MANAGEMENT DISCUSSION SECTION

Sameer Gokhale, Analyst, Keefe Bruyette & Woods Inc.

[Call Starts Abruptly] CapitalSource. Many of you may know CapitalSource is a commercial lender; business model has transitioned over the last few years from a specialty finance company/REIT into now a bank model and this is a company that also has bank branches in California through which it originates deposits.

So this is a pretty interesting story and I think the company has had some changes in the business model over time, but here just to give you more detail about the company and its prospects, we're very pleased to have with us today, Steve Museles, Co-CEO of the Company; Don Cole, Chief Financial Officer, and Dennis Oakes, Vice President, Investor Relations.

So with that, I'm going to turn it over to Don for his comments.

Donald F. Cole, Chief Financial Officer

Thank you, Sameer, and thank you all for coming this afternoon. It's nice to see a few familiar faces in the audience, but it's also good to see some new faces and thank you for those listening on the webcast.

Turning to the presentation, first slide, here's just the forward-looking statement language, which I encourage you all to read in your free time or when you're looking to take a nap maybe on your way home today.

Today's presentation, just a brief go through of what our schedule is. First, I'm going to give you a bit of a background, because I think there are some new faces here, a bit of a background on CapitalSource, where we stand today as of the first quarter and some key messages. We're going to focus a little bit on our bank that Sameer mentioned, our California depository.

We're going to drill down a fair amount on credit, which obviously in these markets has been a real driver of our performance over the last several quarters and our sort of look forward on credit. We're going to talk about funding and liquidity, especially focused on our parent company, and some of the achievements we've had in terms of stabilizing liquidity at the parent. Focus a little bit on our outlook for the rest of 2010 and then talk about the investment thesis for CapitalSource and our sort of key differentiators and strength that back that thesis.

Just going through the overview, CapitalSource is a leading commercial finance franchise focused on middle market lending, and we have proprietary origination, underwriting and servicing capacity within our company.

It's essentially the same origination model that the company has used since its inception in 2000 with some tweaks around the edges, but over that time we basically have accumulated about $8 billion of commercial loans and we have about 1,100 total loans, again focused on the middle market, focusing on working capital, growth, acquisitions and recaps.

In 2008, we started our own depository, actually by acquiring the assets of another institution, Fremont Investment & Loan, the retail deposits of that institution, and that bank has about 22 branches and about 50,000 customers, which is basically what it was when we started it.

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Very sound financial footing in terms of capital levels. You can see here 15.5% tangible common equity, its tangible assets, which is roughly about 1.8 billion of tangible common equity and about 11.5 billion of assets as of the end of the first quarter.

Low leverage of 4.8 times. Again, that's on a consolidated basis and you can see our diversified funding platform, which we have about 4.6 billion of deposits at the bank and we expect that portion of our funding to grow over time.

About 2.4 billion in matched funded commercial loan securitizations financing our sort of parent or legacy portfolio and that is sort of running out over time. And about another $400 million of credit facility borrowing that is run down fairly significantly and will continue to run down over the next year to 2 years. And we have a very seasoned and proven management team. The management team has largely been in the middle market lending space for 15-plus years.

Focusing on this slide for a while, there's a lot of information on here, but it sort of shows what we view as the key strength of CapitalSource and then what our current focus is to maximize or utilize those strengths in 2010 and going forward.

So the number one strength I mentioned. We have a nation-wide specialty lending platform, which gives us the ability to originate assets in our niche areas across the entire country. We have a stable deposit funding base at our bank. As I mentioned, we have about $4.6 billion of deposits. That same depository or the same retail branch network had $8.5 billion deposits at its high. So we feel there's room to grow the deposit base with the existing footprint.

And we have very high capital levels at both the parent and the bank. You know, I mentioned the 15% tangible common equity at the parent, and the bank has about 17 to 18% risk-based capital ratio, which is well in excess of its minimums.

What we're focused now on utilizing that strength is we're lending in our historically strong areas of healthcare, technology security and lender finance. And we've added a few new business lines in equipment finance, multifamily and SBA lending that we think really complement our existing platforms and our very good asset classes for a bank, especially the regional depository we have.

Growth. Our first quarter growth was one of our strongest quarters or certainly our strongest quarter since the fourth quarter of '08. We originated $243 million of new loans at the bank, and those loans were largely in some of our historical strong areas of performance including healthcare and equipment finance, one of our new categories.

At the bank, with our new originations, we're having smaller loan sizes. We have tighter hold sizes than we've historically utilized throughout the parent company and so the loans are smaller and more diverse than our legacy portfolio. And our current focus in growth is we're going to continue to rev that up. I mean, we put out our guidance that we expected to originate loans between 250 and 350 million a quarter. You can see that first quarter number was just at the low end of that range. We expect the second quarter to move towards the high end of that range and for future quarters to again be able to achieve the higher ends of those ranges.

In performance, and most of our recent performance on a consolidated basis has been driven by credit. You can see in the first quarter, we had significant decline in charge-offs and a lower loan loss position in the fourth quarter of 2009. These are still at very elevated levels versus where we've been historically and certainly a key focus of ours is to continue to manage the credit issues we've seen in our legacy portfolio, but principally in the real estate area. And we've reduced our operating expense in the first quarter. Focused on some of our third-party expenses related to working out problem assets and some of the restructuring transactions at the parent, but we feel

like we very much have a fixed cost base that we can grow the platform both on the deposit side and the asset side without significant increases in operating expenses.

And you can see our current focus there is to grow the assets at the bank, all of our new loans were originated in our bank, to enhance the margins and profitability of the bank while managing and achieving the maximum credit results for the legacy portfolio of the parent.

On liquidity, again, liquidity is sort of two different stories, one at the bank and one at the parent, and there's not a lot of cash they can move between the two entities. We've a strong liquidity position at the parent, and certainly much better than we were about a year ago. We've sold most of our healthcare net leased assets; those were the nursing homes we bought at the time we were REIT that we actually owned.

Most of those have been either all of those were basically behind a contract to sell and we expect to close on the final sales of those in the next – in the coming months. We ultimately realized about $500 million of cash proceeds from those sales and so that was a really important add to our liquidity.

We now have no scheduled debt repayments at the parent until July of 2011. And at the bank, we've always had very ample liquidity. The bank has about 2 billion of liquid assets, cash and investments. And it's actually been able to reduce its cost of funds while keeping sufficient deposits. And again, as I mentioned, we think we can grow deposits as needed to fund loan growth.

And our focus there is we think the market has improved in our ability to address our first debt maturity that I mentioned in July 2011, which is a put date on some of our outstanding converts. We think we can now do that with minimizing any dilution impact on our current equity shareholders.

And then finally profitability, the bank has a strong pre-tax, pre-provision earning levels and I'll show you some of the history of how they maximized that through minimizing cost of funds and improving margins. And I think ultimately the timing of return to profitability for the consolidated entity is based upon these credit outcomes largely in real estate, but again as we've said our expectation is that happens in 2010.

And ultimately the focus of that is to continue to make conservatively underwritten loans at wide spreads and funded by our low cost deposits at the bank and continue to manage operating expenses tightly. So there's a lot of information there, but again that's sort of our current focus on how we drive the business going forward.

This arrow chart sort of summarizes that a little bit on how we see the path to return to profitability this year. One is what I said, reducing operating expenses and again particularly focusing on third-party fees, which accounted for about 60 million of expenses in 2009.

Second is redeploying cash and lower yielding assets into higher spread loans. When the bank was formed, it had this A participation interest, which was an L150 with a slight discount that's been running down and turning into cash and we've been investing that in again lower yielding assets, but our goal is to keep originating our new loans.

In our first quarter, we originated loans at about 8.35 yield. So you can see that there is a significant margin increase by redeploying our cash in that A participation into our traditional commercial loans.

And then third, tightly managed legacy loan portfolio of credit performance to maximize return on those assets, and again, we'll have a lot more detail on that. And then finally continue to originate the new loans at CapitalSource Bank to grow the bank in its absolute size.

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Turning now to focus more specifically on the bank, this first slide shows you the bank's basic footprint and its current balance sheet. And again, as I mentioned, this bank was formed in 2008. The branch footprint is largely the same as it was at the time we formed it. The bank has always had strong liquidity and high capital levels. You can see, to what as I mentioned, the 2.2 billion in cash and investments and about $4.6 billion deposits, and total capital of just over $800 million.

Here's our focus on CapitalSource Bank, and again it's similar to the overall focus. We have a very focused lending strategy focusing on our areas, our niche areas, where we've had the best performance over the life of CapitalSource. And again, we're allowed to use our National Direct Origination team to originate assets across the country while funded in a regional depository in California.

The bank has ample liquidity and we see based on liquidity and capital, we can fund up to $2 billion of loans without adding any new deposits and we feel again that once we go through that $2 billion, we have the ability to grow the deposits in the existing footprint without adding any material expense to our operations.

This next chart shows the trend in the bank's pre-tax, pre-provision earnings over the last several quarters. And you can see there's been a very significant increase through the late part of 2009. A lot of that increase was driven by pushing down our cost of funds, which was done through managing our deposit book and there was a fair amount of competition in the California market as things were really stressed and some of those competitors have left the market or have not pushed pricing as aggressively, so we've been able to maintain our deposit levels while bringing our cost of funds down under 1.5%. And just to mention again here, the loan growth at high spreads where our first quarter all in yields were underwritten to 8.35%.

This slide shows the trend of the bank's capital levels both on a risk-based capital basis and a Tier 1 leverage ratio. As you can see, the risk-based capital level, although the absolute dollars have come down some as the bank has experienced some losses through 2009, the risk-based percentage level is almost at the level it was in Q4, 2008 when it was 17.4% and at 3/31/2010, it was at 17.35%.

The Tier 1 leverage ratio has come down some as we've added certain assets that are more capital favored, so you can lever those up a little more. But again, it's a very healthy number compared to banks traditionally viewed as well capitalized.

This next slide shows the bank's margin expansion and again it's reflective of that last slide over the last several quarters. And you can see spreads have widened as I mentioned due to the decrease in cost of funds you can see in the first quarter is down to 1.47% from starting off fourth quarter of last year more than double that.

And asset spreads have come up somewhat. Yield on interest earning assets, which is some of that redeployment as we've added new assets to the balance sheet in the first quarter and again, we hope that will continue to increase as we add additional new assets as we redeploy some of those other investments that are – excess liquidity at this point.

At the same time, we've been adding new assets. We have been building our reserve levels at the bank. The bank has a portion of its portfolio that is – that are legacy loans that are bought from the parent, and so we have some of the same issues that the parent legacy portfolio has in terms of real estate and other areas.

But you can see just from the slide the bank's been conservatively increasing its reserve levels now up to over $200 million reserves, which represents about 7% of our core loans, which is far in

excess about three times what the typical bank reserve levels are for those in the same size. So you can see the bank's been very proactive in terms of making sure it has significant reserves against any of the legacy portfolio.

Turning now to credit on a consolidated basis, what happened in the first quarter we took a fairly significant provision of north of $200 million and we now feel that the legacy loan portfolio reserves are at a level that we view is sufficient to cover our anticipated charge-offs on that static and run off portfolio. Despite the large provision our charge-offs were down 38% from the fourth quarter of '09 level through about $120 million and our provision actually was less than even the fourth quarter of 2009. However, our total allowance for loan losses is now up to 8.25% or 8.24% on a consolidated basis, which again is a very fully funded reserve review from – versus the portfolio.

Specific reserves were up 65% to $192 million. And some of the other credit debts also ramped up including non-accruals and impaired loans. It's important to note, as with the quarters before the first quarter and probably most of the second half of 2009, the real stress was concentrated in our commercial real estate book. You can see 61% of the charge-offs and 74% of the reserves were concentrated in commercial real estate. But we've reduced that legacy CRE portfolio down now to about $1.2 billion or under 20% of our portfolio. And you can see here that the legacy CRE reserves have increased significantly as we've continued to provision for that book, and again that sort of circles back to our first point here where we feel we're fully reserved now for any expected losses or charge-offs in that legacy portfolio.

This next slide. And I won't go into too much of the detail. In other words, you can see there is a lot of information on that, it gives you an historical trend for our reserve levels both general and specific, and then it shows how the specific reserve levels break out against our credit categories that we've been disclosing for the last several quarters. And it's basically what I mentioned before: you can see we have a very significant general reserve totaling almost $500 million, and the specific reserves are concentrated heavily in the commercial real estate categories of land and CRE other, which CRE other includes office buildings, hotels, et cetera.

This next slide gives you the trend of charge-offs by category. And I'll just focus on a few items there. It almost tells the story of how we passed through this credit cycle. If you look at the earlier columns, you can see most of the charge-offs were concentrated more in our cash flow products. And in late 2008, early 2009, when the credit markets were really seizing up and no one knew where liquidity was coming from, when some of our operating businesses that had liquidity issues, no one was willing to put cash in and these things came to a grinding halt at large severities.

That has for the most part stabilized. You can see the cash flow charge-offs have come down significantly over time. The place where obviously it's been ramped up has been in the space of our commercial real estate, which in the fourth quarter of 2008 the three top categories that we've used commercial real estate were only about a quarter of our charge-offs and over the three have been 50 and even in the last quarter topping out at over 60% of our charge-offs. So it really has become a commercial real estate story and we'll have a little more to talk about that in the coming slides, about why we think that is reaching the end of its cycle.

And some other key categories to focus on in the commercial real estate space. We had some significant severities in second lien real estate in the second and third quarters of last year, but again you've seen that has come down significantly as we worked through most of those assets in places like media, where we had a real concentration of losses in advertising-based media businesses. Again, for the most part the pain there has been taken and those, most of those assets that have been work through, and the reminder of our cash flow business or the reminder of our media business is not as focused on advertising-based companies.

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This next slide just gives you a little bit of a comparison of the fourth quarter versus the first quarter and points out some of the things I mentioned earlier about how charge-offs were down; provisions were down slightly. But you can see the allowance both in dollars and as a percentage of assets increased.

This next slide is one that we've been disclosing again for almost a year, which was our sort of expected loss by asset class in our legacy portfolio. And as I mentioned before, we expect the current level of reserves in this portfolio is sufficient to cover our anticipated future charge-offs. But that because the way sort of reserving policies work -- and again, we'll go into that a little more detail on a few minutes -- they tend to be a forward-looking estimate but based on historical evidence. So you can see we've reserved slightly above the top end of our range here against this portfolio.

And we expect commercial real estate credit trends to remain elevated and they were elevated in Q1 of 2010, which caused us to continue to increase reserve levels based upon our historical calculations. But ultimately, this slide tells you that we feel that we're sort of at the end of that reserving process. I think ultimately we expect now that the charge-offs will not be around the midpoint but maybe on the high-end of this range. But basically, we're still comfortable with the ultimate range that we put out almost a year ago.

This next slide just shows how things moved during the quarter versus where they were at the end of the year. And again just to point out a couple of things to show how some things can move, you can see in a couple of categories including media and mortgage rediscount then the numbers actually came down. Again that's a function of certain loans that, we may have been worked out or paid off at par and so the portfolio shrunk in no losses were realized or our loss experience got better. So it's not a one-way street I guess is the point to make there. But you can see the ones that have really experienced the moves in the stress are the real estate categories, again as I mentioned several times.

This next slide is something new, because as I mentioned I think there is some sense that we're sort of getting to the end of the some of this commercial real estate stress. And what we've seen over the last several quarters, a lot of the big numbers have been driven by some of the larger real estate loans – loans of 25, 50 even a 100 million plus in size. So we want to drill in a little bit around the commercial real estate portfolio that larger than $25 million.

And it's the first little point we will tell you at the end of the first quarter we had 16 total loans totaling a net current amount meaning original loan less charge-off of $820 million and those were the loans greater than $25 million. Looking back at the end of 2008, none of those loans were impaired, so they're all sitting on our portfolio unimpaired unmarked. By 3/31, by the end of the last quarter, 11 of these loans totaling $500 million were impaired an experienced charge-offs of 111 million, $115 million, sorry or 19% with an additional specific reserve of $111 million, you can see they are marked about 40%.

Sameer, there is only five left of this size that have not already been marked and already been marked significantly. So the pipeline of potential problems has shrunk considerably from where we were even five quarters ago. And if you look more closely at those five loans totaling 326 million that were not impaired at March 31. Two of them are Manhattan land loans. They are large Manhattan land loans that we've done a fair amount of talking about. But you can see based upon our historical loss factors on land they carry with them a very high – a very high general reserve percentage.

So again, our reserve methodology, which I'll talk about in more detail, basis our existing expectations on recent past history. And we've had a lot of loans in land area that we've had significant severity in, so we feel like that is a very sufficient and large reserve even if one of those

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loans are to become a problem. And then after you take away those loans the only three additional loans that are more than $25 million or between 29 and $32 million and again have fairly significant general reserve provisions. So again the key point there is if you look at it, in the first quarter much of our losses were on three hotel loans all about $50 million, we don't have any more of those hotel loans about $50 million. They are commercial real estate book in terms of the large concentrated loans has shrunk considerably.

So that's the take away, key take away point is that there are very few remaining non-impaired CRE loans. So talking a little bit about how we generate reserves, I think there were some confusion maybe from our first quarter call about how we actually go about generating these reserves. So the allowance for loan losses is comprised of Specific Reserves and General Reserves. And Specific Reserves are those reserves that are allocated to individual loans that we've deemed impaired, General Reserves are allocated to the rest of the pool of loans that are non-impaired, but is designed to capture losses that in the accounting terminology would be inherent in the portfolio meaning, there is probably some loss out there. It is just not clear exactly, which loan it is and how much it is.

So focusing on the Specific Reserves as I mentioned those are loans that are deemed impaired. And we identify loans for impairment based upon on the GAAP standards. And the way that works is we use our internal rating system to identify a population of loans, we've sort of say a watch list and below that we want to test for impairment.

And the way the accounting rules work is, a loan is categorized as impaired when based on any – our current information that we think it's probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement and I read that precisely because that's the way the GAAP standard works. So once we deem a loan is impaired meaning it has to hit a fairly high standard that it's probable they can't pay, then we do a valuational assessment to it, to determine do we need to take valuation allowance and typically that's on a real estate with an appraisal, on a cash flow with some sort of valuation estimate. And so loans that are deemed impaired and deemed to be under water, we take a specific reserve against, so one important point is that not all impaired loans have a specific reserve.

And then, finally, one other point about our reserve is the – there is probably allowance for loan losses assessed at each balance sheet date. As a former accountant or as an accountant I think the reserves as a balance sheet issue not an income statement issue. The income statement just sort of work itself out, so we determine what the appropriate allowance is and then the provision just becomes the change in the allowance plus our charge-offs during the period.

Drilling it a little bit more on our general reserves. We utilized our historical loss experience to estimate the inherent losses in our portfolio as I mentioned the sort of accounting term. And we used 12 different credit categories to calculate the general reserves some are real estate base, some are commercial based, asset based, et cetera.

And then we use the loss experience from several years of recent, seasoned vintages to determine what that estimate the historical loss experience will be. Of course, we determine that estimated historical loss experience, we're going to be weighted based upon our internal loan risk ratings, which we use our internal rating migration to determine effectively a probability default and therefore a loss by each one of these categories. Categories that have seen in the most severe stress recently have obviously the highest expected default rates. And then, when they have further negative rating migration, that leads to higher general reserves and other categories. And that's what we've seen recently especially in the land and CRE spaces.

And then, ultimately, with general reserves, it is, we do use judgment. There are management judgments and we do consider some qualitative factors, not just a purely mechanical model to

increase or decrease our reserve levels. And those factors include such things as loan concentrations, loan collateral, coverage types and the trends in our problem loan statistics on impaired loans, or non-accrual loans or delinquencies. On these qualitative factors, it generally led to increases in the Allowance in recent quarters, because as you've seen in some of our problem loan categories have increased rather than decreased.

When we think about what happened to our reserves in the first quarter, as I mentioned, we took some large incremental specific provisions on a small number of commercial real estate loans. So as I mentioned, three hotel loans accounted for $79 million and three land loans accounted for $48 million of our specific reserves, which was two-thirds of our total first quarter 2010 specific provision of 194 million. So as I mentioned, these are again concentrated in the commercial real estate category and as I mentioned, those hotel loans were all north of $50 million. And some of these provisions are the result of newly received appraisals, which in our view may reflect some conservatism based on the recent past as well as current uncertainty in real estate valuations.

Appraisals are obviously a very objective measure of value, but in certain market conditions, we view they can be somewhat conservative I'm going to give a specific example in a minute, as to one situation where that proved out. But taking those specific provisions, in turn worsened our historical loss experience that we used to calculate the rest of our general reserve. So again in land and CRE, the loss experience worsened considerably and therefore we increased our loss estimates against the rest of the non-impaired portfolio. And our troubled loan statistics also impacted overall view of the reserve levels.

So internal loan rating downgrades during the period increased the estimate of probability of default, which ultimately increased some of our general reserve levels. So in the first quarter, we both had large specific reserves that increased our historical loss experience and therefore led us to take larger reserves on to the remaining non-impaired portfolio.

Looking forward, our view of reserves in future quarters. We anticipate that the income statement provisions for the balance of 2010 will decline significantly from the first quarter level. As I mentioned, we feel now the legacy loan portfolio is fully reserved for us. So this by definition has to happen. As I showed you in the slide before, the population of the large unimpaired real estate loans has shrunk considerably. So a large percentage of that legacy book is now impaired and specifically reserved against. There are some limited exceptions. Our internal loan rating systems are showing some signs of stabilization.

And then this last key point, we start to see some loans being resolved at or above our marks. The first bullet point, here talks about commercial real estate loan that we marked to about 50% of its legal balance, based upon an appraisal because the loan had an event or an issue related to a tenant and so we deemed it impaired, did an appraisal and took a mark but ultimately subsequent to the end of the last quarter we sold that to a 25% recovery above our mark. So that is one example of where we perhaps some these appraisals now in this uncertain market condition are taking a little bit more of a conservative view point than what the market might actually bear.

And the second bullet here points out that certain other loans and REO in our portfolio are undergoing sales processes or workout processes and we've received situations with multiple bidders that have led to have I wouldn't call it a strong bidding or but some increase in prices. And some of already sold or under contract to sell for amounts at or above book value. There is another loan – excuse me, another New York City loan, real estate loan that we also sold for about $1 million recovery, which was 5 to 10% above the appraised value. So we're seeing more activity, more liquidity in the real estate space. We are seeing more conformation of our marks. In certain situations, we're actually getting recoveries against where we're marked based on our ability to work these loans out, and some of the buyers that are returning to buy some these distressed assets.

So turning away then from credit, I mean, we can have obviously questions during the Q&A session, we want to go back to that. One other item, it's been sort of a little bit of a – and often here is a talk little bit about our deferred tax assets because we've had a lot of discussions about that over the last year.

Deferred tax assets are basically the way of saying that I've taken some GAAP expenses for something that I haven't had to, the benefit of use along the tax deduction from a cash perspective going forward. We've reserved against our deferred tax asset by saying under the accounting rules there is some probability we won't actually be able to use that asset going forward.

That is a non-cash accounting charge only that goes through our income tax line or income statement and led to some severe some significantly high income tax provisions. And most of our entities have an allowance now against their deferred tax assets. The reason why we had to take those deferred tax asset reserves was because under GAAP, when you have a situation where if you look over your trailing 12 quarters you are in a cumulative loss position then effectively you can't assume that you are going to make any money going forward to utilize those future deductions.

So even though we're very confident we will make money going forward, from a GAAP perspective, we've had to assume we don't, and therefore, reserve against the DTA. There is no legal issue or tax issue for us, our inability to actually use those going forward. So we view that as essentially an off-balance sheet asset.

And you can see as of the end of the first quarter that has now grown to a fairly sizable number of $477 million, which equates to about almost about 50 a share. Reversing the valuation allowance, the accounting rules are not all of that precise or clear, but it's clear that we acquire some sustained period of profitability whether that's four quarters, six quarters, eight quarters that's not exactly precise, but some period of time of sustained profitability.

So that's sort of what the valuation allowance is. And then if you think about us in a situation with the valuation allowance, how will that impact both our tax expenses and our taxes paid for the next year to year and a half. But we have NOLs on a gross basis at about – of about 391 million as of 12/31/09.

In 2010, we likely, won't be able to utilize those rate tax benefits because when we do read it, we essentially became a non-consolidated tax filer. So the bank will not be able to utilize those NOLs with the parent in 2010.

However, in 2011, we can reconsolidate our tax entity and therefore the bank will be able to utilize the parent's NOLs for some lengthy period of time and therefore we will likely, we'll not be the cash taxpayer for several years.

Turing to the funding and liquidity, focused on the parent. If you look at our liability profile, you can see about 70% of our debt is non-recourse that's non-deposit debt and is used to fund discrete asset pools. And in the first quarter of 2010, we've reduced total debt by $400 million, which again was largely through some of the associated asset pay downs.

Our significant retail deposit base gives us a cost-effective funding vehicle not subject to the volatility of the capital markets, even though we have – we decreased our cost of funding in the first quarter we actually saw a net deposit inflow.

And then, finally, we have very low cost long-term trust preferred securities at the parent that are an attractive source of funding for the long-term.

This next slide shows you just how rapidly some of our debt balance has paid down even over just the last five quarters. You can see our total recourse debt is down by about a third from 2.1 billion to about 1.4 billion and our non-recourse debt is come down by about a quarter to a third from 4.4 billion to 3.1 billion. So the parent is de-levering fairly rapidly, as the assets pay down and therefore we pay down the associated debt.

This next slide just shows you where the portfolio by these credit categories is roughly financed or owned it gives you some sense of what the bank holds. I'd say the bank is somewhat underweight in some of the areas we've had some big issues on including secondly real estate and mortgage rediscount and is a little bit overweight in resort where we've had fairly good performance, little bit overweight in CRE but that CRE includes some of the newer loans we made since the banks founding, which are on stabilized cash flowing properties. And then looking forward to 2010, which somewhat summarizes the presentation and to focus on what our drivers of financial performance will be.

From a credit perspective, as we said again the legacy loan portfolio reserves are now projected to cover our future losses. So we expect then – the provisions that will be taking our income statement will just decline significantly going forward. However, the elevated charge-offs because of the reserve loans we have, will continue to be severe for several quarters before the allowance returns to more normalized levels.

From an asset origination perspective, again we think there's an improving business and lending environment and we've been able to add some highly profitable assets. I mentioned that the first quarter of this year was our highest origination quarter since 2008. And then we're adding assets that spreads that are above our targeted yields and going forward in 2010, we think we'll hit our 250 to 350 million per quarter projection and again, some of the scores including this one will be at the high end of that level which is 25 to 50% higher than what we originated in 2009.

On a cost of funds basis, as we migrate the balance sheet over to CapitalSource Bank, that should drive down the overall cost of funds and will increase the overall margin levels and I've shown you the bank's ability to reduce its cost of funds down to under 1.5%. And then the parent company credit facilities are higher cost compared to deposits, but as I mentioned the parent is de-levering fairly rapidly.

And then finally, we're focused on optimizing CapitalSource Bank, which is growing assets, loan assets that are higher yielding than the existing loan, some of the existing investments. And then managing our deposit levels in the CD profile to lower our cost of funds where possible and increase overall investment yields on the liquidity portfolio to improve our – improve our overall net interest margin.

Finally, thinking about our – sort of overall CapitalSource investment thesis and how we think we differentiate ourselves after the credit crisis and moving forward. We do, we have a viable and stable long-term business model. We have a national origination platform to originate assets in a period in which we think banks will struggle to find good asset origination opportunities and will face a significant asset gap that they'll try to utilize liquidity that's coming back to them sometimes from working out some of their troubled assets. And we coupled that with our deposit funding platform at CapitalSource Bank that we view is sufficient to fund our growth for the foreseeable future.

As I mentioned, both the parent and the bank have very high capital ratios, despite the credit charges we've taken to-date. We think our funded loan production will be significantly improved from last year from 1 billion to $1.4 billion level in 2010. We expect our pre-provision earnings to continue to grow over the next two to three years at the bank as the bank redeploys its lower yielding assets and the higher yielding loans. We expect the level of reserves to be sufficient to

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cover our future anticipated charge-offs in our legacy portfolio and by 2011 our credit losses should return to more normalized levels.

At the parent, we have no scheduled debt repayments for the rest of this year. And we expect to return to profitability in 2010 both at the bank and on a consolidated basis, so that timing as I mentioned before will obviously be dependent on some of the credit performance of the legacy portfolio.

And then, finally, showing how our strength to support that thesis, we view that we have a highly variable commercial lending franchise and again these asset platforms we view it's very valuable in this marketplace because our ability to generate non-traditional bank assets more than just CRE or residential CRE in our areas of niche expertise where we've had very good credit performance, makes us uniquely positioned to capitalize on some of the recent market dislocations.

Funding, we have virtually no funding risk we view for the loans funded to CapitalSource Bank, because we have strong access deposits and fixed rate FHLB borrowing. We have $1 billion line with the FHLB that we've only utilized about a quarter ago. And the funding profile for the legacy loans we view, we've largely taken care of by essentially lending those loans by extending the duration of the liabilities that fund those assets.

Liquidity is much stronger than it was a year ago with about $300 million of cap at the parent and obviously at CapitalSource Bank, they have excess liquidity. There, our capital ratio as I'd mentioned, the banks sort of flushed out high risk-based capital ratio it is sufficient to allow it to fund its growth for the next few years.

Conservative leverage overall, you can see how much parent company, the overall company has de-levered itself just in the last 2 years from 7.1 times to 4.8 times. Strong core earnings, the core base of loans has provided a strong core pre-provision earnings that we think we can grow over the next few quarters.

And then finally credit, we expect a meaningful decline, I mean our provisions and our – and going forward our credit cost, although charge-offs as we work through the remaining pieces of our credit portfolio we slightly elevated over historical levels, but by 2011 we expect the overall credit profile to return to somewhat more normalized levels.

With that I don't know what – how much time we have.

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QUESTION AND ANSWER SECTION

<Q – Sameer Gokhale>: We have a few minutes, couple of more minutes. Maybe I'll start off the Q&A with a question. Don, you talked about the – your reserving policy and provided some additional detail. But the question I had was, is it just a matter of trying to more finely look at historical credit losses and then use that data to your general portfolio, because it seems like I mean not all loans are treated equally, obviously, and you're using just a general pool of data for losses. It seems unfair to apply that reserve to the rest of the pool. So isn't there a way to more finely dice your portfolio historically for comparison purposes so then your reserve doesn't need to be as high as you need to have it?

<A – Donald Cole>: It's a good question. And over time we have refined the methodology by looking at different categories, I mean breaking out some of the cash flow groups like the media that have performed differently. Clearly, it's one of the goals of a reserving methodology is to have something you're not tweaking and changing too frequently. It's meant to be somewhat objective in the process, but we have made some of those adjustments over time to sort of look at some of the categories that have performed differently. You're right that it's probably not fair to say, you know, if you take the land portfolio and look at what's left, some of those are qualitatively different than some of the residential land asset that we lost money on in 2009.

You get to a point where you almost parse it too low and you'll get to the point of sort of the deep dive we did on the assets to say, hey, from our view of this what will happen going forward is X versus sort of using just this historical model leads to a number that's a little bit higher. Ultimately this thing will play itself out as the actual results work their way through.

So I guess the answer is yes. We always take a look at that a little bit. With the level of problem assets we had at the end of the first quarter and some of the other sort of mechanical issues that work the way through the portfolio, it was hard to kind of sort of tweak it in the way that would sort of stop on a dime if you will when we think we are at this fully reserved level.

So I think I view it as sort of typical bank cycles. It's not that unusual for banks to sort of over reserve. Reserves can be a lagging indicator on the way up you're behind for a while, and then you – end up being over-reserved at the back end and you release reserves at the end. That's not sort of an atypical outcome.

<Q – Sameer Gokhale>: Any additional questions? Tom?

<Q>: [Inaudible]

<A – Donald Cole>: You know, I think when we think about normalized long-term allowance levels, we see it more back in the 2% range. I think historically we're slightly below that, and based on duration of our assets, you could see that being a – an income statement provision level of somewhere between 60 and 100 basis points on an income statement basis.

But a lot of that's dependent upon long-term loan mix. As I mentioned, we've been focusing heavily on areas where we've had the best historical credit performance: more asset coverage, equipment finance, SBA loans. Those will have significantly better credit performance than some other traditional transitional real estate or cash flow lending that we'd done in the past.

<Q>: [Inaudible]

<A – Donald Cole>: Sure. At the end of the first quarter, I think our cash on hand at the parent was about $282 million, I believe is the number we showed. We've talked about these healthcare net

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lease assets we're selling. The last two steps of that should take place in the next month or two, and that's about $100 million of proceeds. We had about 25 million on equity proceeds from the first step of that that we never sold. So that's in that calculation as well.

Your point of -- 25 million of equity proceeds that we'll realize. And to your point about over-collateralization that will return to us, if you look or have looked over at the last several quarters at some of the slides we show about where specific securitizations are, where specific credit facilities are, some of them paid down fairly rapidly.

There's one specific securitization in there, I think it's the 2007 A-1, that has significant over collateralization. It's actually paid down fairly quickly, and when those assets are fully paid off that will start generating more cash for the parent company. So a few of the financing vehicles will start to yield cash. Some of the remaining residual sales of these healthcare assets will yield some cash.

And as I pointed out, we're starting to see a little bit more traction in some of our REO portfolios and other foreclosed asset portfolios that will generate some cash as we work towards those debt maturities.

The syndicated bank facility, again, we view the assets within that facility as they pay down, there's a pay – repayment formula. I think we pay 70% of proceeds to pay down principal of that facility as the assets pay down. So those will naturally pay it down over that remaining life. And then we think there will be significant cash growing at the parent that will help us address some of the other debt maturities.

<Q>: [Inaudible] .

<A – Donald Cole>: As the loans underneath payoff and pay down, yes, it will pay itself off, and it's paid down fairly rapidly even from the point in time. It was about a billion dollars at the end of the first quarter of last year. We've refinanced effectively about 300 million, but the rest has been paydown, and the commitment level, I believe, at 3/31 was $200 million.

<Q – Sameer Gokhale>: Okay. I think we have time for just one more question. Was there one in the back?

<Q>: Yeah. Could you just discuss at the current time how you prioritize the various options for paying off the convert in 2011? As the credit markets have gotten a little bit choppy here in the last month, I think you start to think about a little bit of refinancing risk. So maybe if you could kind of talk about your current thinking around that, that would be helpful.

<A – Donald Cole>: Well, I think our current thinking is a little bit of an offshoot of we were just talking about for which is as we started to see a little bit more asset realization and paydown, we think our ability to generate or accumulate cash at the parent makes something of a more cash solution a little bit more of a workable option for us. I hear your point about recent choppiness in the market. We still think there is an ability for us over the next -- we still have 14 months before the first one comes due to if necessary work out some sort of debt solution.

But I think our goal remains the same, which is to avoid dilution as much as possible to our equity shareholders and do something that doesn't sort of do another locked-in long term no-call piece of debt that's fairly expensive while we're going to be generating this cash. So I think we're sort of focused on this ability to utilize cash on the balance sheet is a way to pay off the coming converts.

<Q>: Great. Thanks.

Sameer Gokhale, Analyst, Keefe Bruyette & Woods Inc.

Okay. Thank you all for joining us, and I'd like to thank the CapitalSource team for being here today.

Donald F. Cole, Chief Financial Officer

Thank you.

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