MANAGEMENT DISCUSSION SECTION

John Hecht, Managing Director, Senior Analyst, Specialty Finance and Commercial Banks, JMP Securities

All right. Just to keep it on time, we're going to march on to the next one. Very pleased to have CapitalSource here. With us we have Don Cole, Steven Museles and Dennis Oakes in the back.

CapitalSource, around 11 billion in total assets, about half of those are at the CapitalSource Bank which I think is the focus now. And when I think what differentiates CapitalSource, I think of a few things. One is it's got a very unique asset origination platform. It's very specialized in some important asset classes that are underserved by others. I'm sure we'll talk about some of those today which really increases the value of this company. That it's been able to show loan portfolio growth in the period where most other banks are showing contraction and I think that's due to its unique asset gathering strategy.

And the second thing I focus on is the bank itself. When you look at the bank, you see an institution that's got a tremendous amount of liquidity on the asset side. It runs a very successful deposit gathering strategy and the type of asset that's originating now are types that are going to have very – we hope are going to have very positive credit experience which means that the bank is a growth engine for the company and it's, what we perceive, is undervalued growth engine in the context of its book value and earnings power. So we find the investment very attractive from that perspective.

And with that, I'll turn it over to Don.

Donald F. Cole, Chief Financial and Administrative Officer

Thank you, John. I want to thank John and JMP for inviting us today. We've had a very productive day so far and I appreciate also all of you coming out to see us speak. I also want to thank John for that introduction. I think you framed very well some of the highlights of what I'm going to be talking about. And just want to take a quick second to introduce at the table with me is Steve Museles, our Co-CEO and in the back of the room is Dennis Oakes who is our SVP for Investor Relations. And if any of you have any question or want to speak with us after this, Dennis is a great contact for some follow-up information.

Turning to our presentation, I'll – we have a short presentation, so I'll skip through the forward-looking statements, the legal statements. Feel free to read those in the presentation document. Framing up our presentation today, realizing that we're at this point somewhat late in the third Q or the third quarter, I will give you an overview of the company and some of the key messages that came out of our second quarter performance.

Secondly, as John mentioned, one of the most important aspects of CapitalSource is our bank. I mean we'll focus a fair amount of time on talking about the bank and its performance and success in the recent past. Also talk about our parent company, which really is a deleveraging runoff portfolio that has seen some significant credit stabilization over the last two or so quarters. Finally, we're going to talk a little bit about all the other accomplishments we've had year-to-date and wrap it up with a little bit of the investment thesis, again, to give our view of why we think CapitalSource is attractive at this point, as John iterated.

Starting with the overview of the company, CapitalSource is a balance sheet lender. And what we mean by that is we originate our loans for our balance sheet. We have our own sourcing folks. We have our own underwriting folks. We close the loans ourselves. And we hold them on our balance

sheet and we service them ourselves. We are not a originate-to-sell or we're not a buyer of assets in the marketplace. We think this gives us a couple of key advantages. One is in terms of credit.

Because we're underwriting all the loans ourselves, we understand the credit profile of the asset before we fund it. We don't feel we'll be adversely selected in terms of credit selection. And the second is in terms of yield. Because we're not buying from others, we're not getting skimmed in transactions. We feel we get a more attractive risk return on the assets that we underwrite ourselves.

Our focus in the second section is on our specialty business lines. Many of these specialty business lines have been part of CapitalSource since our inception 10 years ago, and they focus in areas of healthcare. We have a very long track record in healthcare lending. Steve's Co-CEO, Jim Pieczynski, was the Head of our Healthcare Real Estate lending business, one of our most successful businesses over our – the long-term of the company, but also lender finance, security and technology, which can be niche businesses where again we have significant expertise both in our origination platforms and the context we have in those businesses, our ability to underwrite the transactions and actually to service them when we put them on our balance sheet.

And we've de-emphasized over the last two years, especially in our banks, some of the non-specialty areas and more commodity lending areas like general cash flow and some of the general real estate areas where we historically had done more business. So we're really focusing now on our specialty lines of business.

And then finally, again, the key component of the story is our California depository, CapitalSource Bank, which was formed in July 2008 when we acquired the branch network in the deposits of a – of a previously existing institution. So we started running with a very strong deposit franchise and now has $5.8 billion of assets, $2 billion of liquidity and capital ratios almost up to 18% – I'm sorry, risk-based capital ratios.

And then the key to the value story is this last bullet point here, which is pairing our national origination team that originates these very attractive loans and pairing it with our California depository, a very stable and at this point low cost funding source, to give us an overall very attractive ability to source good credit, high yielding assets, and fund them with very stable low cost deposits. And in many cases, if you look at those two parts of the business, they are at this point better than they have been in almost at any point during our history.

Our asset platforms are more diverse. We've recently added some additional platforms. They're very focused and we're actually originating loans where others are saying they're having difficulty deploying loans. And our funding platform, we typically and historically were a warehouse to securitized lender, which meant you were always at the sort of whims of the capital markets. And for a time that worked very well for us. But now we have a very stable funding source with a deposit network that is somewhat underutilized. We have about $4.5 billion of deposits. Historically, that platform had upwards of 8 billion of deposits. So we feel our funding potential at this point is very stable and can allow us to grow significantly using our asset platforms.

Focusing on the second quarter and key messages in the second quarter, we returned to profitability for the first time since 2008, largely driven by a significant decrease in our loan loss provision. And another big driver of our profitability over recently and then certainly improving margins at the banks has been a reduction in the CapitalSource Bank cost of funds to under 1.4%, which is about half of what it was the quarter a year earlier.

We've accelerated our loan growth in those origination platforms. In the second quarter, we funded over $400 million of loans, which was our highest origination quarter since 2007 and compares very

favorably to the first quarter. And subsequent to the second quarter, we've ranged – we've raised our targets for the rest of the year to 300 to 400 million a quarter for the remainder of 2010.

Liquidity at the parent has been significantly improved. And certainly if you think back about 12 months or 18 months about where we were when we had limited liquidity, our capital markets' ability had somewhat dried up and we had pending debt maturities of significant amounts. We've worked very hard over the last year and a half to pay down debt, move out debt maturities. And at this point, the parent liquidity is in a better position than it has been at any time since the credit crisis began.

And then finally, stabilizing credit. In the second quarter, our level of delinquencies and non-accruals declined versus the end of the first quarter, and we had some asset resolutions of some of our pollen assets, both selling assets and/or loans, at values that were above our marks. And so in some senses, we've seen some stabilization in the value of our portfolio and given us more confidence around where we have it marked and where our reserve levels are today.

Turning to the bank, as I mentioned, CapitalSource Bank started in 2008. It's comprised of 21 retail branches, largely in Southern California, some in more Central California. And as I mentioned, it has $5.8 billion of assets which is comprised of 3.5 billion of commercial loans and about $2 billion of cash.

So it's very liquid. It has a significant amount of liquidity to grow the loan balance. And we think the return potential for the bank will be significantly enhanced as we can redeploy that cash and investment into commercial loans and get to a much more – a lower percentage of our assets in liquidity. And as you can see, there's $4.6 billion of deposits and again, as I mentioned, this same branch network supported over $8 billion of deposits at its height.

This shows our loan – funded loan growth over the last several quarters, and again, as I mentioned, the second quarter you can see was meaningfully higher than any other quarter in this chart and was our highest since 2007. And again, it's been focused across all of our lending groups and most importantly, against some of those specialty groups I mentioned.

We've been very strong in healthcare in the first half of this year, very strong in our security lending, technology business, and some of the new platforms. Equipment finance platform that we started in February has contributed meaningfully to this number. And then helping the number going forward, in addition to the equipment asset finance platform I mentioned we started in February, we bought an SBA business in April. It was a pre-existing client of the bank that we had lent to. It was an independent SBA lender that now we've brought onboard to actually originate loans for our bank.

And we just recently added another small lending team, a professional practice lending team that lends to essentially dentists, doctors, veterinarians that has a very long track record of good credit performing assets. So we feel very strong about our ability to continue to generate assets, and as I mentioned that $300 million to $400 million is our target for the rest of this year.

Bank has very high capital ratios. You can see from the left side of this chart, the risk-based capital ratio is about 17.7% at the end of the second quarter. We have a 15% minimum based upon our FDIC order when the bank was founded and that 17.7% is the highest level it's been since the bank was founded.

If you look at the right side, you can see where we are from a TCE to tangible asset level, and we're again at 12.5%. And obviously, if you think about the recent Basel III we're almost two times what the long-term rate of capital that's forecasted for banks anyhow through 2019. So you can see we're very far ahead of the game from a capital perspective. And really we want to grow into our capital base by again originating more loans and growing our balance sheet.

Loan loss reserves at the parent. I mentioned that the provision declined significantly in the second quarter. You can see also our level of reserves came down and that's largely a function of – in the second quarter, we worked out some assets and had some charge-offs in areas where we thought we would have had charge-offs.

So some of the real estate asset that we worked through, we had pre-existing significant reserves and as we charge those off that's what we expected to happen, so our level of reserves have come down. But it's important to note that if you look at the other banks of similar size to CapitalSource Bank, we're still almost exactly two times the level of reserves of banks of similar size to CapitalSource.

The next slide, and I focus you on the orange line in the middle shows the net interest margin of the bank over the last several quarters. You can see during 2009, we were able to significantly increase our net interest margin and that was largely through continuing to push down our cost of funds, which is the purple line which I mentioned you can see we're about half the level we were about a year ago in the second quarter.

Our NIM in this slide, you can see topped out in the fourth quarter of 2009 was causing some of the drag throughout 2010 is the level of non-performing loans of the bank has a significant level of non-accruals around 10% of its portfolio. And that's squeezing NIM or the net interest margin line by about 60 basis points in the second quarter. So you can see absent that and I should mention that in the first quarter it's about 30 basis points. So the squeeze is all around some of the problem assets.

So obviously our goal on the problem asset is to work through them, a lot of them are legacy assets that they brought from the parent. Again some of them more significantly the problems are in real estate. So as we go through the next year or so when we work through the remainder of our problem assets, this NIM can start expanding again, because we will be eliminating some of that drag from non-accruals.

Additionally, the NIM also is dragged down by what I mentioned earlier, which is our asset mix. We've a much higher percentage of cash and investments than what we think our long-term rate would be. And again when your cash and investment are earning you somewhere in the 1% to 2%, but your new loans are going out in the 8%, you can see how shifting that mix can have a real impact on your NIM.

Some of the second quarter highlights just to give an overview of the bank, I mentioned that we really grow originations in the second quarter. And again we've focused on some of our specialty areas and we continue to see good opportunities throughout the rest of the year.

Second area, costs of funds have been declining. And again as I mentioned we're down significantly from a year ago. We're probably nearly the end of our ability to push costs of funds on our CD based down much further.

One thing I should have mentioned with the bank, the bank is California ILC. It's not a commercial bank charter and so it doesn't issue demand deposits, it issues time deposits. And so largely its deposits consist of CDs, it is all retail – has four retail branch that we don't rely on brokered deposits, but we think, we're getting to the point where pushing down our cost of funds much further is probably a little bit limited. But we expect it to stay low as rates stay low and to stay certainly below this 1.4% for the rest of the year.

Our credits has been improving. Second quarter we have significant decrease in the loan loss provisions. And again we expect credits to be relatively stable as compared to some of our recent past history and our provision levels have come down to allow us to stay in a profitable range.

And finally, the key go forward is optimizing the bank, and again, we want to keep managing our deposit levels and our cost of funds, and manage our liquidity portfolio again to get as much yield out as we can keeping it in sort of the safe bank range in terms of the asset types.

We want to continue to leverage the fixed cost in the bank. As I mentioned, we have a same branch network support a significantly higher level deposits, so we feel without materially increasing the cost levels of the bank, we can grow the asset size and therefore drive down our efficiency ratio significantly. And then finally, as I mentioned, utilize all the liquidity in the bank and the capital to make new loans at the existing attractive rates.

Shifting over to our parent company and focusing a little bit of time to look at how the parent company is delevered in the credit history or the recent credit performance of the parent company. You can see the parent company debts come down significantly over the last six quarters, and it shows here it's come down 42% just from the end of 2008. And it will further come down as we deconsolidate one of the securitizations that we had on balance sheet as of 6/30.

So you can see the parent is really a one-off story, it's a deleveraging story, and it's shown significant material debt pay downs and there is a nice slide in the back in the appendix if you want to look at some of the specific numbers, around where that debt is sprinkled around between our securitizations and our credit facilities, but that will continue to run off over the next year or so, as I mentioned as the assets continue to pay down and the debt that is supported by those assets also pays down.

We have no recourse debt maturities at the parent now until July of 2011, so we've about almost a year left before we have any recourse debt maturities. You can see it's largely focused around some of these convertible debt issuances. We feel we have plenty of liquidity to handle these debt maturities, and the Syndicated bank facility which is our sort of our last recourse credit facility, that credit facility was $1 billion at the end of 2008, it's down now close to $100 million. We will just pay off naturally as the assets that are supported by bad debt pay off.

This next slide shows how the assets have shifted from the parent company to the bank and shows the relative size. And again, as we focus our long-term story on being a bank and focusing on CapitalSource Bank and all the opportunities I just spoke about over the last seven or eight slides, it's very important to us to continue to run-off the parent and grow the bank's balance sheet. So you can see the bank's loan book has been growing and we think it will accelerate with the level of originations we've started to see.

And the bank's book, again, I mentioned a little bit and there might be a slide here about one of these securitizations we're deconsolidating and it was about $900 million of assets. So if you take that out, what was there at 6/30 you will see the bank's already larger and that gap will only grow as the parent continues to shrink. So we'll largely become over time very much a bank story with a more distinct majority of our assets in the bank over time.

Looking at parent company highlights for the second quarter of 2010, similarly at the bank, the loan loss provision came down significantly to 25 million from 219 million. And our – but yet we still have a total loan loss reserve of 7.38% of our lending assets.

And again, income statement provisions going forward we expect to be significantly reduced over where we had been in the recent past and allow us to maintain a level of consolidated profitability. The level of non-performing loans decreased slightly, but at least it's stopped increasing.

And again, we expect sort of the worst to be behind us in terms of new loan, problem loan situations. And you know the one – second part of this points out that over half of our non-accrual loans are actually still current. So I think that is a symbol of or a sign that we're very proactive in our credit process in terms of identifying problem situations.

Charge-offs, our quarterly charge-offs increased slightly in the first quarter. But again as I mentioned it would be loans that we already had previously specific marks on or were in some of our strength categories where we had large general reserves against. So charge-offs were in the areas we expected them to be. And we expect charge-offs to remain elevated. If we have at the end of the second quarter close to $600 million in reserves we expect that number to come down to a normal level over time, we expect that to be through largely charge-offs.

And then finally some of the asset sales we had in the second quarter both loans and REO where there were situations where we had some multiple bidders, which was very new to us at the time compared to where we have been through most of 2009 and allowed us to get some sales that were over above – where our book value was at the time.

Turning to overall year-to-date accomplishments, first one, becoming a simple story. Again, we are focused on becoming and being a bank. And a bank typically has a much more simple balance sheet and income statement than we've had historically and we are working very hard to make CapitalSource a much simpler story. In the first half we sold off the remainder of our healthcare and leased asset business, which were nursing homes that we owned during our REIT period. Now that generated a fair amount of liquidity for the parent and allowed some of the debt run-off that I mentioned to you.

We are also deconsolidating the securitization I mentioned which will remove some of the noise of the parent balance sheet, some of the real estate assets which we had no economic interest left in but I think was a little bit hard to kind of separate out from the actual residual part of the portfolio. So, even this quarter when we put out our financials it will be a much simpler story in terms of what the balance sheet looks like.

We've been rapidly de-leveraging. As I said again 1.4 billion of debt repaid year-to-date, securitization debt was 700 million of that, credit facility 230 million of that, and the rest of the healthcare net leased asset that was either repaid or assigned to the purchaser. We'll start to see in this third quarter some of the securitizations, one we had will actually run off where the debt will be gone. And the same is happening in some of our credit facilities so again even trying to think about the places where the parents financed. That will be a smaller number of buckets to worry about.

We've been very much expanding our lending platform. Again, I mentioned some of these new platforms we've added which have helped us to be able to deploy capital and make loans where others are saying it's a difficult environment for them to make loans. This corporate asset finance or our equipment lending team, the professional practice and our small business lending groups are nice complementary lending groups to what we already had and are contributing towards our growth.

And then finally, overall, the improving liquidity profile of the parent. Those net leased asset sales have really added to the cash position of the parent, as I mentioned it's the strongest position it's been since the credit crisis began. We've been actively managing our credit performance. We've aggressively built reserves for our legacy portfolio throughout 2009 and into the early part of 2010 so that we feel largely the reserve build is done. And our total allowance as I mentioned is now at 7.4%, a very healthy level of commercial lending assets.

And finally again, continuing to grow the bank and transition ourselves to a pure bank model is clearly our future. CapitalSource Bank has closed about 900 million in new loan commitments through June 30 and funded 700 million of those. The all-in underwritten yields are very strong, north of 8% year-to-date and the minimum for the second quarter you can see it was much higher than it was this time last year and I mentioned some of the reasons why we think that can grow over the next year.

Deposit costs have come down and again, the bank now is larger than the parent and will continue to grow and over time it will largely become the whole story. We're looking for that time where as the parent runs off the bank becomes the whole story and it will be easier for sort of people to focus on.

Turning now to the overall investment thesis for the company and summarizing the presentation. Again we view we have a viable and stable long-term business model that's in place. That pairs our national origination platform focused on these specialty lending areas with our funding source, a very stable funding source of the bank. Both of which have very high capital ratios, so we have much runway where which we can grow.

Our credit has been stabilizing, again focused on the second quarter. The level of provisions significantly reduced from where it was in the first quarter in all of 2009 and we expect that to remain consistent as we go forward. Current level reserves, we feel very strongly are sufficient to cover all the future charge-offs for the legacy portfolio. So again as I mentioned, the reserve build for the legacy problems we had is largely done. And charge-offs during 2011, as I mentioned for the rest of this year and 2011 they will be somewhat elevated as we work through our reserves and work through the rest of the problem assets but eventually should return to a more normalized level through the end of next year.

Finally, sustained profitability and accelerating loan growth are just a beginning for us. Profitability, we expect to continue from here on and the new loan production of 1.3 to 1.5 billion, we expect for the full year. Liquidity profile, both the Parent and the bank is probably its strongest point, no schedule debts maturities at the Parent as I mentioned. And then ultimately, we're in a position where our deferred tax asset is largely reserved against it at the Parent, that we view as some off balance sheet book value call where over time the profitability is returned to and shown to be stable. We will be able to reverse much of that allowance back in the book value.

And then just to sum up. I think again, the key part for us I think when you look out over the future, if you think about a lending business is a business that has to originate assets and the one that has to fund itself. We feel both parts of those – both of those parts of our business are in about a good as position as they've ever been over our ten year history. Our asset origination platforms are very focused. Some of the new structural changes we have, have made it very clear what we want them to originate and they are doing a very strong job. And as I mentioned, when you think relative to what other banks are saying about asset growth, we're clearly doing very well there.

And on the funding side, previously as a warehouse to securitize lender we're always focused on capital markets and always a little bit of risk for those funding sources and now we have a very stable, growable funding source with very competitive cost of funds. So we feel very strong about the go-forward future of the company and we look very much forward to, as I said making the story simpler and continuing our transition to a bank.

With that I pause, as we don't have too much time left for questions, but if there is a few questions, I'd be happy to take one or two.

QUESTION AND ANSWER SECTION

<Q>: Do you see any risk [Question Inaudible] ?

<A – Donald Cole>: Well, I mean since the bank was founded that was our strategy and CapitalSource came in with a national lending platform actually came into the bank with some assets. And so I think we've been very careful about how we've gone about growing the bank. How we've gone about originating assets. We've stopped doing certain types of assets in the bank, but I would say we have a very, very strong relationship with our regulators.

And I think they have come to really understand sort of the assets we're originating. These new platforms we've put on, we can argue are more bankable. So I think they are very comfortable with some of the new asset platforms we've put on. So we feel very good about our existing origination franchise working in the California depository as it stands today. Maybe one more, I don't know how to choose. I'll get you afterwards.

<Q>: [Question Inaudible] ?

<A – Donald Cole>: The reserve against the deferred tax assets, Dennis, 500? It was 500, right about 500 million at the end of the second quarter. Some of that about 80 million was in this O6A so that'll be consolidated. So think about it in the 430 million and that's the allowance. The deferred tax assets are a little bigger, but some of it's still on the balance sheet. Maybe we can try to sneak in the last one.

<Q>: [Question Inaudible]

<A – Donald Cole>: Our loans are largely variable rate loans, and the CDs are very, fairly short-term. One that are blended time period six or seven months. So we're not – on the very short-term we're actually a little asset sensitive and then it kind of moves a little bit.

So ultimately, I think we're fairly well matched in that area and over time we might evolve to some of these more lending products being a little bit more fixed rate. But we do have some borrowing capacity at the bank through our FHLB line. But it's fixed rates, so we can do a little match funding there. It doesn't really cause us really too many issues of ...