MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the CapitalSource Third 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. Please go ahead.

Dennis Oakes, Senior Vice President, Investor Relations

Thank you, Amy. Good morning and thank you for joining the CapitalSource earnings call for the third quarter of 2010. Joining me this morning are John Delaney, 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 release and website provide details on accessing the archived call. We have posted a presentation 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 carefully read the forward-looking statements language in our earnings release, but essentially it says that 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 with the SEC.

John will lead off the prepared portion of the call. John?

John K. Delaney, Founder, Executive Chairman and Chairman of the Board

Thank you, Dennis. Jim, Steve and Don will discuss the details of the quarter, but I wanted to focus my remarks this morning on the company's strategic direction, which is where I spend the majority of my time.

We continue to take the steps necessary to complete our transformation to a pure bank model. We have been at it for over two years, and while we're not quite a there yet, each passing quarter brings us closer to completion to what has been a very successful transition.

Returning to sustained profitability was dependent upon finishing the significant reserve build required for our pre-crisis legacy portfolio, particularly in our commercial real estate book. As we have stated previously, the credit performance in this portfolio has stabilized, and we expect the current level of loan loss reserves will be adequate to cover anticipated future charge-offs. The sub 40 million provision in both the last two quarters, after preceding seven quarters each averaged 220 million, is evidence of the stability we have worked so hard to achieve.

With the deconsolidation of the 2006-A securitization trust, we have accelerated the deleveraging of the Parent. For the first time this quarter, CapitalSource Bank has a loan balance greater than the

Parent, which we view as an important prerequisite for our bank holding company application. Achieving bank holding company status and converting to a commercial bank are key strategic objectives for 2011.

Paying down Parent company debt, simplifying our capital structure and turning the Parent legacy portfolio into cash over the next 24 to 36 months is another major strategic focus. Doing so will unlock substantial capital which can then be invested in the Bank or returned to shareholders, once certain debt obligations are met.

We can envision scenarios where opportunities for good risk-adjusted lending are abundant, in which case we will invest the parent capital in our Bank. Alternatively, the Bank may have more than adequate capital to pursue its opportunity set, in which case the excess capital will be returned to shareholders. In my judgment, the biggest variable in this analysis is the massive maturity wall from 2012 to 2014 in both corporate and real estate credit.

If the depth of the markets and the conditions of banks and insurance companies have not improved, our Bank would have extraordinary opportunities for smart, profitable loan growth. If on the other hand, the world is in a good place and liquidity is abundant, we will likely be returning substantial capital to shareholders. It is not clear as we sit here today if the corporate credit markets, which I would describe currently as normal, or the real estate credit markets, which I would characterize as just waking up, will be able to handle this maturity wall.

Utilizing our well proven national direct origination platform to grow assets at CapitalSource Bank is at the heart of our going-forward strategy. New loans funded in the past two quarters totaled nearly 850 million and exceeded the total for the previous four quarters combined, which is indicative of the success we are having as economic conditions slowly improve. Finally, we are ever mindful of the need to achieve efficiencies, both financial and operating, as we shrink the Parent and consolidate our operations within CapitalSource Bank.

I will now turn the call over to Jim, who will discuss our new loan originations in greater detail. Jim?

James J. Pieczynski, Co-Chief Executive Officer

Thank you, John, and good morning to everyone. We're happy with – we're very happy with the level of loan production again this quarter, which was slightly above the top end of our projected range. We are continuing to maintain strict underwriting discipline, but are also making new loans when other banks are struggling with the shortage of opportunities. We are able to do so because we have a national direct origination platform, diverse business lines and specialized expertise in areas such as healthcare, technology and security.

Our originations infrastructure is in place, but the good news is that despite the significant ramp up in our loan production over the past two quarters, we are not yet at full capacity. We've invested further this year in our national lending platform. And including the addition in recent months of our equipment finance, multifamily, small business and professional practice lending groups, we believe that up to one-third of originations will consistently come from these new business lines.

Our origination engine is fully built, well staffed and capable of increasing annual production without adding personnel for our 12 current business lines. We will continue to look for opportunities to acquire complementary business lines, however, where we can bring in entire teams of experienced professionals, as we did with the new groups this past year.

Our franchise is outperforming most other regional banks on the lending side, largely because our specialty lending platforms position us well to find opportunity in markets which have contracted significantly over the last few years and are now beginning to show modest signs of improvement.

We expect our deep industry contacts and knowledge in these specialized fields will continue to produce solid results. In fact, our asset platform is currently performing to its highest standard and our funding base is stronger than it has been in several years. Our diverse and niche-oriented national lending platform paired with our strong regional retail bank as a funding source gives us an important competitive advantage in our markets.

Looking specifically at the third quarter, new loans totaled 405 million of funded loans and were spread among most of our lending group. The largest production was healthcare real estate at nearly 30%, but multifamily, technology cash flow, corporate asset finance, and general real estate were each substantial contributors as well.

The professional practice lending group which we added this quarter, is now part of our general healthcare practice. They make what are effectively small-business loans, generally on the order of $1 million or less to finance the acquisition of dental, eye care and veterinary medical practices across the country. These loans are generally structured with full recourse to the physicians and are secured by the practice itself as well as the equipment and receivables.

We continue to originate new loans at CapitalSource Bank that are carefully underwritten and highly profitable. All-in, contractual yields for loans closed in the third quarter averaged just under 7%, which is below the blended year-to-date level of 7.65%, which is primarily due to a mix shift as we had a higher percentage of multifamily, small business and equipment finance loans this quarter compared to the prior quarter.

The actual yield on the full Bank portfolio was up 49 basis points this quarter to 7.83%, which was due largely to the impact of declining non-accruals and the full benefit of a growing balance of higher yielding loans.

We continue to anticipate that average contractual yields will tighten generally and that additional mix shift could impact our total yield in coming quarters, but we expect that the average for the full year of 2010 will be in the range of 7.5%, which we projected when the New Year began. New loans generally continue to carry coupons of 400 to 600 basis points over LIBOR, with LIBOR floors ranging from 1% to 1.5%, on top of our one or two points that we are getting between commitment and exit fees.

It is also important to note that the quarterly payments that we have been receiving on our hyper amortizing A participation interest over the last two years made it difficult to show much net loan growth at CapitalSource Bank. With the final payment on the A participation interest received earlier this month, the Bank is now poised for significant net loan growth in coming quarters on top of the $232 million of net loan growth that we experienced this quarter.

Based on this, we are also expecting – based on what we know about our pipeline in October, we fully expect that our fourth – during the fourth quarter, we will meet our projected origination target of 300 to 400 million of new funded loans. In short, we feel we have a proven asset origination model which is as broad and as strong as it has been at any time since the founding of CapitalSource.

Steve is up next. He will provide more detail about the third quarter financial performance at the Bank, as well as our plans for bank holding company status. Steve?

Steven A. Museles, Co-Chief Executive Officer

Thanks, Jim, and good morning, everyone. I'm going to begin this morning by providing an update on our plans to apply for bank holding company status. CapitalSource Bank recently completed its second annual safety and soundness regulatory exam. Although we are not permitted to discuss

specifics, the results of that examination give us great confidence that we are managing the Bank to a high standard and are increasingly well positioned to our apply for bank holding company status.

We continue to have an excellent relationship with our regulators, and subject to forthcoming conversations with the Federal Reserve staff, which is the regulatory authority for bank holding companies, we expect to file our application in the first quarter of next year. We currently anticipate that the regulatory review process that follows will be completed during the second half of 2011.

We also intend to file with the FDIC and the California DFI to convert the existing industrial bank charter of CapitalSource to a commercial bank charter. Since we were previously approved by those two regulators for the conversion, we expect their approval to be in place by the time the Federal Reserve acts on our holding company application. It is important to note, however, that the existing charter does not present any constraints in terms of our projected growth and profitability in 2011, particularly in the current interest rate environment, which is producing a very low cost of funds.

Our timetable for becoming a bank holding company fits nicely with the expiration next summer of our initial three-year business plan for CapitalSource Bank and the order that approved its formation in 2008. Becoming a bank holding company at the Parent will permit CapitalSource Bank to operate under a commercial rather than industrial charter.

Turning now to third quarter results for CapitalSource Bank. It was another solidly profitable quarter driven largely by higher loan yield on the Bank portfolio and greater interest income. Pre-tax pre-provision earnings increased significantly and our net finance margin moved up 50 basis points to 4.94%. The Bank continues to be very well capitalized with more than 18% total risk-based capital and a Tier 1 leverage ratio over 13%.

Liquidity remains high with cash and investments exceeding $2.1 billion at quarter-end, which is more than sufficient to support projected growth through the first half of 2011 without the need to raise additional deposits. Nevertheless, despite a further decline in our overall cost of funds to 1.3%, deposits were up slightly again this quarter. We paid an average of 0.99% for new and renewing CDs issued this quarter and more than 90% of maturing CDs were renewed, which is better than our past experience. Assuming low interest rates persist, we continue to expect that our cost of funds will remain below 1.5% over the next few quarters.

Credit performance was generally stable in the quarter. While the $15 million loan loss provision at the Bank was about 10 million higher than the prior quarter, one resort/club loan accounted for $12 million of that amount. That same loan with a balance at September 30 of 87 million was placed on non-accrual and impaired in the second quarter, although it was current at the time. It became 90-plus days delinquent this quarter, which largely explains the net change of $85 million in that category.

Total non-accruals at the Bank declined by 11% or $42 million from the prior quarter due primarily to charge-offs. New non-accruals of $11 million in the quarter declined significantly from the 105 million of new non-accruals in the second quarter. Although the total allowance for loan losses at the Bank decreased by $34 million, it still remains a healthy 3.53% of total loans.

With that, I'll now turn the call over to Don, who will address some of the key financial performance indicators on a consolidated basis.

Donald F. Cole, Chief Financial Officer

Thank you, Steve, and good morning, everyone. The focus of my remarks will be on a few key components of our financial performance in the third quarter, including the substantial reduction in our debt, liquidity, credit and our deferred tax allowance.

Looking first at the updated balances in our credit facilities, it is quite evident that several are rapidly approaching the point where the debt will be paid off in full. Ultimately, loans in those credit facilities will be converted to cash at the Parent through national run-off or an ability to re-leverage these loan pools.

The syndicated bank facility was paid down to a zero balance in the quarter to reduce our interest expense. However, we still have $110 million of immediately available borrowing capacity on that line. The total paydown on all of our structured credit facilities was $238 million in the quarter, reducing the aggregate principal balance to only $78 million against nearly 1.8 billion of loan collateral.

Our term securitizations continue to pay down rapidly as well. Excluding the effect of the 2006-A transaction, securitization paydowns totaled $226 million in the quarter, including the payment in full of the 2007-A securitization debt. Including 2006-A, total securitization debt declined in the quarter by 1.1 billion, and CapitalSource equity in the remaining securitization stood at approximately 235 million at quarter-end. Since the beginning of 2010, our securitization debt has declined by nearly $2 billion, with only 861 million still outstanding.

As previously announced, the sale of our junior equity in the 2006-A securitization and the transfer of collateral manager duties to NorthStar during July resulted in the deconsolidation of that entity from our balance sheet. As a result, we no longer show the assets, liabilities or results of operations from the loans and associated debt of that entity in our financial statements.

At deconsolidation, we recognized a gain in the other income line of our financials of $16.7 million, reflecting primarily the cash consideration received in the transaction plus the $14 million fair value of the bonds we retained. In accordance with the accounting rules, those bonds were marked on the date of deconsolidation, based upon the value at which they could be sold in the market.

Through the strong management of the securitization by NorthStar, we actually received a quarterly payment on those bonds this month of $3.6 million, which included significant amounts of past due interest. This payment confirms the view we held at the time of the transaction that NorthStar was an excellent partner to manage the securitization in the interest of all bondholders, including CapitalSource. It also indicates that we may recover more than the fair value marks established in early July.

Moving on to Parent company liquidity, we remain at a very comfortable level. We had $284 million in cash and approximately 110 million in credit facility availability at quarter-end. In addition to normal cash flow, we received approximately 35 million in the quarter from the disposition of the remaining Omega stock we acquired earlier this year and the sale transactions related to our net lease assets.

Turning now to credit, deconsolidation of the 2006-A securitization trust reduced the balances in the non-accruals, delinquency and impaired loan categories, as well as our general and specific reserves. However, even net of the 2006-A impact, non-accruals decreased by $76 million this quarter and impaired loans decreased as well. Charge-offs in the quarter were down by about one-third from the prior quarter at $85.6 million.

Total loan loss reserves at quarter-end had declined to $394 million or 5.9% of loans, which is 185 million less than the prior quarter. 138 million of that decrease, however, was related to reserves

that were previously held against the 2006-A portfolio. The net reduction of reserves in the quarter therefore was $47 million, consisting of 86 million in charge-offs and a $20 million decrease in general reserves offset by 59 million of specific provisions.

For your reference, we have updated the cumulative loss analysis we have been using since the middle of 2009 to reflect the impact of the 2006-A transaction by taking those securitized loans out of the numbers entirely back to the inception of the analysis. It is slide 23 in the investor presentation posted this morning to our Investor Relations website.

Loans continued to pay off at a rapid pace during the quarter. A total of 286 million of legacy loans paid off; 243 million at the Parent and 43 million at CapitalSource Bank. We also resolved 25 troubled loans in REO. Total proceeds were $124 million, which was 5 million above our March 31st marks on those loans.

The valuation allowance for the deferred tax asset was $430 million at quarter-end, a decline of 81 million from the prior quarter due primarily to the 2006-A deconsolidation and a net operating loss carryback we took in the quarter. We recorded a $36 million income tax benefit as a result of carrying back the 2009 operating loss of one of our entities to the 2005 tax year.

Our second consecutive quarter of profitability brings us closer to the point in time where the valuation allowance will reverse into earnings. But we continue to believe it will be well into 2011 before sufficient evidence is accumulated to permit that reversal.

Before turning the call back to John for his closing remarks, I want to provide a brief update on our plans to redeem the convertible notes, which are putable at par next July and which had a balance of 294 million at September 30th. We continue to have a range of options available to us to repay the notes and it is likely that we will decide upon a course of action before year-end. The one option we have no intention of utilizing, however, is the issuance of additional shares.

John will now provide a quick look at our year-to-date accomplishments before we take questions. John?

John K. Delaney, Founder, Executive Chairman and Chairman of the Board

Thank you, Don. I want to briefly review our major activities year-to-date, because recognizing what we have done is important to a thorough understanding of where we're going. We have de-levered the Parent substantially this year, with debt reductions in excess of $2.2 billion. We've also dramatically improved our liquidity profile, particularly with the completion of the net lease assets - the sale of the net lease assets.

We currently have relatively limited cash uses at the Parent. And as I said earlier, we will begin to generate substantial cash in the latter part of 2011 as more credit facility debt is repaid. Our lending teams in the areas of core historical strength for the company, such as healthcare, has served us well, but we knew that diversity would be important if we were to meet our growth targets under current economic conditions.

The addition of our corporate asset finance, small business and professional practice lending groups since the beginning of the year have added greatly to the reach, breadth and depth of our national franchise. In each case, we hired complete teams of very experienced professionals with deep industry contacts to run their respective businesses.

As I mentioned at the outset, we have managed the credit performance of our legacy portfolio through a very challenging couple of years to reach a point of stability. This year, we have

essentially completed the process of building the reserves needed for projected charge-offs in the legacy loan portfolio.

In addition to net loan growth, important profitability measures at CapitalSource Bank continue to improve with all-in underwritten yields on new loans this year averaging in excess of 7.5% and the net finance margin approaching 5% this quarter. Our skilled management team at the Bank has managed down the cost of funds while keeping deposit levels and renewal rates in the 90% range.

Each of these accomplishments has contributed to the growing strength of CapitalSource Bank and helped bring us closer to the pure bank model which we are carefully and deliberately marching towards. Our strategic focus is now clearly forward-looking and we're looking forward to a very bright future.

Operator, we're now ready for the first question.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Scott Valentin at FBR Capital Markets.

<Q – Scott Valentin>: Good morning and thanks for taking my question. Just with regard to the bank holding company application, I mean, is it – I guess in the past, if I remember correctly, the previous application, the Federal Reserve, I guess, had some concern around the holding company capital structure. That's clearly been addressed. And I'm just curious maybe in terms of asset quality, it's been improving, but still it looks like asset quality or impaired loans are relatively high to peers. I'm just curious as to why you think – starting the application process now is – or in 1Q '11 makes a lot of sense?

<A – Steven Museles>: Well, this is Steve. I mean, the first time we went through the process with the Federal Reserve, frankly, their biggest issues with the company were liquidity, number one. At the time, a year and a half ago, we were challenged in that area. And number two, earnings was a particular focus, because we didn't have any. We've significantly fixed both of those areas. Liquidity, as you can see, is incredibly strong, and earnings, this will be our second quarter of profits in a row.

Asset quality continues to improve. But even when the examiners were here 18 months ago, they were complimentary with the way in which our credit administration department managed our portfolio and addressed the asset quality issues and attributed more of the problems, frankly, to economic problems that were impacting everybody. So when we talked to them at that time, the message was have a couple of quarters of earnings, get your liquidity better, shrink the Parent a bit, which we've done.

So based on that, their comments at that time and more recent conversations that we've had with the Federal Reserve, we feel confident that an application in the first quarter will be well received and prosecuted through the end of the year. We also have extremely high capital at the Parent, approaching 30%, which I think mitigates some of the asset quality issues.

<Q – Scott Valentin>: Okay. And just as a follow-up, earlier you mentioned, I guess either – we agree that a lot of capital locks to the holding company, either invest in the Bank or return to shareholders. Just curious if the senior notes, if there is any kind of covenants in the senior note indenture that would prevent you from returning capital to shareholders?

<A – Donald Cole>: Well, I mean, there – in terms of either a straight stock buyback or a dividend, there are sort of the customary restricted payments covenants in the high yield notes. So, yes, there are. I mean, I think our view is it will take some time to generate some of that liquidity at the Parent. We do have some debt maturities to deal with before that. So, I mean, that's still a few years out in any event. But, yes, there are the standard covenants contained in that indenture.

<A – John Delaney>: But not with respect to investing in the Bank.

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

Operator: The next question comes from John Hecht at JMP Securities.

<Q – John Hecht>: Good morning, guys. Thanks for taking my questions. First question, a little bit of a follow-up from the prior question. You discussed the application process, but I wonder, can you remind us what the strategic benefits of the bank holding company charter might be and what does it mean for the de novo status, the current de novo status? In other words, with – upon achievement of the bank holding company status, would that relieve you from the elevated capital requirements and how would you take advantage of that opportunity?

<A – John Delaney>: This is John. I'll start now with – I'll start with the strategic aspects, and then I'll let Steve refer to the effect on the de novo status. The minute we become a bank holding company, nothing really fundamentally changes in terms of what happens at the Bank. The Bank - we view the Bank as a true retail depository at this point. All of our deposits are raised from a retail on-the-ground franchise. It's not a kind of a wholesale or broker deposit model. And so the real benefits I would put under the category of efficiencies and kind of long-term strategic benefits.

As it relates to efficiencies, our model right now, to be just a holding company, if you will, while the Parent is not regulated and the Bank is, there are certain limitations around our ability to consolidate functionality between those two enterprises and lower the operating costs of the business. It's our view that once we're a holding company in both organizations or both enterprises are regulated, if you will, then the ability to streamline operations and drive operating efficiencies are dramatically enhanced because you effectively have one regulated enterprise, if you will. So that's kind of an immediate financial benefit.

The long-term strategic benefit is we're limited in terms of our ability to participate in what could be very attractive bank transactions. And the reason we're limited is because our charter as an ILC is prohibited from doing certain types of banking transactions. And if we were to acquire a depository that had those deposit relationships or those customer relationships, we wouldn't be able to hold them in our Bank. So until we actually change the charter of the Bank, and in order to change the charter of the Bank, we need to be a bank holding company, we can't really fully pursue kind of bank M&A opportunity, should those be attractive. So those are kind of the – those are the real reasons to accomplish this objective. And, Steve, why don't you address the de novo question?

<A – Steven Museles>: Yeah, on the de novo question, what happens at the end of three years, with that being the initial de novo term and the expiration of the order the FDIC gave us providing insurance in the first place. It's a little unclear exactly what's going to happen. I mean, we've looked at the order. We've talked to other people inside the agencies and council about the order. And I think there is a possibility that all the limitations that are contained in that order on the way the Bank operates that are atypical for a commercial bank would go away once we become a bank holding company and become a commercial bank. I think it's likely we'll still be in the new seven year de novo status that the agencies guided to a year or so ago. But I'm hoping, again, with a different charter, it'll be a little less restrictive than the current limitations we have.

The capital, as you all know, right now it's required to be 15% in the charter – I mean in the order. I would hope that there wouldn't be any specific delineation of what our capital requirements would be when we convert the charter and that we would just be subject to the regulatory guidance on that number. But we don't know yet until we actually get there. But again, some of the other things that John mentioned in terms of being able to combine some of the functions within both the Parent and the Bank to create a more efficient operating structure should be allowed when the Parent is regulated and the regulators of the Bank should have a little less concern that there would be anything inappropriate as between the Parent and the Bank going on.

<Q – John Hecht>: Okay. Thanks very much for the detail. A second question is, even in the exclusion of the sale of the 2006-A securitization, the non-performing asset levels appear to be dropping. Is this – can you discuss the credit pipeline and maybe shed some light on this? Is this an emerging trend at this point or is it too early to tell given the state of affairs?

<A – James Pieczynski>: We talked about stabilization for the last couple of quarters. So I think in our sense, it's fair to say it is something of an emerging trend. I mean, the way we look at the credit pipeline and certainly the new incidences of non-accruals. Steve mentioned the numbers at the Bank which were down dramatically. They were also down across the entire organization. So when we look out over sort of the new things moving into problem situations, we feel very positive about that.

And what I'll add to that is what the '06-A transaction does and what's been happening just as we work through the portfolio is that our portfolio of large commercial real estate loans that we haven't effectively dealt with or marked down is now very small and some of the ones we have left, we actually feel pretty good about their performance. So it really for the last year and a half has been largely a commercial real estate story and we've done a lot of work to kind of work through that portfolio, mark it and shrink it.

<Q – John Hecht>: Okay.

<A – James Pieczynski>: The '06-A clearly makes that even clearer, because it moves off the balance sheet. But even with the remainder, we've done a pretty good job of moving that out. So I think it's fair to say that, yes, that should be for us an emerging trend and we feel we've reached kind of that high watermark in terms of some of these non-performers.

<Q – John Hecht>: Great. Thanks very much.

Operator: The next question comes from Mike Taiano at Sandler O'Neill.

<Q – Michael Taiano>: Hi, good morning. Just a couple of questions. I guess first on the credit side, the increase in the provision, was that just entirely due to that $187 million resort/club loan

<A – Steven Museles>: I mean, I wouldn't say it's entirely due to that. I mean, we obviously run a full process. We have a few loans that take specifics. But generally speaking, the reserves have come down a little bit. I think maybe the 38 is a little higher than what I would have expected it to be in our – sort of our new lowered range. But I wouldn't call it just on the one loan. Clearly, that one loan we indicated had exactly that amount, so you can do that math, but there was obviously a lot behind it as well.

<Q – Michael Taiano>: Okay. And then just wanted to drill down a little bit on the loan growth at the Bank and just what you're seeing competitively. We've heard a lot of banks through earnings season just talk about pickup in the middle market. And I'm just curious what you're seeing in terms of – it seems like pricing has held pretty steady for you guys, but just curious if you've seen anything that would suggest that yields might come under some pressure here in the near-term.

<A – James Pieczynski>: Yeah, this is Jim. Relative to that, I think in the areas where we have the specialty, we're seeing less competition and, therefore, quite frankly, we believe we're able to get good reasonable yields. In our business this year, we haven't really done much in the general cash flow space, because, quite honestly, the yields on that seem to be getting compressed, the leverage multiples seem to be going higher, and we think it's more prudent for us to pull back from that. The other areas where we do have the expertise, we're coming up against less competition and we think we are able to drive the transaction better. So from our perspective, we are definitely seeing significant areas of opportunity and growth. Although in general, as I said in my comments, that we're seeing margins come down a little bit, but we still are comfortable that we'll be up to 7.5% range for the full-year.

<Q – Michael Taiano>: Okay. And on the healthcare real estate, like what – could you give an example, what exactly – what type of loans are you talking, are those like hospitals, like what exactly is that?

<A – James Pieczynski>: Right. What we're doing in the healthcare real estate space is largely skilled nursing facilities. So nursing homes around the country. And that's been a hallmark of what we've done since the company was formed and it's a significant area of strength and expertise that we have that we will continue to do. I think other areas that we look at doing is, we do look at doing hospitals. But we also – the other area that we think is going to present some opportunities for us is

going to be on the assisted living side. So if you sit there and say, what do you see in the healthcare real estate space, it's largely coming out as a long-term care market.

<Q – Michael Taiano>: Got you. Okay. And then just the last question on, you talked about perhaps returning capital to shareholders at some point. It seems like the unsecured debts are roughly 300 million that you have – bonds that you have outstanding could be a bit of an impediment. I was just curious as to like what options you could perhaps have there, and I know you have some time before you get the sort of cash flows where you can return capital, but would it be worse, what sort of prepayment penalties are there, just maybe discuss some of the issues with that?

<A – John Delaney>: Don, why don't you...

<A – Donald Cole>: Yeah. I mean, just to the specific terms of the deal, the deal is a no-call deal through its maturity, which is 2014. It also has a fairly high contractual redemption price should we chose to redeem it through that provision, which is effectively a treasuries plus 100 full interest payment with a discount at the treasuries plus 100. So it's a pretty significant prepayment penalty. So – and, again, as I mentioned, obviously our view is our liquidity position is such that right now we're not sitting on a lot of cash to say we should redeem those early. But we obviously look at that. We look at that through our forecast to determine if there was the ability to generate cash and make a meaningful investment or return to our shareholders, we'd consider that. But as I said to one of the earlier questions, clearly there are some restrictions there really to do that.

And one last thing I'll say, because it was pointed out to me at a bondholder conference, you mentioned unsecured, they are secured with a sort of first lean on the similar assets to one of our bank credit facilities.

<A – John Delaney>: Yeah, and the reason we were talking about that is this is kind of under the category of a long-term plan. When we look at the business, we do see there being the potential for very significant loan growth opportunities and there being the potential for a much, actually better market than we're even seeing today on the loan origination side, which is really related to these maturity walls that people refer to which clearly exist in the leverage loan market, clearly exist in the CMBS market, but actually exist to a much greater degree in the bank market.

When you look at the sheer amount of bank loans that are going to need to be refinanced in 2012, 2014 and if you have some view as to the condition of banks, which I'm still somewhat negative on the overall condition of banks. So there – we could find ourselves in an environment where there's enormous amount of opportunities and spreads even widen compared to where they are today, in which case we would be able to put a substantial amount of capital in the Bank and grow the Bank, because there is no question at some point in the future, not in '11, because we'll be dealing with our convertible bonds et cetera, but starting in '12, '13 and '14, the Parent company starts just piling up cash. And either we'll put it in the Bank to pursue these opportunities or we'll think about how to get it back to the shareholders. And obviously to get it back to the shareholders, we have to deal with some of the restrictions that we just talked about. But we'll see what those restrictions look like and what kind of prices exist for modifying those restrictions when the time comes, which won't be for a couple of years.

<Q – Michael Taiano>: Okay, that's helpful. Thanks.

Operator: The next question comes from Sameer Gokhale at KBW.

<Q – Sameer Gokhale>: Hi. The first question I had was just on the tax expense. I just was – I know there was that carryback tax benefit of 37 million, but then when I look at your tax expense on a consolidated basis, it looked like even if you add that back, there was virtually no tax expense. So

I was just wondering what was driving that, how you record your tax expense for the quarter, excluding the effect of this other tax carryback.

<A – Donald Cole>: Well, Sameer, I think because of the position we're in where effectively our deferred tax assets are a 100% reserved against, basically, we would expect to be effectively a 0% taxpayer until such time as we work through that deferred tax asset allowance. Because when we make money, we were – instead of recording tax expense, we released some of the allowance and in some – in entities that lose money, we record a little bit more allowance. So across the board, until we start releasing some of that deferred tax allowances, we expect to be effectively a 0% taxpayer.

Again, there is always nuances between entities, but, effectively, that's what it blends out to be. And then in this one instance, because we're carrying back through a 2005 period, we're able to utilize more of an NOL we hadn't necessarily been able to forecast our usage of, and we released some allowance to cover that. And I will add that that 36 million, $37 million roughly carryback, we will get in cash sometime either late this year or early next year, so it's a real cash transaction for us as well.

<Q – Sameer Gokhale>: Great. But maybe is the correct way to think about it that you have this deferred tax asset, you have a valuation allowance against that, which if you maintain consistent profitability you could realize that and they have to reverse the valuation allowance out. And because your expectation is to in fact realize that deferred tax asset and the tax benefits, because of that fact you're essentially recording virtually no tax expense now because that you expect to realize that benefit in the foreseeable future. Is that essentially the way to think about this?

<A – Donald Cole>: I would say the way to think about it is, because we have a full allowance, which basically says I can't think that in the future I'm necessarily going to make money to use my existing future deductions. I think the way to think about that it is when I actually make money, then I've proven that I can use some deductions, so I release allowance, so I accept a 0% tax rate.

<Q – Sameer Gokhale>: Okay. Okay. I see.

<A – Donald Cole>: So until such time as you sort of say, well, now I've had this period of sustained profitability, I can therefore actually look out each quarter to the future of what I'll make and release a big chunk of the allowance, at which point you would have a big tax benefit and then in future quarters you'd start taking tax expense again.

<Q – Sameer Gokhale>: I see. That's helpful in terms of thinking about it. The other question I had was, I think last quarter you had mentioned this goal of being able to generate like a 15% ROE in the Bank in 2011. Basically in your current trajectory, do you still feel that that is like a realistic timeframe? I mean, it seems like you can get there at some point, but given the high capital base and do you still think that that's a reasonable timeframe or do you think that's more like an '12 event?

<A – John Delaney>: Well, I think the important point here is, we feel like that's a obtainable goal. There's no doubts in our mind about that. I'm not sure what we said specifically last quarter about the timing, so I don't want to reference specifically the timing, but I think the important point is, we feel like that goal is easily achievable.

<Q – Sameer Gokhale>: Okay. And then just the last question was, this professional practice that you acquired, just out of curiosity, was that like an – was that practice acquired from Bank of America/MBNA, because I remember MBNA used to have some sort of practice that was similar. Is that – are those are same folks?

<A – James Pieczynski>: Right. This is Jim. We didn't acquire. What we did was we hired a team and they're – quite frankly, that's a team that had come from a couple of different institutions and we brought them in. So to answer your specific question, no, they didn't come from BofA/MBNA. But they are people that have worked together in the past and have now joined us.

<Q – Sameer Gokhale>: Okay. All right. Thank you.

Operator: Your next question comes from Henry Coffey at Stern Agee.

<Q – Henry Coffey>: Good morning, everyone, and obviously congratulations on a solid quarter. Couple of perfunctory items. What were your next charge-off ratios just for the quarter in the Bank and on a consolidated basis?

<A – Donald Cole>: Henry, I'm going to reference our – I keep the...

<A – John Delaney>: Do you want the ratios?

<A – Donald Cole>: Yeah, I don't know if I could do the trusts for you, but in our investor presentation we have the relative amount. Our total was...

<Q – Henry Coffey>: I'll figure out it or get back to you. And then your tangible book value was?

<A – Donald Cole>: On a percent – on a dollar basis?

<Q – Henry Coffey>: Yeah. Per share.

<A – Donald Cole>: Our tangible book value per share rose to 5.86.

<Q – Henry Coffey>: And then the DTA on a per share basis, it looks like it's about $1.33 of sort of potential recapture, is that...

<A – Donald Cole>: That sounds the right calculation for the allowance number.

<Q – Henry Coffey>: And then obviously from a strategic basis, I mean, the way we should continue to think about this company is profitability in the Bank, but if we – is there also sort of an entity where you'll have a viable active holding company or finance company outside of the Bank going forward or should we just really think of this as 100% bank two or three years out?

<A – John Delaney>: You should think of it as a 100% bank. And the kind of analytical framework as to why we've come to that conclusion and you've come to that conclusion is that we believe the Bank, as we said in the prior kind of question, can generate a very high return on equity. So we cannot, we believe, in the current environment, nor I do think anyone else can, create a non-bank finance company that can generate a return on equity as high as we can generate in the Bank. So therefore we should either put the money in the Bank or give it back to the shareholders.

<Q – Henry Coffey>: Does that – John, does that restrict anything you'd like to do on the lending front or...

<A – John Delaney>: Not – no, not materially. I mean, around the edges it does. But it also opens up a whole range of opportunities on the lending front and potentially on the transactional side and the fee side et cetera that I think, in our judgment, clearly outweighs any limitations.

<Q – Henry Coffey>: And then I know you've dealt – you've had a long history of dealing with regulators. Are they easier to read this time, were they encouraging in terms of you submitting the application? I know they tend to be very poker-faced on these things, but...

<A – John Delaney>: I'll let Steve handle the – their reaction to us submitting the application. I will say though a general comment as it relates to regulators is that I think what we present to regulators, which is very high capital levels, and a business model with kind of a high degree of core profitability and a track record of being fairly open and transparent about loan problems related to our legacy portfolio and aggressively reserving against them, I would define as exactly what regulators are looking for in regulated institutions these days. Steve will talk about how they feel about our timing et cetera.

<A – Steven Museles>: Yeah. Look, I mean, we've had a lot of a very recent conversations and exposure to the regulators, both in connection with the FDIC and DFI exam of our Bank. And just this month, the FDIC and DFI did a visitation of the Parent Company, which is they're entitled to do under the order. And I would say, as I said in my prepared remarks, that it's a very productive relationship in that, as John said, we're aggressive on managing our portfolio. We get ahead of the problems. And I think they see – I know they see that, the regulators do, and they appreciate that, and they've mentioned it several times. I think that, again, that creates a very positive working relationship where we call them up, we ask questions, they respond timely and we work together to make the Bank as strong and as safe as it possibly can be.

With respect to the Fed, which is the next regulator we hope to be regulated by the Parent company, we've had a couple of conversations. And they were friendly and encouraging us in terms of filing an application under the assumption that when we file that application we'll be ready. And, again, as I said earlier, ready means a couple of quarters of earnings and strong liquidity, improving asset quality and a shrinking Parent. All of those hurdles I think we've met, which is why we're working on an application and planning to get it in in the first quarter, subject to conversations we may have with them up until that time where they say, well, I need you to do this and that first. But as it stands now, that's the plan.

<Q – Henry Coffey>: Thank you very much and congratulations on a solid quarter, everyone.

<A – Steven Museles>: Thanks, Henry.

<A – John Delaney>: Thanks, Henry.

Operator: The next question comes from Moshe Orenbuch from Credit Suisse.

<Q – Moshe Orenbuch>: Great. Morning. I was hoping you could talk a little bit about the loan growth in two respects. Number one, how much of the loan growth that you're reporting now comes from refinancing loans that are on the books outside the Bank and how big an opportunity can that be? I know you talked about the opportunity kind of broadly in terms of refinancing, but could you talk about that a little bit?

<A – James Pieczynski>: Well, if you're referring to loans that we're refinancing that are currently at the Parent, when I'm talking about new loan origination, those are truly new loan originations. They're not refinancings of existing Parent loans. So the large – the loans that we're doing are literally new originations. Now, some of them – some of those relative to are they new acquisitions or are they refinancings of existing loans, I'll say in our multifamily space, a lot of that is refinancing of existing loans. In our corporate asset finance space, a lot of that, that is all the purchase generally of new equipment. So it's going to vary on a – kind of on a division by division space. But it's – there's a mix. Some of it is acquisition and some of it is refinancings and it depends upon each of the 12 lines that we're doing. So everything in our leverage lending space is generally new acquisitions that are happening. But you do have a little bit of refinancings there as well too.

<Q – Moshe Orenbuch>: Okay. And just on a separate topic, could you just give us any kind of update in terms of your thoughts about timing of when – or method in terms of the converts?

<A – John Delaney>: Well, I think we can talk about timing. We probably don't want to talk about method.

<Q – Moshe Orenbuch>: Got it.

<A – Donald Cole>: Yeah, I think in my prepared statement, Moshe, I said we expect to have something that – to sort of announce by the end of the year. And as we said before, we have a number of options. We continue to work on those options, but our focus is to redeem them with cash. As you can see, we have a fairly substantial balance sheet position in cash.

<Q – Moshe Orenbuch>: Okay. Thanks.

Operator: Our last question comes from Bob Napoli at Piper Jaffray.

<Q – Robert Napoli>: Good morning, everybody. Questions on the Bank. What type of – under the current capital requirements, how much can you grow the loan portfolio in the Bank approximately?

<A – James Pieczynski>: Well, we have – right now we are currently at an 18% capital level at the Bank. And then what we look at – the number we look at, quite honestly, is based on the loan paths that we're expecting. We actually have the ability to do another $2 billion of new loans at the Bank. So when we're looking at the Bank and looking out forward, the Bank has adequate capital to support its growth for the foreseeable future, which is the combination of loans that are going to be paying off at the Bank coupled with the fact that the earnings at the Bank gives us the exponential impact of – that's additional capital that therefore supports more loan growth. So from our perspective, we're looking at it that we have that capacity to do another $2 billion of originations at the Bank without having to do anything relative to capital.

<Q – Robert Napoli>: Okay. So at least through next year, at the current rate, would you – putting new capital into the Bank, would that be – getting bank holding company status, does that make it easier to put capital from CapitalSource into – from the Parent into the Bank or could you do that, I mean, 12 months from now, you really don't have the capital to do it?

<A – John Delaney>: The ability to put capital in the Bank is – there's no limitations on that. So bank holding company doesn't really change that. Really what – that decision is based on the opportunities. As Jim said in a more artful way, when we – no matter what projection we do for the Bank, we don't really see it needing capital, right, because it's a very efficient business. It's going to generate a good return on equity. It's got a very high capital level now. There could be some unique opportunities that could grow the Bank much – at a more substantial rate either through very, very large portfolio opportunities or other bank transactions that could require more capital, in which case, we would have the ability to invest that capital into the Bank.

<Q – Robert Napoli>: Okay. On the credit side, I mean, what could go wrong? I mean, we have seen steady improvement, are there – what are you most worried about on the credit side? You seem to have positive momentum continuing from that perspective, but where – what could go wrong?

<A – John Delaney>: I mean...

<Q – Robert Napoli>: As I say this, the economy is kind of steady. We don't implode as an economy.

<A – John Delaney>: I think we feel very good about how we're positioned from a credit perspective. We have very significant reserves. A lot of the larger loans have shrunk in size as a result of the '06-A transaction, the deconsolidation. In other words, if you were to look at a list of the largest credits in the company before and after the '06-A deconsolidation, afterwards the large

loans go down substantially. So typically what would worry you on the downside around credit is some large exposures. On a relative basis, the company has fewer large exposures than it did, and we think the provisions are very substantial. So we would worry about all the things you'd expect us to worry about. But in many situations we actually think we have more upside on credit than downside.

<Q – Robert Napoli>: Do you think the environment, the credit environment has – continues to improve modestly, I mean, economically, from the liquidity in the market for commercial real estate loans and et cetera? I mean, is it...

<A – John Delaney>: Yeah, I think it has. But I think the bigger variable in why we answered the question the way I just did is, how well provisioned we are.

<Q – Robert Napoli>: Yeah.

<A – John Delaney>: So our view as to why we think credit will perform well is not based on the fact that we have this rosy view of how the environment is. It's based on the fact that we have built up substantial reserves and taking very significant charge-offs against the legacy portfolio and have been very honest and objective about the condition of the legacy loan portfolios. And under the theory that the sooner you're marked, the better your life is, I would consider us in that category. So it's much less related to – sure, there's positive signs, liquidity in the commercial real estate market et cetera, but, I mean, there's also a lot of things going on in the credit market that you could view as unsustainable, right? A lot of CLOs are investing kind of liquidity that they have through reinvestment periods, and that will ultimately go away. There's an extraordinary amount of government funding into the – even in the commercial loan markets through a variety of government-sponsored programs that have to be unsustainable over time. And then you have this huge maturity wall coming up, which if you look at the data for CMBS and CLOs, it's quite scary, but then if you look at the data for banks, it's terrifying.

So there's this supply and demand imbalance coming in the future. So I don't think we have any kind of rosy view about credit that's giving us – credit broadly or economic conditions broadly that are giving us confidence to making our statements about our credit performance. Our statements about our credit performance are based on our level of provisioning, the charge-offs we've taken and the view that we feel like the portfolio is very well marked.

<Q – Robert Napoli>: The last question. Thank you. On the new business that you're doing, what is the right – I know it's a broad mix of several different specialty businesses and they're going to be different by business, but what is the right reserve level for this company on new business that's being originated, kind of reserve range, given the mix that you expect in loan originations?

<A – James Pieczynski>: Right. I think that's a fair question. And the way that we look at it is I think on new loans that we're originating right now, I would expect to see total loan losses in the 1% to 1.5% range. So once we – once you kind of sit there and look at it and say, based on the new loans that we're originating, I think the ultimate loan losses we'll have will be in that 1% to 1.5% range, and I think that's a reasonable number to be using going forward.

<Q – Robert Napoli>: Thank you.

Dennis Oakes, Senior Vice President, Investor Relations

Thank you, everybody. Just a reminder that the replay will be available on our website later today.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

John K. Delaney, Founder, Executive Chairman and Chairman of the Board

Thank you, everybody.