MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the CapitalSource First Quarter 2010 Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Dennis Oakes, Senior Vice President of Investor Relations. Please go ahead, sir.

Dennis Oakes, Senior Vice President, Investor Relations

Thank you, Andrea. Good morning and thank you for joining the CapitalSource first quarter of 2010 earnings call. Joining me this morning are John Delaney, our Executive Chairman; Co-Chief Executive Officers, Jim Pieczynski and Steve Museles; and Don Cole, our Chief Financial Officer.

This call is being webcast live on our website and a recording will be available beginning at approximately 12:00 noon Eastern Time today. Our earnings press release and website provide details on accessing the archived call. We have posted a presentation with slides on our website this morning that provides additional detail on certain topics which will be referred to during our prepared remarks.

Investors are urged to read the forward-looking statements language in our earnings release, but essentially it says statements made on this call which are not historical facts may be deemed forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All forward-looking statements, including statements regarding future financial operating results, involve risks, uncertainties and contingencies, many of which are beyond the control of CapitalSource and which may cause actual results to differ materially from anticipated results. And CapitalSource is under no obligation to update or alter our forward-looking statements, whether as a result of new information, future events or otherwise, and we expressly disclaim any obligation to do so. More detailed information about risk factors can be found in our reports filed with the SEC.

John is first off this morning. John?

John K. Delaney, Founder, Executive Chairman and Chairman

Thank you, Dennis, and good morning, everyone. Since we last spoke in February, we have made further progress on our conversion to a bank model which includes strong loan margins, a proven nationwide commercial lending platform, and substantial capital combined with a stable deposit base to grow our business.

Specifically, over the past several months, we have accomplished the following. We reinvigorated our origination engine and funded nearly $0.25 billion of high quality loans in CapitalSource Bank during the first quarter. This represents our highest originations quarter in over a year.

To complement our proven specialty lending businesses in healthcare, security, technology, lender finance and other niche areas, we added two new origination platforms, equipment finance and SBA lending, which positions us to continue this quarter's new loan growth momentum throughout 2010.

We have continued to work through and aggressively manage the credit challenges in our legacy loan book with a goal of resolving those issues quickly and prudently. As a result of the shrinking

parent portfolio and loan growth at CapitalSource Bank, our bank statement is for the first time larger than our parent, Other Commercial Finance segment, as measured by total assets.

Because we have substantially paid down parent company debt while maintaining sufficient liquidity, we're now able to explore several alternatives for dealing with our longer-term debt maturities.

Our first quarter results reflect these accomplishments, but commercial real estate credit performance in our legacy loan portfolio once again caused pre-tax losses for the company. As you know, we have provided a detailed view of the expected losses in our legacy loan portfolio in 10 separate categories for the past three quarters.

After concluding the process of setting our reserves for the first quarter, which took us somewhat above the top end of our cumulative loss estimates, we believe the current level of reserves should be sufficient to cover all anticipated losses over the remaining life of those legacy portfolio loans. As Don will describe, a substantial portion of the reserves in the quarter were for loans in our 2006-A securitizations, where we are required to continue reserving beyond our junior economic interest in the transaction.

One word of caution is necessary, however. The reserving process requires a high degree of judgment, but relies on historical data to support its conclusions. It is nearly certain, therefore, that we will continue to replenish some amount of reserves against the legacy portfolio throughout 2010 until we see sustained signs of stabilization. Assuming our expectations about the ultimate level of charge-offs are correct, however, those additional reserves will later be released.

Before turning the call over to Jim, I would like to provide our high-level perspective on current economic conditions and how CapitalSource Bank is poised to take advantage of improving markets. We believe our bank is extremely well positioned as a regional depository with a national lending franchise to thrive over the next several years, where there is a growing consensus that banks will face a significant asset gap.

Our macro view of the economy is based largely on observations of the financial health and business activity of our borrowers, who represent a good cross-section of many economic sectors. I would characterize our current view of the economy as constructive, which is far better than the very negative and pessimistic orientation we had in the past.

We feel CapitalSource Bank is particularly well positioned to manage through a period where high quality assets will be scarce, and the extensive and diverse lending expertise of our origination teams will be a relatively rare commodity. Much of our business has always been transaction oriented, so we made more loans when businesses were growing and expanding. We saw very little of such activity during 2008 and most of 2009, but did notice a clear and measurable uptick in the latter part of last year and increasing levels of activity in the first few months of 2010.

Our recent addition of mid-ticket equipment finance and small business lending, when added to these existing transactional platforms, meaningfully strengthened our lending capacity and positions us to achieve the growth targets we have set for 2010 and beyond. In contrast, most regional banks have historically focused their lending on real estate and do not have the personnel, the expertise, the geographic footprint to make sufficient level of non real estate loans to generate attractive ROEs. That is the asset gap I referred to a moment ago.

Jim and Steve have been spending a considerable amount of time since the beginning of the year making sure our team of asset originators is properly focused, appropriately staffed, and devoting the right time and resources to the area of greatest opportunity for loan growth. As Jim will discuss in a moment, it is becoming more evident with each passing month that we have made substantial progress in restarting our growth engine. Jim?

James J. Pieczynski, Co-Chief Executive Officer

Thanks, John, and good morning to everyone. I'm pleased to report that we are happy with both our volume of new loans that we funded at the bank in the first quarter along with the composition of those loans.

As we have outlined on several occasions, our intention is to focus loan origination most heavily in areas of our historic strength such as healthcare, technology, security and lender finance. We now have 12 origination platforms, including our recently added equipment finance team, in addition to our small balance lending team, which further increases our capacity to reach our projected growth target.

For the first quarter, with regard to the mix of the new business, nearly 50% were healthcare related loans, which included asset based, cash flow and healthcare real estate loans.

Our corporate asset finance group, which started with us at the beginning of February, also closed its first set of loans this quarter which totaled $30 million. In addition to that, when we take the asset based loans made by this group along with the loans made by our security lending group, that represented roughly 30% of our 243 million of total originations for the quarter. In addition, we have our multi-family lending platform, which is another new product, that represented 15% of our originations. And we had two lender financed loans close during the quarter, which accounted for the balance.

As I said on our last earnings call, we firmly believe that our several areas of specialty lending provide a competitive advantage compared to most other regional banks. The loans we have made over the years in healthcare, security, technology and lender finance were closed by teams that know those industries well and have deep contacts which are critical to their sustained success.

In a similar vein, we are confident that the addition of the experienced and accomplished corporate asset finance team in addition to the small business lending team to our national platform will serve us well and be a source of strength for new originations. As indicated, when we recently announced the acquisition of a small business lending platform, George Harrop and his colleagues have a long and successful track record of originating SBA loans. They are already working out of our offices around the country and have even closed their first loans.

In addition to a new area of asset generation for CapitalSource, small business lending is particularly attractive in the bank because of the current 90% federal guarantee which allows us to post significantly lower risk-based capital. A federally-guaranteed SBA loan that we make in whole requires only 4.2% of risk-based capital in the bank rather than the usual 15% risk-based capital that we are required to post for a traditional commercial loan.

As John mentioned, we are definitely seeing greater levels of economic activity and improving confidence among our borrowers. Though the total of new loans closed and funded in the first three months of the year was at the bottom end of our projected range, that level of production was higher than any quarter in 2009. We remain comfortable, therefore, with our 2010 expectation of funded loan growth of 250 to $350 million per quarter, and we expect future quarters for this year to be at the midpoint or high end of that range. In fact for the month of April, we are already clearly ahead of the target relative to where we were in the first quarter of this year.

For the loans that we closed in the quarter, the average all-in contractual yield was 8.35%, which was above our initially expected range of 7.5%. We do, however, believe that margins will tighten somewhat throughout the course of the year, and we are expecting our 2010 yield to ultimately

average in the 7.5% range with coupons ranging from 5 to 600 basis points on top of LIBOR floors averaging 1.5 to 2%.

There was also a very modest pickup in loan prepayments in the quarter. Though adding only slightly to our loan yield via discount accretion, it is a positive sign of economic recovery to see loans prepayments beginning again. As we anticipate ongoing economic improvement throughout the year, we would also expect to return to more normalized prepayment levels over time.

I'll now turn the call over to Steve who can provide an in-depth look at the first quarter performance at CapitalSource Bank. Steve?

Steven A. Museles, Co-Chief Executive Officer

Thanks, Jim. Good morning, everyone. The first quarter was a solid one for CapitalSource Bank despite continuing credit issues on commercial real estate loans purchased when the bank was formed from the parent's legacy loan portfolio. As Jim described, our originations engine is beginning to rev up as the economy improves and our borrowers have a greater appetite for growth. We are showing progress on most major pre-provision metrics, which will influence both the short and long-term profitability of the bank.

In addition to healthy loan yields, we continue to drive down our average cost of funds, which declined to approximately 1.5% in the quarter. Even though we are successfully executing our strategy of extending the average duration of our CDs while reducing average interest costs, we still saw net deposit growth in the first quarter. We attribute this deposit inflow, compared to monthly outflows throughout most of 2009, to competitive market dynamics since we've generally lowered our CD offering rates while boosting total CD retention to nearly 90%.

Essentially, pricing for deposits in the Southern California market has become significantly less competitive than it was 6 to 18 months ago when a number of banks, which ultimately went out of business, were attempting to attract deposits with above market rates.

Over the past several months, we have made a concerted effort to shift a higher portion of new CDs into terms of 12 months or longer. We succeeded, as evidenced by the extended duration of our book of CDs from 5.6 months at the end of last year to 7 months at the end of the first quarter. Though the current weighted averaged term of new and renewing CDs continues to be about 12 months, we are now reducing our emphasis on longer-term CDs consistent with market expectations of a continuing low interest rate environment. We are also targeting flat deposits for at least the next two quarters as a result of continued client reductions and offering rates.

Our net finance margin remains a very respectable 4.6%, and we believe there is a possibility of modest margin expansion through the balance of this year as we continue to redeploy lower yielding assets into higher yielding loans. The current level of non-performing loans, however, will act as a drag on our loan yield and likely offset the majority of benefits to be realized from asset redeployment.

Assuming low interest rates persist throughout 2010, we expect our cost of funds will remain well below 2% through the end of the year. Interest on loans and investments was up slightly in the quarter.

Pre-tax pre-provision earnings, which we view as an important indication of the bank's long-term earnings potential, were slightly ahead of the fourth quarter, excluding a 3 million gain on sale of loans and a 1.4 million additional discount accretion on the "A" Participation in the prior quarter. Today's balance on the "A" Participation is approximately 250 million. And given our expectation

that it will be paid off over the next several months, the bank's income statement will soon no longer reflect the quarterly volatility associated with this discount accretion.

Our capital levels remain very strong at quarter's end with a risk-based capital ratio of 17.35%.

Turning now to credit, delinquencies and charge-offs declined while reserves and non-accruals increased. Most of the credit charges and new non-accruals in the quarter related to legacy commercial real estate. Specifically, there were only two small loans 30 to 89-days delinquent in the bank at March 31, and 90-plus day delinquencies were down about 40% from the prior quarter.

Charge-offs declined by 25% to 18 million, while provision for loan losses increased from 49 million in the fourth quarter to 88 million this quarter. We, therefore, added a net of 70 million to the bank's total allowance for loan losses this quarter, driven primarily by three CRE loans. Excluding the "A" Participation, our ALLL now stands at 222 million, or 6.9% of loans, which is a very healthy level when compared to the year-end 2009 industry average of 3.1% as recorded in the FDIC Quarterly Banking Profile.

We also had a substantial uptick in non-accrual loans. But the increase relates primarily to two hotel properties, one recently opened in Portland, Oregon, and one scheduled to open this fall in New York City. Neither is delinquent, but new property appraisals, which came in with valuations below our fully funded loan amounts, caused us to take additional specific reserves of 36 million, and put both loans totaling 157 million on non-accrual.

When loans are placed on non-accrual, our asset yield is negatively affected. The impact was 44 basis points in the first quarter. To the extent we collect additional amounts on non-accrual and other impaired loans, we will record a reduction in loan balance rather than interest income. So these higher non-accrual levels are also currently depressing pre-provision income.

As we close in on the completion of our second year of operations, we have a first class leadership team in place at CapitalSource Bank, and continue to maintain an excellent working relationship with our regulators. We expect 2010 will be a solid year for the bank, including net loan growth and quarterly after-tax profitability by year-end.

Before turning the call over to Don, I'd like to provide a quick update on consolidated operating expenses which were down modestly in the first quarter. Since assuming our Co-CEO roles at the beginning of the year, Jim and I've spent a considerable amount of time focused on the steps necessary to reduce our OpEx. The decline in the first quarter reflects some early savings from our dedicated effort to reduce third-party fees, as well as a favorable comparison to some increases in the fourth quarter of last year for compensation and benefits largely related to separation agreements for departing senior executives.

We estimate there will be meaningful reductions in professional fees related to the legacy loan portfolio as these loans continue to run off and credit issues are resolved over the next 12 to 24 months. There should be little if any incremental expense associated with achieving our loan growth targets, as the existing organization is highly scalable and capable of originating loans at a much higher level than our production over the past two-plus years. We will, however, see a small bump-up in second quarter compensation expenses reflecting the SBA lending group, which joined the company last month, and a full quarter of the corporate asset finance team.

Don's up next. He'll review our first quarter financial performance on a consolidated basis, with a particular focus on several balance sheet items. He will also drill down a bit on credit performance. Don?

Donald F. Cole, Chief Financial Officer

Thank you, Steve, and good morning. As consistent with other recent quarters, our overall financial results this quarter were negatively impacted by credit charges largely related to our legacy commercial real estate portfolio. Consolidated quarterly commercial loan charge-offs were down by about 38% from the fourth quarter, and provisions were roughly 16% lower. Of our total charge-off amount of $119.4 million, 62% was related to legacy commercial real estate loans. Those CRE charge-offs were largely concentrated in six loans, three of which were land loans.

Similarly, three-fourths of the quarterly provision of $219 million was related to commercial real estate. Two cash flow loans, one traditional media loan, and one general cash flow loan accounted for an additional 17% of the first quarter charge-offs.

The remaining 84 commercial real estate loans in our legacy loan portfolio now total $1.25 billion, which is 18% of the legacy portfolio. Only 35 loans totaling less than $580 million are land or second lien. We are holding specific and general reserves against those loans of $168 million, which represents 29% of the current net balance, and a total of $118 million or 18% against the other commercial real estate loans in the legacy portfolio. One-half of all legacy CRE loans by dollar amount have an established specific reserve.

Our analysis of future expected losses on our legacy portfolio suggest that quarterly reserves should decline throughout 2010. The methodology we follow to estimate our reserve levels, however, will impact how quickly those amounts do decline. The reserving involves a judgment of future losses inherent in the portfolio. It is supported largely by recent history.

Consequently, given the level of charge-offs and non-performing assets we've experienced in the previous six quarters, reserve levels against the legacy portfolio will most likely remain elevated for the balance of this year. Additional charge-offs taken during 2010 will necessarily lead to some further provisions recorded on the income statement. Of course, if our present cumulative charge-off assumptions are correct, as we believe they are, those additional reserves will be reversed at a future date.

When analyzing the forecasted remaining charge-off levels for the legacy portfolio, it is important to remember that 879 million in charge-offs have already been taken against the original $8.7 billion legacy portfolio. That equates to an already charged-off level of 10.1%. It is also instructive to note that nearly $2.9 billion, or roughly 39%, of the remaining $7.4 billion legacy loans are in healthcare, security, technology, resort and timeshare which have experienced very few losses.

On a consolidated basis, the various first quarter credit statistics were fairly stable as compared to the prior quarter. Slide 23 of our investor presentation provides detail on these metrics. As indicated, both short-term and 90-plus day delinquencies were down slightly. Non-accruals were up by $73 million, but that increase was largely attributable to the two real estate loans held in the bank, which Steve discussed.

Turning now to other aspects of the quarter, our period-end liquidity at the parent company was $282 million in available cash. We view this as an adequate level, especially with no significant expected uses of cash in the second quarter, and a reasonable expectation that the Omega Step 2 and Step 3 transactions will close over the next 60 days.

As announced recently, Omega has given us notice of its intention to exercise its option to purchase the Step 3 assets, and only approval by the U.S. Department of Housing and Urban Development for Omega to assume HUD mortgages on the Step 2 properties remains for that transaction to close.

Our quarter-ending cash level is net of significant debt repayments during the first quarter, including approximately $100 million to reduce principal balances under the syndicated bank facility and the open market purchase of approximately $19 million of our 4% convertible debentures. The quarter-ending principal balance of the syndicated bank facility was thereby reduced to approximately $150 million, and there are no remaining scheduled debt maturities or step-down payments during the balance of 2010.

As usual, unfunded commitments were a non-event in the quarter, that is, net draws were flat, and our level of unfunded commitments at the parent declined by $181 million to approximately 1.7 billion. That is down from approximately 3 billion at the end of 2008.

We do have a multi-currency denominated credit facility for our European loans which matures at the end of this month, but we are well into the renewal process which we expect to be completed within the next few weeks.

In addition to the reduction on the syndicated bank facility commitment, we paid down approximately $35 million of other bank credit facility debt and 276 million of securitization debt through loan and collateral payments during the quarter.

As we have discussed previously, during 2009 we established a valuation allowance related to our deferred tax assets which increased to $477 million or nearly $1.50 per share at the end of the first quarter. The valuation allowance is a non cash accounting charge that will exist until there is sufficient positive evidence to support its reduction or reversal. Such evidence would include a period of positive free tax income for those entities for which an allowance has been established. The allowance does not reflect any limitations in the tax code that would prevent us from using these deductions in future years.

Before turning the call back to John, I want to touch on two other items we mentioned on our fourth quarter call. First, we are continuing to explore our options for raising the cash needed to redeem the remaining 311 million of convertible bonds putable in July of 2011. With ongoing improvements in the credit markets, we remain confident we can identify and execute a plan that avoids or substantially minimizes any dilution of our equity-holders and does so at a reasonable cost. In addition to the prospect of raising additional debt, we are looking carefully at our ability to generate the needed cash internally.

The other item I want to touch on relates to the loan loss reserve levels in our term debt securitizations. As you may recall, roughly half of our legacy loans are financed in six non recourse securitizations, which means our economic losses are limited to the equity we own in each.

Because these securitizations are on balance sheet, however, we are required by accounting rules to apply our reserve and charge-off methodology to the entire loan balance, even if that results in marks over and above our junior economic interest as is the case with 2006-A. That securitization includes approximately $500 million of commercial real estate loans, and we are now effectively reserved approximately $80 million above our most subordinate economic interest and some other junior tranches of debt in that securitization we purchased.

Slide 30 of our investor presentation shows the level of junior equity in each of our securitizations, though 2006-A is the only one so far where we have reserved more than our economic interest. Such recognized losses in excess of our economic exposure will be recaptured into earnings at some point through losses on the outstanding debt, the release of reserves, or a gain in the event these assets cease to be consolidated on our balance sheet. Though our economic loss is limited, we continue to service these assets to achieve the maximum return for the debt investors and on our own ownership interest.

John will now provide some closing comments and then we will be ready for questions. John?

John K. Delaney, Founder, Executive Chairman and Chairman

Thanks, Don. In closing, I would like to remind everyone listening of the substantial progress we have made over the past two years, allowing us to weather the economic storm and position CapitalSource for success as the economy recovers and business activity picks up. Six initiatives we have undertaken will be fundamental to our future success.

First and foremost is the formation of CapitalSource Bank, which is nearing its two-year anniversary. We have a very well run bank with substantial earning power, healthy margins, a reliable deposit base, and the CapitalSource national direct origination team to source high quality loans.

Secondly, we have paid down a meaningful portion of our debt and extended maturities for most of the bank lines into 2012, which we estimate is sufficient for the loans to self-pay based on collateral payments.

Third, we've dramatically improved our liquidity profile last year, particularly with the monetization of our net lease asset portfolio. The final steps of that effort will be completed this year further bolstering our liquidity. We are now well positioned with no major liquidity events facing us until 2011 when the next tranche of converts is putable.

Next, we have dealt in a straight and open manner with respect to credit issues in our legacy loan portfolio.

Fifth, we have restarted the company's growth engine, and supplemented our asset generation capacity with the addition of experienced teams in equipment finance and small business lending. Our net funded loan growth in the first quarter was above 2009 levels and we expect further growth throughout 2010.

And finally, we have restructured the senior management team to form an office of the Chairman, where Co-CEO Steve and Jim have joined me. To be certain, we have the capacity to effectively and efficiently execute our going forward strategies.

As we look ahead, we see our principal strategic objectives as growing assets and increasing profitability at CapitalSource Bank, managing the credit performance of our legacy loan portfolio to minimize losses at both the parent and in the bank, further reducing credit charges and operating expenses in order to return the consolidated entity to profitability, and developing and executing on a plan to redeem the convertible bonds putable in July of 2011.

I want to thank all of my colleagues at CapitalSource for their incredible hard work and dedication over the past 24 months as we worked through these various initiatives, which has brought us to this point where we are very enthusiastic about the opportunities in front of the company.

Operator, we are now ready for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Our first question is from Sameer Gokhale of Keefe, Bruyette & Woods. Please go ahead.

<Q – Sameer Gokhale>: Hi, thank you. Just first a question about the cumulative credit loss chart on page 26. Do you have an estimate now for where that cumulative loss number, I believe it's 17.7% now, where you expect that to come out? Because I'm trying to reconcile that to the slide on the previous page and, John, your comments about provisioning largely being done with at this point.

Because it seems like wherever you expect cumulative loss rate to eventually end up, that's the amount of remaining provisions you probably still have to take in your portfolio. And again when I look at the $44 million at the high-end, it's a negative, is that the expected remaining charge-offs that you now expect from your portfolio? So some color on that would be helpful.

<A – John Delaney>: Sure, I'll start, then I'll let Don chime in. It's our view that cumulative losses in the legacy portfolio, right, have been now fully reserved for. That's the specific kind of answer to the question. How the reserve methodology plays out and how the charge-offs play out across the next several years is consistent with what I described in my comments. But we have a view that the legacy loan portfolio is now fully reserved for.

Because so many of the assets are on our balance sheet that we actually have a negative economic interest, that actually obviously informs that answer. But in terms of the amount of reserves we have now as it relates to our cumulative kind of economic loss in these assets, we feel we have sufficient reserves.

<A – Donald Cole>: Yes. And I agree with that and, Sameer, you mentioned additional charge-offs. Obviously, on the slide on page 25, it shows remaining charge-offs up to $610 million that are left to take in terms of charge-offs. But in terms of the legacy portfolio income statement hit, sort of we think we've taken the aggregate amount that's necessary to take. And as we've tried to indicate over time, just based on the methodology of projecting reserves, we might overshoot a little bit and then ultimately come back.

<Q – Sameer Gokhale>: Okay. No, I mean, what I was trying to really just get a sense for was the commentary about provisioning. It seems like it was taken into account the fact that you have a difference between the way you account for this stuff on a GAAP basis and your economic interest. And sounds like when you're talking about your provisions, you're talking about over a period of time the fact that some of your assets you've, in effect, over-reserved for because – over and beyond your economic interest – and you seem to be taking that into account.

And I was trying to look at more from just a simplistic GAAP perspective. So that's what I was trying to get a sense for. It sounds like you've factored in the economic limit on your provisioning into your numbers. So that's what I wanted to clarify.

<A – John Delaney>: Yes. So the difference between GAAP and our economic interest provides, what I would consider to be, an enhanced level of cushion in our ability to make that statement, right? The data that we've looked at would indicate that we are fully reserved, even ex the fact that we get the benefit of kind of recapturing kind of economic interest, if you will. But the fact that those reserves are – those losses are effectively ring-fenced on those assets, provides us or puts us in a position to be even more comfortable making the statement.

So let me try to summarize that in a more concise way. We think the data indicates that we're fully reserved on a GAAP basis assuming all the loans stay consolidated. When you add to that the fact that we don't – we've reserved beyond our economic interest in many of these loans and we expect

to recapture that, that obviously makes us even more comfortable making the statement we made. It's how I would – I don't know, Don, if you would --.

<A – Donald Cole>: No, I'd agree with that.

<Q – Sameer Gokhale>: Yes, that certainly helps to clarify. The other question I had was, if I recall correctly, your previous guidance was for a return to profitability by Q1 or Q2. So now are we expecting Q2 to be a profitable quarter at this point from what you can see, or would you expect that or feel more comfortable that the thing's going to be more a Q3/Q4 event?

<A – John Delaney>: Well, a lot of it comes down to what we just discussed. So go over the point we just made, which is we think on a GAAP basis, we've fully reserved for cumulative losses based on the data we've done. Which, by the way, is typically a higher standard than GAAP because cumulative losses take multiple years to play out and we think we have sufficient reserves. And as I said, it's the fact that many of the losses are ring-fenced; and in fact, we have kind of a negative economic interest in certain of these assets at this point, which we expect to recapture, makes us comfortable making that statement.

When we can actually translate that view, right, into the accounting reality of the business will determine when we flip back to profitability. Might that happen in the second quarter? Perhaps. Might that be the third quarter? Perhaps. I think the most important point is the first part of the statement I made. Obviously, we would like that to tip back as soon as possible, including the second quarter.

I don't know, Don, if you would ...?

<A – Donald Cole>: Yes. And I would say based on that and based on our view, we still believe there will be a profitable quarter in 2010.

<Q – Sameer Gokhale>: Okay. And then just my last question was, any sense on – I know, it's still a little early – but any sense for exposure to this oil spill and loans made in the Gulf Coast, any sense for that at this point?

<A – John Delaney>: No. Well, we have some sense. Nothing has bubbled up from the portfolio kind of related to that. We did have a loan – there was a problem loan actually that did have some exposure to, kind of call it, repair work on oil rigs. But that was already a problem situation and is not likely to be exacerbated by this situation. But nothing has bubbled up from the portfolio that would indicate any issues there.

<Q – Sameer Gokhale>: Okay, thank you.

Operator: Our next question comes from Don Fandetti with Citigroup. Please go ahead.

<Q – Donald Fandetti>: Hey, just want to follow-up. I think, Don or John, you had mentioned that there were two hotel loans that are now on non-performing. I wanted to confirm, are those both in the bank? And then can you talk a little bit on where the valuations came in versus the loan balance?

<A – John Delaney>: I'll start and say yes. One is fully in the bank, the other is partly in the bank and partly in the parent, but I think the majority of the other one is in the bank.

And then valuations on an appraised basis, they can move around a lot. I think the one loan that's 100% in the bank, the valuation was somewhere in the 60% range. And I'll let other people sort of look up the data as they bring it up.

And the other one was a higher level of valuation, but it's a little bit more complicated because it's a loan that's not – the building is not yet complete. So the appraisal is based on an as-completed-stabilized basis, and then we figure out how much we have to fund before we determine how much reserve we're going to take. And the reserve on that against our ultimate funding level was something closer in the 10 to 15% range.

<Q – Donald Fandetti>: Okay. And then on the land, from your presentation, it looks like about 13 of the 15 loans are non-performing. I was just curious if you could talk about the 2 that are not, they look like they're relatively large?

<A – John Delaney>: Yes. The two that are not are Manhattan-based assets where the sponsor and the developer have continued to make substantial progress on their strategy, which has involved them putting and committing substantial additional investments into the projects. So those two remain on performing status, because of the – not only the kind of the obvious features of the loans, they're current, no defaults, et cetera. The appraisals thus far have supported the valuation of the assets.

The sponsors and the developer continues to make progress against their business plan, and the sponsor and the developer continues to commit additional capital to the projects. So those fact sets are very different than the other land exposure that we've had, where kind of almost none of the things I just mentioned have occurred.

<Q – Donald Fandetti>: Okay, thank you.

Operator: Our next question is from Bob Napoli of Piper Jaffray. Please go ahead.

<Q – Robert Napoli>: Good morning. Questions on page 30, I guess, on the securitizations, non-recourse. And just trying to – the 80 million reserve, trying to follow through where that – how I understand the equity, the actual equity you have in the securitization. How do you get to the 80 million on the 2006-A that's recoverable, or that you reserved above your equity?

<A – Donald Cole>: So sure, I'll walk through it. It gets a little bit complicated. As we do this calculation, we show the total assets and total debt of these entities and then compare what's net of that, which is effectively the junior GAAP equity if you will against our reserves, and that shows this $138 million --.

<Q – Robert Napoli>: Right.

<A – Donald Cole>: -- negative amount. So if you then assume that $138 million negative amount is going to be applied to the most junior debt tranches and work you away from the bottom up, we hold approximately 61 million of that portion of the debt classes, because we bought some of these back during 2008. So then the net of the two is 77, $78 million, and that's where the approximately 80 comes from.

<Q – Robert Napoli>: Okay. And do you expect – what progress have you made on being – I guess, what you need to do to deconsolidate is to sell the servicing. And are you looking at – I mean, is that something you believe you'll accomplish in the next few months? And is there any other securitization other than 2006-A where you're looking to sell the servicing?

<A – John Delaney>: So what we discussed earlier, Bob, is this kind of notion of when we can start using obviously the very significant general reserves that we have in the portfolio against charge-offs as they occur. And clearly, to the extent that we find ourselves in a position where the math indicates we even have more reserves as a percentage of assets, which would impact happen if these assets were to be consolidated, that would be something we would like to have happen.

I'll let Don discuss kind of the deconsolidation strategy and issues associated with it, but I think it's fair to say that most people would view the deconsolidation of these assets as a very good outcome. Don, why don't you talk about how that --?

<A – Donald Cole>: Sure. And obviously, consolidation of assets on balance sheet is a sort of hot topic in the accounting world, and the rules have recently changed somewhat at the beginning of this year and leading to more people to consolidate more assets rather than less. So first of all, it's kind of a complicated accounting analysis in determining exactly what steps or what circumstances would lead to assets not being consolidated. It's something that takes a lot of analysis that we're working on.

So at a minimum, things to consider are servicing, economic interest et cetera. So we want to make sure that, a, we understand fully what leads to consolidation and/or deconsolidation, and then secondly, what affects us from an economic perspective, which obviously just if it's purely a deconsolidation exercise is limited.

What I will say is, our effort here was to point out what that will ultimately result in, which is sort of the net equity position of this, so that people can understand it. Whether or not we actually achieve it, they can understand how much sort of off-balance sheet asset, if you will, exists because of this reserving above our junior economic interest.

So what I will say is, obviously, as we service these assets, we're obviously focused on getting the best return on the assets, as I indicated in my remarks, because we are servicing them on behalf of investors. And that won't change as part of whatever our ongoing interest is in these loans.

<Q – Robert Napoli>: Okay. Question on the – I guess, talking about reserves, it sounds like you expect balance sheet reserve dollars to decline from here. I wasn't sure if that was just outside the bank or on a consolidated basis?

<A – Donald Cole>: I think our statement would be on a consolidated basis. Obviously, the bank is growing as a sort of percentage of the total balance sheet. So as this loan book grows, it will put on some level of reserves, although not significant level of reserves on our new loans. So I think we're focused on the level of reserves kind of coming down from here on a consolidated basis more than sort of separating the two.

<Q – Robert Napoli>: And last question, the non-legacy assets. What ex-charge-off expectations do you have? And what reserve levels do you expect to apply against the non-legacy assets, the new assets if you will?

<A – John Delaney>: I mean, thus far the non-legacy assets are performing very, very well. And I don't think at this point we're comfortable kind of breaking out. We obviously have reserves allocated to those loans, and as we make those loans we continue to provision for them. The amount we're provisioning for those loans relative to the amount of reserves on our books, I would describe as inconsequential because of how well those loans are performing et cetera.

So if you look historically, the reserve loans for the company kind of pre-crisis times were 1 to 1.5%. That's not a bad place to focus, I think, for how to think about non-legacy loans. But at this point, Don, I don't think we're being that specific.

<A – Donald Cole>: So, I don't think we have a specific number Jeff, but I'll add one more point to yours which highlights it a little bit. I mean, as we talked about originations in the first quarter in that $250 million, I think as Jim ticked off those loans, it was not concentrated in any of the areas where we've had the significant issues. There were no CRE loans, no land, no second lien real estate, no

media, and no sort of general cash flow loans. All the originations were in asset classes where we've had significantly better performance.

And so as you think about that, reserves are sort of a function of two things: the asset class and the risk rating. These are fairly new loans, very well risk-rated. There will be some eventual seasoning, obviously, and some downgrades. But because of the classes they're in, I would say now the reserves are at the low end of the ranges John indicated and will creep up slightly, but the asset classes are such that the reserves should be very sort of minimal on those asset types.

<Q – Robert Napoli>: Thank you.

Operator: Our next question is from Mike Taiano of Sandler O'Neill. Please go ahead.

<Q – Michael Taiano>: Good morning. Just a follow-up on the questions around credit. So do you expect on a consolidated basis to release reserves over the course of the remainder of the year?

<A – John Delaney>: Well, I mean, under the answer of "what does release mean," I mean we expect reserves to come down because we expect that some of the charge-offs for the remainder of the year will be loans that we've already reserved for. So I'd say we expect their levels of reserves to come down.

If we view release as meaning having a negative provision, I don't believe we forecast that for 2010. We think levels of provisions will come down and levels of reserves will come down, but I wouldn't say we would see provision contributing to income during 2010.

<Q – Michael Taiano>: Right. No, I mean relative to charge-off levels.

<A – John Delaney>: So I would say yes. So obviously, for absolute reserve levels to come down, then the provision relative to charge-off levels would be less.

<Q – Michael Taiano>: Right.

<A – John Delaney>: I mean, this really comes down to in some ways kind of a – it's very simplistic at some level. How it works through the accounting is more complicated, which is when we determine we have sufficient reserves, then as we have charge-offs, we simply charge them against existing reserves effectively. It doesn't quite run that way through the accounting world, but that's effectively how most people look at the world, which is we have charge-offs and we provision for those expected charge-offs, and as the charge-offs occur, the reserves go down.

I think the notion of when we are releasing reserves above whatever the charge-off amounts are, that's something that could happen. It would be significantly in the future because you'd certainly want to feel and have substantial evidence to suggest that you in fact have excess reserves above what you expect future charge-offs to be. I think we're more focused on being very comfortable and being able to act accordingly that our reserves are sufficient for future charge-offs as opposed to in excess of future charge-offs.

<Q – Michael Taiano>: Okay. And I guess just to ask another way. I mean, do you expect your provision going forward to be more heavily skewed towards your new originations relative to your legacy portfolio?

<A – John Delaney>: It depends on the level of the originations, obviously. So --.

<A – Donald Cole>: And then type.

<A – John Delaney>: Right.

<A – Donald Cole>: I mean, there so many things that move around in that. Again I would say, again based on the math that we just discussed, the answer is obviously yes, because over time that level of new originations will continue to overcome the sort of size of the legacy portfolio.

<Q – Michael Taiano>: Okay. And then a separate question. On the healthcare facilities that you're closing with Omega, are there going to be markups on those? Because I think initially when you announced it, you said that you had to mark some down and then the way the accounting worked. Is that right?

<A – John Delaney>: Yes. So I believe there is a bit of a gain in the second quarter on those assets. And I don't have that number in front of me, so I don't want to guess what it is, but my recollections is it's a 10 to $20 million gain on when those assets actually close.

<Q – Michael Taiano>: Okay. And then just lastly on the SBA acquisition. I mean, can you give us some sort of sense – you talked about the fact that there is less capital required in the bank for those types of loans. I mean, if you could give us in terms of ROA or ROE that you would expect going forward in that business?

<A – James Pieczynski>: Well, from the bank perspective, obviously with the risk-based capital, there is a lower level of capital that's required to be posted with that given the fact that 90% of it is guaranteed. What that does, generally, is that's going to allow us to be able to charge a lower rate of interest than we would on our normal commercial lending assets. So based on that, I think when we look at kind of the ultimate ROE, the ultimate ROE is going to be probably similar to where we're at on our commercial loan book. And when that's all said and done, that is probably going to be in the low to mid-teens.

<Q – Michael Taiano>: Great.

<A – John Delaney>: After tax.

<A – James Pieczynski>: After tax.

<Q – Michael Taiano>: After tax. Okay, great. Thanks.

Operator: Our last question today comes from Scott Valentin of FBR. Please go ahead.

<Q – Scott Valentin>: Good morning and thanks for taking my question. I'm just trying to get a sense – it seems to me that maybe the guidance has changed a little bit regarding return to profitability. It sounded like, if I recall correctly with the fourth quarter earnings call, it was more a first quarter – seemed most likely by second quarter return to profitability; seems like that's changed a little bit, the timing is less certain. And was curious, one, if that's the case? And two, if that did happen, then what drove that? Is it more uncertainty with regard to credit?

<A – John Delaney>: I wouldn't say it's more uncertainty with regard to credit and I wouldn't say it's changed. I would say, having our view on cumulative losses translate into our kind of GAAP earnings and kind of reaching the point where those things intersect perfectly, is hard to predict.

So I think we've done a lot of work this quarter on being able to say with conviction that we think, based on the work we've done, that we are fully reserved for the cumulative losses in the legacy portfolio. As I said earlier, we think that's kind of true on a GAAP basis, and we think it's particularly true when you consider the fact that we've actually provisioned for loan losses beyond our economic interest in certain transactions.

Having said that, when that ultimately translates into our ability to start applying future charge-offs against reserves we already have on our books, is based on seeing certain signs of stabilization in the portfolio et cetera that is quite frankly difficult to predict. We'd obviously like that to occur in the first half of this year. There is reasons to believe it could occur in the first half of this year, and there is reasons to believe it could get pushed to the second half of the year.

So it may be a modest change in our view, not as it relates to what the ultimate losses will be and where we stand vis-à-vis provisions, but more in terms of when it actually translates into the GAAP financial statements. I don't know, Don, if you want to add anything to that.

<A – Donald Cole>: No, I'd agree with that. I mean I think, I don't have the words we said in front of me, but always thought we'd sort of focus on 2010 at some point, and there is a possibility of first half, which I think we never thought was first quarter. And I think I would echo John's sentiments that it's certainly possible for second quarter.

I think, absent credit, some of the improvements in margins and some of the improvements in OpEx, leave us encouraged that we're moving in that direction. And ultimately, the level of provisions in the first quarter sort of leads you down that path also as we view that a lot more has been taken now and, therefore, the amount later will be less.

So I still think we sort of view it as a 2010 thing. I think as we talked about it, it wasn't that there was going to be a quarter of bullish, bullish profitability. So it's a return to profitability, and so obviously it's probably a smaller or a lower profitability level than we've had in the past as we start back. So trying to forecast exactly when you sort of trip over to the green light, if you will, is – it can be a little bit of a challenge.

<Q – Scott Valentin>: Understood, and I appreciate the clarity. And then just, Don, a follow-up question on the deferred tax asset. How fast can that be reserved or captured back into income? Is that based on just level of profitability, the greater the profitability, one-for-one, you'd see DTA recapture?

<A – Donald Cole>: So I think that's sort of right for a period of time. So as we return to profitability, you won't effectively eliminate your reserve, but your DTA itself will come down. Therefore, your reserve will come down. So sort of on a net-net basis, you'll effectively have zero income tax even though you're profitable which will bring your allowance down. And then there's a point in time where you've established enough of a period of profitability where the whole thing sort of comes gushing back of whatever is left.

<Q – Scott Valentin>: Okay, thanks very much.

Operator: Thank you. Our last question comes from Bruce Harting of Barclays Capital.

<Q – Bruce Harting>: Is there any update you can give us on – and maybe I missed it – on the Fremont participation and negotiating with iStar? And I think the plan was that would probably amortize off or pay off by the end of the year. Any update there?

And then just to be very clear. So in theory, it's overly simplistic to say if they'll – can you just remind me the dollar size of the legacy portfolio as defined or the point in time before which it's legacy and after which it's new loans?

And then overly simplistic, if you're fully reserved, then on a go-forward basis, we should just be looking at a provision of 1.5 – although you didn't come out and say it, but you said the historical is 1 to 1.5% of new loans. So why is that overly simplistic in terms of looking at how to provision on a go-forward basis?

<A – John Delaney>: It's not overly simplistic. And I'll start with the iStar Participation and then I'll let Don give you some of the specific numbers. We certainly expect the iStar Participation to be paid down by the end of this year. And in fact, the rate of paydown has accelerated. Then we would expect that to be paid down certainly before the end of the year. It was 328 million at the end of the quarter and we continue to see good payments there. And we expect it to pay down in the normal course.

So I would describe the history of that as – for a while it was kind of, it slid the date of our expected paydown based on there being a lack of liquidity on the underlying assets. But recently, and when I say recently, really, in the last six months, there has been a meaningful uptick in the amount of liquidity that iStar has been able to generate against the underlying assets. And that has caused our expected paydown to get back to kind of where it originally was. So it wouldn't be unreasonable for that thing to be paid off by the third quarter.

<A – Donald Cole>: And as an added bit of color, I think we've said that the paydown in April was another 75 million. So we're down to about 250 at the end of April.

And then, on your other question about legacy portfolio, first the definitions. When we first sort of set this cumulative slide up, we defined the legacy portfolio as loans originated before June 30 of 2008, which was roughly the time that the bank started – so sort of pre-bank versus post-bank.

And then in terms of simplicity, obviously when John said 1 to 1.5%, we're talking about sort of reserve levels, obviously that's sort of a steady state on a clean portfolio. So when you're starting to put new loans on, you put on a little less. As those loans season, it grows. So ultimately as we get to the point of a steady state, it's not the wrong way to look at it. But there will be a little bit of sort of move up or down. Like in the early periods, it should be something less until you get sort of to a seasoned non-legacy portfolio.

<Q – Bruce Harting>: Okay, thank you.

Dennis Oakes, Senior Vice President, Investor Relations

All right. That concludes our call for today. Thanks, everybody, for listening.

Operator: Thank you for joining. You may now disconnect.