved in things that aren't necessarily middle market focused because, for technical or supply and demand of capital reasons, there are spreads that are at least similar to what you might be able to do in your middle market business?

John Delaney: Well, it's a really interesting question and I don't want to steal Joe's thunder in answering, but I know he would steal mine so I'll do a little bit. We actually get along pretty well here. So, we actually think there's a bit of an inverted market where some of the risk adjusted return in the smaller LBO business is not as attractive as the risk adjusted return in the larger LBO business. I think we have our views as to why that's the case. I think there is the supply and demand aspect that you're focused on, I mean some of these delays like Columbia [HGA] just absorbs a lot of capacity in the market and you can, and Dan Duffy will also drill down on this, you can see spreads move around some of these transactions.

But the other thing that's interesting is I think the large deals, the large buyout funds have to work together because no one's going to write the equity checks of the size of these deals, so

you basically don't get as much competition I think, which is keeping purchase price multiples a little more stable. Where in the middle market space, you know it's really interesting, but you see in these deals that are auctioned where literally 50 people look at them someone has to win, for some reason that's unique to them that day, and they just push the price. And so I would not, if it was my choice, I would not want to be in the middle market LBO business right now for that reason.

And so it does create an interesting opportunity for us. Really where we cover that space is Dan Duffy, who will talk at length about what he's building in our CLO Asset Management business where he takes part of our loans and puts them into CLOs and then he buys broadly syndicated loans and puts them into CLOs. And then he takes the CLOs to market and he sells largely through the equity, as opposed to what we do with our CLOs which we use to finance our business and we hold the equity. And it really is an asset management business so he's forced to go into the broader syndicated market to get transactions because he needs diversification beyond CapitalSources' to service it, kind of by definition in the way these are structured if you want to sell the equity.

So he has in his business, he is going after larger deals than we do. It is not really in the large LBO market because even with some widenings of spread it's still not attractive enough. It tends to be the larger middle market space, which I think some of the observations you have apply. But it hasn't quite moved us up into the real large deals. You know I'm sure he's done some that are larger syndicated deals, still a lot of CLO, but it's not really been a core focus. I don't know if, Jason? Would you add anything to that?

Jason Fish: Just one thing I'd add is that there is a portion of the portfolio that's been set aside for Dan Duffy's group to actually buy pieces of loans that have attractive yields, that we think are safe, that we retain on our balance sheet. But it's a fairly small portfolio to date and I think we'll continue to look at that. As you said, there are certain opportunities where the risk and the reward are out of whack relative to the quality of the companies that are being bought. And when they're out of whack in favor of the reward, we'll buy small pieces of those loans.

Unidentified Audience Member: And then quickly for Dean, as you move towards a more formulaic compensation structure, can you talk a little bit about what you're doing to ensure that you don't have people managing their businesses to the formula and getting results that you might not have otherwise hoped for?

Dean Graham: Yes sure, that's a good question. When I say we're moving to a more formulaic compensation structure, what I mean to say is we find ourselves here in 2006 at this point with over 500 employees in the company where we're really seeking to define much more objective performance measures for deployed performance. So I don't want to leave you with the impression that there's some sort of magic formula that people push a button and that's how they conduct themselves on a day-to-day basis, that's not the case. All employees, as you would expect, get judged based on their performance, based on the performance of their groups, based on the performance of the company and also there's factors relating to other things beyond just their actual lending performance if you will.

So I don't want to leave you with the impression we still have -- there's still a wide variety of subjective factors, we still demand both that people are performing exceptionally well and are acting and are performing professionally very well. But I don't want to leave the impression there's just a magic formula, that's not the case. So I think our alignment is actually very good. We're very focused on aligning our top performers with the company going forward as we always have, and we're very -- I think the key takeaway with the compensation is really quite simple, which is we're working very hard to keep the company to be a meritocracy, which it was at the beginning and which we are trying to keep as we go forward.

John Delaney: You asked him the tough question, that was good. Joel?

Joel Houck: Thanks. I'm wondering if maybe you want to talk about the changing competitive landscape. I mean CIP obviously is attacking healthcare in a big way, you've got BDC is doing more senior deals and then there is a new public entity in registration that looks a lot like CapSource. It seems like, relative to three or four years ago, the landscape's getting more challenging, I don't know whether you agree with that or not, but your thoughts around that?

John Delaney: I would certainly agree that relative to three or four years ago it is a more competitive environment, I couldn't challenge that statement at all. I don't think the competition has changed materially though in the last year, in some ways the last year and a half or two years I think it's been pretty stable. So you're referencing a point where it was actually the wind was at our back, I mean it's clearly more competitive now. There are new entrants in the market obviously, we do compete with them, I'm familiar with the ones you're referring to. You know the thing about one new public entity, the shear number of kind of hedge funds and other specialty kind of asset management vehicles that are entering this market dwarf any one or two new entrants, so that's not a significant situation and that company's been around for some time.

So yes, it's a competitive market, that's why we think some of the way this business has been built is so important right now, which is we're balanced, we're not looking at all these businesses to grow all the time. Our Corporate Finance business, which I think it'll prove that we were right about doing what we did which is we slowed it down. That was driving the growth of the business, as those of you like yourself, Joel, who have been close to this business for some time, if you look back at the numbers a few quarters before we went public, that business was 45% of the portfolio. Now it's 23% of the portfolio and we've reinvented the business.

It's a much different business now based on the market that exists now where you want to be a little more of an originator and seller of credit than a holder of credit. So we have shaped the business around where we see the market opportunities and we always run the business in a way where it looks like we're allocating capital where the best opportunities are, and we have some views about that. But it's much more bottoms up where each of these groups has two standards, they have a credit standard and a pricing standard and they have to meet both of them for us to make the loan.

Now in our real estate related businesses we've lowered that pricing standard because we can. We're not being taxed, we get to the same return. Right? And so that's actually allowed us to move up market from a credit perspective and move into a vein that we think is richer, which Mike and Chris will talk about, and Jim Pieczynski. But I would say it is competitive, I think some of the things I went through in terms of the attributes of this business, the fact that it's balanced and it's diversified and we can be disciplined is exactly what you want in a competitive market. And that's why I feel confident that we can have sustained growth.

Because when I look at these various businesses, I have my views as to which one will grow and which ones won't. And I probably won't be right about all of them, some will probably exceed the expectations some will come in below and that happens every year. It happened this year. Some businesses grew more than we thought and some grew less. And we're okay with that because we deliver. And that's a benefit of a balanced business.

And, the other thing is we have a very, evolved credit platform at this company at this point, we've done a lot of deals, we see an enormous number of deals in this business. I don't think there's any question that we see more of these middle market deals. So I think we're really good at figuring out how to do this actually. You mentioned CIP getting in the business, I would say that that has had an inconsequential effect on our healthcare and business, and I'm sure Keith and Jim will say the same thing, it's really been a non-issue. We continue to compete principally with two people in that business, Merrill Lynch and GE, I don't think there's any difference there and they're good and we compete with them. So that's my view on competition.

Joel Houck: Is there a point where they're -- threshold where you'd get concerned about public entities coming into the marketplace, because it sounds like we're a ways away from that?

John Delaney: What do you mean by coming into the marketplace?

Joel Houck: Well, it seems to me like the rate of entities going public, whether they're in the BDC --.

John Delaney: Yes.

Joel Houck: Or actually C-Corp -- I think it's slowed down actually, don't you think?

John Delaney: Well, it may have on the issuance side.

Unidentified Company Representative: It may have.

Unidentified Audience Member: Just because rates backed up, and now --.

John Delaney: Right.

Joel Houck: They've come back down, but what we see in our pipeline is lots of companies trying to get out in the next six to twelve months, and while they don't -- they do mezz and equity, it just seems like there's a lot more focus on the middle market.

John Delaney: Yes.

Joel Houck: And my question is, is there some level of attention, whether it's public formation --.

John Delaney: Right.

Joel Houck: Public entities, capital flows, where you would say, or are just years and years away from that?

John Delaney: Well, it's a very big inefficient market. And, you want do be a direct originator. Because as I said, if you're a direct originator -- listen, I think you have to start by saying, "Is it an internally advised vehicle or an externally advised vehicle?" Because, externally advised vehicles a whole different game, because they're incentives are few people, lot of assets. Returns, yes, those are important. But few people, lots of assets, that's the business they're in because the people running the business, they own the management companies. They don't own the fund. And so, those people are not direct originators. And, they generally buy paper or participate more in the syndicated market. We sell them a lot of paper.

The ones that have done well are the ones that have huge investment banking relationships, because they can lever those to get deals, quite frankly. The ones that don't have those enormous investment banking relationships, it's a little tougher. So, I think you have to differentiate between externally advised and internally advised. So, the externally advised, I think, are actually in a very different business. The internally advised ones are the ones that are actually trying to build an operating company. There's examples of that. Some of them do a great job. Some of them don't do quite as good of a job.

We haven't really seen that our -- that any material increase competition from new, public internally advised vehicles. We still, I would say and I'll let different people or Jason, your view and Dean, your view, that most of our competition comes from banks, established commercial finance and specialty lenders and hedge funds.

Unidentified Company Representative: Don't know, I would just add one comment to complement what John says, if you look back at the conferences we had in '02, '03, '04, '05, almost every year someone is there saying, "Well, Merrill Lynch is getting the market. Is that going to take away all your business? And the latest hedge funds getting into the market, is that going to take away all of your business? And CITs now in the market?" And, this CIT is in the market now, and we had a record year in Healthcare, as we've had every single year over the last five years.

And so, I think to John's point, the markets -- you've got to remember, the markets that we've tracked, and particularly Healthcare, are enormous. They're fragmented, and just saying you're going to get into the market doesn't necessarily -- don't necessarily assume that it's a quid pro quo and everything they do is a negative on us.

It's not a zero sum game. In fact, their strategy is probably a little different from ours, probably going after much more equipment type style lending and other types of business. So, I'm just saying, "We're trafficking over some pretty familiar ground here, new participants, just getting in and we've had this over and over again. And, I think you can see that the business is very stable, proven it's been growing at the very steady clip throughout all of this.

Finally, I think it takes a lot of time and money to build a broad-based origination platform. We were fortunate we entered the market when nobody was lending, so we were able to get our name out there early. We were also fortunate that we raised a lot of initial equity capital so we could under-lever our business substantially, and have frankly as a private company, pretty inadequate returns on equity. I just think in today's very competitive environment, it's going to be much harder to build a platform for origination that really competes with what we do, and we haven't seen it yet. And then, Bob?

Unidentified Audience Member: I was wondering if you could touch on the payout ratio a little bit in terms of, if I understand it correctly, given the non-real estate revenues you have and a lot of the diversification, your payout ratio could go a good bit lower. And, given some of the benefits of not having to raise equity capital, could you see that going lower in the future?

John Delaney: Yes. You're hitting on a really good point. And, let me take a minute to go through really how it works, which is that, as a REIT, and there are people here that are more technical than I am on this, so they should feel free to chime in, and I'm referring to Steve and Dave or Tom, but as a REIT, we are required to pay out 90% of our net income in the REIT part of our business. And, we have the REIT, and then we have the taxable REITs that you see here, which I refer to as the REITs and then what we call the qualified REITs that you see here, which are where all the real estate stuff here. And then, we have the taxable REITs you see here where all the corporate lending is.

We don't actually have to pay out any of the earnings from the taxable REIT's subsidiaries. And if today, we're not disposing of specific percentages, but it's pretty close to 50/50, you get a sense as to how little we could pay out and still meet the REIT standards, quite a bit lower than we do. We made the decision to do 80% to 90% now. That results in a 20% increase in our dividend from '06 to '07.

That 80% to 90% puts a lot of comfort, I believe, around that dividend number. It really makes it very secure and shores it up in my mind and my judgment. And, I think what would be nice over time is to continue to dial that payout ratio down. We want to always grow our dividend, and we're committed to doing that. So, any dialing back of the payout ratio will be overlaid with a view that we want to grow our dividend, and we're planning on doing that.

But, I think there will be a point in time where this company's top line asset growth will inevitably slow. And, if we can dial back that payout ratio and potentially increase leverage a little bit, which I believe we can based on some of the things we're working on, you could see a situation where we invest some of the accretion associated with additional leverage into

a lower payout ratio as opposed to a big spike in dividend and get the company to a point where its payout ratio is low or it's got some internal capital. It's not depending on the capital markets, and it's still paying a strong dividend. I think kind of a long-term aspiration in terms of where we want to go to, but for now, this is where we are with kind of '06 to '07.

Unidentified Company Representative: And, what that'll also do obviously is we have been a fairly frequent issuer of equity capital. It'll minimize the amount of equity capital that we will raise going forward.

Unidentified Audience Member: Sure.

John Delaney: And, if you look at companies that actually retain earnings in this dividend world, and not to get specific on this, but you do see companies that can retain earnings and grow through retained earnings, trading at very tight dividend yields, as they should, because the investors are getting returns from internal growth. And, that's kind of what we think makes sense.

Unidentified Audience Member: Thank you.

John Delaney: Sir, and Bob, you had a question. But, it's been a while, so I'm not sure. I think if I could do Bob first because he had his hand up for a while there.

Unidentified Audience Member: All right. Just on the two things, I guess, on the expense ratio and the adjustment in compensation side, first of all, I was wondering what kind of target or what kind of efficiency opportunities are there using your 2.68%, I guess, for the first half of this year? How much -- what is the target of the organization? And then, I just had a follow-up on the adjusted -- the compensation structure.

John Delaney: Well, I think -- I think we have the targets up there, 2.6% for full year '06 --.

Unidentified Audience Member: Oh, okay.

John Delaney: And 2.2% for '07.

Unidentified Company Representative: [Inaudible - microphone inaccessible]

John Delaney: To give you a very direct answer to your question.

Unidentified Audience Member: And on a longer-term basis --.

John Delaney: Probably one of the few.

Unidentified Audience Member: And then, Dean I think relates to the compensation, what was --?

Dean Graham: Well obviously, longer-term I think our collective goal has always been looking ahead, getting a 2%.

Unidentified Audience Member: And then on the compensation adjustment, frequently you've seen organizations adjust the way they compensate people and there's a lot of turmoil sometimes around that. And, I was wondering is this already something that's in place that has been laid out for the employees? And, what kind of feedback are you getting? Is there -- are there any concerns on the reactions that you're getting from employees in that regard?

John Delaney: Are you implying that people in the financial services business care about compensation? Is that what we're here to talk about? It is -- it's -- we're in a rollout phase now. A lot of time's gone into this with committees assembled representing a variety of different divisions in the company and coming up with a methodology that was more logical that factored in all the things we care about, profitability, credit and growth, into a formula that was a -- that guides us but doesn't commit us. So, this was very important to the Board to keep a fair amount of discretion in the system so that the year-end compensation discussions are not just an Excel spreadsheet basically.

But, you want to have some rational approach to the business, which is if you do deals and they turn out to be good deals based on their credit performance and they're profitable because the spreads are wider because we originate loans. Some groups originate a small amount of loans with very high spreads. Some groups originate more loans with lower spreads. You have to factor all that stuff in. So, the compensation structure factors all of those things in. I think it's pretty elegant the way it does that, and it's in the process of being rolled out now.

Unidentified Audience Member: And reaction that we know -- you're not at that point yet?

John Delaney: I think people have really felt like it was needed. I think CapitalSource, relative to our peer group, we're a good payer. And so, that wasn't the issue. The issue is, is it always as logical -- it'll never be perfect. But, I think it can be more logical. And, it was easier for it to have less kind of rule -- it was easier for it to be less rules-based when the company was smaller. The company gets larger, you don't want people benefiting just because they happen to know other people more. Do you see what I mean? And, that what happens when a company gets larger. You get a little out of sight, out of mind, things like. And, you want to make sure the compensation's structured. It's a really important issue. We spent a lot of time on it, and it's -- it'll likely continue to get tweaked.

Sir? Maybe we'll make this our last question and then --.

Unidentified Audience Member: Yes, thank you. Just a couple of questions so I can understand better the fragmentation of the market that you choose to compete in, could you give me a sense of you had a slide there about the $368 billion of screened prospects. How much does that represent of what you thought that you'd be competing? What proportion are you screening out of the total market? And then, if you could go a little further and describe how the ratio of closed to proposed has evolved over time, if that has changed because of competition or lessened?

John Delaney: Well, the closing ratio generally has gone down. And, I'm going the wrong way here, sorry. I have a slide here somewhere, somewhere. There it is. The closing ratio has gone down. We don't deconstruct the deals reviewed to the closing ratio, but the general

trend is a tightening of all those things. So, that's been positive. But, it makes sense. The quality of originations are up. The value of the direct origination platform continues to prove out. We continue to make investment in it, and it continues to get better.

We can become more selective, all the points I was making. And, that results in a tighter closing ratio. It'll move around. You saw it move around net the last few quarters. It's not a perfect science. Some large deals can move it, et cetera. But, we've seen a continued tightening of those various metrics that you would care about to reflect that we're being more selective. Clear on that point, I think, at least I don't have the specific numbers, but I kind of know what they are.

The -- your other point about what percentage of the deals are we seeing? I'm not sure -- I'd probably want to -- it might make sense for you to save that question for some of the specific groups. I will say this, that we actually did do a study of market share, which is incredibly hard to do in the middle market, how you define it, what your -- what is your potential market? There's a lot of middle-market companies that never borrow any money, so they're not a potential market.

And, what share do you have? We did that -- what was that, a year and a half ago, maybe? We did -- a big consulting company did it for us. It was actually a good report card. But, the net/net, and it didn't include certain of our new businesses like the Business Credit Services business wasn't in it and a few others, we had about 4% penetration in the market that they thought was really kind of our potential market.

So, if I could leave it at that, I don't want to talk too much, because we have so much on this point coming. So, why don't we turn it over to Jason?

Presentation

Jason Fish: My name is Jason Fish. I was told to announce myself, in case you don't know me. And, I co-founded the business with John back in 2000. I'm going to talk about four things today generally, the origination process, which while being refined for certain of our businesses, is essentially the same as it was when we started the business back in 2000. I'll talk about building our portfolio and our considerations when we make a loan and the areas of focus for our origination engine.

I'll talk a bit about the impact of the REIT election, although Jim Pieczynski and Chris Kelly will go into much more detail on that, but really what the change in the portfolio composition has been since we elected to go forward and also, the new advantages that we face -- that we have generally in the commercial real estate and the re-discount markets that we work in. Finally, I'll spend a little bit of time on portfolio management, our approach and the results we've had to date and then, a few minutes on credit statistics before turning it over to Bryan for a more detailed discussion.

We've maintained a consistent approach to underwriting and originating loans since we started the business. It's based upon a dual-track, underwriting model where our lending professionals are in the business group and underwrite the loan from a top-down basis, and

they are supplemented by a forensic audit underwriting done by professionals in our Capital Analytics group, which is a separate organization within the company.

The deal professional or investment officer is credit focused as opposed to new business origination focused. That process is taken care of by the development officer. And Capital Analytics, as I said, is an independent guide. Both the underwriting officer and the investment officer write their own reports and jointly present a collective support of the deal to the Credit Committee, and then, all Credit Committee decisions are unanimous. And basically, we make two types of loans.

We make either loans secured by assets in which the asset value is what the basis for the underwriting was, and we know that value in all market conditions where the loans are secured by business enterprise. And basically, that means that we do a cash flow underwritten deal, where again over time and through cycles, we feel we can look at a predictable level of cash flow in the companies. We underwrite in this consistent manner that I showed in the previous page to a zero loss tolerance, and we've had excellent results to date.

And, when we look at whether or not to make a loan, we really have to abide by three criteria. One is a qualitative credit analysis. So first and foremost, it has to meet our credit parameters. Do we understand the credit or the industry or the specific need of the borrower? And then, can we customize a structure that protects our principal and makes sure we get paid our interest? If we can do those two things, then we have to figure out whether we can actually price it to a level that allows us to meet our returned hurdles. And only under those three circumstances will we go forward to make a loan.

The key to this investment thesis, we believe, is to have selectivity. And as you've seen and John and Dean have talked about, we see a huge number of deals. And, we only close very few. And, the key to that really is, the more deals we see, the more we can understand credit on both an objective, independent view but also on a relative debut to all the other deals that are out in the market that we may not find as attractive. So, it's both a relative and absolute credit analysis. And, we always run the business to an after-tax return on equity target. So, we're not going to grow just for growth's sake.

We think we get that ROE by focusing on higher risk-adjusted yields for the portfolio, so we lend it in markets that generally are under-served by traditional lenders or might be out of favor. We understand the true yield of our instruments, and it's not just based on coupon and fee, but also on the average life and the average outstanding of the loan. And often times, we can create our yield through a loan structuring.

So by example, if we think of the loan as really a five-year loan, but it's going to pay off in two, we may more heavily weight the yield to fees as opposed to coupons because, if the loan does pay off in two years, the face rate will look actually quite low but will actually maintain a better yield through an acceleration of the yield on those fees.

We'll also create yield through the syndication efforts, and Dan Duffy is going to talk in detail about the syndication process. But generally, there are two forms of fees there, which is number one, you can create syndication fees or skim income off of the fees up-front.

And then secondly, you can bifurcate loans into senior and B pieces and hold those pieces that conform to your yield parameters. Finally, we lend to borrowers who want and will pay for a value-added product. And, that takes many forms. In corporate finance, it really takes the forms often of doing leveraged buy-outs, management buy-outs through acquisitions and recapitalizations where speed of execution, flexibility of payoff and the like really matter. Or, it could be situations where a company is growing rapidly and the cash flow, historically, does not support the loan they need, but we're very confident of the pro forma cash flow.

In real estate, oftentimes, we'll see our borrowers have a change in use planned for the property, or they're going to reposition the asset, either from a single-tenant building to a multi-tenant building, or from warehouse to sell stores, or what have you. But, there's actually also going to be an interruption in the cash flow on the asset, which we have to structure around but still will allow us to make the deal happen.

In the rediscount business, we tend to provide a Wall Street style financing to meet the middle market -- the needs of middle-market companies who can't access Wall Street for highly structured transactions. And across the board, we provide specialized industry expertise, which can facilitate speedy execution. This requires a high-touch process, not just by the many people who touch a deal along the way, but also by the fact that over the course of the life of a transaction from term sheet through underwriting, there are multiple times when Credit Committee and other members of senior management are looking at the deal and having regular reports made on that.

The portfolio today, as you can see, is about 40%, 41% to be exact, in first-mortgage product. And, about a third of the portfolio is senior secured asset-based lending. And, that's either AR, inventory or our rediscount business, actually a lot of loans, many of which are real estate based. So actually, that sort of does not tell the whole story about how many are actually real estate based loans underneath. About -- less than a quarter of the portfolio is in our cash flow or senior secured cash flow lending. And, we've maintained a fairly consistent 4% pool of mezzanine, and that's really derived and by chance, more than it is a target of 4%.

In terms of breaking down the portfolio between the qualified REIT subsidiary and the taxable REIT subsidiary, you see we've made great progress just since the end of last year when less than a quarter of the portfolio actually was eligible to go into the qualified REIT subsidiary. That number is now up to 40%. It's growing every quarter, and we continue to make progress there and will and does not again, reflect the full number of assets that are real estate related and that some are trapped in our taxable REIT subsidiary through our securitized bond deals.

I'll talk for a minute generally about the benefits of the REIT election and what the general benefit is, is that it's allowed us to expand the existing real estate business. We're doing larger deals. We're doing better credits. And, the basic reason we can do that is we can lower the yield that we're charging our customers without ROE compression.

And, there are two illustrations here that I've put up on the board. One says, "Well, if you make the same loan and you have the same operating expenses, same leverage and same cost of leverage, what's the derived ROE from that?" And as you can see in the Illustration A, if you make a 10% loan today with everything else being held constant, the taxes will bring that yield down to from 19.3% in the REIT structure, down to just under 12% if we were C-Corp, making that loan a loan we would not make generally at CapitalSource. So, this actually gives us access to loans we wouldn't otherwise make.

Said another way in Illustration B, if you hold your ROE firm, what's your pricing power over where we were before we made the REIT election? And as you can see here, to have the same ROE within the REIT, you can price 200 basis points lower than you can at a C-Corp giving us a much better competitive position than we had previous to that in our real estate business.

The other benefits are, and Dean touched on this and Jim's going to talk about it some more, Jim Pieczynski, triple net lease transactions. What we like about these is they're long term. They're fixed rate. They have slightly less leverage, because we own the asset. They have residual value in the asset, which generally, we underwrite very conservatively, much more conservatively than we think is actually going to happen.

And the origination process, which for loans, we have to repeat every two or three years in our portfolio, we don't have to repeat here, which again, adds a lot of efficiency to the business. And, we're willing to give up a little bit of yield. The initial yields are 8.5% to 10% on this, relative to where we would necessarily price a real estate loan, because over time, the cost of operating that loan or the cost of re-originating the loan would be a lot more.

And then the rediscount business, we've really been able to broaden our market there by redirecting the focus, rather than broadly across the rediscount space to really focus on real estate. And not just real estate, but really the quality companies that are doing smaller deals that we can then create rediscount financing for.

We manage the portfolio much the way we originate the portfolio with high touch. There are a lot of people actively involved. We have both the business groups as well as Capital Analytics involved. In the business groups, you have a loan officer and an account executive assigned to every borrower. One of Dean's slides showed that we're sort of a little north of four professionals in loan administration to every loan. And, that basically breaks down that each loan officer has somewhere between 8 and 12 borrower relationships and is always backed up by an account executive.

And, those are the simple numbers there. They report through the portfolio managers of each of the business groups. And then, they're supplemented on a regular basis by continuing, ongoing audits performed by loan analysts who report through the Chief Credit Officer, Bryan Corsini.

It's an active process. We take in a lot of information from the borrowers in terms of financial information, in terms of collateral information on a daily basis for those companies that have borrowing-based revolvers. And, we continuously monitor that performance, and we discuss this in group meetings every week. And any time that a company starts to

perform less well than we've underwritten or they've pro formaed, we start to take action on that. We are a very proactive loan administration business, because we believe that based on early detection and early action, we can actually take a much more rational approach to loan and work out with the goal being to achieve the best economic outcome.

We don't believe in quickly moving loans off our balance sheets, regardless of costs. So some of these loans, especially in our Corporate Finance group, they into -- if they go into -- if they get into trouble, if they go on non-accrual, they stay there for a while, and they stay there for a while because we think at the end of the day, we'll have a higher result and economic outcome from them. And, I think the results show that.

Our recovery analysis, and Bryan will use the same slide to actually talk about something different, but our recovery has been excellent, 91% on the loans that we basically resolved to date, which is two-thirds of the loans that have gone on non-accrual. We currently have 12 loans remaining unresolved, but all of those, which are either in non-accrual or in delinquency are in active workout today, and we feel very good about our process.

Before we look at the actual credit metrics, which you've probably seen through our second quarter report, let me just re-review some of these definitions. Delinquencies are pretty straightforward. Sixty days or more delinquent for interest or principal, it's a very objective measure. Non-accrual, slightly less objective or more subjective, which is when we believe that there's a probability we won't be able to collect all of the interest. If that's the case, we will start taking in cash, even if the loan is paying currently and applying to principal and not accruing the interest.

Impaired loans, impaired loans is again, a more or a less objective definition because the exact definition, which is very clear, is the contractual terms of the original loan agreement are not going to be met. That means interest could come in late. The principal can come in late, or it could be compromised. And, all of those things exist within our impaired bucket.

The other thing that exists within our impaired bucket is we could restructure a loan and end up getting all of our interest and all of our principal but move out the end date or relieve some amortization in the early going. And, those loans are performing perfectly and have become what they call troubled-debt restructurings, but they'll stay on our books in the impaired category for up to a year after we clean up the loan.

Finally, charge-offs, again a fairly objective measure, when we write off a loan and we write it off either if it goes off the books permanently or if we write it off because we know that there's permanent impairment to that loan, then it becomes a charge-off.

And, these are the resultant statistics. Of note here, a few things. Number one, 60 days delinquent, and we've always said this on our quarterly earnings announcements, they're lumpy. They come in and out.

In fact, the big jump up from the first quarter to the second quarter revolved mainly of one real estate loan, which was days from being resolved and has been resolved.

Loans on non-accrual status have maintained very consistently north of -- just north of 2% for the last five quarters, and we feel very good about that. The other thing to note is that loans on non-accrual, are on average, double what our 60 days delinquent are. What does that mean? It means that these loans are paying currently. We're just not applying those payments [technical difficulty].

Two more things of note, the last 12 charge-offs, which is really the numbers at the charge-off numbers because the month-to-month charge-offs are obviously very lumpy have been very consistent between 25 and 35 basis points. We think those are good numbers, and they're good numbers because we model that we're going to be losing 50 basis points a year. And finally, they're very good because they only represent a small fraction of our total allowance. So, we feel very good about our credit quality ratios. And, Bryan's going to go into excruciating detail about the process.

Finally just putting these credit statistics in the perspective of what we've done as a business over the last six years, we've made 1,700 loan. Slightly over 700 have paid off. Of those, 25 have been either delinquent or non-accrual. The existing portfolio is about 900 -- not about. It's exactly 944 loans. Of those, a dozen are either delinquent or non-accrual. I don't know anybody who could take a measure and say that kind of performance statistic isn't excellent.

With that, I'll turn the mic over to Bryan.

Bryan Corsini: Good afternoon. My name is Bryan Corsini. I'm the Chief Credit Officer at CapitalSource. I've been the Chief Credit Officer since the company was incepted. I will attempt not to be too excruciating, which is difficult to do, and I realize we're only at the halfway mark of what seems to be, well, a pretty long meeting. So, I'll try to be concise and have -- leave plenty of time to questions.

A couple of things that I was thinking about as we've been going through the presentations so far is a couple of themes, I think folks ought to keep in mind, is that after six years of building the platform out, we have a very deep, expert origination process as seen by all statistics and how selective that process is coupled with a very robust and detailed expertise in both the origination, the structuring, the underwriting and the servicing of the loans. And as we start talking about credit and start talking about the performance of the company and how we're able to move, in our view, be very nimble and operate within an ever-changing environment on a macro basis, again, all resulting in very positive and very strong performance.

The current environment, and we've -- interesting that we kicked this around a lot prior to even before the conference starting out in the hallways and at lunch and whatnot, the macro environment from our perspective is relatively stable. And by stable, I'm really focusing on things like default rates, that's a nice tune, default rates, a little distracting, default rates and things of that nature.

But as you see in some of the slides and going -- not just again, try not to steal thunder from Joe, but looking at some of the Corporate Finance slides later, what interesting statistic, which doesn't show up on the credit stats is an ever-increasing competition in certain segments of the environment reflecting the higher leverage, tighter spreads.

So as we suspect, and jumping around a little on the slide, we think eventually that will result in some type of a credit correction. A lot of that activity has been just a large influx of lenders into the market over the last six years. They were questioned about the [RICs] and the hedge funds and a lot of different folks getting into the market. And I'd look at it, having this for a very long period of time, as simple supply and demand.

There's a lot of capital in the market in certain segments, and again, it's [topped an uptick] on the LBO market. But what you're seeing is higher multiples paid from companies. You're not seeing much of an increase in the amount of dollars the equity sponsor's putting in the deals. So, the math will tell you that the leverage has got to go up. And just given the competitive environment in some of those spaces, spreads will continuously tighten and have tightened.

So, the correction that we anticipate, and this is sort of the magic and if I had an exact feel on this, I'd probably be doing something else than standing here talking about all this stuff, is the key is when is this going to happen? We expect that something should begin to correct sometime in the next 12 months, plus or minus a few months. And I think what we'll see in that correction is tightening of spreads, maybe less or rather loosening of spreads, less credit availability, maybe consolidation of some of these platforms, maybe wholesale portfolio plays, possibly some distress activity but again, just the influx of different lenders, different platforms, folks pushing to get their platforms out into a public market. It's very difficult to figure out when that's all going to happen.

I think the other things I did mention in terms of our platform are robust, very industry specific, lots of expertise, fully built-out servicing platform. And one item to highlight that I don't think was in any of the slides is our systems to track all this and manage this business. They're proprietary, very robust, very flexible. It allows us to delve into a lot of different markets. I think using that expertise across a lot of different areas we think will allow us to continually flex the business to respond to an every-changing market.

By maintaining the discipline, and again thematically as we've talked about, we've maintained a credit-first approach. We don't look at loans from a port we're really a portfolio metric in terms of trying to understand an acceptable, say, loss performance, non -accrual performance. Literally every deal is evaluated on its own merits on a credit-by-credit basis. And as Jason and the others have laid out, we've been operating under the same model. As John pointed out, a model he employed in his own business, so it's really a proven out model.

And I think the whole key is, it's somewhat simple. The way I look at is that we do a very good job of making sure we've got good information on the borrowers. And, we haven't deviated from that standard. And, I think where we have had issues, as we've -- we mentioned, we're in a business where losses could be expected or are expected and will continue to happen.

Generally, those issues come out as a result of judgments made and typically not based on making a loan based on erroneous facts. It's very important to mention.

Our focus is -- is again, remains as a senior-based platform. 96% of the loans that are in the portfolio are senior secured loans. Within that, 73% have shifted into a loan secured by actual assets, which is either real estate or accounts receivable inventory, healthcare receivables, things of that nature. And again, that -- we'll defer a lot of this to the Corporate Finance discussion. But unlike competitors or other competitors, we have not really chased market leverage. So as we've seen, again, leverage go up, spread tighten, our platform allows us to selectively go into transactions that we feel meet our credit standards. But, we've also shifted the business away to try to take or really de-emphasize some of that risk due to the marketing version that John referred to.

Portfolio management, again, very high touch, it's very specialized within the business units and then across products within the units. And again, we think that we're well poised to take advantage of really any shift in the market on a go-forward basis. To dig a little bit deeper into the products and the environments and again, on the cash flow LBO side, obviously the risk is changing, primarily due to that supply and demand dynamic that I referred to. Our posture has been, again, to maintain the highly selective focus, looking at that 5% ratio of the deals that we've touched.

In fact, I think folks who have been in this conference over the last several of years, if you look at that pyramid, the numbers -- the inverted pyramid rather, the numbers have actually changed. But that bottom line, 5% to 5.1% selectivity figure really hasn't moved much at all.

And, I think that's a very important thing to note. And again, we've shifted that business to try to move up market, take advantage of syndications strategies and things of that nature, which Dan will go into a lot more detail on later. Looking at the other businesses, each Healthcare ABL, the mainstream ABL and the real estate businesses, I think the whole key is to really hone in on the true loan to value, which the basic premise of really making any loan is trying to determine the value of it, whether it's an enterprise or the collateral and trying to size an appropriate discount for the value.

It's not -- somewhat formulaic, however it's stylistic. A lot depends on the individual credit, the management, the business, the strengths, our ability to monitor those assets. And as you look at different loans across the portfolio, thematically it's very similar, but it's again, truly very customized. And the platform that we've built, the servicing platform we have and the underwriting capability allows us to do that.

Touch on this slide again. I'll try to mix it up a little bit different. As Jason said, the 37 loans have hit non-accrual or delinquent status since we started the company. And again, I'll mention that it's out of 1,700 that we have funded since the company has started, resulting -- the loans that we have, we've been able to push through this process, a 91$ recovery rate. As you can imagine, the cash flow loans have been slightly lower than loans that are actually secured by hard assets. And as Jason mentioned, the workout strategy in these loans tends to be a little bit longer in duration.

There's a lot of operational things we need to consider. There's different debt tranches. We've got the equity sponsor who, of course, has their equity at risk, and there's just a lot of different things you need to go through. And, we'll maybe talk about some of those things later in terms of how we get out of those credits.

This slide is more just to sort of frame -- what's interesting, if you look at that we have -- again, we've talked about the noise of 37 loans that hit our grids in the footnotes that we've published quarterly and annually. I think one thing's that important to note is that there's a lot of other activity that takes place well before loans hit this status. As this slide indicates, we've worked out about $237 million worth of loans in the last nine months on a [cat] of what we call our watch status. If I were to roll that up on a 12-month basis, it actually exceeds about $300 million.

So, I think it tells you a couple of different things is one, with a very deep, robust servicing platform, the key to good recovery on these assets is early indication that you have a problem in very succinct and industry-specific strategies to work out those problems. As Jason showed you in the slide earlier, the business units are set up so that origination, structuring and loan management is spread across each individual unit. So, each actually has management and governance over those functions. There's a -- the overlay is the Capital Analytics, which provides the governance in terms of that dual track. But again, that type of a model allows you to develop the resonant expertise to result in, again, high recovery rates when we find loans that are problematic.

And conversely, we don't have, as Jason indicated, we don't have any kind of metric when a loan hits a certain point, whether it's a credit grade or a loan to value or a cash flow metric or something like that, we immediately push a button. We push the loan out. Because of this ability that we have due to the platform that we've built, it actually gives the ability to understand the risk, and in a lot of cases, actually enhance pricing for the additional risks that we've taken.

Again, high touch, active portfolio management, we have a very thorough recurring loan portfolio review process going from weekly to monthly to quarterly, depending on the risk, the type of asset. On a rotational basis, we literally touch all asset classes, even at a very senior management level. Problems are identified very quickly, elevated through communication and then again, action plans being discussed and decided upon and then monitored.

There are specific things that can occur that are early warning signs, and as the slide said, it's not limited to the things on this page, but things like technical defaults. A loan may be coming up close to its contract expiration that we thought maybe there was some kind of a transitional kind of transaction that should have been paid or close to being paid off at that point, and then the basic operational things, unpaid property taxes, maybe specific metrics on the healthcare side such as reimbursement, things or clinical issues down to looking at granular things like tightening liquidity in individual bars.

So, there's a lot of different things that we monitor. And again, it's very specific to the type of business in terms of the business unit and the product within the unit, the metrics that we're actually monitoring and again, by the business unit in off -- and enhanced by periodical field exam and review by the Capital Analytics team.

This slide just really tries to contrast and of some of the questions earlier, the difference between our platform and sort of the conventional platform. A lot of the broad-based lending platforms, at least that I've seen, the early-warning sign of loans that are becoming delinquent or maybe pushing contract date, and that's your sip to try to figure out which ones of those loans are problematic. And again as I demonstrated on the earlier slides, we have a very high touch, robust process, which allows us to act on borrowers, sometimes even before they even go into covenant default in terms of trying to understand what our position is on the loan certainly well before loans hit non-accrual or delinquent.

And in fact, if you look at the -- I'm going to shift, I apologize. I'm going to go ahead two slides. To stick on that non-accrual, delinquency theme, I think it's really important to note that our non-accruals tend to always run ahead of delinquency. And basically what that means is that was, we determine that risk has increased individual transaction. We think it's prudent to start taking interest and adding it to principal versus pulling it in as an income. And I'd say currently, about half of those cases the loans are actually current and being paid current. We just think it's prudent and maybe somewhat conservative even, to treat the loans in that fashion.

If you want to go back up to the credit trends and expectations, in my view, the portfolio is very seasoned. I think as you've seen, the credit metrics, as Jason pointed out in some of his slides, is begin -- we think it's very smooth. It's very stable. Obviously, the resolution of assets tends to add some lumpiness to the stats. Again, to talk a little bit about the LBO side, loans generally take a while to get resolved in that space. And so, if we hit to the point where the loan is resolved and we charge it off, in a lot of cases, that's a 12 or 18-month process. So, it's difficult to predict when those charge-offs are going to occur. But again, I think year-over-year and a long period of time, it should stabilize at about the 50 basis points that we've been talking about.

And, the other important takeaways on this page is again the business has shifted to more of an asset-based portfolio. Again, loans secured by either real estate or other hard assets as the Corporate Finance business has leveled off and we've become very selective due to the competitive nature.

Obviously, with the REIT election allowing us to add to the origination capability on the real estate side has resulted in this favorable portfolio mix. And then the last point on this slide is, I would expect over time that, that allowance for loan losses should go down for a couple of different things. Obviously, hitting resolution on some known situations will result in charges against the reserve, and again, that favorable asset mix should result in a lower allowance going forward.

We already talked about this slide. This slide again, just hones in on if you look at overall payouts year-over-year on the -- for the various products, cash flow, real estate and asset base, if we just look at the dollars paid out versus the actual losses incurred, it steadily has improved. The only blip thing, the asset base, but candidly, it's only really two situations. So just mathematically, an additional situation kind of made the bar look the way it is.

The hold size is very important and from a risk management perspective, we don't do an across the board hold size, because it's really not prudent to do that, given the diversity of the portfolio and the business that we have. Hold size on cash flow loans tend to be lower than asset-based loans, just given that with our loans not secured by hard assets and just given the operational risks and the other risks inherent with that business. The other factor when looking at the asset-based side is obviously the quality of the collateral in terms of the size of the loan, and candidly, the amount of funds you're willing to advance against what you perceive the collateral value to be.

The other important break on the asset-based size is the difference between what we call pooled obligor to a single obligor. So, a single obligor asset-based loan might be a manufacturer where you're lending on receivables, inventory, equipment and they hit a certain hold size where based on the risk and based on what we see from the asset quality, we may decide to sell that position down, which as Dan will talk about a little bit later, the -- our syndication capabilities allow us to do that on some larger situations. Other loans such as a pool of nursing homes, so possibly a large hold size that may be supported by numerous mortgages across various states. We look at that as more of pool obligation, and we would actually hold a much larger hold size. Again, that results in a $10 million to $15 million hold size, and possibly several hundred million dollars for a secured real estate transaction.

The key takeaways, again, we think we're well positioned to take advantage of really any turn that we see in the credit cycle. I think the company's -- obviously, the overall balance sheet leverage, the diverse platform, the number of personnel and expertise we have in all these businesses. Again, a very selective and robust origination platform, I think again, just results in us being able to literally emphasize or de-emphasize markets based on what we see, and we're not pigeon-holed into a small number of products, but again, very broad but ones that we feel we've really developed some expertise. Our credit focus and market positions, we think will lead to favorable outcomes going forward.

And again, the theme here is consistency. It's largely been built and run the same way over the last six years. If anything, it's just continuously enhanced. And as Dean talked about some of the operating metrics, as we just think about the sheer size of some of the documents, there's analyses that we can fine-tune based on products, so you don't necessarily have to do all analysis for every loan. You truly are risk-based analysis on each situation.

And again, the credit collect correction as I've said, we think it would be well posed -- poised, rather, to take advantage of any correction that will be coming at some point in the future we all would expect. And, that's it. Answering the questions? There probably isn't any. Well, well.

QUESTION AND ANSWER SESSION

Unidentified Audience Member: That was quick.

Bryan Corsini: It's always quick, trying to make an exit. Thanks.

Unidentified Audience Member: A couple of questions.

Bryan Corsini: Yes.

Unidentified Audience Member: About non-accruals, delinquencies, recovery rates, the fact that your non-accruals are always running above delinquencies, are those situations in which you're placing bets on whether the next check shows up that you kind of expect that maybe they're very close to going delinquent? Or, are those situations in which the borrower knows that you've probably put on non-accrual? Or, are they kind of ones in which you're just looking at them and have concerns and maybe even, the borrower isn't aware that you're concerned?

Bryan Corsini: Well certainly, if we're in a situation where loans -- where we're deciding to put a loan non-accrual, I doubt very much the borrower wouldn't be aware that we've got a problem with the situation. So certainly, that communication through either forbearance, reservation of rights and different legal remedies that we have would have taken place. I look at non-accrual kind of thematically that if we are concerned that our position isn't either supported by abundant liquid collateral or sufficient cash flow to keep servicing the debt for whatever reason, it could be a changing environment, it could be mismanagement of the company, it could be shrinking liquidity, we think the prudent thing to do is to stop putting interest into income and start adding it to principal.

Generally as a matter of course, and if the borrower stops paying us, the borrower at that point's figured out they've got to be on non-accrual because we -- how could we be incurring interest without actually getting any funds? But, we certainly don't go back to the borrower and say, "Well, you're put on non-accrual status." There's some terms of trying to maintain your leverage in the situation. So, there is a little bit of subjectivity in non-accruals. There's obviously some rules.

If someone stops paying, it's got to go on non-accrual. So, there's some cut and dried things. I think the whole thing is to really try to maintain what we think is a proper ratio, what the value of the collateral is, whether it's enterprise or hard collateral and what our loan position is. And, that non-accrual calculation helps us maintain what we think is a proper ratio.

Unidentified Audience Member: That's actually a good lead into my second question, which is, when you show your recovery rates, they are as a percentage of delinquencies and non-accruals and I assume less the overlap. Is that right that there's -- less the ones that are in both categories? You're not double counting in other words?

Bryan Corsini: Yes.

Unidentified Audience Member: Is there any way for us to think about, maybe on average over time, what the overlap is? In other words, for us to look at your non-accruals and delinquencies and have a decent guesstimate of what that non-accrual plus delinquency less overlap number is so we can think about applying recovery rates on a current basis? Or I guess another way of asking that question would be is there a reliable or consistent recovery rate related just to non-accruals since that's a number that we get consistently? Does that make sense?

Bryan Corsini: Well --.

Unidentified Company Representative: [Inaudible - microphone inaccessible]

Bryan Corsini: Yes, excess --.

Unidentified Company Representative: I don't know if this is on. I guess it's on. I guess I speak softly. The -- I think the short answer is that the correlation is definitely between non-accruals and recoveries or non-accruals and charge-offs. And, that's what we should look to. I think that delinquencies can happen for any number of reasons including trying to work out a forbearance. So it's -- we've always said it's not a good arbiter of what losses are going to be or even necessarily what's going to roll into non-accruals. So, I would always look at the -- what I tried to point out, which is the last 12-month charge-offs to non-accruals and look at what that ratio was.

Bryan Corsini: That -- I think that's -- that is probably your best indicator, although as we've said at every time we've made a public announcement, it's a lumpy business.

Unidentified Audience Member: Yes, two questions. First question, Jason, you showed a chart of the benefits of the REIT election, and you went through the example of a sale/leaseback versus a loan. And, you showed a sale/leaseback as a 10 to 15 year term and a loan as a 3-year. And, you made the point that when you think about the overall expense, the loan you have to re-originate every three years. The sale/leaseback is 10 to 15 year life. Does that imply that over time, your average life of your loan book should be increasing, because you're putting on 10 to 15 year paper?

Jason Fish: I think the -- over time, the short answer is yes. And, it's not in the loan book, but in the investment asset book, because the sale/leasebacks aren't loans. At this point, sale/leasebacks represent such a small percent of the balance sheet that I think you're not going to see a material difference. But over time if this becomes a substantial part of our real estate business, yes, you will see the average life extend out.

Unidentified Audience Member: And what do you think on a three-year basis? How big do you think the business can be? Do you think it becomes material, such that it does affect the average life?

Jason Fish: I think it could have been -- I'll let Jim speak. He's coming up shortly, but I think it could be well in excess of a billion dollar business.

Unidentified Company Representative: Tom, do we have a -- do you have a number in your section?

Tom Fink: [Inaudible - microphone inaccessible]

Unidentified Audience Member: Okay.

Unidentified Company Representative: Which is? Thanks Tom, that was helpful.

Tom Fink: We do have a number. I can confirm that.

Unidentified Company Representative: That's okay. We'll wait to get to that.

Tom Fink: No, no, it's my fault.

Jason Fish: No. Well, the answer is, we expect the business to be close to a billion dollars by the end of '07. And, Jim can talk about how strong his pipeline is and how big the market opportunity is there.

Unidentified Audience Member: So, I --.

John Delaney: I knew we had a -- just to give you a -- that's the one number that we're committing to.

Unidentified Audience Member: Okay. So and then, a second related question, I guess Bryan, you talked about the fact that you see a credit cycle. You don't know when it's going to come, but ultimately it will come. John, can you just comment in terms of how well positioned you think you will be to take advantage of the credit cycle? So, you made the point in Corporate Finance, you have cut back your loan exposure over the last couple of years.

John Delaney: Right.

Unidentified Audience Member: You've been less aggressive. You've done more syndication. In theory, you will know where the bodies lie when credit problems start to arise. In theory, if someone ends up with a problem and has to sell something at $0.80 on the dollar because they're getting mark to market, you might be in a position to capitalize on that. Is that a true statement? Do you think over time, is that part of your guidance on your dividend that you're positioning yourself over the next two years to the extent problems arise in this market with people who don't really understand credit that we're in a position to take down big sums of money at really opportunistic prices?

John Delaney: Yes. And, I would say there are four areas of the company that I think even -- beyond -- including the one you just mentioned. But, let me go through the four areas of the company that I believe will be well positioned should that happen. The first is exactly what you're talking about, which is, we built the Corporate Finance business when the wind was at our back because of the things you're talking about. And, we've done it.

We did a great job at it. Joe and his team executed very well, produced high returns, very good credit outcome, so we know how to do it, and we can do it again when that happens. That's just day in and day out business.

And then, you throw in the fact that in part of what Dan Duffy's doing, which is getting some exposure through his asset management business through the more broadly syndicated market, we're going to have lots of little pieces of larger deals, which will give us good insight. And unlike a lot of people in these deals where they're more just pure asset

management platforms, and it could be kind of a run in the bank because all of their exposure is in highly leveraged CDO/CLOs.

And, we've actually seen in even the last week or so I think an example of that, where people just have to get liquidity. And, because that's such a small part of our business, and we have a very good, very liquid balance sheet, we will be able to, we believe, take advantage of exactly what you're talking about. That's one area, but there are more areas.

The second thing is, we've been building this business, Credit Services business, which is all get the loans and loans to come [responsible] for restructuring, so we're getting really good at that in a market where there are, let's face it, not a lot of opportunities. And, we're still building that business, but I think there'll be more. The other areas within our Healthcare and Specialty Finance business, we have an initiative, a joint venture, with another financial institution where we're doing pure distress.

And, we fund half of the loans. They fund half of the loans. They do some originations, and we do all the credit work and asset management. So, we're building this whole distress team. And, it really -- that initiative came out of our effort, as some of you may know, that we were hired by a group of banks to manage a loan to another -- a healthcare lender two years ago. And, we did a great job, and we built the team to provide that service.

And, we've basically taken that team and repositioned them into our -- this new distress service. So, we have a pure play distress effort going on. We have the BCS businesses, well positioned to do a lot of financings in the problem situations. And then within Corporate Finance, the core business was ready to go -- the kind of old core business is ready to go when the opportunity presents itself, plus we have now a syndicated part of the market that we're playing in. We're getting little pieces of things.

If there's a problem, there's a run no a bank and a lot of these highly levered CLOs, we're going to be able to go in and buy pieces of loans at good prices. So, it's a really good question, and we think we're positioned across a whole bunch of parts of our company. Thank you. Bryan, it's all yours.

Bryan Corsini: Who's going next?

John Delaney: Henry.

Bryan Corsini: Henry?

Henry Coffey: You made an obviously rational comment that some -- at some point, the cycle's going to break. The shared credit report came out in -- Monday, it looks pretty good, except for the non-bank lenders, which is interesting, but what -- get specific. What met -- what I am -- you've been around a long time. You've seen a lot. What's out there that tells you when to – it's a compliment.

Bryan Corsini: Yes.

Henry Coffey: As a very young guy, because you started in the banking business when you were nine years old, and --.

Bryan Corsini: Thank you. Thank you for saying that.

Henry Coffey: Yes, so --.

Bryan Corsini: That's my story and I'll stick to it.

Henry Coffey: Yes. What triggers the whole thing, what are you looking at?

Bryan Corsini: Well, I think what's in as you mentioned, if you look at all the published reports and you get information on bank credits and institutional lenders, and a lot of that information is public. And, I think what you don't see is the non-public information, the alternative finance companies, the hedge funds. A lot of those folks aren't publishing what the leverage is in the portfolio, what delinquency stats they have or any of those things. I think what we've seen, and again, Joe'll have a chart on this a little bit later in terms of looking at the absolute, multiple levels that middle-market buy-outs are getting at. It's approaching eight times.

And, we've seen just through the work that Dan and his group does and the rest of our pipeline, what you see, a lot of transactions. Loans that we choose not to bid on, I'm seeing competitive lenders coming at five and six times for middle-market, cash flow loans, which we'll look at and kind of politely put those fish back in the lake. So, a lot of that's somewhat anecdotal. But in terms of just actually being in a pipeline for six years, you'll certainly see that move up. And, it just seems to me you just, and again, you politely said being around for a long period of time.

I actually fully expected as the interest rates kept creeping up, that would be the beginning of the breakdown, because we've seen a lot of leverage financed deals that don't have any amortization, so the debt service is all interest. And if interest starts getting tight, that's when the defaults are going to come. And, it's not principal default. It's all interest default. With the rates settling down, you wonder if it's 12 months turns into 14 months, at which as I mentioned, if I had the magic ball, I'd be sitting somewhere else doing something different, because I'd be able to completely predict where it was going to go.

But just based on what I've seen over the last several years, as you start seeing leverage go up, spreads tighten and inevitably, you're going to have a correction that should follow. Credit losses will hit.

I just look at again, anecdotally, some of these alternative finance companies without having the depth of expertise that we have, not having in-house diligence and in some cases, candidly, not seeing any diligence at all on some of their transactions.

That leads me to believe is that when it goes the other way, how are they even going to work out of those situations. And, you're seeing middle-market loans parked into CLOs being managed with five kids with a Bloomberg. What are they going to do if their portfolio starts to leak. You've just got to believe there's going to be a bit of a domino effect.

I think the issue is, there's so much liquidity in the market it kind of keeps it alive. And, it's hard to figure when it's going to happen. But, I would expect that -- I would expect it to happen if rates continue to soften, maybe just delays the inevitable.

Unidentified Audience Member: [Inaudible - microphone inaccessible]

Bryan Corsini: Hopefully, it's one of Jason's slides.

Unidentified Audience Member: [Inaudible - microphone inaccessible]

Unidentified Company Representative: 58 is normal disclosure. It's recovery. 59 is kind of a month to date -- it's three quarters since the beginning of this year so this isn't like a like-to-date number because obviously as you go backwards you've got to sift through different loans to pay off because there's a slide that John had earlier to show that the volume of loans that we've originated and what's -- obviously we've got a lot of payouts. Not every that paid out we would have paid out.

So what we literally did is went through all the payouts for '06 and kind of marked off loans that we purposely pushed out. And it doesn't mean loans that maybe got refinanced within the portfolio or something like that, true payouts that we actively wanted to get out of.

Unidentified Audience Member: [Inaudible - microphone inaccessible]

Unidentified Company Representative: [VitaLoan] that [inaudible] in the work out.

Unidentified Audience Member: In that quarter?

Unidentified Company Representative: In that quarter.

Unidentified Audience Member: [Inaudible - microphone inaccessible]

Unidentified Company Representative: Yes.

Unidentified Company Representative: There's two more questions. That gentlemen and I think Joel.

Unidentified Audience Member: Jason, I think you mentioned earlier that the delinquency uptick in the second quarter was primarily due to one loan and it's been resolved. I just wanted to make sure I heard that correctly. Is that the case?

Jason Fish: Yes that's correct.

Unidentified Audience Member: All right and then I guess to focus a little more on the deterioration concept of I guess the correction in 12 months. You have 50 basis points guidance in terms of charge-offs. What would that number become post that 12-month correction?

Jason Fish: I don't think it would change. I think the key thing is again the easy step to point to is the leverage loan market. The leverage within our portfolio which is just debt to EBITDA really hasn't changed a whole heck of a lot over the last couple of years so I wouldn't really expect a credit correction would result in a whole change in our credit metrics. So I think it just goes to discipline that we've employed over the last several years.

Unidentified Company Representative: And just I want to follow up on the delinquency question about the one loan and I know we've made this point many times. I want to make it one more time. Just the record all the senior team at CapitalSource we track delinquencies obviously. We're required to do that. We track them for our own variety of reasons because it is something we're tracking. But relative to the non-accrual statistic it is a irrelevant metric.

I don't think anyone would disagree on that. What really matters is the non-accrual and I want to take an opportunity because there's a lot of discussion around that loan which I said was -- we had a commitment to be refinanced out of. And the only reason was it was past its maturity date.

Given that delinquencies you can be paying current but if it's past your maturity debt and we keep the loan and we don't renew it, it becomes a delinquent loan. Because technically it was due and it didn't refinance. So the delinquency statistic and that's what's really interesting because we did a lot of work -- we actually were going to have some slides around on this topic but we elected not to do it.

Some of the data is different. Some lenders use 30, 60 or 90 -- it varies on the delinquency. Most lenders have delinquent loans bigger than non-accrual loans so you find your non-accruals within your delinquencies, right, and that's kind of where they start. Well what's our delinquents? We're finding our non-accruals way before delinquents. So this aspect of a delinquent loan is not a relevant metric. We obviously track it and we know when loans go delinquent and we've required reported. We really want to make that point.

Unidentified Audience Member: Bryan I'm wondering if -- you know wrap up here and maybe talk about the expected sensitivity or volatility of these recovery rates in these three products given as you laid out plus or minus 12 month spreads widen, and if we just set the baseline to a kind of normalized recession, credit spreads going out 500, 600 basis points, what happened?

Bryan Corsini: It's hard to predict and I think the reason it's hard to predict is that the asset mix is going to change. So intuitively as our asset mix changes more towards an asset-based real estate portfolio generally when you have credit problems your recovery rates are higher and so if your mix change is going forward you actually would guess that that recovery number would go up.

Unidentified Audience Member: No I understand. What I'm asking is in the individual categories I mean is going to go where it's going to go. What do you think -- how does those change in the individual three categories up there?

Bryan Corsini: The over and under I -- if I was a betting man which sometimes I do I would actually say the asset base and the real estate should stay pretty firm. I actually think if I look

at the asset-based loans there's really one situation that resulted in a loss which still actually rubs me the wrong way so I would expect that to get better. And that is based on being around for a long period of time and having to work through a lot of these type of assets. If you look at the healthcare business and the legacy healthcare business I think you said so you're dating yourself too -- 14 years of doing the same thing with no credit losses at all.

So I would firmly believe that it won't get any worse. I would actually hope it would get better. I would say the same for the real estate. The cash flow loans is a little bit more difficult. I mean I'd rather -- obviously I'd rather see 95 or 100% of those loans. I think 83% is actually pretty strong. Just again it's anecdotal. Unfortunately I have no public information to point to.

In my prior life having a portfolio that actually began the mix more to a cash flow portfolio towards the end of the '90s certainly we had loans we had to work out and over time the recovery is actually strong. And I think the key is the way our company is set up with the expertise we have, we have the ability to stay in the assets for a long period of time which increases the recovery versus sort of a cut and run or selling loans at a discount.

So I'm kind of dancing around it but I think that the cash flow side I would suspect it's somewhat stable. I don't know if it's going to improve or deteriorate marginally from where it is.

Unidentified Audience Member: But if you're at well below the market in terms of debt to EBITDA, certainly well below enterprise value is that --?

Bryan Corsini: You expect it to get better.

Unidentified Audience Member: Yes okay.

Bryan Corsini: Because again you can look at certain operational or event driven things that kind of causes the stack to be where it is. So you hate to go well I can pick out the loans that were sort of aberrations and make the number look better but there will be some aberration two months from now that I'm not aware of.

John Delaney: And it's a hard question to answer right now.

Bryan Corsini: It's hard.

John Delaney: I mean I've come out and said I think it could be as low as 70% based on lumpiness of the business et cetera. So, you know.

Bryan Corsini: Jason you were going to?

Jason Fish: Well, I was going to add a slightly more positive comment than John. No this we're not guessing about. It's a much more granular portfolio today that it was two or three years ago, the corporate finance portfolio or the cash flow portfolio. The average hold size is lower. The cap that we have on loans is lower. So relative to a per-loan recovery it may be as low as John says or slightly less low that Bryan says. But what it will have is a smaller

impact on the overall portfolio and I think that's the key takeaway here. It's a much more granular portfolio so any loan is going to impact the portfolio less.

So let's break and we're running behind schedule so I would suggest that we come back in ten minutes and I'm sure you'll be notified of that.

[BREAK]

PRESENTATION

John Delaney: What we have next is an overview of our Healthcare and Specialty Finance business. Keith Reuben will start who is Co-President of that business. And then we're going to actually going to open it up for questions for these two gentlemen when Jim Pieczynski is finished who is the other Co-President. And the reason for that is they are actually heading to Chicago, right after this, they have to catch a plane because there's a big nursing home conference that goes on once a year, we're one of the main sponsors of so they have to rush to get to that nursing home conference.

So we're going to have Keith and Jim go and then open it up for questions. And then Mike Szwajokowski and Chris Kelly will follow and then we'll do questions for Mike and Chris after their section. So with that Keith please. Thanks.

Keith Reuben: Thanks, John. My name is Keith Reuben. I'm the Co-President of the Healthcare and Specialty Finance business. I've been with CapitalSource since May of 2001 and before that with John's predecessor company and held various positions within the Healthcare and Specialty Finance business. Most recently before being named Co-President I was the Chief Operating Officer.

As a road map for Jim in my discussion today I'm going to provide a general review of the Healthcare and Specialty Finance business describing the six businesses we have, what our targets are and how we've performed. Jim is going to discuss and give an indepth look at the healthcare real estate market, the benefits of sale leaseback transactions and our unique opportunity in healthcare real estate.

It looks like Jim had three bullets and me one. Must be because he has a much nicer suit than I do, anyways. First the Healthcare Credit Group. We have six businesses within the Healthcare and Specialty Finance business -- the first one I'll describe is the Healthcare Credit Group.

That's our asset-based lending business into the healthcare industry. Generally, we lend on accounts receivables, typically payable by Medicare and Medicaid. Our Healthcare Real Estate Group which Jim will talk more about is a first mortgage -- provides first mortgage financing and sale leasebacks to predominantly the nursing home industry but we're branching out into other industries.

The Healthcare Cash Flow Group provides senior secured cash flow loans to private equity sponsors for the healthcare LBOs. Business Credit Services as John has described is the

business in which we provide general asset-based loans to all other industries. CaptialSource mortgage finance is one of our fee businesses in which our group generates fees by processing loans through HUD that are guaranteed by HFA.

And finally, our Security Alarm and Homeland Security business provides asset-based loans to the security alarm industry and senior secured cash flow loans and asset-based loans for the ever-growing Homeland Security industry. The products included within these businesses are first mortgage acquisition loans secured by healthcare facilities, asset-based loans secured by accounts receivable, inventory and other assets like machinery and equipment and cash flow loans.

I'm going to skip this slide and come back to it so I can talk about how we distinguish ourselves. As many of us have described up here our target market is the middle market. That's an enormous market as everybody knows. Therefore our strategy has been to target niche markets with specialized niche products. With that we can ensure that we're providing the right product to the customer in that market.

Many of the businesses we have like healthcare real estate and security lending are underserved by traditional lenders in the market, banks and other finance companies. Therefore we're able to command premium pricing which rewards our speed and execution and industry specific knowledge. Furthermore, our real estate business we'll further describe has been enabled by our REIT election.

Backing up to the slide right before that to describe how we service these markets we do it by employing teams of people who have deep knowledge within each industry group, not only on the investment side but what we -- what Bryan and his team have done have hired specialized capital analytics resources. For instance in each of our groups, for instance, in the Healthcare business we have an in-house reimbursement team each of its members with 25-plus years of experience which monitor changes in the Medicare/Medicaid laws. We do this because when there's a significant change we can make sure that as necessary we adjust the amounts that we loan.

Finally, we track our loans using a proprietary loan management platform, intensive collateral review and fundings that are limited to either a strict borrowing base or in the case of some of our businesses, formulas.

So how does this translate into the performance and growth of the Healthcare and Specialty Finance business? I'd like to spend a little time on the portfolio statistics. Our outstanding loans have grown from 342 to 454, a 33% increase. The borrowers, because some borrowers have many loans, have grown at a 23% clip. However, our commitments as you'll see are almost $5 billion from $3.2 billion or a 55% increase with our loan balance going from 1.9 billion to 3.1 billion, a 65% increase and that doesn't even include what Jim's going to talk about with our direct real estate investments which is our sale leasebacks of almost 250 million that we booked this year.

The average loan amount has also increased to 1.3 million, by 1.3 million and the average borrower balance as well has gone up by 2.5 million or 33%. Again this is from 2005 to 2006. The growth in the last two statistics highlight the significant growth in the real estate

business because those loans are generally larger than the loans in the asset-base business. This growth has been further enabled by our REIT election.

In summary, let's talk about this slide. The significant growth of the Healthcare and Specialty Finance business demonstrates our ability to capitalize on these targeted markets, the expanding market opportunity as Jim will further describe and our deep underwriting expertise. We've done all this -- all this growth without incurring a loss since inception.

Now I'm going to turn it over to Jim, the guy in the nice suit.

Jim Pieczynski: Thank you. My name is Jim Pieczynski. As Keith said I'm the Co-President of the Healthcare and Specialty Finance Group and I focus on the Healthcare Real Estate Group. You know one of -- my team consists of roughly 13 people on the investment side who are responsible for the origination of loans and leases within that group. And that's a group that when I started with the company five years ago it was me and -- and I was the guy who was in the Real Estate Group and we've built that up to the level that we're at today.

And I think we are now at the point where we've got the team that we need in place to propel us to the growth levels we're expecting to attain in the future. So when we talk about the growth and where we're going with our sale leasebacks and where we're going with our loans the team we've got in place today is the team that will be able to be there and originate the loans we're going to be doing.

And so that's when we talk about the scalability and the scalability on the front end our group is definitely a demonstrated example of being able to do that growth with the people we have in place. In terms of giving you an overview of the Healthcare Real Estate Group, we are a significant part of the Healthcare and Specialty Finance Group and represent roughly 50% of the total investments in that group.

Our current portfolio is at roughly $1.7 billion and we do expect there to be significant growth in there between this year and next year. Our portfolio consists of over 120 different loans to 60 different operators and the most important part of this aspect is that we do have relationships with numerous operators throughout the country.

And what I find in this business is who you lend to is very, very important and having those contacts within the industry is very important because a) it's a source of new origination and b) it also results in - in the event that you do have an issue with the loan we always know that we've got back up operators that we can go to if a current operator ends up having a problem operating the property.

Since we've been in existence we've originated in excess of $2.4 billion worth of loans and as you can see given that we're down to 1.7 billion we've had 700 million of those loans pay off. We've had an excellent credit performance and I am very proud to say that we've had no losses to date at all in our portfolio.

When you look at what we provide in the market and where I believe we have a significant competitive edge is we truly can be a one-stop shop of financing for people. We provide the full array of loan offerings to borrowers that no other of our competitors can do. As Keith

mentioned we can do accounts receivable financing in addition to doing the first mortgage lending.

And what that does for us is two things. One it provides borrowers the one-stop shopping but what it also does is we ensure with respect to any borrower we are the only source of credit there so we don't have to worry about inter-creditor issues or wrangling over collateral. Generally when we do our deals we've got the first lien on all collateral and so in the event that we do have an issue we're the only lender sitting at the table.

And in addition to that, we can provide sale leasebacks. That's something that we could not do prior to our REIT election because we couldn't justify it based on the return. But now we can offer that product to somebody. And then finally, one of the other things that we are is that we are an approved HUD MAP lender and what that means is we have the ability to do the direct underwriting of loans that are ultimately going to be guaranteed by HUD. And for a lot of our borrowers they kind of view the HUD financing as kind of the Holy Grail of healthcare financing in that they can get long-term fixed rate mortgages.

So the product that we can provide to somebody when they're acquiring a facility we can go in there and provide the accounts receivable financing. We can provide a bridge loan for the real estate financing and then once they're seasoned and they're been operating that facility for a year or two we actually can take them through the HUD process and give them a long-term fixed rate source of financing on the business.

And what it does for us is it keeps that -- for us that keeps the borrower kind of in our family because they're going to HUD. They're not going to another lender so they're there in our family and they are the borrowers that are more likely to come back to us for repeat business.

The other thing that we have now is we've got the ability to compete in a very wide spectrum. When I first started we did loans as small as $1 million and $2 million. We'll still do those kinds of loans today because we believe it's those small operators that are going to be the operators that are going to grow into the larger relationships.

And I've had several customers where I've started out with a $5 million revolving line of credit and they're grown to 50 million or $100 million type relationships. So for us being able to compete on that small -- that small spectrum really provides us a greater opportunity for growth in the future.

And now with our new status and our syndication ability we can do very large transactions. And that's something that we could not do before and now we're got the ability. So I can do a $2 million deal or I can do a several hundred million dollar deal and it really does kind of allow us to compete across the whole array.

In terms of the high profile deals that we've done we've done a lot in the senior housing space and I think the discussion with some of these deals really shows kind of where we've been and where we're going. Two of the deals -- the first two deals you see on there is Fountain View which is now called Skilled Health Care and Centennial Healthcare.

This was a typical deal that we did when we first started out in that they were deals where they were exits out of bankruptcy. And so we came in and provided the exit financing out of bankruptcy and in connection with that we were able to get good yield in an environment where other lenders were a little reluctant to jump into. So, we were able to get good yields. We were able to do it at a great loan to value and both of these are success stories where the first loan we were taken out of it was done in connection with our REIT financing.

It was actually done by a Wall Street firm and then this next one Centennial Healthcare is a loan that we expect to get paid off because those properties are going to be sold and the ultimate value of our loan relative to the value of that property is roughly at 50%. And so we stepped into a situation and got a good yield and we're now getting taken out and the evidence of it being successful is by how much somebody is willing to pay for those properties.

In addition to that, we've done the Mariner Health Care deal which was a deal that was the taking private of Mariner Health Care which had previously filed for bankruptcy and was ultimately being taken private after they had exited bankruptcy. We also did the Kindred Florida portfolio which was Kindred Health Care was disposing of facilities in Florida that were owned by Ventas and actually leased by Kindred, and we were able to step in and do that deal which was a story deal.

Two other deals that I kind of want to focus on, on here, are Laurel Health Care and Tandem Health Care which are two deals that we did this year. And those deals are the kinds of deals that we would not have been able to do last year in that they were large deals with a significant amount of institutional equity involved in them so the yields that we got on those were lower than the deals we would have gotten on the other deals but it's a very safe, solid loan whereby there is a significant amount of institutional equity that's also there supporting it.

And that's something we could not have done last year. So what all this does is this does gives us the ability to grow with our client. We can start with the small relationship and continue it to a larger. And the other thing that we have is we have many repeat customers in this business.

And I think that's been one of our strongest assets has been as I said I started with CapitalSource roughly five years ago when other lenders weren't really jumping into this space. And because of the fact that we were able to step in there and do a deal and do a deal at a reasonable rate, we got a good yield and we could have taken advantage of people and really kind of jammed them on pricing and we elected not to do that with the belief that we'll be here for a long time and we're going to be in this business for a long time. So I find a lot of my customers -- a lot of the loans I'm doing today are with people that I did deals with three and four years ago who don't go anywhere but to us.

They're like, "You were there in the beginning. You've been with me through this whole relationship," and they continue it. And I think -- that to me has been the greatest part of our business. And because of that we've got a very, very strong pipeline. When we look at the healthcare real estate market and what our target market is most of our investments on

the healthcare real estate have been in the skilled nursing area and that's a significant part of our margin.

Our focus is on operators with solid management teams in place. I've found that the nursing home business is a very local business and if you've got a good solid management team in place that focused on providing good quality care it's those operators that you will want to align yourself with who are going to do a good job of maintaining the asset which serves as our collateral.

Our area of strength has been in financing opportunistic acquisitions. A lot of the lenders out there like to look at nice training 12-month financial statements that show a very easy story. What I find is those deals tend to get bid and bid very, very competitively and so your yields are a lot lower. Whereas in an opportunistic acquisition there's generally a turnaround story associated with it.

We can pinpoint why the previous operator did not do a good job operating that property and we've got faith in the new operator because we've had significant experience with them in terms of what they did on other deals. And what we've found is because there's less competition in there and because we've got a good relationship with that borrower we can do deals that are very solid deals and still are providing us with a good yield.

And so when I look at our business I think our strategic strengths are in our speed, our expert industry and the market knowledge. I've been doing this for an excess of 13 years. I started when I was 9 as well and I've got other people on my team who been doing this an excess of 10 years. So what I find in this market we generally -- every operator or every deal that comes we either know of the operator or we know of somebody who knows that operator.

And that's what allows us to really be able to capitalize on this market. If you look at the nursing home industry in general there's roughly 16,000 nursing homes in the country and there's 7,100 assisted living facilities. On the nursing, if you look at the chart on the right, of those nursing homes roughly 85% of those are owned by the small owner operators and the rest are owned by the larger, national chain.

And so this is an example of having that fragmented market with a lot of different operators out there that really allows us to exploit our advantage in this space. Looking at kind of the fundamentals of the industry nursing home supply is -- contrary to what people might think is actually decreasing. If you look it kind of peaked in 1988 and slowly but surely the supply has been decreasing over time. And I think that's for -- there's two reasons associated with that.

One is that you've had some facilities that were in dying towns that have just been taken out of the market. You've had some facilities that are old and can no longer compete in the market. But the other part of it is that you just don't have a lot of new construction going on. There is Certificate of Need requirement with respect to most states or you need to have a Medicaid contract in order to pick up Medicaid residents which is a key part of the business. And if you don't have that the economics of building a new nursing home generally don't work.

So we find that the collateral that we're lending on to highly specialized collateral is going to stay there and you do not have that supply that's increasing. And as a result the nationwide occupancy of nursing facilities has been in excess of 90%. It's been there for a while. I expect that occupancy level to continue to creep up. But what you also had happening is obviously the 85 plus population is growing. If you look in 2000, there were 4 million people in excess of 85 years old. That's expected to grow to 6 million in 2010, 8 million in 2020 and naturally it is going to be increasing.

So from my perspective, I sit there and say we've got two great things going for us. The demographics are going our way and the supply constraints are going our way. And I think that naturally bodes well for retaining the value of our collateral. So when I sit there and say why do they -- why do skilled nursing facility assets retain value?

As I've mentioned, Certificates of Need create a significant barrier to entry. And a lot of states in order to build a nursing facility you need to get a Certificate of Need approved by the state health organization allowing you to build. If you don't have that Certificate of Need you can't build the facility. So that by definition creates a barrier to entry. In addition to that you need to have long-term Medicaid contracts that are in place.

In the nursing home business roughly two-thirds of the residents tend to be provided for and are paid for by Medicaid. And so you need to have that Medicaid contract in order to make sure you've got some provision for revenue stability. And I think the other aspect is just the limited availability of land, the rising construction costs in this market that really reduce the ability for people to go out and build new facilities.

The other part of this business is it truly is a local business. Every time we do a nursing home loan we go out, we visit with the operator. We meet with the program director at the facility and the thing that always amazes me is that the people that work in these facilities really care about who they're working for. And I know people have probably heard the horror story about scattered nursing home -- you were there, but in general the people that work at these facilities live in the community. They know the resident.

They went to school with the resident's children and what you find is people who really care about what they're doing. And the fact that it is a local business and that's ingrained in the heart of the community is what really helps provide a retention of value.

The facility is obviously integral to the operating business and without the facility that business could not survive. And so we know that the real estate is going to be a key part of this business. The other thing is capitalization rates in this industry have stayed pretty constant in the 12 to 14% zone. Now people who are used to seeing other real estate out there and saying, gee what are apartments trading at say, you know, apartments are in a 5 and 6% cap rate. What we've found is that the cap rates on nursing homes have stayed in a relatively narrow band. It's been a relative high band and because of the fact of that that's what allows us to get to generate higher yields because somebody can buy a property at a 13 or 14% cap rate and still pay us 10% on our investment and still be able to retain a good amount of income.

The other favorable characteristic is if you look at our portfolio our facilities are located nationwide. Obviously we've got more facilities in the sunbelt states such as Florida. But you do have a -- if you look at our portfolio we are very diversified both operator as well as geography.

And the other aspect of this is that we do have numerous take out sources. I mean we've had some of our loans be taken out by CMBS. Some are taken out by HUD and some are taken out by banks. So what we find is when we do invest in this business to the extent there's a relationship there that we want to exit out we can put pressure on a borrower to go in and bring somebody to refinance this out.

A lot of people kind of asked about the sale leaseback and said, "Well, geez, you're doing sale leasebacks right now. What does that do for your company in terms of returns?" And what I wanted to do was just kind of demonstrate a typical -- the difference between mortgages and sale leasebacks as it relates to our business. First of all, a typical life for a mortgage is going to be three to ten years and that's generally -- it's going to be the range that we're at. Whereas a sale leaseback is generally going to have a minimum term of ten years and more likely than not have renewal options so we know we've got a long-term tenant in place.

The typical size of a deal is a sale leaseback we're going to be lending kind of what we believe is probably closer to 100% of value whereas a mortgage is going to be at 80% of value. On a mortgage loan we'll get a commitment fee of 1%. We'll get an exit fee of 1% and we'll get an initial of LIBOR let's just say plus 3 and a quarter and it can go higher. But a typical deal today is in that range.

However, if we did a sale leaseback we're going to be starting out at a LIBOR rate plus 4%. But the other aspect of this is we're going to have annual increases in our rental stream. So no matter what happens with respect to this our rental stream is going to go up. So if you sit there and say okay so what does that mean from an effective yield perspective and you look at a mortgage our effective yield is going to be closer to LIBOR plus 345 whereas a sale leaseback is going to be at an effective of LIBOR plus 490.

And so what we're doing is we're saying we're putting that extra 20%. We're getting a very strong incremental return on our investment. The ROE on a mortgage once we lever it up with our sources of financing generally provides us with an excess of an 18% ROE whereas in a sale leaseback we're going to be at an 18.5% level assuming zero appreciation in the property, which I think obviously is the most conservative way to look at it. But we recognize that we're going to have appreciation and so that's going to pull our ROEs significantly higher and put it more into the 20s.

When we look at what are the benefits of sale leasebacks, why do we do them? One of the key important things we talk about is that all of our leases are triple net leases. What that means is the borrower or the operator is responsible for all maintenance, all repairs, all capital expenditures, taxes, insurance. So when I'm sitting there and telling you the yield that we're getting that yield that we're getting is reduced to literally a check that we get each month and that money is ours to keep. We don't have to pay for any other cost of operating that facility.

So we look at what are the operating expenses associated with the sale leaseback the answer is there's none. And that's one of the true nice aspects of this business. In addition to that, there's steady growth in the rental instance so we start out with our initial yield and we'll have a set increase every year that's generally going to be based on CPI or there'll be fixed rate increases that are agreed to. But in any event we know we're going to have an increasing income stream.

In addition to that, we have stability in our portfolio without run off. If I'm doing a deal for ten years I know I don't have to worry about somebody refinancing me out. That's an asset that I own and I've got that for the long haul which allows me to keep a core group of assets in my portfolio. We also have the ability to realize appreciation in our property value and these facilities generally operate in a stable operating environment. So you just don't have a lot of variation in the profitability of these facilities. And given that they're stable we know we're going to have any issues with it.

The other aspect of sale leasebacks that I don't have on hand but I do want to spend a little time on is when we own the real estate we are getting the deprecation for tax purposes. So when John's talking about putting ourselves in a position where we don't have to pay out all of our income in the form of a dividend the depreciation that we get from these properties lowers our taxable income and thereby lowers the amount of dividend that we're 'required' to pay pursuant to the REIT rules.

So I've got one more slide to go and that is if you look at where we're at today we, from our perspective, we have gone and created a healthcare REIT within CapitalSource. If you look at the market that's out there, there are several healthcare REITs. I'm sure a lot of you are familiar with it and if you look at that that where we're at today after having only been elected REIT status for less than a year we're roughly the fifth largest healthcare REIT that's operating out there.

In addition to that, if you look at the other lenders that are out there, there's GE, Merrill Lynch and CapMark. CapMark is the old GMAC but the thing that I want to point out is that out of all of these competitors we're the only ones who provide all of the products that are listed here? And I think that's one of the competitive advantages that we have that we can provide all these products and still do them in a REIT environment that provides us attractive returns. So with that Keith and I have -- we can take a few questions if anybody has any.

QUESTION AND ANSWER SESSION

Don Fandetti: Hi Jim, Don Fandetti from Citigroup. Number one is there a timing on when you might do a commercial real estate CDO and do you have the diversification for that?

Jim Pieczynski: That's a question -- one of the benefits when I came to CapitalSource and John said, "When you come here," he said, "I just want you to focus on building the business and focus on the assets and we've got other people who are going to deal with accounting

and treasury and all that." And I said, "That's great." So that's a question that I'm going to defer to Tom Fink because I'm in charge of spending the money. Tom's job is to raise it so when Tom comes up I think he can give much better guidance with respect to that.

Tom Fink: Actually I'll answer the question now for you, Don. We, as you'll hear, have -- have heard from Jim, a very strong Real Estate business and Health Care, and as you'll hear from Mike Szwajkowski and Chris Kelly who come on later, a very strong business in our Commercial Real Estate business that gives us a very diversified, total real estate portfolio. We have been a very successful issuer in the securitized market from our taxable REIT subsidiary and I would anticipate that we would also do some form of secured debt out of the REIT side as well. And I think we do have significant diversification to support that.

Don Fandetti: Thank you. Question, on the difference in the credit characteristics versus a mortgage versus a sale leaseback. I mean arguably you're taking some more risk on the sale REIT to leaseback 100% ODV and do you underwrite that differently?

Tom Fink: Yes, the way that I look at it is you know when I -- I'll say that when I look at doing a loan and typically when I'm doing a mortgage I'm doing kind of an 80% loan-to-value, and a sale leaseback on that obviously a little higher on the risk profile, I'm at 100% loan-to-value. And the way we look at it is, if I'm comfortable loaning at 80% I should be comfortable doing a sale leaseback at 100% because the asset value is there.

If you look at the difference in the yield between what do you get on a sale leaseback versus what do you get on a mortgage, typically we're generating before any appreciation or anything like that, we are going to be getting, generating an additional 15% ROE on that incremental investment that we do. So if you sit there and say alright what's the extra yield you're getting by putting that final 20% in, that number works out to be generally to be another 15% ROI.

Don Fandetti: So, then in all cases you would prefer to do the sale leaseback versus the mortgage, and you're looking at each --.

Tom Fink: I would say in general yes, I would say yes, that's -- that would be my druthers to do, but what I also recognize is that their -- I've found that you know, this -- my business is more driven by customer's wants than my wants. And so you've got some people that may sit there and say "Geez, a sale leaseback works for me" where I may have other people that sit there and say "You know what? I'd rather put you know, the 20% equity into it because I want to hold this loan and I want to take it out to HUD and I want to have it for the long haul".

So the way that I view it is when I meet with people, and I tell them this. I'm like "Tell me your ideal world. Tell me what you ideally want and what you're trying to accomplish." And because of the fact that we've got all these products I can meet exactly what it is they want to do. So I don't find myself being a guy that's like peddling eight products and saying "This is what I sell and I'm trying to convince you to buy it." It's much better the other way which is "Tell me what you want and I can provide that for you."

Unidentified Company Representative: Let me add one thing to that if I could. The difference also between a mortgage and a sale leaseback in terms of the opportunities, -- and this is a bit of a generalization, but you can define situations where mortgage is more appropriate, that has a little more upside. So the borrower is putting in the money and they're folding a new acquisition into you know, their kind of operating footprint, and they've got some synergies they think they can realize or some change in [patient quality mix] things like that.

So with mortgage you tend to have a little more upside, putting up the equity and you might say it's a less stabilized asset, not in general, but you don't generally do a sale leaseback unless it's a stabilized asset. You know because you're underwriting it for the long-term. And the sale leasebacks tend to be stabilized so you're really -- there's less risk to the underlying operations, more predictable, they've kind of reached peak and settled in.

And then secondly, they tend to be a little larger and more pooled transactions. Again, not always true but that's been our experience. And the thing about pooled transactions you get a lot of cross collateralization, so you look at these master leases, and in the loan situation you tend to have more one-off loans --.

Don Fandetti: When you say that general [Inaudible - microphone inaccessible]

Unidentified Company Representative: And so sale leaseback, even though you're going to a higher [LTV] you get the master lease, so you have a portfolio theory typically within the sale leaseback, then the property's going to be a little more stabilized. And one of the things Jim sells so well, if he goes to someone whose buying an [asset] particularly if it's turnaround, and we go in with a loan, because the turnaround's a little uncertain they think there's upside. We want to underwrite to the downside, they put up their money, lower our position if they achieve the turnaround, and it stabilized we'll take them out with the sale leaseback. So there is I think a little different profile in the underlying stability of the asset.

Unidentified Audience Member: I think that [inaudible]. Thank you.

Unidentified Audience Member: Thank you very much. Looking at page 81 I guess we can assume, on a leasing transaction, you're going to get around 9.5, 10% up front?

Unidentified Company Representative: That's right, in today's environment you're probably going to be in that 9 to 10% range.

Unidentified Audience Member: Which is not as rich as that first large pool you did, or --?

Unidentified Company Representative: That's correct. Yes, the first large pool we did Senior Health was kind of -- as Bryan Corsini had said this is one where we hoisted to the rafters. He said this was -- it was just a great transaction for us. And I think that was our first watershed you know, Sale Leaseback transaction, and it was a great deal for us. And I -- but, I think where we're going to be right now is we're going to be in that nine to ten zone.

Unidentified Audience Member: And then looking at page 83, maybe this is a Tom question but, so when you do this Health Care REIT spinout, HUD Loans, are those re-qualified loans, those three loans to the right?

Unidentified Company Representative: No what we'll do, is if you look at what we've got obviously our Sale Leaseback and our Mortgages are -- that's in our portfolio and that's what we have. If you look at the HUD Loans, the HUD Loans are what we offer to our customer -- so if you look at my portfolio, my portfolio doesn't include any HUD Loans because those are what's been refinanced. So the HUD Loans are more just a product that we can offer to our customers as opposed to something that focuses on our balance sheet.

And then the A/R -- and the A/R it -- one of the things that's been great about the REIT status is that I can go and do a loan, and let's just say use my example where I have a property that's worth $7 million and I make a $5.6 million real estate loan. Well, if I do a $1 million A/R Loan, because of the fact that my value of real estate is in excess of the value of my mortgage loan plus my A/R that becomes an REIT eligible asset. And so --and so for us that's a great thing that we're able to take stuff that would have been typical A/R stuff and be required to pay taxes on, and we don't have to worry about.

And with the cash flow loans what we'll do is several times we will do -- we will have several homes that are scored by leasehold mortgages, and those will be cash -- REIT eligible assets. So the answer is this. Generally everything that I'm doing in my business is REIT eligible.

Unidentified Audience Member: Thanks. Can you just elaborate on the you know, the competitive landscape within the nursing home business? You know one of the things you mentioned was that the nursing home supply is decreasing and you know the -- you mentioned that the certificates of need -- now I'm not a healthcare expert, but you said that they create a significant barrier to entry. So you know on the one hand you have a supply of nursing homes that's decreasing which suggests that when you have a fixed number of competitors to CapitalSource, it increases the competition for those nursing homes, the existing nursing homes. So can you address that? And B, why is there specifically -- you know why aren't these certificates of need awarded?

Jim Pieczynski: Well Yes, let me first address your certificate of need question. And the reality on that is that the state -- you know, as I said two-thirds of the residents in a nursing home are paid for by Medicaid. And so if you look at, you know if you look at it from a state government perspective that's largely a state-government funded program. And so the states are reluctant to have new nursing homes built because the reality is going to be, as more beds are built, more beds are going to be filled and their cost of providing care is going to go up. So you find that states in general are reluctant to do it unless the occupancy rate is you know, nearing a hundred and they really have kind of no political alternative but to say "Okay, we've got to allow for more facilities to be built."

As it relates to the competition and you said "Okay let's look at that and focus on how many facilities are out there." One thing I don't want to -- what I don't want to lose sight is when you sit there and say there's 16,000 facilities in this country. There is still a big market out there. And so although you're not a growth in that business, you are seeing turnover and you are seeing acquisitions and movement, and that's really where we believe we're able to

capitalize on because then it becomes, once you've got movement it's a matter of "Okay, now who's going to provide the financing for it?" And I'm very confident in saying if you talk to any of the people who've done loans with us, they've said "I've dealt with other lenders, I've dealt with other REITs and you guys are great to deal with.

You do exactly what you say you're going to do." And quite honestly that's how we get our business, so I get business -- I've had people call me saying you know, "My at -- an attorney that I know worked with you on the opposite side of a deal and said you guys were great to deal with, and he's telling me that I should come to you guys for financing." And I took that quite frankly as one of the highest compliments I could ever have because I've never had an opposing attorney sit there and say great things about us. And, but that's what happens in this business. And so because of that in that word of mouth, that's how we're able to compete out there.

John Delaney: And we'll -- I think we'll end on that note because we're running a little bit behind schedule so that Jim and Keith can get off to their conference in Chicago. And we'll have Mike and Chris come on stage. Thank you all.

PRESENTATION

Michael Szwajkowski: Good afternoon. I'm Michael Szwajkowksi, I'm President of our Structured Finance business here. And today there's a few topics I'd like to cover. One, I want to provide an overview of our business and the platform that we've built over the last six years. Secondly, talk about our current portfolio, where the business is headed. And then I'm going to spend some time to describe one of our three operating units, our Rediscount Finance business. Excuse me. My colleague Chris Kelly then will discuss our Commercial Real Estate platform and in a little bit you'll hear from Brian Graham who runs our Residential Investment business.

So, today the Structured Finance business is actually a very coherent real state finance platform comprised of three operating groups, our Commercial Real Estate Finance group, our Residential and Mortgage Investments, and our Lender and Rediscount Finance business. And we believe that the breadth and diversity of this platform provides us very unique insight and access to a bunch of different segments of the real estate market, and that that affords us very attractive and diverse opportunities for our business.

We coupled that access to transaction flow with strong underwriting and portfolio management capabilities, with the goal of always delivering strong risk adjusted returns. And in fact in 2006 across all of our businesses we have enjoyed expanded opportunities as a result of the recent re-conversion that we did. And specifically what that has really enabled us to do is expand our team and our origination platform. We've also expanded our product offering, and we've been able to expand our client base significantly in 2006. And as always and I think as I said last year, our goal continues to be to be the premier player in our targeted markets by delivering creative on balance sheet capital solutions and intelligence and hopefully highly responsive manner.

So I'd like next to talk to you on the two specialized lending platforms of Real Estate Finance and our Lender and Rediscount Finance business.

Within our Commercial Real Estate business I think today we're viewed as a leading provider of on balance sheet solutions for real estate owners and developers. And we do that by delivering a broad array of products, debt products to virtually all property types across the country. And we do that with a large direct origination team which we've built over the last six years. We currently operate out of six offices coast to coast. And we continue to broaden our product offering.

The same is true in our Lender and Rediscount Finance business which is a very unique market and a market in which I think CapitalSource is clearly viewed as a leader. It's a highly fragmented and inefficient market. And our clients there encompass a broad range of commercial and consumer finance companies, although we have a very specific focus on mortgage finance companies which we always have had, but which again our re-conversion has actually been a real boom to that business as well.

So, businesses do share so very important key attributes. One within both of these large markets, we try to attack what we view as inefficient niches. And we do that by underwriting really unique strategies and unique business plans of our clients. And in that respect I think we're really a very hands-on kind of fundamental lender. And that's important because consistency, creativity, execution, these are key competitive advantages today. And in fact today the environment is pretty competitive, with significant liquidity really across all debt markets and in varying degrees within our target markets.

The obvious one to talk about is the real estate capital markets in general. And in particular we've seen today unprecedented levels of liquidity in the commercial market. That's driven by strong investor demand in an increasingly sophisticated capital markets capability.

What that's done in general from an underwriting perspective is I think we've seen relaxed underwriting standards over the last couple of years, higher leverage, and lower pricing in the broader market. And in this large $2 trillion commercial mortgage market today, that growth and liquidity is continuing to accelerate.

Whereas, over the past 50 years, which is a long timeframe to look at, but nonetheless an interesting one, it was a 10% compound growth rate in the growth of the commercial mortgage market. However, from 2003 to the first quarter of this year we've actually seen that accelerate to 16%.

And while there's a lot of factors that drive that, one very interesting point is that during the last 15 years the securitization market has truly changed and become a much more sophisticated and clearly relevant factor. Whereas, in 1991 approximately 1% of all commercial mortgage debt was securitized, today that number is approaching 25%. And if you look at what's gone on just in 2006, you can see our year to date volume is approaching $170 billion as of mid-September, and that represents an additional 16% increase over last year. So there is tremendous liquidity in the current environment and that puts significant

pressure on asset spreads, particularly within commodity businesses. But fortunately, that's exactly what we are not. CapitalSource has really three very important distinctions and these are true in our business.

One, we have a fully built-out, national direct origination platform. We have a very strong credit culture at the firm, you've heard about that earlier. And within our Structured Finance business that's equally true both on our underwriting -- on our origination and underwriting teams as well as all the resources that we're able to access through CapitalAnalytics. And then finally, we have an established and disciplined portfolio and management team in the business. So we have these three very important elements that we do on proprietary in-house basis. And when I look out at our competitors in the market, virtually all of them will outsource at least one of these elements.

So, if you think about a conduit for instance, a securitization conduit, they'll typically originate but not underwrite or manage. If you think about hedge funds which have been on the market to some degree, they'll tend to not originate for service. And I think having all three of these things in-house, and bringing them to bear on our business is really critical. And Chris Kelly when he gets up is going to give two examples of real transactions on portfolio that I think will further emphasize this point and demonstrate it.

So during the past six years I think that Structured Finance has built a real franchise in the market. I think that we're widely known coast to coast now as a go-to lender for on down sheet real estate financing in the 5 to $50 million range. And these prolific originations that we've been able to build do a lot of important things for us. One they help us unearth opportunities that aren't addressed by the broader market. That's frequently due to size and timing requirements and transaction. It also enables us to identify new and emerging niche opportunities, again a critical element of our business. And thirdly it enables us to grow with our clients as they expand geographically and by product type.

And as a balance sheet lender that's a huge strength because we're able to follow our clients, we're able to find new niches because we are able to actually use our credit skills to underwrite these things and hold them. So these are opportunities that absolutely require a lender who desires to hold and manage credit which we do, and these are opportunities that generally provide much greater risk-adjusted returns and are available in the broader market.

But the key is finding these opportunities, and that's where this focus on direct origination is so important. We have a highly effective loan origination platform. We have teams of investment professionals in offices across the country as I mentioned. They are organized generally, or not generally, they are all organized into banking teams. And in our parlance that means a banking team is an investment officer, an associate, and an analyst. They have very specific parts of the market that they're charged to go after.

Most importantly, this isn't just a volume business to us, in fact our compensation is largely key to the contributed value of those transactions. Which means that we care a lot about credit, and so does every single person on the front line. So there's great alignment for the whole system. And then finally we also use our CapitalSource Dual-Track operating model, which provides further credit stability to the -- to our business.

So in addition to that the -- our direct origination channel enables us to identify not just an enormous amount of opportunities, but what's important there is that this deal flow allows us to be highly selective. And the best byproduct of selectivity is obviously better credit outcomes. And while many market competitors really are dependent on third-party originations. That's one thing that we've focused on building right from the beginning.

And we're going to continue to do that by adding additional people selectively to our platform in the coming years, and expanding geographically, as well as all the advertising and conference sponsorship et cetera that we do. And I think through all these things we'll drive better diversification, better returns, and better credit outcomes. And I think that that is evident by the diversification of our portfolio.

As you can see there's not a lot of concentration on any one asset type. This is divided between Real Estate and then our Rediscount business. And then I think when you look at the portfolio statistics you'll also note very strong growth year over year. So our outstanding commitments in 2006 are up nearly 53% relative to '05, and you also note that the actual outstanding loan balance of the portfolio has increased by approximately $1 billion, or 65% year over year.

I'd like to take a couple of minutes to talk specifically about our Lender and Rediscount Finance business. It's a very interesting business in which we provide asset-based loans to smaller consumer or commercial finance companies, and effectively what we do is bring more sophisticated, we would say Wall Street style financing to firms that are really too small to access the capital markets. And we do that really by bringing our specialized credit skills and our specialized credit skills to bear on this very large and very fragmented market which today includes approximately 15,000 different specialty finance companies just across the United States. And generally the capital markets are really only addressing companies with needs of 200 to $250 million and larger.

This is also a business as I mentioned which has really been further enabled by a REIT election, largely because a significant amount of this business is focused on mortgage related companies. And to be effective in this Rediscount market requires certain skills, capabilities and resources which are not very easy for competitors to develop. You need a very strong direct origination capability to address this large fragmented market.

You need very sophisticated underwriting expertise because typically we're lending against large pools of receivables whether it can in some cases be literally thousands of loans. And you need very strong portfolio management because these are companies, and these are loans that are [inaudible] for thousands and thousands of loans where we need to do constant monitoring, auditing, and funding.

This slide provides a quick snapshot of our Lender and Rediscount finance business, from the top down. As I mentioned our customers, our broad array of different finance companies. However we do have a strong focus on mortgage originators. And the product that we offer is really a senior product virtually exclusively, and it's typically a senior secured revolving warehouse facility, secured by the company's receivables. So we're hypothecating those loans.

And there aren't many people or firms that are out servicing these markets the way we do. So these are markets that require highly specialized lending expertise, they're fragmented, they're underserved, and they need highly customized solutions, all of which we've been doing of a number of years.

And we are able to do that because we have specialized credit skills which we've developed over that period. So we do intense collateral analysis, rigorous structuring. And then the ongoing monitoring and servicing expertise which is so critical in this business we've also developed.

The competition that we face in this business can really be divided into two general categories, commodity wonders and non-commodity wonders. Commodity wonders I've labeled as regional banks, investment banks, some securitization programs, although in this case they're really going after only really the largest deals that we would see, not our typical bread and butter.

There we really compete with what I would refer to as non-commodity wonders. Wells Fargo Foothill is one, Textron, and then certain hedge funds really enter the space. However we don't have -- while we do compete with these groups I would say that we compete very, very effectively for all the reasons that I just mentioned. And I think these are things that are really true of CapitalSource. We're able to bring flexibility, strong balance sheet, speed, and expertise to bear on this market.

And the market in terms of the competitive environment remains quite favorable for us. This is a market where there really aren't a lot of -- there's not a lot of institutional focus to do what we do. And so in that respect it remains fragmented and inconsistent in terms of the competitive landscape. There are built it barriers to entry, there's a need for servicing capabilities and very organized business development capabilities as well.

You also need to have very robust infrastructure to manage these loans which are very complicated and demanding. And these are things that continue to keep people out of the market so to speak.

So I believe that going forward CapitalSource will remain a very dominant player due to all these reasons as well as our strong balance sheet, our origination engine, and our servicing expertise.

So with that I'd like to turn it over to Chris Kelly who's going to talk about our Commercial Mortgage business.

Chris Kelly: Thanks very much Mike. And thanks to everyone in attendance for your time today. I'm Chris Kelly and I'm Managing Director with the Structured Finance business. And over the next few minutes I'm going to provide a detailed overview of our Commercial Real Estate Finance business, as well as walk you through a couple or recent Real Estate transactions.

Our core business is providing customized non-commodity lending products for owners of transitional real estate. We are a portfolio lender in a market that's dominated by securitization lenders. We are a loan-to-cost lender in a market that's generally focused on a loan-to-value, with value determined by capitalization of property cash flow often times by third-party appraisers.

As we build out our originations platform we see better real estate opportunities and higher quality sponsors. As we stand here today we have six regional offices for our real estate group which allows for deep penetration into our primary markets. There is a gradual but strategic shift by the real estate group to direct originations as we believe there's a strong correlations as we believe there's a strong correlation between direct originations, and better pricing and repeat business.

In addition to building out our platform, we are actively looking at market driven opportunities to expand our real estate lending product line. Our real estate lending products today would include our Advantage Senior, our Stretch Senior, our Enhanced Mezzanine, our flexible fixed rate, and construction loan products.

The REIT structure permits us to be more competitive in the market and extend our reach. The REIT allows us to better access sponsorship and more consistently be competitive on price. The majority of our Commercial Real Estate originations are senior debt combined with some form of mezzanine debt, delivering a product that provides our clients with one-stop service. What is the credit profile we look for in our real estate activities? Well, nearly everything we lend against -- pardon me, we lend against nearly every type of real estate asset.

Almost all of our real estate transactions are supported by an acquisition of a real estate asset with a plan to enhance value over a two to five year horizon. As mentioned earlier, we're a loan-to-cost lender. Sponsors typically contribute meaningful cash equity at closing providing credit enhancement and alignment with CapitalSource.

Our view is that sponsor equity is critical to obtaining optimal alignment. This is a focus of our real estate lending activities.

The typical exit from our interim loan is in asset sale or refinancing through a conduit or conventional lender once the asset achieves stabilization. We bring a sharp credit focus to the asset in the market, but we're also typically looking to the sponsor and a sponsor plan to be executed. As such our lending is more execution dependant and less cap rate dependant, which provides greater risk-adjusted returns and a greater margin between our debt and the sponsor equity.

A snapshot of our real estate finance business. Our clients are real estate developers and owner investors in commercial real estate. The market opportunity that we look for includes situations where there's a need for on-balance sheet financing, a highly customized solution, and certainty of execution.

Our entrepreneurial clients were typically acquiring assets with time-of-the-essence closings and hard money deposits. They cannot afford execution risk. We bring a critical and

experienced eye to our credit evaluation. This includes but is not limited to and intensive review of the market, evaluation of sponsor capabilities and their track record. A careful evaluation of the sponsor business plan, and often times involvement by CapitalAnalytics. CapitalAnalytics can play a role in the real estate credit process in a number of ways including verification of property cash flow, and audit of the sponsor net worth and liquidity. And verification of existing equity that might be in a property that we're re-capitalizing.

Competitive advantages of the real estate group at CapitalSource would include our creative structuring -- sorry about that, pardon me, -- competitor advantage would include our creative structuring, flexibility, speed, expertise, and one-stop service. As well as being a non-recourse portfolio lender in a market that's dominated by secured ties lenders.

Now that I hope you have a better appreciation for our strategy, our origination process, and our credit approach, I'd like to walk you through a couple of real estate case studies. Both I think excellent examples of our execution dependant opportunities.

The first opportunity started as a small one-off transaction. And based upon our favorable view of the property sector as well as our originations team's ability to develop a relationship, we built this into a $70 million warehouse line. The sponsor plan was to acquire RV parks, a strategy similar in many respects to the investment strategy in the late '80s and early 1990s to buy mobile home parks. The plan was to buy the parks from Mom and Pops and wring out efficiencies on both the revenue and expense side. At this point, the sponsor would look to long-term financing to take out our interim loan. It should be noted that at the time of origination, the permanent debt market for RV Parks was not terribly deep.

At the time of refinance the CapitalSource loan -- I should say the capitalization looked like the left bar -- the chart on the left side which was a $53 million senior loan backed by $8.3 million in sponsor equity. Our 85% loan-to-cost senior loan was priced at 5.30% over LIBOR. The borrower was, in fact, successful in delivering on their plan to ring out efficiencies on the expense side and grow revenues.

In addition, the capital markets became much more active the capital markets became much more active in the RV space. This is demonstrated by the take out of our loan where the borrower sourced a long-term fixed rate financing at 6.85%, and perhaps more important than the fixed rate financing was the proceeds the sponsor was able to achieve with a $75.5 million senior loan, the borrower was able to repatriate their $8.3 million in invested equity and cash out another $14.3 million. It should also be noted that the proceeds were driven by a cap rate valuation. Based upon the take-out valuation, the CS loan represented 56% loan of the property value.

The second representative transaction involved the acquisition of a functionally obsolete office building in Times Square with a plan to convert the property to a boutique hotel. Unlike the preceding example, while hotels are widely considered more mainstream, this sector was in the early stages of recovery at origination. The boutique product was not yet proven in the marketplace and security was a lease hold as opposed to fee interest in the property.

CapitalSource provided at 51% loan-to-cost at a healthy spread of 4.25% over LIBOR. Again the borrower was successful in delivering on their plan by completing the adaptive re-use of this office building to 140 room boutique hotel. Added momentum came in the form of a spike in the New York City hotel market. Take-out financing was sourced through the real estate capital markets, and the terms resulted in a dramatic reduction in the spread from 4.25 to 150 over.

In addition to that, the borrower was able to source proceeds of $22 million in excess of the capital source loan. The proceeds -- the excess proceeds were -- allowed the borrower to acquire their fee interest in the property as well as recoup $5 million of their invested equity. Based upon the take-out valuation, the CS loan represented 34% of the property value.

As I conclude my overview of the real estate lending business, I'd like to return to one of the central themes of today's discussion, which is the very, positive tangible benefit from our REIT election. As demonstrated by the nearly 62% increase in real estate originations, the real estate group has been able to derive significant near-term benefit from our REIT election. We see this momentum continuing.

At that point I'd like to ask my colleague Joe Kenary to come up and speak a little bit more about his activities in Corporate Finance. Thank you.

Joe Kenary: We're going to go right to Corporate Finance for Joe and Dan and then open up the questions for both Structure and the Corporate Finance business at the end.

Joe Kenary: Thank you Chris. We'll now go from the specific to the general here. My name is Joe Kenary. I'm the Executive Vice President for Corporate Lending. I'm one of the first employees of CapitalSource, and over the past six years I organize bills and managed the Corporate Finance business. And today I'd like to give you an update on the developments in the Corporate Finance business.

When I think about this business the last few years have really been one of evolution and adaptation. We're really in a situation with an evolving company and an evolving market. As many of my previous speakers have mentioned CapitalSource is a bigger and broader business, and we're able to leverage the scale and efficiencies to earn superior returns on equity, at lower spreads with less volatility.

In addition, over the course of our existence we've gone from a very [illiquid] cash flow lending market to an extremely liquid market. And later in this presentation I'd like to illustrate that point. So CapitalSource's Corporate Finance business has had to adapt to that situation. And what I want to do today is provide a road map for that discussion.

What I want to talk about first is an overview of the business which is really who we are and what we do. Then I'd like to give you -- highlight some of the trends in the leverage lending environment. And then finally talk more specifically about the evolution of CapitalSource's strategy and execution. And then finally one of the most important aspects of that strategy, Dan Duffy will cover regarding syndication and asset management.

So what do we do? CapitalSource provides senior secured cash flow loans to support private equity sponsored leverage buyouts. In addition, we'll also do some Second Lien and Mezzanine, but that was more -- we were more active in that market in the past, more recently we've shied away from that business. In addition, we consistently receive an Equity Co-invested anywhere from $500,000 to $1 million, and we've been able to amass an attractive portfolio of equity positions that we believe should provide an attractive recurring source of income over the next several years.

With regard to underwriting, I think we've always maintained a very fundamental focus on fundamental enterprise value, and lending at a discount to that enterprise value. And if you look at those ratios here, those remain unchanged since two, three, four years ago. But I think what we've happen in the market is purchase price multiples have crept up, so therefore enterprise value has gone up and CapitalSource has migrated its business with that increase in multiple towards a more senior profit.

With regard to competition, we really look at this as a bifurcated market. We have our earlier core market, and it's really the lower middle market of $5-15 million EBITDA companies. And when we started this business our primary competition was Regional Banks. Those banks subsequently exited the market and more recently they've come back. In addition, we've seen new entrance, such as Hedge Funds, and new commercial finance entrance such as NewStar and Golub Capital. The Larger Capital Markets Focused business which is really for companies from the $15-50 million markets, where we focus on providing a syndicated lending transaction, our competition there tends to be commercial finance participants such as Merrill Lynch Capital or the newly formed GE Antares. In addition, we've seen -- some hedge funds and hedge funds sponsored CLOs very active in this market.

With regard to competitive advantages, I think all these ring true for this business and for every other business at CapitalSource. I mean the combination of these attributes enables CapitalSource's Corporate Finance business to have a reputation as a smart reliable lender in all markets.

A quick look at the portfolio, I think, highlights the success -- the direction of which we're going. If you look at the top half of the chart the outstanding loans and current borrowers have gone up significantly. But the outstanding commitments, loan balance and average loan amounts has gone down. Now one might think that the Corporate Finance business hasn't been active. But in point of fact we've had gross originations in the past year of over $600 billion. But I think we've done it in a very disciplined fashion.

I think we've managed our pre-payments we've actually encouraged some of our borrowers to leave. We've made a very active effort to reduce our hold sizes. And the overall result has been the average loan per borrower has gone from $15.8 million down to $12.7 million.

So a quick review of the current environment in middle-market lending. And I want to caveat from the beginning that the middle -- these statistics do not capture the entire middle market because smaller companies tend to either not report or under-report the data. But I think these are indicative of the trends in the market and I want I really want to do here is focus on the compelling trend that we're seeing.

These -- I think illustrate the dramatic upswing in liquidity and leverage lending. And the activity in the last two and a half years is more than double the activity in the prior three years. The next slide which I think really does a lot to explain what's going on. It shows the composition of the market. And if you look in the previous credit cycle, the primary source of liquidity were banks, both domestic and foreign and at one time they were over three quarters of the market. The current market is dominated by institutional capital. CLOs and hedge funds, or CLO spans -- or hedge funds sponsored CLOs.

And considering that the market is much larger with a relatively new and untested player, I think it will very interesting to see what happens with liquidity at historic highs, we all expect as other [] speakers have indicated, we expect a turn in the credit cycle. As I often say, "We know it will end", I just don't know when it will end.

And I'm not here to venture what I would call an unsubstantiated opinion, which I think is a huge surprise to John over here, but given the fundamental source -- or shift in a source of capital for middle market Lending, I think it's safe to say that this downturn will be very, very different. Banks have been the largest and most volatile source in this market in the past, but banks and institutions are very different with fundamentally different imparities, and fundamentally different operating structures.

So with the influx of liquidity we've obviously seen a significant increase I think Bryan alluded to this earlier in terms of purchase price multiples. Purchase price multiples are up almost 50% since 2001 and 20% since 2004. And the equity contribution as you can see has basically remained reasonably - in a reasonably tight range. Many believe that lenders have actually driven the increase in multiples, and I think it's safe to say since senior leverage is currently at an all time high at over 4 times EBITDA, which is well above the peak in the last credit cycle.

So with the rise in liquidity, we're obviously seeing a decline in spread and deterioration in credit consistence. B Rated Loans, to use as a proxy for the overall middle market have dropped over 200 basis points, and interest coverage has dropped 70% from its peak. So basically the fact is balancing lenders are taking more risk for less return.

So what has CapitalSource done to adapt to the situation? Well I think as we were reviewing credit committee memos we started seeing more and more empirical evidence that we are in an inverted market. And what we mean by an inverted market is that smaller companies are getting market terms, market pricing, and market leverage. And frankly five years of experience, or six years of experience has taught us that small companies demand a risk premium. But right now the market is not providing an adequate risk premium given the influx of liquidity. So what did we do? We've shifted our business to a more capital markets focuses model, more of an arranger than an aggregator of assets. We're targeting larger transactions and using syndications to sell off those loans.

We think the capital markets business also provides an excellent source of risk management, and an additional benefit is obviously the fee income that we can generate as well. In addition, we're getting better credits, higher quality companies, at comparable spreads to

what we're seeing currently in the lower middle markets. And finally, one ancillary benefit is by participating in the capital markets we're able to get a better sense of the overall value of risk-adjusted returns.

In addition, I think we took a hard look at our portfolio management. First of all, we took a very aggressive tack in terms of reducing hold size, and we've been very consistent in doing so. But more importantly I think we started aggressively out placing underperforming cracks. In the past year, we've taken 9 -- we've -- 9 credits -- in the past nine months, nine credits have exited the portfolio totaling $175 million in funding. And I want to be clear only one credit totaling $15 million was ever on the troubled loans stats that are in our public filings. I like to call this the triumph of experience over hope.

We've taken a timely and rational assessment of underperforming borrowers, and also taken advantage of the prevailing market liquidity to take action against potential problems before they become real problems. So overall we now have a broader business focus, and Capital -- we always have to remember that CapitalSource is a service business and we can continue to service customers in both liquid and illiquid markets. And we also think that the breadth of our business will reduce volatility on the balance sheet. But to execute successfully on this business I think we needed to focus on certain aspects of our business. Now John and everyone have emphasized the importance or strength of the CapitalSource origination platform and the Corporate Finance origination team is no different. They've built a fabulous franchise and a fabulous reputation in the market.

But that effort has typically been on a more opportunistic basis, applying a broad reach across the entire market in search of the higher yielding CapitalSource deals. But as CapitalSource sought to develop a capital markets effort, we recognized the need for a different more cultivated approach to capture agency mandate. What we needed to do was narrow our calling effort into more fertile territory. so we took a look at the market and recognized that less than 20% of the market executed more than 55% of the deals.

We also think that developing a cultivated approach to the market enhances our risk management. So what we've done is driven more frequent and substantial calling of a select universe of private equity sponsors in search of those capital markets opportunities.

One thing that hasn't change though are the fundamentals. When it comes to capital lending, you must always focus on fundamental business values and we emphasize strong companies with strong historical and perspective cash flows, experienced management teams and high quality sponsors, companies with limited operating leverage and event risk to avoid any liquidity prices and companies with significant competitive advantages and leadership in their market niches. And finally, I like to say to my team, "Lend to what you know. Focus on industries with experience and expertise."

So I believe we've shown the Corporate Finance business has successfully adapted to the business environment. Now I'd like to elaborate on some new efforts that we're developing to make the Corporate Finance business better. Last year I described two major strategic initiatives, Europe and asset management. The European initiative, lead by {Richard DeBear] has taken hold over the last nine months. We currently have over $100 million outstanding and we expect 2 million by year-end. We have five professionals on the ground,

three of whom are European nationals, and we've received a strong market response. In building relationships with top tier sponsors and arrangers we've seen over 150 transactions totaling about 2.5 billion in funding.

On the Asset Management side, and this slide's a little disjointed, I might blame Tom for this but I'll take responsibility, I'd really divide that into two assets. Initially one effort we were focused on was private equity joint venture in which we wanted to exploit the CapitalSource origination platform for what we deemed to be attractive private equity opportunities. And that effort has been validated, CapitalSource expects to take that in-house and we intend to organize some third managed alternative investment platform for junior capital to exploit the entire origination platform. More recently Dan Duffy has successfully executed CapitalSource's first off balance sheet PLO, and he'll talk about that more in a minute.

So in closing I think it's safe to say that CapitalSource has adapted to the evolving business and market. We're developing a broader more robust business, we're using sophisticated risk management to mitigate volatility, we're refocusing the origination platform to execute on our strategy and are developing promising initiatives that ensure growth into the future. Thank you.

And now I'll turn it over to Dan.

Dan Duffy: Thanks, Joe. My name is Dan Duffy, I'm a Managing Director in the Corporate Finance area of CapitalSource. I've been with the company since April of '03 and have a little over 21 years of total leveraged advanced experience. I'm going to focus on two areas within capital markets loan syndications and our Asset Management business, which is currently emerging as we speak.

From a syndication perspective, it's important to note that we've actually been syndicating deals since the fourth quarter of '03, but it's been clearly an increasing area of focus, especially in 2006.

We had modest growth in that area in '04 and in '05, but as we'll see in a few minutes, significantly more activity this year. We have a fully built out team, we're capable of syndicating cash flow or asset-based structures as well as first lien, second lien and to a lesser degree mezzanine structures as well. You'll see in a later stat that we've been consistently in the last three quarters, in the middle market lead tables, we'll talk about that again in just a few minutes.

There continues to be very strong demand for CapitalSource product in the middle market leverage finance area among investors. That demand is really driven by three things. First, we have obviously a strong reputation with regard to credit culture and disciplined underwriting strategies.

Secondly, we tend to bring product that has some amount of premium pricing and very attractive structures in terms of leverage, and obviously that's born out in our own statistics for our own balance sheet. And then lastly, we have a number of areas of industry expertise that many of the transactions that get syndicated, they know that we've got specialty areas in place with like healthcare, retail finance, media et cetera and we bring those middle market

transactions, we're know to have that expertise and that obviously gives us a leg up in selling those deals.

The next thing we'll talk about is what we think is a pretty complementary business as it relates to our Asset Management business, and we'll talk about why we feel that is our complementary to our syndication activity as we go through that. We did close our first transaction recently and open up a second warehouse just yesterday. First, with regard to syndication capability, as I said we have a fully built out team that's comprised of six individuals, we have been in place now for a couple years and that team has increased in its size according to the increased activity.

We really focus on two primary things as it relates to deal teams, we provide structuring pricing of an ultimate execution on the syndication of the deals in what we design to be a very well coordinated process with the deal teams. Secondly as it relates to CapitalSource's credit committee, we provide two basic things, real time ongoing market data related to trends in terms of pricing, leverage et cetera, as well as specific confidence opinions on individual transactions.

There's really three strategic areas of focus for syndications, the first as we've been talking about, strategically we've decided to extend our reach into the upper middle market as a natural extension of our business plan within Corporate Finance. Having syndication capabilities allows us to do that. The all-in yield on transactions is enhanced to skim income we generate to the sell down process. That's equally important, especially as we move into larger transactions that are more competitively priced. The all-in yield to CapitalSource continues to be at a premium because of that skim income. And then lastly from a risk management perspective, it's obviously important to maintain appropriate hold sizes on each transaction, the syndication process obviously allows us to do that.

As I mentioned just a bit earlier, our activity in syndications has increased pretty substantially. In the last 12 months we syndicated 17 deals. That equates to aggregate commitments from CapitalSource to the market of $1 billion. We syndicated just over half of that. We syndicated that to 29 unique investors in the last 12 months which for a middle market syndication shop is a fairly diverse group of investors.

We actually are engaged in ongoing discussions with about 50 investors on a regular basis but the sole deal is just under 30. We've also had no syndication failures actually not only the last 12 months but since inception. And the way we define syndication, success or failure, is really two things. Do we sell down to the whole side's limit which CapitalSource's credit committee has approved and that's not only aggregate whole side but also our relative exposure and maybe a first lien and second lien for the transaction that has that. We may like the first lien better in certain transactions, and the second lien better in other deals and we obviously tailor ourselves on process to achieve those goals.

Secondly, we want to make sure we achieve target and skim income. There's obviously risk associated with syndication and we need to prove on a consistent basis that we've paid for that risk which we've been able to do. There's two transactions that I think will provide at

least a little bit of a flavor for the kind of deals we've been doing on an increasing basis as we've moved up market.

The first deal is a company called Technical Concepts. It's based just outside of Chicago. It's controlled by a well-established middle market private equity sponsor, Liberty Partners. Earlier this year they decided to do a strategic acquisition of a company just outside of Amsterdam for Technical Concepts and Liberty what this acquisition did was it expanded their exposure in Europe. It also -- the two companies had fairly complementary products that allowed them to be a stronger company on a combined basis.

What distinguished CapitalSource in this particular deal, is really two things. There's only a limited number of middle market finance companies that have true capability to provide deals dominated both US dollars and euros. Not only original financing, but also ongoing working capital finance in euros for their European working capital needs. And also we frankly took a fairly aggressive position in terms of what we underwrote both in terms of dollar amounts with a limited amount of flex as well as the timing in which we said we would close the deal. Typical syndication in a middle market start to finish takes about six or seven weeks.

We committed to shorter timeframe. The markets today command that you typically underwrite to a firm dollar amount but you have certain price flex to allow the deal to clear market. We limited ourselves substantially in that regard in this deal and didn't need to flex the deal and obviously we're successful in selling the transaction.

The second deal is another company that sort of levers off another strength of CapitalSource that being some of our industry specialties. We have a retail and apparel team that focused on those areas. It allowed us to be strongly positioned when the deal, Citizens of Humanity, a company controlled by Berkshire Partners. It's a provider of premium denim products, read expensive blue jeans basically.

Typical senior lenders would look at that deal would say its fad. It's got fashion risk. I'm not going to lever that kind of deal. We happen to have known the space through a prior transaction. Berkshire engaged a bank consultant to do an industry study which validated our view of the market and frankly also helped sell the transaction. It was also a low lever deal given the nature of the transaction and fairly attractively priced.

It was a relatively easy syndication only because we targeted the right people. Of that 50 or so people we talk to on a regular basis, here's probably only ten that would really seriously consider this deal. Just because of that immediate reaction many lenders have. We went to the right people. It was a relatively easy sale actually and it's a company that's performing quite well.

I'd noted earlier where we fit in terms of lead tables. You might think that coming up and bragging about being 18th may not be the best idea but actually there's a couple of things to note in terms of put that into context. The way this chart is designed by LPC is based on transactions of companies with sizes of $50 million EBITDA or less.

If you think about it well we can certainly do 40 million and $50 million EBITDA companies. Our relative shrink against other competitors that have Wall Street Capabilities with high yield and other things starts to dissipate at the 35 million to $40 million range. We certainly can do those but on a more limited basis. If you look at that list of names obviously most of them are pretty familiar names.

There's really only three real middle market players that are ahead of us in that market so we feel very good about that. We've also had honestly a fairly slow second quarter but a very active third and now going into the fourth quarter so we would anticipate moving up even further but we're quite happy with where we fit in our relative market position.

I'm certainly not going to go through the details bullet by bullet in terms of our syndication process. The thing that's very important to note is that it's got to be a very cohesive process. Syndications in the middle market is very club oriented, much different than the way broadly syndicated deals get sold from the investment banks. We really have either customers or constituents that we need to satisfy and that literally ranges from credit committee, the deal team, the equity sponsor, the borrower and obviously our investors in the deal and having that cohesive process allows us to basically make a fair amount of hard work look very easy which is what the goal is.

Let me move quickly into our asset management area. We spent a fair amount of time last year looking at this as an area, deciding whether or not we should focus on that. We decided to do it. We think it makes a lot of sense. We really began this effort in the fourth of last year between the fourth quarter and say January of this year we've staffed up to a full team of a total of 11 individuals. Our strategic focus in our asset management business is to really take a lot of CapitalSource's capabilities and extend them into the upper middle market and the broadly syndicated market in the context of a fee-oriented asset management business with vehicles structured for off balance sheet treatment.

The reason we were able to be successful in entering this market really was driven by the strength that CapitalSource brought to bear including a fully built out infrastructure, a credit culture that's respected among the investor base, proprietary deal flow which is particularly important to investors today and general market access whether it's middle market or broadly syndicated.

Just to note a couple of things we did and where we're going for the rest of this year and beyond. We closed our first deal in August of this year. It was $325 million. I'll walk through a couple reasons on the next slide why I think it was a highly successful issue. We opened the warehouse for CapitalSource advisors, [CLO2] yesterday which we're happy about, fully three days ahead of schedule it looks like or maybe four.

We would anticipate in terms of activity level about every 6 to 12 months to raise a new fund and that's really driven by market conditions whether it be to leverage loan market or where liability pricing is -- where equity interest is among actual investors into the CLO vehicle. And in terms of scale we would expect to be about $1.5 billion in assets under management by '08 in this particular asset management area. We may move into other areas and other sections of CapitalSource but for this particular area that's the size we expect to get to.

A quick summary on the first CLO that we closed in August, in terms of the kind of assets that you find in that CLO. It's really 60% focused on middle market which was clearly CapitalSource's heritage what helped us to sell the deal and to differentiate ourselves among obviously many other CLOs managers out there And again in market we raised 80% of the equity in the first deal which again greatly differentiates us from a lot of first time issuers where the parent company is providing for the first one, two or three deals anywhere from 40 to 60% of the equity so we're quite happy about that. We would expect that actually, that percentage in fact deal two is targeted at 15 to 17.5%. We would expect that equity investment percentage to continue to go down to turn this into a pure asset management business.

Debt pricing, liability pricing on the deal was quite attractive. It was in line or better than all accounts we saw in the 90 days prior to the deal. Typically you might find a bit of first-time issuer premium or a middle market premium. We saw neither. Our AAA bonds priced at LIBOR 25. Many very specific comps in the -- like 30 days prior to our deal closing priced in the 26, 27 or 28 range.

And obviously with the leverage it's 70% of the structure being AAA that has a point to a point and a half improvement in IRRs which is obviously important for the equity investors. Lastly one of the questions that we got on the road show for the first CLO and we wanted to make crystal clear here is the difference between what we're doing with our off balance sheet activity and on balance sheet.

Unidentified Audience Member: This slide does not support that point.

Unidentified Company Representative: Yes I apologize. Just the four categories, the walk through for the CLO advisor's activity the assets again come from the broadly syndicated market as well as the middle market, generally cash flow leverage deals.

The primary sourcing is outsourcing from other third party originators, 10% of the current fund as of today is CapitalSource originated paper. The rest comes from other middle market players as well as broadly syndicated investment banks.

The deal is a little over 90% leverage. All of that obviously sold to third parties. And as I mentioned earlier the 9.5% equity tranche in this deal we sold 80% of that to third parties. So CapitalSource has about a $6 million equity investment in this deal. The motivation again is asset management. If you like asset management in terms of -- from sort of a financial metrics in terms of recurring revenues, contractually obligated recurring revenues as well as the scale you can build in this business.

As we add additional funds we'll obviously double, quadruple et cetera the fee income from these funds and at this point we really only need to add modest headcount of loan analysts to make sure we can manage the portfolio properly. There's a balance sheet financing as obviously you're even more aware of. It's much more focused on -- it's all senior cash flow and asset-based deals. It's all CapitalSource originated paper. We retain the equity and then obviously the motivation is financing. Thank you.

QUESTION AND ANSWER SESSION

John Delaney: Okay if we limit questions to about 15 minutes we'll be right on schedule. So questions for this group, Joel?

Joel Houck: Thanks. A question for Joe. He's a big guy so I had to speak up I guess. I think last year you guys may have disclosed your leverage multiples in your Corporate Finance business, maybe not. The implication is that you're below the market. Can you talk about how the numbers have trended debt to EBITDA in the Corporate Finance business and how specific end markets or verticals where you see maybe more risk or less risk if that's possible?

Joe Kenary: Well I think the overall portfolio we still reside below market for the entire portfolio recognizing that there's been turnover. I don't think the overall Corporate Finance portfolio is much above three times. With that said some of the transactions that we're seeing particularly with some of the larger syndicated transaction again leverage has crept up in the market and if we're executing more or less deals than our add market terms we are seeing leverages slightly higher.

So some of the newer transactions will have modestly higher leverage but as I mentioned earlier I think it's higher quality businesses, larger companies. It's a very different -- it's a little apples and oranges if you follow what I'm saying. We're not -- what we didn't want to do or what we noticed is we saw companies getting higher leverage and we didn't really want to do that. So if the market is essentially taking that risk of higher leverage you'd rather deal with a higher quality company, if you follow what I'm saying.

Joel Houck: And then the end market is there any --?

Joe Kenary: The end markets in terms of industries, we're seeing --.

Joel Houck: Yes ,verticals like.

Joe Kenary: Well, you know look everybody knows it's not the best time to be a lender to the auto supply sector or I think certain people are cautious about other consumer sectors. But I think we tend to less focus our portfolio and overweight it in X or underweight it in Y. I mean we're very micro down in the details, company to company focus. I think from a portfolio focus we're not seeing any distress or any issue.

I mean all the issues that we've ever had in our portfolio have been very company specific, management specific issues, not sector. Very few sector issues. We've had no sector issues.

John Delaney: Add anything to that Dan or do you have any?

Dan Duffy: No I agree. I think the only other industry to add is housing. Obviously we've been cautious in that area because there's been a number of transactions recently that have stumbled coming out of the market and have had a flex and we still passed given the obvious issues there.

John Delaney: I think Henry you were first and then Bob.

Henry Coffey: Yes I'm trying to understand -- thank you -- I'm trying to understand the asset management business because I'm over -- I'm so old. I can go back to 1998 with real but scary feeling. So you're building up a portfolio of loans to put into a securitization. They sort of are/are not loans that you'd ideally want to hold on the balance sheet and then you're hoping/waiting to sell them into a pool. But you own them during the process?

Unidentified Company Representative: Yes the way it works is we engage in an investment bank that typically provides them warehouse financing for the specific deal. We structure it such that's off balance sheet. Actually the first deal we did have on balance sheet during the warehouse and then it came off at the end of that process but in all deals going forward it's been structured where it's off balance sheet day one.

And it's really -- you have a design portfolio strategy and you have a very clear sense of what the market response will be to that. It's not as though you're building a pool and hoping you can sell it later. It's certainly well thought out with a clear sense of -- and you're building all the parameters that will ultimately wind up in the indenture and the final deal upfront relative to the weighted average spread, weighted average [WARF] et cetera. It's a very diverse portfolio. And the reason -- these are all frankly extremely good credits in terms of current deal the weighted average risk is between B1 and B2, closer to B1 actually.

And the issue for those assets being on CapitalSource's balance sheet are essentially great quality assets at relatively unattractive yields. We could obviously build a huge business on balance sheet if we wanted to in that space but we think doing it in the context of the asset management business is much more attractive for our particular financial model that we have for the business.

Unidentified Audience Member: So looking at the $325 million that you did do and using that kind of as a benchmark what did the fees look like that were realized by CapitalSource and literally what would have happened if we had had a repeat of '98 and you couldn't have gotten the securitization done?

Unidentified Company Representative: Sure you're always, I guess, at the risk during the -- first of all with respect to the warehouse period they're off balance sheet day one. You have a limited amount of first loss risk so you're actually [down] a risk in the deal is fairly small, if there were a correction in the market that occurred while you're in the middle of the process in one of these deals. So I think that greatly mitigates that risk.

As it relates to the economics of the business the way you make money in this business is ongoing management fees which typically are in the 50 to 60 basis points of a deal on an annual basis, you also have incentive fees that either come later in the deal or at the end of the deal based on achieving minimum yield requirements usually 12 or 13% kind of IRRs. You're making another 25 basis points of fee at that point.

You also make the excess spread during the warehouse period which creates fairly attractive income and in the first year that's actually a more attractive part of the deal. Obviously, on

an ongoing basis the fee income is more attractive. And then what you want to do again we have sort of this team of loan people were to add another deal that we've opened up yesterday as it makes sense and the market conditions allow we'll continue to open those up and your operating expenses are essentially inflation plus modest increases in headcount frankly at lower expense levels. You're not adding an entire senior management team for every deal.

Unidentified Audience Member: [Inaudible - microphone inaccessible]

Unidentified Company Representative: Yes.

Unidentified Audience Member: [Inaudible - microphone inaccessible]

Unidentified Company Representative: You've basically got a deal -- it's really limited to the first loss in the warehouse. You've got a bank that's providing 100% financing. You've got a limited loss if the deal couldn't happen.

Unidentified Audience Member: [Inaudible - microphone inaccessible]

Unidentified Company Representative: Single-digit percentages of the deal.

Unidentified Audience Member: So what's our advance in the warehouse?

Unidentified Company Representative: The advance is 100%. But just the sort of mid-single digits.

Unidentified Audience Member: You're also presuming --.

Unidentified Company Representative: I've got a bunch of people that want to debenture a higher number in the next deal.

Unidentified Company Representative: It's also presuming every [inaudible] data in the portfolio assuming these are high quality companies.

Unidentified Company Representative: And let me just relate to the fall of '98 I gave because like you I was around then, a different company. But there's no gain on sale that's really driving the economics here so that's one of the things that happened in the fall of '98 which was unrealistically tight debt spreads that led people to originate based on some gain on sale economic model that they had that basically changed so they were caught and they couldn't securitize. They had no earnings and it started spiraling –

Unidentified Company Representative: No it's almost all originated in the primary -- we sell some at a premium like in building the portfolio. Yes.

Unidentified Company Representative: Yes, it's almost always originated in the primary.

Unidentified Company Representative: And so really the risk is -- I mean the way I think about this business pretty simply is what's the return that we sell the equity to, 14?

Unidentified Company Representative: They're targeted at a 2% default, 80% recovery is 16.5% in deal one. Obviously, our economics are better if we get a better price in equity.

Unidentified Company Representative: We sell the equity here on a pretax 16, 16.5 which is lower than what we want to earn with out equity, right? That's why we do it in this deal.

Unidentified Company Representative: There are people who want to accept that rate of return. We don't want to accept that rate of return for our equity which is why we put it in this vehicle. So our risk is, is if the markets collapse the capital structure has some spread risk as it relates to execution, right? Which could mean that we sell these things at a higher value probably/basically which would compress our fees.

We have that same risk in our core business because really paying loans by our securitization and have the same kind of spread risk between relative tranches within the capital structure. And so the risk is if the markets collapse we have loans on our books which we've approved and underwritten as part or our normal processes. We just own a portfolio with a certain amount of equity in it that's at a lower return than we want. It's pretty immaterial in terms of the size of the whole balance sheet that might be a risk. One of the reasons you don't get four or five of these deals open at one time is to mitigate that risk so you want to do one at a time. But I think that might have been also where you're going. Great Bob?

Bob Napoli: Thank you, and just one piece on that before I ask my other question. There is no gain at the time of the securitization?

Unidentified Company Representative: No.

Bob Napoli: Okay.

Unidentified Company Representative: No where in the -- the only time we had a gain on sale and Tom correct me if I'm wrong here we had a gain on sale in our HUD business where the originated loan has a HUD guarantee we sell in the market and we'd get gain. But there's no --.

Bob Napoli: That's a cash risk.

Unidentified Company Representative: No credit risk, right yes. Is there any other -- I think [inaudible] there's no gain on the sale of the portfolio I just want to make sure it's accurate before I say it again. There's no gain.

Bob Napoli: Okay with regards to the commercial real estate business the industry has grown as you said 16% per year over the last several years, 10% of the last 50 years, accelerated above trend. And is there a bubble growing in that market? You know you've seen a number of bubbles over the last decade. Is this the next bubble and what are you most concerned about and what's the exposure to the condo market? Maybe a little color on that?

Brian Graham: Well I'll take a short at that. I think it's pretty widely known that the residential market is cooling and we've reacted accordingly by being much, much more selective in terms of our real estate lending in that sector. We are a very diversified originator of commercial mortgages so we're looking across all asset classes, some mainstream some less mainstream. I think if you look outside the residential sector the underlying the property market dynamics are quite favorable for just about all other asset classes, retail, industrial, apartments, hotels.

And so we're focusing our originations activities in many of those sectors and also looking to sectors that are merging like the RV business that we highlighted in one of the examples today. So I think we're somewhat uniquely positioned to move out of certain sectors that might not look as favorable from a fundamental standpoint and find opportunities elsewhere. But to answer your question directly I think most real estate property markets are performing at a pretty good level today and I don't see any -- personally don't see any real storm clouds on the horizon.

Unidentified Audience Member: Head structures and all that?

Unidentified Company Representative: Sorry, I was going to say, one other comment I would make is that we didn't just react to the residential markets. I like to think we're pretty pro active. So in terms of like the condo business for instance there was great business three years ago. We really exited it substantially 18 months ago some time period like that. And if you look at the portfolio it's a fairly low percentage today.

Unidentified Company Representative: 14%.

Unidentified Company Representative: 14%.

Unidentified Company Representative: So real estate.

Unidentified Company Representative: Yes just the real estate sorry.

Unidentified Company Representative: And a lot of those deals are all sold out just waiting to be.

Michael Szwajkowski : Right so we're very comfortable with that. We think we're well positioned. And the other thing I'd point out is we try to use this growing liquidity in the market to our advantage. So we kind of want to be in asset types or new emerging sectors early and kind of get out early and use that growing equity to be our exit.

Unidentified Company Representative: Right and just to echo that point by Mike we built out our platform and we're big and at least relatively speaking. We've doubled the size of our group in the last year but we're still quite nimble and we can move in and out I think pretty quickly when we see opportunities.

Unidentified Audience Member: And then have lending structures gotten a lot more aggressive, any topic from originators and they say on the middle of the fairway say was not a big one three years ago.

Michael Szwajkowski : Yes, they have and I think when you saw things like condo conversions get securitized you kind of knew it was time to leave the market from my own perspective. So I would say that was fairly aggressive and I think there will be a fair hangover in those deals.

Unidentified Audience Member: [Inaudible - microphone inaccessible]

Michael Szwajkowski : Well I think we've maintained the same kind of credit posture that we've had since the beginning of the quarter, very, very proactive. I think we structure things very tightly. We see the more aggressive stuff is really more in the commodity end of the market, more in the conduits or Wall Street space.

I mean I think three years ago no one would have thought you would securitize condo conversion loans and it was really neat idea for about six months.

Unidentified Audience Member: In the REIT discount business is there any exposure to subprime mortgage in that particular area and if so how are you managing those risks?

Michael Szwajkowski : There is some subprime mortgage in our Mortgage business. None of it's direct is the first comment I'd make. So when we finance a finance company we're advancing anywhere from let's say 60 to 85% of their cost basis in a pool and it's all cross collateralized because it's one pool. So there are underlying loans some of which are to subprime borrowers although that's not an explicit focus of ours and a lot of what's in here is actually commercial. So I think between diversification our conservative, we think conservative advance rate plus the fact that the consumer, to your specific question, also has equity in the transaction. There's really two layers of equity if you will.

Unidentified Audience Member: Okay and you're not seeing any problems in that?

Michael Szwajkowski : We've seen none and we've actually never had a loss in that business.

Unidentified Audience Member: Thank you.

John Delaney: Okay, oh Bob you had a question?

Bob Napoli: I'd like a little more color on Europe if I could and what the plans are and how rapidly you want to grow that and what the differences are between the European market and the US market? Is it becoming as frothy as the US markets?

Unidentified Company Representative: John, how long am I allowed to talk about this?

John Delaney: 51 seconds.

Joe Kenary: All right I'll keep it short and sweet. Bob, the credit statistics in Europe are different. The market is different. Banks I think as a competitor are different than in the US but it's an enormous market. There are opportunities. We basically went over there because some US-based private equity firms started opening up offices and doing transactions in

Europe. I think we think that the junior end of the market if you look at the statistics over the last ten years is actually a more attractive end of the market than the junior capital end of the market here in terms of if you look at the risk-adjusted return leverage is higher, spreads are a little tighter but the loss experience over the last ten years has been much better than in the United States mezzanine market.

So that's one aspect we're considering and looking at. But we still present a nimble alternative to large, bureaucratic organizations. They're really not a big commercial finance platform over there in Europe. I think our goal is we're going to establish a foothold in the UK. Obviously it's the one place we all know the language and then we're going to -- I think we want to move off of the continent because I think there's some obstacles there from a regulatory perspective that pose problems for many lenders getting over there. So I think if we can do that I think we can build a real franchise.

John Delaney: Yes we think there's an opportunity to build a business over there as big as the business we have here. It's going to take a very long time. But we think that opportunity exists. As Joe said we started in the UK which made sense for lots of reasons. We have to get a certain licensor in place which we're in the process of doing which will take some time. Effectively you end up with a banking license that allows you to do business across Europe. And you really need that and so we'll do that and that will be a big advantage. And then we'll start rolling it out.

And I think our view was to start with the Corporate Finance business because we could leverage relationships we have here. A lot of sponsors do business here and there and we could leverage those relationships et cetera and so we started with that business. But we expect to be rolling out our Healthcare business and Real Estate businesses and Mike you had the view of the REIT discount business. It's attractive over there based on things we're seeing.

So listen we've taken it very slowly. We didn't want to go into the market and plow a lot of money out because you're the new person on the block and you need to meet people and develop relationships. You need to take it really, really slowly which is what we're done. And I think now I mean we have 100 million now. We expect to have 200 million by the end of the year so it's really starting to pick up. And we feel very good about that now. We feel like it's the time to allow more stuffing.

And I suspect we didn't do a lot of stuff we probably in hindsight should have done but we didn't do it just because we were taking it so slow. So I think we think we can build as big of a business as we have here, over there, a diversified commercial finance company which is a unique platform. There isn't something like that over there. It's just going to take a very, very long time.

So I think we are absolutely right on schedule. I know it's getting tiring at this point but if we can take our 10 or 15 minute break we probably then only have about 45 minutes or so and it's the Finance stuff and some interesting things so thanks.

[BREAK]

PRESENTATION

John Delaney: Okay let's start sitting down. The crowds are thinning. Maybe some people drifted into the Securities Fraud Conference across the way. That is actually the conference that's going on next door. A how to. Yes that got everyone's attention. Okay. I was dead wrong about being on schedule. Good to admit your mistakes quickly and get them over with. We're an hour behind schedule actually, but it was so neatly behind schedule that I, four or five, does it really matter? But fortunately we left a lot of time in the schedule so

I think we will be fine as it relates to ending up and I suspect between questions we can get through the next section in an hour. Because there's only really three sections, there's Brian Graham, who will come up next, discussing the Residential Mortgage Investment business that we have at CapitalSource, and then Tom Fink will go over the financial overview, which we kept for the end so that people would stay, and then I'll wrap up very briefly.

So with that I'd like Brian to come up.

Brian Graham: Thanks, John. My name's Brian Graham, I've been at CapitalSource almost exactly a year. This meeting last year was really my first kind of formal meeting with the CapitalSource group, it's fun to be back. My responsibilities are to manage the Mortgage Investment portfolio. Now I was asking myself what the heck that really meant and I think my job, I think our job as a team is everyday to make $5 billion or more of assets well predictable, monotonous, uneventful, perhaps unremittingly boring is the right thing.

And I think today I'll give you some perspectives and some metrics and some information to let you judge for yourselves how well a job we've done making this business boring, but I feel profoundly confident that I'll be able to make my own presentation live up to that lofty standard in the next couple of minutes. Anyone who isn't adequately bored, please see me after the session, we can talk at length about duration convexity and what those in the business call the Greek measures of risk, gamma, Vega, [ducedetes] and Herodetes That was for you English majors and ancient history majors in the audience.

Okay strategy summary. Let's start right here which is that, as with any investment plan, you've got to start with what you're trying to accomplish because unless you know that and you know it in very robust rigorous priority order, kind of nothing else matters. And these strategy objectives, these five bullet points are listed in very careful order. The first objective is to make sure that we meet or exceed the asset targets that Tom provides us on a monthly and quarterly basis so that the company's positioned to optimize its REIT structure, by far the most important objective of the business.

The next three are about managing the risks that are inherent in investment in mortgages and we take those risks very seriously and we take the risk management strategy we have to adopt equally seriously. And then finally, maximizing the ROE. But given that that's at the end of the list, we manage our risk first and maximize ROE second.

Which brings rather neatly to risk management and the most important tool we have for risk management is realistic return expectations. Because when you try to squeeze blood from a stone, when you try to get more return out of an investment than is really legitimately there, that's when you run into trouble. Obviously, we also have tight risk metrics for duration, convexity and other things. We have high credit standards for the loans we invest in, the counterparties we take risks to and exposures to. We want to make sure we have ample funding and derivaty capacity and indeed we have more than twice -- the unused capacity we have is more than two times what we've used. We also want to keep it simple for the simple reason that it makes it easier to do it right.

One example of this is in accounting, which is decreasingly easy to keep simple, but we chose to put our investments, our mortgage-backed security investments in trading accounts. And we chose that despite the fact that we intend to hold them to maturity. And we chose that for the simple reason that GAAP has become so impenetrable when you try to deal with the things you have to have in place, hedges and derivatives. And what have you in investing in a mortgage portfolio, that the complexity is inherent in putting these investments in available for sale or held to maturity, FAS 133 and a myriad of other things that I still can't get anyone to explain to me, made putting these investments and the associated derivatives in trading as the best, simplest, most predictable strategy.

We also want to make sure we get our money and that means over resourcing the back office, internal and external, and hire the best. Externally we've retained BlackRock to manage the portfolio for us, internally we now have four senior professionals, each of whom has 20 or more years experience in the mortgage market. [Chris Harms], who I think is still here some place, joined us about -- there he is, joined us about what? Two months ago? Almost three. Dog months. And we have a wonderful team of people.

That strategy has shaped and defined the investments we make and how we make them. We invest in high quality assets, we use appropriate and aggressive hedging of all the interest trade brands and we use appropriate leverage. And that's driven us into two basic investment types, first is mortgage-backed securities and the second is what the accounts have told us to call mortgage-related receivables, known by most normal people as loans. So let me start with the first one.

We've invested in a set of Fannie Mae and Freddie Mac guaranteed mortgage-backed securities, we've chosen what are called hybrid ARM securities and we've chosen them because their asset durations are lower than a fixed rate mortgage security and therefore there's less interest rate risk in there to begin with. These have been typically seasoned mortgage-backed securities and typically discounts, all of which also serves to reduce the risk. We finance those to repo, one month repo, and if that's all you did you'd have a massive mismatch between your assets and your liabilities. And so we've used swaps, swaptions, caps and futures to hedge intensively every component of the interest rate risk inherent in those assets. We've got just over $3 billion of those assets on the balance sheet as of the end of June.

The second category of investment is mortgage-related receivables, these are jumbo/hybrid ARM mortgage loans originated by Wells Fargo. Most of them are relationship loans, that

means they're loans that they're making to the folks who also have a checking account with them, these are the most high quality of the highest quality loans you can get. As you can see from the FICO scores and the LTV, they really are high quality. We finance those positions with non-recourse securitized debt on balance sheet, no pain on sale there, and a little tiny smidge of repo. In the first category we've got interest rate risk, in the mortgage-backed securities we've got interest rate risk that we hedge carefully. In both cases we've sought highest quality assets we can find, lowest risk assets, and we've tried to hedge them and finance them in an appropriate way.

Let me share a couple of implications, a couple of metrics that kind of flow out of this investment strategy. The first is that low risk plus aggressive hedging and appropriate leverage leads to capital efficiency that converts more than 42% of our balance sheet assets into less than 10% of our invested equity. And that's just a function of the fact that we've chosen high quality assets and we've hedged and financed them appropriately.

The second implication is interest rate risk and here this graph shows the duration of our mortgage portfolio. The pinkish line is the assets alone, that's just the mortgage-backed securities, and the blue increase is the portfolio, the assets and the hedges. And here the Y-axis, the vertical axis is in months of duration. And as you can see, despite whatever's going on with interest rates, and if we had mapped interest rates over this they would have been wildly swinging over the past year, the portfolio stays nicely behaved at functionally zero duration. And the reason is because we spend a lot of money to hedge it carefully. You can't hedge and achieve zero duration without spending the money appropriately to buy those hedges and manage your position. By the way these are daily measures, this is every day. I doubt if you could find another mortgage investment company that has such well behaved risk measures on the interest rate risk side.

The third implication is that, if you end up buying high quality assets from the highest quality servicers you can, you get good credit performance. And these are the 60+ delinquency measures of that mortgage-related receivables, those sets of pools of loans we discussed earlier. And the pools are still young, these numbers will continue to increase gradually as the pool seasons but the numbers are remarkably low, as they should be for high quality assets with such a high quality pool. So that's it. The portfolio is composed of high quality assets, it's managed and hedged aggressively, and as a consequence you get well behaved and I sure hope boring results.

Thanks very much.

Tom Fink: Thank you, Brian. That was indeed very, very boring.

Brian Graham: Just wait, Tom's coming back.

Tom Fink: Yes exactly. It was a set up. Good afternoon, everyone, I'm Tom Fink the Chief Financial Officer for CapitalSource and my main obvious for you today is to review our outlook for the rest of the year and for 2007, and also to review our dividend guidance. I will do this in some detail so that you can feel good about what we expect with respect to the main drivers of financial performance in the business, and I think a good place to start with that is to look at where we've been.

CapitalSource has a very strong history of improving and increasing financial performance. Since our IPO three years ago, we have been a very strong originator of high quality, high returning assets, we've grown the successfully which has led to strong growth in our top line revenue, our net income and earnings per share. Specifically if you average them over that three year period, our net investment income is up 58%, our net income up 42% and our earnings per share up 32%. So clearly, a very strong record of increasing financial performance.

So far this year, we've continued to execute across the business. The REIT election, as you've heard from many today, is working and working well. We've maintained our credit discipline and the platform continues to produce strong earnings and dividends. Our accomplishments so far this year are I think fairly impressive.

First and foremost,we implemented that REIT election plan very successfully, including the specail E&P dividend that was paid in January, we will have paid as of September 30, $3.97 in dividends. We've had strong increase year-over-year in our adjusted earnings. You've seen stabilized credit metrics from the portfolio. We've expanded and diversified our sources of funding and we continue to employee I think very conservative financial leverage in our Commercial Lending segment. At the end of June, it was about 3.5 times from a debt-to-equity ratio perspective, which is far below that of banks and other commercial finance companies you may be familiar with.

And then most importantly we're achieving our hurdles, which internally we're targeting to achieve greater than a 20% adjusted return on equity, and we have done that so far this year.

So I think it's easy to say that we've continued our record of improving and increasing our financial performance. Our net investment income year-over-year, this is for the first half of 2006 compared to the same period in 2005, net investment income is up 34%, net income up 63% and our adjusted earnings per share, which is our new performance metric, is up 23%.

How do we achieve such terrific financial results in the business? Well it comes from having a very strong and a very superior I think financial model. As you've heard from all the others before me, CapitalSource has a broad-based platform, we focus on directly originating product which generates very high quality assets that have strong risk adjusted yields. We employee conservative financial leverage but we have the ability to draw on multiple low-cost sources of funding. Compared to other tax advantaged dividend paying entities we have significant financial flexibility due to the fact that in our taxable REIT subsidiary where we're making our corporate loans and our asset-based loans, we can retain the earnings.

We have an efficient and we think scaleable cost structure and now, due to the REIT election, a very tax efficient corporate structure as well. All these things combine to produce I think very attractive financial characteristics for the business that complement the very strong franchise that you've heard everyone else talk about today.

Now let me switch gears a little bit and start looking forward. Yesterday we issued a press release containing our updated dividend guidance and our expectations for our payout ratio

of dividends to adjusted earnings. I will discuss the dividend guidance in a minute, but let me first touch on adjusted earnings.

For those of you who are new to CapitalSource, we began using adjusted earnings this year in connection with our REIT election. Adjusted earnings is an alternative measure of our performance to supplement GAAP, net income and earnings per share, it's similar to other alternative performance measures that other Refits use, things such as funds from operations or FFO, funds available for distribution or cash available for distribution.

We think adjusted earnings is a better measure of our financial performance, it's focused on our core Commercial Lending and Investment segment. For example Brian talked about how we have all the residential mortgage-backed securities and trading, that means we're marking those to market. Our adjusted earnings take that mark-to-market out of the equation so you can look purely at the Commercial business. And I think it gives you a greater ability to compare CapitalSource to some of some of these other tax advantaged dividend paying entities. And it's also a measure that we're using internally to gauge our thoughts about the regular quarterly dividends we will pay, so that makes it an important measure as well.

In yesterday's press release, in addition to announcing the guidance for our dividends, we also mentioned that we had modified our adjusted earnings definition. What's listed on this slide is the 11 components that we had included in the adjustments for adjusted earnings and some commentary on each of them. Very simply what we're doing with this modification is to remove Item number 11, which is the adjustment for income taxes, with the simple explanation that, just because we're making these adjustments on a supplementary performance measure, it actually doesn't change our tax position at all.

We had a lot of questions about this particular line item in the adjusted earnings and, after we thought about it some more, basically concluded we shouldn't have had it in there in the first place. So we've taken that out beginning with the third quarter results.

To put that number in perspective for you, and this slide reconciles adjusted earnings to net income removing the adjustment for income taxes takes about 18.8 million out of the year-to-date results, which is about $0.11 per share or about 10%.

This slide, I won't spend much time on, it's just a little bit more of an explanation of what those particular reconciling items are.

So let's move on to guidance. As we talked about in our press release yesterday and as John mentioned earlier today, we are increasing our dividend guidance for the fourth quarter to at least $0.53 per share. That compares to $0.49 in the third quarter, this is an 8% increase in that quarterly dividend and brings our total 2006 regular quarterly dividend guidance to at least $2 per share. For 2007, we announced guidance of at least $2.40 per share, which is a 20% increase over what we expect to pay in 2006.

And we're very pleased to bring you this updated guidance because the business is performing well. It's performed well throughout 2006 and, based on everything you've

heard from the folks in the lending groups who presented to you earlier today, we expect strong performance in 2007 as well. So we're very pleased about that.

An important point I also want to make is about the payout ratio. Last year at this conference, we talked about dividend guidance way out in the future in 2007 of $2.67, we also talked about that guidance coming from 100% payout ratio. As part of our press release yesterday we announced an 80 to 90% range for the payout ratio which is the ratio of dividends to adjusted earnings. Which we think is an important point for the company to be able to retain a little bit more capital and also to make sure that's there is an adequate cushion in the business that we can continue to deliver that dividend and make it a very stable dividend that we think is going to grow over time.

This dividend guidance is based on our outlook for 2007, so all my remarks from here forward are going to talk about the Commercial Lending and Investment segment. We expect strong growth across all of these businesses as we reap the benefits of having the fully built out national, direct origination platform and then also to capitalize on the expanded opportunities that we will see through the REIT election.

We expect to see and have seen somewhat lower spreads in the business, but I want to make very clear that this is by design. We are steering the business towards lower spreads due to both a defensive mix of assets, that is more asset-based lending, more real estate lending, but also the very important point that Jason made that on the Real Estate side we can use the pricing power of the REIT. When we talk about lending spreads it's a pretax number, what really matters is the after tax.

We maintain our credit discipline and expect to see stable asset quality in the business. We're going to expand our sources of income, including the Asset Management businesses that have been mentioned today. We will continue to expand and diversify our funding sources in the business. An important point to note here is that we're not assuming really any deposit based funding in our guidance, in our forecast for next year.

CapitalSource is very interested in deposit based funding. As has been talked about, we made an application for a Utah industrial bank that application is on hold, along with all other applications with the FDIC, as they try to sort out how to handle commercial firms applying for these bank licenses. CapitalSource is not a commercial firm so to some extent we're an innocent bystander in this process, but it's something we're very interested in. But the point I want to make is that we haven't assumed any benefits from it in our forecast, so if we can arrange deposit based funding I think that would be a big positive for the firm.

And the last on the operating expenses, we do expect to realize some efficiencies as we continue to grow the business, see the scalability and then also the relatively high costs and professional fees associated with the REIT conversion as they recede beyond the horizon.

So let's go through each of these one by one. Strong growth trajectory. First, as you can see in 2004 and 2005, the lending business grew at a net rate of close to $2 billion. Our net loan growth assumption for this year is $2.4 billion, that's an ending balance, and you can see with

this green bar on the right that we're, as of halfway through the year, halfway there. So very good progress on that.

We also expect increasing activity in the sale leaseback business. It's something that was started this year in 2006. Someone had the question earlier how much do we expect in sale leasebacks and you can see what our expectations here. We expect that part of the portfolio to be $854 million at the end of '06 and growing beyond that to over $1 billion in 2007. So, clearly a very strong growth trajectory in the business.

With respect to spreads, the point I want to stress is that I think the factors affecting spreads in our business are very positive ones actually and I think are unique again to CapitalSource. Again, we're steering the business towards lower spreads due to the defensive mix of assets we're addressing and also the effect that the pricing part of the REIT has on the real estate side. And you can see this on this chart where I'm showing you the portfolio two years ago, the composition of the portfolio compared to the end of June. And as a stark comparison here, 41% of the portfolio two years ago was in senior secured cash flow loans, today 41% in first mortgages, again where we have the pricing power of the REIT. So I think that makes the point about steering the business towards these lower spreads.

The outlook for spreads is you see our core lending spread decrease a little bit from 7.1% this year to 6.3, again by design, the key takeaway being we're using this tax efficiency of the REIT, we're targeting more defensive mix of assets and we are managing our credit risk. We still also maintain our target of about 50 basis points in yield for prepayment related fee income, that's in addition to these core lending spreads that I show you here.

In terms of asset quality, Bryan Corsini talked about the strong credit posture of the business from a more proactive portfolio management approach and really the positive recovery outcomes we have seen both with loans that enter the delinquent or non-accrual buckets and with loans that we've worked before they've ever reached those buckets.

I think that leads us to a stable charge-off forecast for the business, we had been forecasting 50 basis points of charge-offs for 2006, we're maintaining that both for 2006 and 2007. But when you couple that with the changing asset mix again the portfolio moving more towards first mortgage loans and more towards asset-based loans. That's also going to translate into a reduction in our allowance for loan loss just due to the mix of asset types. So whereas the allowance for loan loss was 141 basis points at the end of June, we expect it to be closer to 120 basis points by the end of this year and 110 basis points by the end of 2007.

Other income, this has been a significant contributor to our results and we expect it to be a growing contributor to the bottom line. But historical sources of other income include the HUD Mortgage Finance business, occasionally we earn some very nice fees on certain loans, equity gains, Joe Kenary mentioned the co-investments we make on some corporate finance loans, if we see equity gains there they'll come in through the other income line. And then also dead deal fees are what we formally call due diligence deposit forfeited as another source of other income. And then the growing sources will be these asset management businesses.

So far this year we're ahead of last year's pace both in terms of a percentage of average assets and also in terms of dollars. We expect other income this year to be approximately 50 basis

points in total and approximately 50 basis points in 2007 as well. The one caveat here being that sometimes, due to the facts and circumstances of these extraordinary loan fees, they might actually go above the line in loan yield, but you would see that with a spike in loan yield.

Operating expenses, you've heard many times we think there are efficiencies in the business and we do expect to realize them in the first half of 2006. We expect for the full year operating expenses to be 2.6%, this is all in including depreciation and amortization, which is something that comes along with the sale leasebacks, you own a property, you depreciate it, that comes into our operating expense number. So 2.6 will be slightly less than 2005's level but we do expect to see more of 2007 efficiencies in 2007 where operating expenses we expect to decrease to 2.2% of average assets.

So now let's talk about funding. We've shown this slide many times. CapitalSource has multiple, diverse and low-cost sources of funding. We have very deep and broad access to the capital markets and as a result of this I think we have some very attractive financial characteristics that come from the funding platform. Low-cost of funds first of all, no gain on sale which John has already mentioned. And then also a business that is largely interest rate insensitive. We're typically borrowing and lending on short-term rates so the business is naturally very interest rate insensitive.

What's new and different on this slide this year is the fact we have more slices in the pie. A particular focus for us has been to increase the amount of unsecured funding in the business.

We've done that, we've been very successful there, we closed a $640 million unsecured credit facility, which has added significant financial flexibility to the company, and we expect to do more unsecured financing. What hasn't changed on this slide is the commitment to low leverage. Beneath the pie chart again you see the 3.46 debt-to-equity ratio for the Commercial Lending and Investment business.

Our cost of funds expressing a borrowing spread to 30 day LIBOR has decreased over the years. Candidly the pace of that decrease has slowed a bit this year, year-to-date our cost of funds as a borrowing spread to LIBOR is 97 basis points versus 105 basis points for the full year last year. Two reasons for that, number one is, as you can see, that the green parts of these bars, this is the amortization of the first financing fees.

One of the features of our prior securitizations, which is the term debt that I showed on the previous pie chart, we had previously done what we call static pool transactions, which is just to finance a specific group of assets. And as our portfolio turns, as our borrowers execute their business plans, loans get paid, those liabilities pay off and as a result we get an acceleration of the amortization of those deferred financing fees.

We closed a transaction this year, just this month, actually tomorrow we're closing it, our 2006-2 securitization, which for the first time includes a replenishment feature which basically allows us to take those repayments or prepayments and invest them in new collateral and keep the liabilities outstanding longer. This will allow us to amortize these deferred financing fees over a longer period of time and should reduce our costs. Our

guidance for borrowing spreads is also I think for 2007 to be roughly 100 basis points. Again no credit for deposit based funding and also we're assuming an increasing percentage of unsecured debt which is more expensive.

The funding strategy is just to continue what we've been doing, which is broadening and diversifying our funding sources, using more efficient term securitizations as I just mentioned, greater use of unsecured, we'll opportunistically pursue other sources of capital as well. And then from a capital efficiency point of view, we earlier this year in March implemented a dividend reinvestment and direct investment plan that can help smooth out our capital raises, I think that will make the business run a little bit more efficiently a return on equity perspective.

When we talk about funding we naturally talk about leverage and ask ourselves the question what is the right level of leverage. There are several considerations that go into determining the right level of leverage. The important point here is that it's a concept that needs to evolve as the business evolves. We consider our asset quality and the returns of those assets, which are both very high, we consider how strong the franchise is and its ability to continue generating stable returns on assets, have a diverse portfolio, have a large size business. And also importantly funding and liquidity considerations, we want to maintain a strong balance sheet which we have done, and that's why we target leverage that's below that of traditional C-Corp commercial firms or the regional banks.

Another way to view leverage is well what does the market allow you to have? What I've laid up here in this bar chart is the capital structure of our 2006-2 securitization, which again closes tomorrow. It's 1.5 billion in assets, we sold 1.3 billion in notes rated AAA through BBB, so all investment grade rated notes, a three-year replenishment period and if you look at that investment grade debt, it equates about 88.5% of the total capital structure, which if you flip it around to a debt-to-equity ratio it's 7.7 times debt-to-equity.

So here is a representative slice of CapitalSource's portfolio that has been market tested both on the asset side and structuring liabilities that are investment grade to 7.7 times debt-to-equity. We are targeting for our Commercial Finance business 4 to 5 times which, if you look at these dotted lines on the graph, slots in between the BBB and the A. So again, a very clear market statement that we're targeting I think lower leverage than what we could achieve in the business, which shows you we're committed to having a strong balance sheet.

This is another way to measure capitalization of the firm and leveraging the firm. We have a view of the prudent amount of capital we would like to acquire against each asset type. You apply those capital ratios to our June balance sheet and you'll see that, on a risk adjusted basis, we have ample capital in the business.

And finally, how it all matters and how it all rolls up, and this is CapitalSource on a consolidated basis is return on equity. And you can see that we have achieved our objective both last year and this year of more than 20% adjusted return on equity and we expect this trend to continue into 2007.

The final two slides I have I don't think I need to spend too much time on with you. This first one just rolls up all of the guidance we just talked about, all those statistics so you have it on one page. At the bottom of the page is the Residential Mortgage portfolio, which Bryan already talked about we target very low returns, I think you can see that in the difference between the yield and the cost of funds. And finally on a consolidated basis, a couple metrics here on blended tax rate and our dividends. Tax rate obviously going to be lower in 2007 as we take further advantage of the, or make further use of the REIT structure.

And with that I'll turn it over to John. Or actually we'll do Q&A now.

John Delaney: Yes why don't we do questions now.

QUESTION AND ANSWER

Tom Fink: Okay. Joel?

Unidentified Audience Member: Thanks. The reserve levels, is it safe to assume those are all mix shift and no actual releases of reserves? That's the first question.

Tom Fink: Well I think as we have resolutions of problem loans to the extent there's reserves allocated and they get resolved, those will disappear. So that would be part of it but also mix of business is part of it. We spent a lot of time on our reserve policy, our loss policy last year and we talked about having ranges 25 basis points for asset-based loans, 100 for first mortgage loans and 300 for cash loans. So you can see, as you start doing more asset-based and less cash flow that will drive the average down.

Unidentified Audience Member: So are you implying that, of your identified problem loans right now based on what you see as a work out, that maybe there is some excess reserves in the balance sheet or not?

Tom Fink: I don't think we would say that we have excess reserves. I think we have adequate and sufficient reserves. And as you do resolve problems, to the extent you had a specific reserve on a specific asset and that asset's resolved that all washes out. There might be recovery involved as well.

John Delaney: Let me just add to that because if what you're getting at is, is there any assumptions in our future reserve levels, it would imply some greater sense of optimism. I think the answer to that is no, I think it's a pretty apples-to-apples comparison.

Unidentified Audience Member: Great. Yes. Okay.

Tom Fink: I think that's what you were, in other words that lowering really is a mix thing. We make certain assumptions about allocated reserves as part of the mix and those are similar year-over-year. So there's nothing in those reserve numbers that is a rosy picture kind of what we think is going to happen based on what's happening next. I'm not sure if that's what you were -..

Unidentified Audience Member: No that's good. The second question was, the Residential Mortgage portfolio and the projections is projected to be up in '07 and I was under the impression that this would kind of run off as you originated more core assets that got put into the REIT. So can you talk about that assumption? The 5 8 to the 4 7 seems inefficient relative to the returns and how you have to pay out for the hedges.

Tom Fink: Sure well there's no doubt that the returns in the Residential Mortgage business are substantially lower than the Commercial business. I think what we have reflected here, again when we do our forecasting we kind of build it up from the bottom with all the lending groups in submitting input and what they think they're going to be able to achieve. You know what would drive a higher amount of residential mortgage investments, which is what we're showing here, is that as you've heard about in the asset-based businesses, there's lots of opportunities also with the syndication effort in sort of a revamping if you will of the Corporate Finance business.

We see some opportunities there and have assumed that that's going to grow where this year it's been shrinking. All of this is kept in balance, as Jason outlined, when we're looking at loans and managing loans we're targeting appropriate levels of returns. So, I would say for shareholders and others, we should run our business and if we see good cash flow opportunities or asset-based opportunities at TRS we should do them.

If we see good opportunities on the Real Estate side we should do them and the Residential Mortgage portfolio is just a really nice way to balance that and let us do both things. It doesn't require a lot of capital. You know less than 10% of the firm's capital is in that business and on an asset basis it's between 3 and 4%.

Unidentified Audience Member: So this growth is not really being driven by the need to be in compliance to the REIT, it's more of a business strategy after '06. Is that correct?

Tom Fink: Well I think we have ample assets to ensure our compliance with all the REIT rules. And to the extent we're investing more in it, perhaps there's going to be greater opportunities in the taxable REIT side of the business next year. But we could also see, it's a very dynamic business. I mean we see lots of good opportunities in the Real Estate side, I think we've been pretty conservative in our modeling here. To be conservative for this purpose would tend to air a little bit on the side of TRS versus REIT.

John Delaney: And just to add a little color to that, I think when we -- the Compliance Act is simply the result of an equation like the value of your TRS versus your non-Real Estate, and that's due to plug number. And I think your point is that the trend was growing real estate, growing core real estate less compliance assets, and that's actually what's happened this year that we've seen the steady decline in our compliance assets. I think it's fair to say that in the forecasting of the business next year, we were pretty conservative about real estate growth based on some things in the real estate market and wanted to be prudent, particularly on the Commercial Real Estate side, and I think we're seeing really good corporate opportunities. And I think that the results of that series of assumptions resulted in probably

us being more conservative with respect to real estate growth than with respect to non-real estate growth so that this would then also be a conservative assumption. Do you see what I mean?

Tom Fink: And then also something I think I should have said right at the very beginning, which would have I think put this whole thing to bed. In the first quarter we had that whole issue with the residential mortgage-backed securities, financing it on repo with the same part that sold it to us and the accounting determination was you count it net. And we moved all the collateral around because we wanted to show all this stuff on our balance sheet everybody could see it and now it's gross. And I think these numbers here reflect the GAAP balance sheet, which was we had more than 3.9 billion in assets at the end of the first quarter for tax ownership purposes, but they all kind of came on the balance sheet during the first quarter due to this collateral restructuring if you will. So I think that explains it.

Unidentified Audience Member: Really two sets of questions, but the first has to do with the Residential Mortgage portfolio. I'm sort of surprised to hear any discussion in terms of profitability. I thought the intent of the asset was always simply to comply and --.

Tom Fink: Well it's not very profitable.

Unidentified Audience Member: I'm hoping it's not profitable at all. I'm hoping it's miserable without losing money. I mean nobody wants you to lose money on it, but it's not -- I mean if you suddenly made $100 million in it, it would have a capitalization value of about nothing.

Tom Fink: Technically we agree with you. You'll notice that the objectives were in priority order and maximizing the ROE was the last one on the list. And there were three managed risk bullets before maximizing ROE. So I think you're right and as a consequence, effective returns on equity reflect a very low risk position.

Unidentified Audience Member: Zero would be delightful.

Tom Fink: But there's no such thing as zero in any of that and you've got to be honest about being able to manage as much of the risk as you humanly can.

Unidentified Audience Member: But just related to that question is outsiders looking in, how do we track whatever interest rate risk you're taking? What's something we can grab onto [Multiple speakers]?

Tom Fink: Yes I think the disclosures that are provided and the 10-Q and the 10-K provide interest rate shocks, and the graph we just provided you is I think a very good estimate of interest rate risk inherent in the portfolio that was a daily measure. And so I think we should continue to give you as much information as you need to assess those situations.

Unidentified Audience Member: And a completely unrelated question, something you said, John, at the very beginning that you said this is very much a business where it looks like the sum of the parts are worth a lot more than the whole right now. And the obvious place to

look for that is at the Healthcare side, but I was wondering if you could comment more on that?

John Delaney: Yes actually in my wrap up I have kind of a whole slide dedicated to it. So if I could hold off on that, I think we'll get a pretty direct answer. But just sort of clear on the Residential, we didn't mean to imply that we're making any money doing this, because I don't think --.

Tom Fink: I certainly didn't mean to.

John Delaney: If it is, it's a surprise to us. I mean it's a mid single-digit ROE business pre-overhead.

Unidentified Audience Member: That's kind of where it is at this point, right?

John Delaney: Yes. Mid single-digit I'd say, net of overhead. It depends on where in the mid you are.

Don?

Unidentified Audience Member: All right, a couple questions, I'll get the housekeeping out of the way quick. On the Syndications business, just to be clear, your profitability on that is enhanced yield on what you keep, right? There's no income component the day you close the syndication?

John Delaney: Right.

Unidentified Audience Member: Just wanted to make sure of that.

Tom Fink: And that's an important point. I think we're in the minority of people who do that. I mean most people accelerate their income when they sell a loan our view is we sold credit risk, the better thing to do is take that income and actually amortize it over the loan just like we repaid a commitment fee.

John Delaney: Right. I think that's how we treat it, just like it's a commitment fee.

Unidentified Audience Member: The second housekeeping item, warehousing on the CLO business, that interest income, even though there's no assets on the balance sheet, is that coming through the interest income line? Or is that, the spread income --.

Tom Fink: Yes I think that section is below the line in other income.

Unidentified Audience Member: Okay. All right. So the next question for you, John. Obviously you look at where the secured debt markets are willing to finance your portfolio, there's a lot more leverage available than where you run the business. What's the best way to ask? Is the level of leverage that you have chosen the level you would use if you were a private company? Or are public investors an arbiter of how much leverage you're willing to apply to --?

John Delaney: No I don't think whether we were public or private it would make any difference. There is an argument that as a public company you have more active to debt capital because of the disclosure requirements. And we've learned in our securitization [mochos] that there are certain investors who won't invest in securitizations from private companies just because it's too hard to get the information. But I think that we run this business at this level of leverage because we think it's prudent. And because fundamentally right now, even though Tom's done a terrific job in diversifying the funding sources with the unsecured, the trust preferred and the convertibles we've done, let's face it, we rely on the secured debt capital market to fund our business.

We are actively trying to change that because if we did have two sources of funds, like deposit-based funds, to a material degree it would change our view on leverage. I suspect because we wouldn't have to run the business assuming a meltdown in secured debt capital markets, right? Because we'd have the stability of funding that say deposit based would do. That's why it's really important to us. But I think our opinion is completely informed by that, that it's prudent to keep a margin of safety in the balance sheet and excess liquidity in the balance sheet, and give up some return to do that until we can fix it. And I think we're [runs] completely on the same basis, I don't know what you would add.

Unidentified Audience Member: I'm sorry, final question. Just a little color on the relationship between your team and BlackRock. Are you managing BlackRock? How does that relationship work?

Tom Fink: Yes BlackRock is the investment manager for the account, they work for our team.

Unidentified Audience Member: So you're overseeing BlackRock's analytics and overseeing -- BlackRock's reporting to you, you're asking them questions?

Tom Fink: Yes. And as I mentioned, Chris Harms joined us three months ago he tells me. Three months ago Chris came from [Makeish Hields] where he ran a mortgage investment portfolio for 20 some odd years. So I think we've got exactly the right skill sets to that and we've also got the best in class investment manager. So a little belts and suspenders never hurt anybody.

Unidentified Audience Member: Two questions, one very quick and then one longer term. Your '07 guidance, does it assume any equity raise?

Tom Fink: Yes we do assume we're going to raise equity, I mean at a very minimum we have our direct investment plan and dividend reinvestment plan that we expect to raise. But you know I think rather than put a number out there and say we're going to raise exactly x on y date, I mean we have a significant capital cushion in the business now as we grow, depending on the timing and the extent of our growth opportunities we may need to raise additional capital. I think the company has lots of ways to do that, one of which is through this dividend reinvestment plan and direct investment plan where we've raised almost $100 million in less than six months.

Unidentified Audience Member: But if you ended up raising equity, the 2.40 wouldn't go down, the 2.40 per share, your 2.40 is a conservative number that assumes some equity raise in there with cushion so you're not going to have to adjust the 2.40 because you raise equity.

Tom Fink: Correct. We have assumed a certain amount of capital we would like to have to run the business and that's all baked into our guidance.

Unidentified Audience Member: Great. The second question, which is a somewhat longer-term question, obviously last year at the Analyst Day you talked about an '06 number and '07 number and you have obviously refrained from three-year growth rates, five-year growth rates and things like that. Can you talk about stress testing that 2.40? So one can believe that you can continue to grow your business at this very nice growth rate, but at some point someone's going to say, "You know that's a really heavy growth rate and the growth off of a large number, do you want to do that? Is that the right thing to do?"

So, when you think about the 2.40 and you think about an 80% pay out, that leaves basically 70 $80 million of cushion in there, and then you think about the run off, how much run off do you expect per year? So if I said to you that I want to go to sleep at night and believe you can do 2.40 for '08, what's my worst case scenario? It gives me room for 75 million of additional
charge-offs per se per year, which is the 80% cushion versus the 2.40, and then how much run off, how much new asset growth would you need to do instead of 3 4?

It's something a whole lot less than that if I'm just not trying to grow. Just say 2.40 for the next five years. That's all I'm going to do because the markets bad or whatever it may be, and in essence I can have 75 million more of losses and just stay in place, what's the run off per year such that I can grow at a slower rate and still pay 2.40 as far as the eye can see.

Tom Fink: The data point you're seeking is what's our expected run off in the portfolio. I mean today I would say it's about a 20% rate. Now at the same time you've heard a number of people talk about, in the healthcare space specifically, the we're now actually getting longer-term assets --.

Unidentified Audience Member: That's why I asked that question earlier about longer-term assets because in theory, if you move your business to longer-term assets, in theory your average life extends, which means you don't have to run as hard to stay in place, which means over time people should get more comfortable that the 2.40 is alive and well. To the extent you lower your payouts from 100% to 80%, people should get more confident that the 2.40 is alive and well.

To the extent that you get a confidence that 2.40 is alive and well, 2.40 is 2.40 is 2.40 is 2.40 and anything you do above that becomes growth that accrues to an equity shareholder. And 2.40 is something we can sleep at night and put a yield on and then grow off of that. But if you want to stress test it and stress it as though you could take your charge-offs from 50 million to 135 million and still pay your 2.40, you could slow your growth from 3.5 billion to 2 billion and still pay your 2.40.

Tom Fink: Well I think that some other --.

John Delaney: The answer is yes to all that.

Unidentified Audience Member: I just want to make sure I'm doing the numbers right, I'm not missing something, and that's sort of the thought process one should leave with instead of thinking about the real estate assets and what you may lose or may not lose. Because the 2.40 is a pretty good number for the next couple years.

Tom Fink: Sure. And I think John touched on this also earlier, that it's inevitable that the growth rate will slow, I mean just the portfolio gets so big you can't keep growing at that big rate every year. But then I think you'll see us have other levers to pull on in the business, including the operating efficiencies that we talked about, further funding efficiencies in the business. And then if we get an even more diverse more stable funding base, maybe we can take the business up above 4 to 5 times and that'll provide additional return to equity.

John Delaney: But it's a good observation that we really hadn't focused on in some ways in that, if you think about the run off at the level Tom talked about, which is 20%, and if you were to factor in that over time, that should go down based on the sale leasebacks which are long-term assets. It doesn't seem like a particularly hard day at the office to keep the assets stable considering we've been growing them as much as we have.

Yes?

Unidentified Audience Member: A two part question on deposit funding, one is what's your strategy now with the industrial loan bank? Are you just going to wait out the FDIC? Or have you pulled your application? And secondly, would you consider other alternative deposit funding vehicles such as a thrift charter?

Tom Fink: Well we are currently waiting, I think the FDIC announced a six month moratorium back in July, so we're waiting. I mean I think we have a very good case if you will, I mean every day we're out there competing with banks so the loans we're making, our assets are very bank quality assets. We're not Wal-Mart, we're not you know these things that people are concerned about. And some of our competitors, Merrill Lynch Capital is part of Merrill Lynch Bank, which is a Utah industrial bank. So it makes perfect sense, we'll just have to see how that sorts itself out.

You know I think there are other alternatives available to us, I don't know if we want to comment on them at this time, but I think it suffices to say it's an area of interest to us and we'll look for ways to get that. Because we think it's just a natural for the company, given the type of assets we have, and it's also a very attractive thing for us given what it would bring in terms of diversity of funding and also cost too, because I think deposits will be lower cost sources.

Yes?

Unidentified Audience Member: I had a question about you mentioned earlier that the plan is to retain additional capital that reduces your need to go back to the equity markets. But

let's say something happens in the macro environment or investors get worried about credit again and then share price of CapitalSource decline. Is a share buy-back a possibility? Or is that completely off the table, you would just use the excess capital to continue to grow and assume that the stock takes care of itself as you go along?

John Delaney: Yes that was a good one to dish off. Well you know listen, I think when you're a dividend paying entity and you're dialing up and down payout ratios, it's kind of like a stock buy-back. [So it's like return on capital] to shareholders. So you know I don't think we can comment specifically on any stock buy-back plans, I mean we're a growing company, we've got a lot of very good growth prospects.

One of the reasons we're dialing back our payout ratio is to retain capital so as to have internal growth. I'm fairly confident that the credit of this company is going to perform very well, so I'm not concerned about the credit concerns about this company affecting our ability to execute against the plan. You know when stuff happens, which it does, you deal with it when it happens. You change and rethink your opinions based on that. But based on what I'm seeing now I think the credit performance is going to be good and I think that will allow us to do what we need to do
to deliver on our plan. I think that's probably all I can say.

Unidentified Audience Member: Yes first of all, similar to what we saw in '06 with the $0.49 dividend per quarter, is it going to be consistent through '07, you know $0.60 per quarter? Or is it going to ramp up through the year?

Tom Fink: You know I don't think the Board's made a decision about that yet. Clearly we're going from 49 to 53 and if you divide 2.40 by 4 it's higher than 53, but I don't think we've made a recommendation to the Board yet and the Board's not decided how to do that.

Unidentified Audience Member: Okay. And then in terms of the actual breakdown of Corporate Finance, you know I think the cash flow base you said was around 23%. And it sounded like from the presentation that the overall Corporate Finance segment is going to end up being -- you know a lot of growth drivers behind the asset management and the fee based income coming forward, is the 23% number going to actually be reduced going forward even further?

Brian Graham: It may. I mean right now I think we see good opportunities in the other businesses and that's really what's happened to that slice of the pie. I mean the rest of the company's kind of grown up around it, the Corporate Finance bounds if you will have not really changed very much in the last 18 months. But it might go down, but I think the point I would like to leave with you is we're not targeting it to be 20 or 30 or any number. I mean we have standards for these businesses with both credit standards and return standards, and we've got a very strong origination machine if you will and if people can find opportunities that meet both of those standards we'll do them. It's not through trying to, at a macro level, steer the portfolio allocation.

John Delaney: And I would even add a little more to that in that our Corporate Finance business is a great business getting better. I really do believe that. And I think it's reasonable to assume, based on some of the stuff we talked about like doing sale leasebacks,

which don't pay down, I mean we put up a slider earlier showing where our healthcare REIT within CapitalSource is relative to some of those other companies. And I expect us to climb up that list across the next year or two.

So, it's reasonable to assume, based on the strategy we've laid out, that Corporate Finance as a percentage of the company will go down, but that doesn't mean it's not a really important business for us and a very profitable business for us. It's just at a level of its lifecycle and based on the strategy we're pursuing now, which is essentially based on the way we see the market, it'll grow but at a slower pace and maintain its profitability and improve its risk profile.

Yes sir? Carl first and then Bob. Thanks.

Unidentified Audience Member: Thanks. If you were to have a loss in your direct real estate portfolio, the sale leaseback portfolio, how would that run through? It wouldn't be a charge-off would it? It would be --?

Tom Fink: No it's not a loan, but you would recognize an impairment of the asset.

Unidentified Audience Member: Okay. So that's not baked in to the 50 million in any way, any potential losses in the sale leaseback side?

Tom Fink: No it's not, but I think we feel very good about that business having been in it not just six years at CapitalSource but all the history if you will of healthcare financial partners. So I think we feel about that.

John Delaney: Jim Pieczynski, who spoke today, prior to joining CapitalSource was the President and CFO of a publicly traded healthcare REIT that was on that list, so he's been doing this for some time.

Unidentified Audience Member: Okay. So it'd be an impairment or would it be a depreciation that it would run through?

John Delaney: It would be just a write down of the assets.

Unidentified Audience Member: Okay thanks.

Tom Fink: Now Bob's next.

Unidentified Audience Member: Thanks. Just trying to maybe summarize what I think I see in your outlook. I mean you have a lot more asset growth than I think what we had expected. And I think probably generally there's just -- and the margin comes down somewhat more, so therefore -- and the reserves are lower therefore the mix has to be lower at Corporate Finance in order to, I mean if charge-offs are actually lower than what we had modeled even on higher assets. So you must have a mix of assets of real estate growth in real estate loans versus -- in order to come up with your provisions and in order to come up with the reserve ratio, and that's -- what is the growth in real estate embedded within in order to get to the reserve ratio that you had? The mix and the margins I guess is --?

Unidentified Company Representative: Well again I think to take our statement about the expected decline in the allowance and translate that into expected growth, difference in growth levels in the businesses is a big step to make. I mean the decline in the allowance is two things. It is asset mix and it is -- you know as we forecast 50 basis points of charge-offs they've got to come from somewhere and one would think that we would have had reserves for some of those losses. So I think that's going to be part of that component that comes out.

So it'll be hard to answer your question. I don't think we want to be predicting, it's hard enough to make a single growth forecast if you will and make that and then to kind of well real estate's going to do this and that space is going to that, I think that's getting pretty far down into the [multiple speakers].

John Delaney: It's contrary to completely how we want to run the business. We're absolutely not going to give specific business lines because there's really no point to it. We think the benefit of having these diversified franchises is that not all these businesses have to grow. People who run these businesses understand that. That it's okay to sit on the sidelines if there aren't good lending opportunities and having that flexibility is a huge advantage of this company. And so we would essentially be gutting that if we were to say that this is the number we've put out, you've got to meet it for your business. Period, end of story. It would just be a really dumb way to manage the business.

So, what we want to do is we take what we think these businesses might do, and we know we'll be wrong in exactly what each of them will do. And then we haircut them and blend them and come up with assumptions and come up with a reasonable probability of what the overall portfolio will grow, recognizing, just like it did this year, we're on track for asset growth but guess what? It's different than what each of those businesses thought. So we don't want to get into specific asset growth assumptions for the individual businesses, it would actually be a bad thing for the culture of the company. We're not trying to avoid giving you information, but it would just be a dumb way to run the business and I always think about the business.

Unidentified Audience Member: And again on deposit funding, Tom, you had mentioned earlier today I think that you had other plans if -- you know it sounded like you had other plans if the industrial bank doesn't come through. And I just wondered if you could maybe give a little bit of color on what those could be?

John Delaney: Yes do you want to lever it on?

Tom Fink: Well I would just say we do other plans, it's probably not important to elaborate but it's really important we think, because it can really take the business even to a higher level. And we're very focused on it. We're looking at all the obvious things that people have suggested we look at. With the IOC thing, we think if logic prevails we'll be fine. If it doesn't, then we should pursue other avenues and we do believe there are other avenues, there's things you have to do and there are some complications associated with it, but we've got now several things that I would kind of going on parallel paths. But it's important but

it's not productive I think to elaborate specifically. We did that with the IOC and now we're talking about why we didn't get it, so.

John Delaney: Right. Don, I think you had a question in there?

Unidentified Audience Member: Just real quickly on the Healthcare sale leasebacks, John, you were pretty bullish on that opportunity a year ago, are you comfortable with where you are today? Are you comfortable with where you are today on the Healthcare sale leasebacks? And also is this a buy and hold strategy or sort of a consolidation, arbitrage or a combination of both?

John Delaney: Well yes we are very bullish on the Healthcare sale leasebacks. AS I said, we put up a list of where we stand as this Healthcare REIT within CapitalSource and I expect us to climb up that list. We've put out some, I think Tom went through some Healthcare sale leaseback projections and we feel good about the business. I think we've got a terrific team with a lot of competitive advantages and it's definitely a buy and hold strategy.

So why don't we phase to the wrap up based on that, because I think that actually ties into the next -- that was actually a great lead in, thank you. So we're on the wrap up, just in cases people --. We're often asked the question about the valuation of the company and it's not necessarily our business to speak specifically about how this company should be valued, but we do spend a fair amount of our time as professionals in what we do in day in and day out thinking about how one should value a business.

A big part of our underlying lending philosophy. And one way that we value businesses often is by deconstructing them and looking at the different parts. And the interesting thing is, if you can dress a financial services company to a non-financial services company, your non-financial services company most people think, "Well I don't really like companies that aggregate businesses because I'd rather build my own portfolio by picking the best in class in each of those businesses." And I understand that perfectly.

It's not really the case in financial services. If you have businesses that are all high performing, similar growth rates, similar financial characteristics, if you aggregate those businesses the whole is clearly worth more than the sum of the parts. Full stop. I would challenge anyone to argue the counter of that because of some of the benefits I discussed earlier. The benefits of this diversified franchise that I discussed. And so what we did is we took a look at our business and said, "Well let's just deconstruct it along those lines." And this is why it ties so nicely into your question because one of the areas we looked at is this Healthcare REIT that we're building within the business.

So what we did is we took the business and we broke it down into four components, Commercial Real Estate business, the Healthcare Real Estate business, also known as a Healthcare REIT, a niche asset-based lending business, which is really what we have if you think about where we do asset-based lending it's in a very focused specialized manner. And then a cash flow lending business and there's lots of those comparables out there, these BDCs et cetera that are actually doing more junior capital than we are, but they're a reasonable comparison because we're in essentially the same sector financially in leveraged buy outs. And we looked at the comparative yield for this different kind of components and

we can give you the comparables that are in the group, we don't have it footnoted here but we have the information for those of you who are interested.

And then we took a look at our business and we looked at our kind of blended asset mix and our blended yields that come out of these businesses and we said "Well if we were just doing a sum of the parts here, and you took each of these businesses and you compared it to its kind of comparative yield and, on a blended basis, CapitalSource should have a 7% dividend yield, based on the 2006 dividend that we're paying." Yet we have a 7.9% dividend yield. So I started the discussion with a strong view that in financial services the whole is clearly worth more than the sum of the parts for all the reasons I've discussed and have come out throughout this presentation. Yet we're trading at a fairly significant discount.

And then secondly we're projected to grow that dividend 20%. And I think we've had a lot of discussion about how we feel very good about the 2.40 and we even had discussion about how the 2.40 is 2.40 is 2.40 to make the point. So I think I said earlier that there is some low hanging fruit here I think for shareholders. And I think it's just based on us doing a better job communicating what's on this page. That for a variety of reasons, which again we can go through and we already of have, that the whole is greater the sum of the parts and right now it's trading at a discount and guess what? No one on this page that we look to for this comparative yield, which is generally a basket of companies, has anywhere near the growth rate we're talking about.

So to some extent it's a double discount, right? It's a discount assuming we're growing like these companies are, which shouldn't exist, and then we're growing much faster. So I think it's a very significant discount and I think, again under the category of low hanging fruit, this is something we will work on from a shareholder's and investor relations point because I think it really is an important point and we owe it to our shareholders to explain this to people. So that's my own view of kind of the valuation of the businesses. And again, that kind of translates into a slide that many of you are familiar with where we compare ourselves to other dividend paying entities. And there's a variety of groups that we have listed on here, commercial mortgage REITs, diversified equity REITs, healthcare REITs and these BDC REITs.

And you can see on the page here we've looked at our current yield, which is the Y axis, and we've looked at our growth rate from '06 to '07. And again we're trading with the peer groups and as I just went through, I think we should trade much tighter than the peer group for all the reasons I discussed. Because most of these businesses again are monoline businesses. They don't have any of the benefits of diversified franchise, the ability to balance your business, to be a more predictable grower, to be more disciplined, to have a more stable funding platform. They don't have any of those advantages. So we should clearly trade tighter and we're projected to grow at a much faster rate. So this is really the investment pieces of CapitalSource fits I think now coupled with the prior page. So that's the main point of my wrap up.

So let me summarize by talking about our priorities. We will continue to balance the business. Again I spoke earlier about the benefits of this diversified franchise to the extent we identify opportunities that we think present similar risk adjusted returns and leverage our expertise, it makes sense for us to do that. Obtain deposit based funding, we're fairly direct

about this. We haven't been direct about exactly what course we'll pursue, obviously we have the IOC application still pending, we're optimistic that that will resolve itself in our favor. If it doesn't we have other alternatives that we will pursue and this is something that I plan on spending a fair amount of my time focusing on. This is a high priority for the company.

Continue to build our fee businesses, you saw one example of that today with Dan Duffy who talked about what he's doing, and there are a few similar opportunities going through our company. Deliver on guidance. Clearly we feel very comfortable in our at least 2.40 guidance for next year and we think the lowering of the payout ratio certainly supports that notion. We think this market may dislocate and we're starting to see a little bit of that, and we could be opportunistic and that could actually drive some increased asset growth which I think, if its good asset growth, would clearly be good. And then as I said, we need to information investors of the value proposition of the company.

And to kind of go back to something I said earlier, we hope you leave here today sharing our sense of optimism and enthusiasm for this company, which the management team has and the Board has. And we own a lot of the companies who are very focused on doing the right thing and, as I said, to me achieving significant success in financial services is generally about two things, one execution, and we are a very execution focused business. We really focus on the details, we know what we have to do day in and day out and I hope that came across today. That's very important to this business.

This is a grind it out business, as I said. And secondly, continuing to execute against what I believe is a superior business model because of the balance that we have in the platform, because of our focus, because of this origination platform that we've built, because of our credit and investment culture and the superior financial model. And that's why I believe this is a singular business and we're very optimistic about our future.

So that's the wrap up, and as we said earlier, we're serving cocktails and dinner for those of you who can stay. For those of you who can't, thank you very much for coming.