FINAL TRANSCRIPT

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CORPORATE PARTICIPANTS

John Delaney
CapitalSource Inc - Chairman & CEO

Dean Graham
CapitalSource Inc - President & COO

Tom Fink
CapitalSource Inc - SVP, Finance and CFO

Bryan Corsini
CapitalSource - Chief Credit Officer

Chris Hague
CapitalSource Inc. - Managing Director, Rediscount Group

Bill Polk
CapitalSource Inc. - Managing

Dan Duffy
CapitalSource Inc. - Co-President, Corporate Finance

Jim Pieczynski
CapitalSource Inc - Co-President, Healthcare & Specialty Finance

Mike Szwajkowski
CapitalSource Inc - President, Structured Finance

Keith Reuben
CapitalSource Inc - Co-President, Healthcare & Specialty Finance

Mike Sznajder
CapitalSource Inc - Chief Credit Officer, Corporate Finance

Mike Keller
CapitalSource Inc - Managing Director, Restructuring Group

CONFERENCE CALL PARTICIPANTS

Jim Shanahan
Wachovia - Analyst

Sameer Gokhale
KBW - Analyst

Steve Grangee
Grangee Capital Management - Analyst

Carl Drake
SunTrust - Analyst

John Hecht
JMP Securities - Analyst

Brian Hogan
Piper Jaffray - Analyst

Omotayo Okusanya
UBS - Analyst

PRESENTATION

John Delaney - *CapitalSource Inc - Chairman & CEO*

Welcome and thank you, everyone, for coming. I've always actually like the story of David and Goliath, not just because it's the story of someone overcoming tremendous odds and prevailing, because there's lots of stories like that out there in the world certainly. But I like the story because of a subtle detail that's in the story.

And they say that when David first saw Goliath, this giant formidable warrior, his initial reaction was not to do what most people would do, which was to step back, they say he actually stepped forward. And he stepped into a crisis and he was able to step into this crisis because he was confident that he was prepared for the day, he was confident in who he was and he was confident in the plan he had.

And I think it's informative, when faced with a crisis or a difficult circumstance, if you feel like you've got a plan and are prepared, the best course of action is to step into it, which is what CapitalSource, in a much smaller and less historic way, obviously, is doing in this market context. And what we plan on doing here with you today is spending time not only doing what we normally do in an investor conference, which is to provide a deep dive about our business, which we'll be doing, but also to spend some time talking about why we've built the business the way we have. We've always -- we've built the business with a view that things could get worse and I think everyone would agree things have gotten worse. And we have a plan as to how we'll deal with this situation and we plan on spending time on that.

So let me go over the agenda very quickly. I'm going to start with some relatively brief high-level comments and then I'm going to turn it over to Dean Graham, who is at the podium with me, who is our President and Chief Operating Officer, who will really provide that deep dive about our business. And Tom Fink, our Chief Financial Officer, will talk about liquidity and Bryan Corsini, our Chief Credit Officer, will talk about credit. And credit and liquidity are obviously very much related, particularly these days. And then we'll have a Q&A session for the four of us.

So we'll have a break and then Jim Pieczynski who is the Co-President of our Healthcare and Specialty Finance business, but is really in charge of the real estate aspect of our healthcare business, will talk about our new Net Lease segment in healthcare, which is a business we've had for a few years but we recently broke out as a new segment.

And then we thought we'd do something different this year is we have two panels. And Mike Szwajkowski, the President of our Structured Financial business, will moderate each of these panels. The first will talk about our lending process, which gets to why I believe we're prepared for this market opportunity -- or this market situation, and he'll also then monitor a panel about the Specialty businesses within CapitalSource.

So let me start and I'll start from the top. In my judgment, CapitalSource is the premier commercial finance company in the United States, with a particular focus on the middle market. We have a very large, fully built out platform with about 550 employees in the Company at this point and we have a large footprint in several businesses that are attractive in the U.S. economy. But what we don't do is we don't necessarily lead as a generalist in the market; we lead as a specialist, and that's a very important theme in terms of how we run the Company and what our asset strategy is.

We've taken this business and we've organized it around specialty business platforms. And these platforms either focus on a particular industry, which is our preference and we think is clearly the right answer in terms of how to run a lending business, or they focus on a particular sector. And they also share another common attribute in that they offer what we like to call our high value add financings to our customers. And what I mean by that is we're either financing an acquisition, we're financing growth or we're financing a recapitalization transaction.

So we're dealing with the most senior decision makers in the Company and if we do that well we believe we can get paid an additional premium for the level of service we provide, not just for taking additional credit risk. And we believe all these businesses benefit from significant barriers to entry in that you need expertise to successfully originate, underwrite and manage these assets and these target markets.

But at our core we're really a credit shop and I like to say we have a hands-on credit-first approach to the lending business. And what that really means is we like doing senior debt because it's safer, we like originating the loans ourselves, we don't like buying loans from other people and the reason is because we like doing all of own credit work, we think that leads to a much better outcome. And we like servicing these assets.

So it's a very intensive model. And in fact we actually are a very process-driven business and there's a process that we apply around the Company that we really think is our edge in the market, we call it our dual track underwriting system. Now we've actually been employing this process in lending money to middle market companies really since 1993 when I started my first finance company, which was a healthcare lending business. And while this model is very people intensive, again this company has about 550 employees applied against our various lending strategies, in my judgment, and I think our track record speaks to it, it clearly produces a better credit outcome.

And so we focus on really three areas and Dean will spend much more time going around these businesses and filling in the details around these businesses, but it's effectively three big lending platforms. The first is the Healthcare business and there's a whole variety of asset-based lending platforms beneath our Healthcare business. Then we have a Structured Finance business which either provides senior asset-based loans to other finance companies or engages in commercial real estate financing.

And then we have a Corporate Finance business which principally focuses on senior debt to finance middle market leverage buyouts. But we do it principally across specialty platforms, in other words platforms focused on different industries. And we believe this level of specialization that we have in the Company allows us to bring value to our customers. And we bring value to our customers in terms of speed, in terms of flexibility, in terms of expertise, we can be thought leaders with them in terms of structuring the transactions that best meet their needs, and in terms of providing a higher level of customer service.

And again, as I said a minute ago, what we try to do with the Company is, by building these specialty platforms, provide this better level of service and get paid for that. Because I'd much rather get paid for working harder and being smarter around a customer's needs than get paid for taking credit risk. And CapitalSource has been able to maintain very high unlevered yields on our assets, in my judgment, by doing this stuff really well, these qualitative aspects of our business, and not by stretching for credit.

What we bring to investors is several things, first a dedicated, very cohesive team that has worked together for a long time. And I think this is always important, but it's particularly important in the kind of markets we're in now. We bring a deep credit expertise, we bring a very disciplined view of pricing, we have a leading brand in our market and we have a platform that can certainly grow. And we also have very good alignment with our shareholders, that 36% of the Company at this point is owned by the Board and management, so the notion that you don't wash the rent-a-car certainly doesn't apply here.

And what does that mean in terms of what we deliver? Well we deliver a high return on equity. I mean, at the end of the day the reason a financial services company has a balance sheet is to deliver high ROE. There's lots of financial metrics that financial services companies track and we track them all and we'll talk at length about them. But at the end of the day there's really only two questions I think that need to be asked most fundamentally about a financial services company with a balance sheet. The first question is what's your return on equity and the second question is how much risk do you take in giving me that return on equity.

And I think CapitalSource answers those questions as well as any other balance sheet oriented financial services company in that we earn a high return on equity through sound lending. We don't necessarily earn a high return on equity through financial leverage. And if you look at our results on a pretax basis across the last four years, 28%, 34%, 28% and 24% pretax return on equity across the last four years.

I wanted to touch on our decision to be treated as a real estate investment trust for tax purposes which, as most of you know, is a decision we made two years ago. And when we made that decision there were really two things we were hoping to get out of this election. The first is we were hoping to lower our taxes and the second thing we were hoping to do is to make our real estate businesses more competitive by allowing them to achieve this return on equity hurdle that we have for the business, which is quite high, to do it in more liquid markets and allow us to expand the opportunity sets and allow those real estate businesses to go after stronger customers.

We believe we've achieved these two standards. Across the last two years we've saved between 150 million and $200 million in taxes. These are taxes we would have otherwise paid in our real estate businesses if we were treated as a C corp. We can't quantify the number exactly because there's allocations that go on between these various entities, but it's somewhere between $150 million and $200 million.

And then in terms of making our business -- our real estate businesses more competitive, I think you'll see first evidence of this in a few minutes when Jim Pieczynski talks about our Healthcare Net Lease business, which was a business we were not in two years ago and we would not have been able to be in it but for our decision to be a REIT. And we think it's one of the more valuable portfolios in the Company.

And so as we look back two years later, we do think the REIT decision has been a sensible decision, it's been a sound decision, it's achieved our objectives even though we don't necessarily present ourselves as a REIT. If you look at us most people say they're a commercial finance company, which is true we are a commercial finance company, but we happen to have 48% of our assets that are real estate related in some form and the REIT has driven those benefits.

So let's talk about what's happened in the markets the last six months, and I certainly don't need to educate anyone in this room about it because you see it and live it every day. But I think it is informative to spend some time talking about it because it does frame the discussions that we'll have this afternoon. Obviously we're experiencing what I like to call -- is an utter collapse in the capital markets. And it seems to me this collapse has occurred across two different phases.

The first phase occurred in the summer when the problems within subprime became very apparent to people and it caused a fairly massive sell off across all asset classes. And we saw this in July which was one of the reasons we made the decision to do our convertible transaction, which at the time was somewhat controversial. We had a securitization ready to go that we weren't able to get done and we saw some disruptions in the market. And I would say this phase one continued into the early fall, which really then triggered phase two.

All of the pains and write downs associated with phase one caused most of the major Wall Street banks and many of the other large or regional banks across the country to either reduce the size of their balance sheet through deleveraging or to raise capital. And that's even put more pressure on the market and the selling overhang is very significant. And the interesting thing about this crisis that we're in is that it's very much focused on the AAA buyer. It could be focused on the junior buyers as well, but you don't even know that because you can't really get past the AAA buyers.

And I think that's what makes it unique relative to other situations that have occurred in the capital markets, which is there's no liquidity on the short end of the AAA investor, who seem to all basically just want their money back. And in many ways this crisis is more significant than other crises because, like most things in life, your greatest success is your greatest weakness or your greatest strength is your greatest weakness. We talked a lot across the last several years about how these capital markets that we have are so robust and so liquid and so efficient, and we've been able to de-emphasize banks as providers of liquidity in the market.

Well the nice thing about being a bank is that your funding is not tied to your assets. So even if people have a lack of confidence in your assets, based on the government guarantee of $100,000, they still get funded. Well that's not true in the capital markets, the capital markets are confidence based markets. And if there's confidence in assets or there's confidence in pricing, there's a real lack of liquidity and that's why the situation is really -- is so significant.

So what does this situation mean for CapitalSource? Well it really means three things, one of which is positive and two of which are negative. And in my judgment the things that are positive have the opportunity to persist across the long-term and the things that are negative I would characterize as either short or near-term, in my judgment, in terms of how they'll work for our business. So let's first talk about the positives.

By any measure this is a terrific environment to lend money in, whether you look at pricing, whether you look at structure, whether you look at terms. It is the best market I've ever seen, and I've been in the lending business since 1993, to provide liquidity. Spreads are high and your opportunity to put money to work in new originations, obviously there's an enormous opportunity to put money to work in secondary paper, but your opportunity to put money to work in new originations is incredibly attractive right now.

And I think this situation will persist because I see that a lot of our competitors across the last several years have been small teams of people without much of a business, with a pool of capital and a warehouse credit facility. And I don't think that those people will be returning to the market any time soon, if ever, and we'll talk about this, but really most of our competitors have left our market. So it's a terrific time to lend money. That's the good news.

The bad news is our ability to leverage our business is less than it's been and certainly less than we thought it would be at this point. And in fact we've actually taken steps to delever our business. This is not a negative in the classic sense of the word but it obviously does affect the return on equity in the business.

And the second negative is funding costs. We've seen a significant increase in funding costs. Obviously not our whole balance sheet because we have a lot of our balance sheet that's securitized already and those liability spreads are locked in. But we do, unfortunately, have debt in our warehouse credit facilities and those warehouse credit facilities are repricing and there's been a whole variety -- a whole set of anomalies around prime, LIBOR, CP, which Tom will talk about, that have squeezed our margin.

And so what does this do to our ROE? Because again, we think about our business first and foremost in terms of ROE, ROE translates into earnings per share. We see in '08 that our ROE will be negatively impacted in that the benefit of the increased spreads on the assets do not offset the deleveraging of the business and the increase in the cost of funds. That's just a fact, we talked about that pretty directly in our last conference call. But we do think over time it will. We think our ability to originate assets at higher spreads will start overcoming for the deleveraging and the increased cost of funds and that this business, I'm very confident, will return to the same ROE profile it had in the past.

So let's talk about our report card for '07 because I think that's a fair thing to do as we look into the future. And I've broken this down into two categories -- what worked and what didn't work. We'll start with what worked. Credit worked, asset quality worked. As I said in the beginning, we view ourselves as a credit shop, for years we've been talking about how our credit processes will lead to very strong credit outcomes. And I think certainly relative to other peers that we have, we've consistently put up good credit numbers and in fact, across '07 our credit performance has actually improved. So asset quality worked in '07.

Our funding strategy worked in '07. We actually set up this business with a view that these capital markets could experience significant disruption and we built our funding strategy around that view. That view informed our position on leverage and informed the position in terms of how we set up our warehouse credit facilities. And that worked in '07, our funding and our liquidity now is solid.

And as I like to say, I mean, no one has come through this market unscathed, unless you bet against the market which is not what we're in the business of doing. And the pain is really felt one of three ways, or perhaps all three -- it's felt in asset quality, it's felt in liquidity and it's felt in terms of profitability. Clearly based on the comments I just made, this situation has affected our ROE, our profitability, but has not affected our asset quality and has not affected our funding. And to me the first two, asset quality and the funding strategy, are the essence of value in financial services. I believe we can work through to get the ROE back to where it was.

The other thing that worked is operating expense management. We had built across the first six or seven years of the Company's existence a very good sized business, we fully built our infrastructure and we really focused in '07 on better leveraging that infrastructure and making it more efficient. And we made terrific strides there, you'll hear about that later. Our market positioning improved in '07 as well and certainly in Healthcare, one of our most important businesses, this decision to become a REIT which allowed us to get into sale lease back business really has made that business more competitive. And there's examples of that throughout the business, which we'll touch on.

And our Residential Mortgage Investment Portfolio worked well in '07. As many of you know, we built up a portfolio of Residential Mortgage assets, principally agency securities, to help qualify and optimize our REIT election. And other people pursued a similar strategy to have a similar compliance portfolio. Our team, both in terms of how the strategy they laid out for that portfolio and how they executed against that strategy, they did a terrific job because we had none of the issues that some of our peers had in that business.

And I'm really proud of the job they did, you couldn't think of a market that came under more siege and our portfolio of heavily hedged, largely agency securities did just fine. So that's what worked; credit, funding, our operating expense management, our positioning in the market and our Residential Mortgage Investment Portfolio.

So let's now talk about what didn't work. One of the first things I wanted to touch on was what we call our CLO business, and this is not to be confused with the CLOs that we've used historically to finance our business, which is a completely different animal. In those situations, as Tom will describe, we're not selling 100% of the capital structure, it's really a financing transaction for us.

But in our CLO asset management business we established a business a few years ago whereby we would buy loans from other lenders and rather than putting them on our balance sheet, we would put them in vehicles that we manage and we would effectively sell through a CLO the entire capital structure out. It's called a CLO arbitrage business. And the reason we did this was not so much be we wanted to be in that business but we did it to make our syndication efforts more effective. Because in order to sell loans in the market, which we do a lot of that, you have to buy loans. And we thought it was better to buy loans in a managed vehicle like this than to buy it on our balance sheet.

The first CLO we launched, we invested, we got the CLO permanent financing done around the transaction and we were managing that vehicle for a management fee and had basically no capital at risk. So we got one CLO done. The second CLO filled up, this is 100% -- the way these things are structured is we have 100% advance rate against these assets, they're off our balance sheet, we're about to take that CLO to market in the summer. And based on what's happened in the market, we're not able to get that done. CapitalSource has very limited recourse in that CLO, it's up to about $10 million. And then the third CLO we're about to ramp up and then, based upon what happened in the market, we stopped ramping it up any further.

So what we've decided to do is exit that business. We sold the management agreement on our first CLO for somewhere between, I think it was $3.2 million was the final price, and then the second CLO is still out there, it's off our balance sheet and we have a very limited exposure against it. So the CLO business didn't work. It would have been nice if we would have ramped up more of these things, we would have had more asset management fee income, but in light of today's market opportunity there was really no opportunity for that business so we've exited the business.

The second thing that didn't work is our deposit strategy. As most of you know, we've talked extensively about our desire to have a depository institution as part of CapitalSource. We still have a view that that strategy makes terrific sense for this company. At the time we announced our acquisition of TierOne Bank we said we wanted to have deposit based funding for two reasons. The first reason was that it would lower our cost of funds potentially significantly over time and make the business more profitable, increase the ROE of the business.

But the second things we said is that positive based funding is inherently more stable. And we produced some data that showed how BBB spreads in the market trade when there's a period of market disruption and then what the depth or availability of that market is and we compared that to what happens to depositories.

And we were able to demonstrate that, in periods of market dislocation, depositories cruise along, assuming they don't have major asset issues, they cruise along and there's dramatic depth to the market and pricing stays stable, whereas the capital market stuff moves all around. I don't think we have a slide big enough to show how much that capital market stuff is moving around right now and the depository funding is hanging in there to be a fairly stable source of funds.

So I think our original insight, or our thesis around deposit based funding, still makes terrific sense for this business and will make this company more profitable, more stable and more valuable in the long term. However, we weren't able to execute against that strategy in '07 for a variety of reasons and that's a disappointment, obviously, because it would great if we had that now. So that didn't really work as well as we had wanted it to.

And the third thing that didn't work is our warehouse credit facility management. And this is somewhat linked to our depository strategy in that our business plan was to originate in our warehouse credit facilities, which we've structured in a way that derisks them and Tom will talk about that, but then to move those things into securitization transactions. We had a little more in our warehouses than we wanted when the market disruption occurred. And the reason for that, principally, is we had loans in the warehouses that we were keeping there to put in the depository, TierOne Bank.

Based on what happened in the market and based on the fact that TierOne hadn't closed and based on the fact that we weren't able to get a good sized securitization done that we had teed up in the summer, based on what happened in the markets, we made the decision to do three securitizations in the fall, these were private securitizations where we sold the bonds to one buyer. They were more expensive than we wanted but in hindsight it turned out to be the right decision. So this didn't work out as well as we had planned either. So that's our report card for what didn't work.

So as we focus on '08, let me go over our priorities. First is to continue to manage our credit book. We've done a very good job with this so far and I believe we'll be able to do it even in a recessionary environment. And Bryan Corsini has a very lengthy discussion about credit, which I'm sure everyone will be interested in, so I don't want to say too much more about that.

The second thing is to restart our securitization program. And again, Tom has a lot to say about that, see how I'm passing everything off to everyone else here. But it's a very high priority for us and we believe we can do that as well. Third, we want to continue to reduce operating expenses. Obviously there's been margin compression based on what's happened in the market and we think it's important for us to focus on reducing our operating expenses to make up for some of that shortfall. And we believe we're in the kind of market that we can do that.

Fourth, we want to explore ways to more aggressively leverage the platform to take advantage of the market opportunities. The market opportunities that we're seeing in terms of our ability to lend money are terrific and we want to make sure we have as much dry powder and capacity around doing that as possible. And then finally and most importantly, and it's really the punch increase of all these other things, we want to position the Company to return to its $2.40 per share in adjusted earnings, which I believe we can do.

And so I'll conclude here by touching on some of our business principals. When we took the Company public we laid out ten business principals for the business, which are on our website and I encourage everyone to look at them because it really does speak to how we think about the business. But this slide actually appeared in our IPO offering presentation, or at least it did for a while and then people probably took it out, and it was really a summary of how we think about the business and the things that are important to us.

First is this credit first approach. We really view ourselves as a credit shop and that's the most important thing we do. Secondly we try to organize and lead with uncommon talent and I think, as soon as I stop talking and other people do start talking, you'll see what I mean by that. We've built the best team in the business and the fact that we're together and we've worked together for a long time is a huge advantage to this business.

Third is valuable original input and multiple viewpoints and I think this is particularly important in the credit business. Perhaps in the equity investment business it's good to have unique insights and to go out there on a limb or take risk, but in the credit business you don't really do that. In the credit business you want a lot of people talking about credits. You want people from all different perspectives talking about credits, you want people who have an accounting head set that talking to people have more of a business head set talking to people who have more a legal structuring head set. That's the way you come up with the right answer for good credit work and that's key to how we run the business.

And then finally, create a spirit of cooperation among our team so that we can execute as effectively as possible. And we continue to refine these principals with commitment, realism and integrity. So with that I'm going to turn it over to Dean who will do the deep dive, if you will, about the business.

Dean Graham - *CapitalSource Inc - President & COO*

Thanks, John. For the next 20 minutes or so I'm going to dive a little deeper into our core Commercial Finance business, walk you through some types of the loans we use in those businesses, walk you through a little bit of the processes of those businesses and talk a little bit about the markets, the current update and the strategy for 2008. After my presentation you're going to hear from a number of other people across these businesses throughout the presentation, particularly after Bryan Corsini and Tom Fink finish up. And so you'll have a chance to listen to a number of folks who run a variety of the different businesses we're going to walk you through right now.

Our Commercial Finance business is clearly the engine of CapitalSource. It currently occupies about close to 60% of our asset distribution. Here on the left you can see that Healthcare Net Lease business is 6.1% and our Residential Investment Mortgage Portfolio is about 35.1%. Tom Fink will detail more on the Residential Investment Portfolio and Jim Pieczynski, later on in the presentation, will talk about the Healthcare Net Lease business. In terms of capital allocation, our Commercial Finance business consumes about 75% of our capital.

CapitalSource was built from the beginning to be a diversified financial platform. Many of you are familiar with some of these businesses and some of you may not be familiar with any of these businesses. What I'm going to try to do is walk briskly through the businesses, lay out what they do and then we'll have a chance to dive into some more detail later on in the program. All of these businesses really fall into three general categories for capital. We have three central businesses that we run all of our Commercial Finance operations out of -- our Corporate Finance business, our Healthcare business and our Structured Financial business.

Our Corporate Finance business makes principally senior loans in the context of sponsored leverage buyouts. Our Healthcare business really makes two or three principal types of loans, they make real estate loans to owners and operators of senior housing facilities across the United States and they make asset-based loans. In addition, you're going to hear from Bill Polk about our Security Finance business, which makes asset-based loans to Homeland Security and defense and public safety companies. That also is in our Healthcare and Specialty Finance business.

And our third business is our Structured Finance business, which houses our Commercial Real Estate business and our Rediscount business. So within these six broad categories we essentially conduct all of our lending activities. We also have some fee businesses, which John mentioned, our syndication business, and we have a HUD servicing business, which we'll talk about. And we often detail our CapitalAnalytics division on this page, which is our forensic auditing department.

All of these businesses share a number of common attributes and one of those is they benefit from our national origination platform. We have 23 offices around the United States and in Europe and we think we have the best middle market origination platform of any company in our class. All of these businesses utilize the service of CapitalAnalytics in one way or another. CapitalAnalytics has about 80 people to 90 people at any given time and they essentially operate as our in-house forensic audit department. And they do all of the deep dive granular credit work that we do before we make an investment decision.

So all of these businesses share the utilization of CapitalAnalytics, they share our origination platform and they also share a few other things which you'll hear about later on, which is they all conduct their business in a similar manner with respect to credit, with respect to process, with respect to how they get deals approved and with respect to how they manage loans that are approved and closed.

Our business remains diversified. On the left you see our loan portfolio by lending group and on the right you see our loan portfolio by product mix. For those of you that follow the Company pretty closely, you may notice that Structured Finance and Healthcare at 40% and 30% is somewhat different than you may have seen last quarter, and that's because of our Sale Leaseback business which we are breaking out, which you'll hear more about from Jim Pieczynski later on in the program.

Okay, with that I'll dive right into the three business groups, starting with our Healthcare and Specialty Finance business. Our Healthcare business and Specialty Finance business makes a number of different types of loans. We make first mortgage loans in the context of acquisitions secured by real estate of healthcare facilities, we make asset-based loans secured by accounts receivable, equipment and other assets. We also make cash flow loans specifically to healthcare companies -- healthcare sponsors who are in the business of buying healthcare companies.

We also have a HUD business, which -- where we make fees providing our client services to access long-term financing from the government. And the average loan size in the Healthcare business remains very granular at $10.2 million per client. We've always been in the Healthcare business, as John has mentioned, principally because of the market opportunity. Healthcare is a sixth of the U.S. economy, obviously the demographic trends and political trends continue to be very favorable and more importantly, it's dominated by small and mid-size borrowers. It's been under served by traditional lenders and it is generally unaffected by certain general economic conditions.

The other thing about healthcare is it's always undergoing rapid growth and change. So when we started this presentation we talked about how our entire business is designed to focus on different specific niches in the middle market, healthcare is really a classic example of that. We lend to a market that we know well, we lend to a market that's not served well by banks and by Wall Street and we have invested mightily in resources in both our CapitalAnalytics and our clinical reimbursement areas to make sure that our lending in this area is as strong as it can be.

Our target borrowers in Healthcare and Specialty Finance are owners and operators of senior housing properties, middle market healthcare service companies, hospitals, home health companies. In our Security Finance area we also lend to security alarm dealers and government contractors focused on Homeland Security and public safety. And again, you'll hear more about that from Bill Polk later on in the program.

Our competitive advantages, and you'll hear me talking about these competitive advantages several more times as we go through the other business groups, are a number of them. We have intense collateral -- we go through intense collateral review of all of our healthcare deals, we control our funding often through lock-box arrangements, we have invested heavily in in-house reimbursement and clinical expertise.

We have what we call our own proprietary loan management capabilities and that is to say not only are we leading with people who understand how to make a healthcare loan and who know how to underwrite a healthcare loan before we actually make that healthcare loan, after we make that healthcare loan the people who are managing these assets are typically people with ten to 15 years experience. And so we believe that that is a great strength of our company.

We have unmatched healthcare workout experience and we're going to have a part of our presentation later on, you're going to hear Michael Keller talk about our workout experience both in the healthcare context and our broader business. And in general we feel like all of this adds up to deep domain expertise across this Healthcare and Specialty Finance business.

So let's talk about what's going on today and give you a quick update. Our current market is obviously undergoing a massive dislocation and this is presenting lots of new and interesting business opportunities, particularly for the Healthcare and Specialty

Finance business. Specifically, our Healthcare asset-based lending business and our Healthcare real estate business is benefiting from the recent exit of some major competitors in the market.

Those include Merrill Lynch Capital, Credit Suisse First Boston and the general absence of Wall Street -- the ability of any middle market borrower to access in any meaningful kind of way any sort of Wall Street financing. So the market conditions are adding up to less competition and that's dictating higher pricing and tighter structures. And we are, across our company and particularly in Specialty Finance, trying to price deals with pricing and structure that reflect the current economic conditions.

Going forward in 2008 Healthcare and Specialty Finance strategy is really quite simple. It's to focus on our franchise. We're going to emphasize supporting existing clients but we believe we can continue to gain market share through the absence of competition and the disarray that's out there today. We're going to, as I said, price new opportunities consistent with these conditions and we're going to maintain our focus on our portfolio and our credit as we always have. We think in general the market conditions today are such that we can continue this business, can continue to move up market at higher spreads.

The second business I'd like to delve deeper into with you is the Structured Finance business. Our Structured Finance business makes several different types of loans. They make asset-based loans and they make senior asset-based revolvers to finance companies and they make first mortgage loans, predominantly in our real estate business. The average loan size in the Structured Finance business is approximately $19 million.

The market opportunity for Structured Finance over the years has been strong. These are the market segments we focus in, typically require expertise, speed and execution. They're generally fragmented and under served and the customers in our market are typically looking for more highly customized solutions. Our target borrowers are specialty lenders, mortgage companies, consumer and commercial lenders, real estate developers, investors and funds, some sponsors -- real estate sponsors and some privately held finance companies.

And our competitive advantage in this -- in Structured Finance, much like it is in Healthcare, is our sophisticated structuring capabilities, our flexibility expertise, our speed our ability to use our balance sheet to provide one-stop financing solutions. In our Lender Finance area, much like in our Healthcare area, the group specializes in intensive collateral review. Their analytical capabilities in this regard are really best-in-class in our industry and you'll hear more about that later in the program. We also have been very good in this business at acquiring portfolios at very attractive prices.

So the update on the Structured Finance business as it's dealing with the market today, the market dislocation is certainly driving decreasing advance rates across this business, anywhere from 5% to 15%. The deal structures are tightening overall versus where they were six months ago, or particularly a year ago. Many of -- much of the fast money and the hedge funds has left or is leaving this market and we also, in this market, have seen decreasing commercial finance competition.

Again, the absence of Merrill Lynch Capital, CMAC and other regional banks exiting the market. The confluence of these exits are serving to increase this group's ability to look at and find attractive deal flow. Significantly in this business, there is far less -- obviously, far less Wall Street competition. And even recently in the last few weeks and months you've seen several large Wall Street banks leave this particular area, all of which we think is very attractive for us going forward in 2008 and beyond.

The strategy for the Structured Finance business, again, is fairly simple. We're going to emphasize supporting our existing clients. Like Healthcare, in Structured Finance, the clients in Structured Finance and across all of our businesses are normally in some sort of transitional aspect. They're doing a merger, an acquisition or they're going through a growth phase. And we think there's much business to be gained in emphasizing and supporting our existing client base.

We think we can extract premium pricing that reflects market conditions, given the lessening of competition. It's also providing this business an opportunity to transact with more and more well capitalized funds to gain market share and desirable clients to continue to move up market and build our franchise. This business is a very efficient business. John spoke a bit about increasing operating efficiencies, you're going to hear a lot more detail about that from Tom and from the other folks in the other businesses.

The Structured Finance business is one of our most efficient businesses. They've also done a terrific job with the credit. So we think, moving into 2008, there will be some very, very good opportunities for the Structured Finance business.

Finally I'd like to talk about our Corporate Finance business for those of you who may not be familiar with this. Our Corporate Finance business essentially follows middle market sponsors and provides them senior debt in the context of middle market leverage buy outs. We also make co-equity investments principally through this business unit. The loans types in this business are primarily senior secured cash flow loans and to a lesser extent, Term B loans and second lien and mezzanine loans. Typically our mezzanine loans that we make, as I mentioned in the beginning of the program, are roughly about 10% of our company. Most, if not all of those are typically made in the context where we also make senior loans.

This business, much like the Healthcare business and the Structured Finance business, is organized around small specialty teams. They focus on retail, technology, media and healthcare. The average loans size in this business is about $11.5 million per client. We think the market opportunity in this business has never been stronger. Our principal business to date has been making loans in the range of $25 million or less, there is an increasing lack of liquidity in that part of the middle market. So we think the market opportunity going forward for Corporate Finance will remain very strong.

The target borrowers are those focused on industries -- they focus on industries with experience and expertise. They focus on experienced management teams, they focus on sponsors that follow specific industries, like I mentioned, retail, technology, media or healthcare. There's essentially about 200 or so sponsors in the universe of people -- in the universe of equity sponsors that we principally focus on. And obviously we look for companies with strong historical cash flows, strong management, limited operational leverage and event risk. And you're going to hear more from Bryan Corsini and Michael Sznajder about exactly how our credit process works in great detail.

Our competitive advantage in Corporate Finance is our one-stop shop capabilities utilizing our balance sheet. Again it's our focus, like all of our businesses, on our industry expertise and targeting our markets to where we think we can add value and where we think we can bring execution, flexibility and speed to create a better solution for our middle market customer.

The update on the Corporate Finance business is much the same as Healthcare and Structured Finance. Increasing pricing and improved structures is really what is happening on a daily basis, it's changing every day. Leverage profiles are decreasing rapidly as lenders are either leaving the market or are less willing to provide capital.

So in general, this entire market dislocation, if you will, is improving the competitive landscape. Specifically again, Merrill Lynch Capital, which was one of our primary competitors, was recently acquired by GE. We have seen many hedge funds absolutely leave the market. Having said all of that, there still is somewhat of a disconnect out there between buyers and sellers and that's going to take some time to reach equilibrium.

The Corporate Finance business also has an interesting opportunity as we move into 2008 to review opportunities to purchase high quality discounted loans across all those sectors. Many companies' debt is trading at severe discounts for all sorts of reasons that may or may not be connected to their actual under -- their actual performance.

So the strategy for Corporate Finance going into 2008 and beyond is to capitalize on this decreased competitive environment. They're looking to enhance their new deal and portfolio yields and structure consistent with market conditions and they're going to focus on their domain specialties. These specialties are big markets, they're markets that are not very easily commoditized and they're markets we think that, over time, can produce good steady growth opportunities for our company.

As I mentioned, they have -- there are opportunities to pursue below-market loan purchases today that didn't exist before and they will be reviewing those. And they're generally going to leverage their franchise, they're going to leverage the CapitalSource origination platform and grow our existing sponsor relationships, they're going to take advantage of our decreased competition and in this time they're going to increasingly, as always, continue to focus on credit.

That's the general overview of the business, you're going to have an opportunity here from a variety of other folks who will dive deeper into all of these businesses for you and will be happy to answer questions for you at the end of the presentation. And with that, I'll turn it over to our Chief Financial Officer, Tom Fink.

Tom Fink - *CapitalSource Inc - SVP, Finance and CFO*

Thank you, Dean, and good afternoon, everyone. My topics today are on funding, liquidity and performance of the business. Funding and liquidity are absolutely critical issues for not only CapitalSource but all financial institutions. And I think a number of people are being reminded of that fact very clearly this year, but those of you who have been to this conference before, you know that this has always been an important topic for us. Funding and liquidity are really at the core of the business, just as much as -- a part of the success of the Company as is credit and it's always been an important topic for us.

Our funding strategy is and really has always been focused on four very important core principals. The first of those is maintaining multiple diverse sources of funding, lots of different ways to fund the business, that's always been important to us. And also within each of those sources to have diversity within those sources, clearly something that we have focused on in the past and will continue to do so going forward. We also center our funding strategy around committed sources of funding, that is not mark-to-market funding. We maintain a number of committed credit facilities to help support our business in having the surety, the certainty of knowing that we've got committed funding has been important to us.

Match funding, simply trying to match our assets and liabilities in terms of the duration of those. You don't want to fund long assets with short dated debt and we do a pretty good job of match funding the balance sheet. And then also low leverage, probably the most important element on this page. As we built the business we knew that the capital markets would from time to time go through periods of deleveraging or periods of instability, we're certainly see that now. And because the business is not dependent upon high leverage to achieve our returns or to achieve positive returns in the business, we've employed a low leverage strategy and that's really been important to us in our relative success in the current market environment.

Just to review what the funding sources are, I alluded to some of these already, but we maintain eight credit facilities currently in the business. That's seven secured credit facilities totaling over $4.5 billion in commitments with nine banks. We also have a multi-currency unsecured facility of just over $1 billion in size which is funded by 23 different banks. So a number of different sources there in the credit facilities and diversity within those sources in terms of the numbers of banks.

We've been a leading issuer of middle market securitizations. Since 2002 we've done 14 transactions raising over $10 billion of securities, clearly a preeminent, a leading issuer of these middle market securitizations. And the reputation that CapitalSource has built up and enjoys is going to be an important element going forward for us in the future as we restart that program. We've also been an active market participant in other capital markets, since the IPO of the Company we have raised a significant amount of common stock, also convertible debt and trust preferreds, the vast majority of this being subordinated financing that we've been able to raise. We continue to be opportunistic about opportunities in the market.

We've had a DRIP program, which is our Dividend Reinvestment and Direct Stock Purchase program where we've raised almost $800 million since its inception in April 2006. And just one data point on the success of this program, we have not done an underwritten equity offering since March, 2006, which points to the success of the DRIP program. And then also something that's been important to us in recent years is establishing the Company as an investment grade company and we have done that. We have BBB- ratings from both Standard & Poor's and Fitch, which was a very important accomplishment for us to achieve in recent years.

I mentioned a commitment to low leverage in the business and this slide clearly demonstrates that. You can see since 2005 the leverage in the business hasn't been higher than four and a half times. We ended the year at under four-times debt to equity, this is for the combined Commercial Finance and Healthcare Net Lease segment. And as I mentioned already once, the fact that we've built the business around low leverage has really been an important differentiator for CapitalSource, as we have been able to withstand this period of really severe deleveraging in the capital markets. It has been much less of an issue for us because we just haven't had that much leverage in the business.

We've certainly been aggressive in capitalizing on the opportunities and really being ahead of the curve with respect to opportunities. Since the second half of 2007 we've done three securitizations, John mentioned these, these were single investor transactions, but securitizations nonetheless, that we completed in the second half totaling $2 billion of issuance. We also did a convertible note offering -- a subordinated convertible note offering in July which seemed expensive at the time, we felt it was good insurance and we're glad to have completed that transaction.

And as you can see from these three charts that are on this slide, in the right hand side, the undrawn capacity, this is the number we keep referring to. You can see how that has been increased throughout 2007. It comes at a cost of course, on the margins these incremental financings are more expensive and we've certainly seen a widening of the borrowing spread, it's expressed as a spread to LIBOR. But very importantly, the liquidity in the Company has been enhanced and is very strong.

For 2008, our priorities are to continue to renew our credit facilities as they come up or earlier. We're already engaged in that process, even though many of these facilities don't come up until much later in the year. As we've mentioned a couple of times, an important ambition of ours this year is to restart our capital markets program. Since the beginning of the year we've had several efforts under way to really proactively go out and talk to our historical as well as other investors in our securitizations and to make sure that, number one, they know that CapitalSource is alive well and then, number two, that we do have plans to return to the market and get a sense for where they are.

I would certainly characterize most investors these days as being on defense and playing a lot of defense. But encouraging for us was the positive view that they hold of CapitalSource and its programs. There are lots of things for people to invest in and there are certainly investors who have money that are waiting for the opportunity to put it to work. And our program is really well designed for those investors. We have approached this business where we're just seeking financing, we're not trying to achieve a risk transfer. We also have significant scheme in the game and that really is the most important feature. These are loans that we have originated, that we've underwritten, that we're managing and we've got our own equity at work in them.

And we're simply seeking some financing for the business and that is just a theme that really resonates well in the market. This year we are going to continue and have continued our DRIP program, which, as I mentioned has been a big success, and then we're remain agile with respect to any new opportunities. And of course deposit based funding, which is clearly of interest to the Company and something that we think would be very attractive as an addition to our funding platform.

So the securitization market, which I mentioned. Where is it going? We've certainly seen the growth and evolution of the securitization market. We've been active in the market since 2002 and these three slides here break down our program over the years in looking in on an annual basis. And you can see back in 2002, on average the transactions we did were pretty small.

But we were able to grow those transactions over time, the market also accommodated higher degrees of leverage, certainly 2004 through 2006, and then an incredible tightening of spreads. Our view of where the market is going in the future is to -- to borrow a line from the movies, back to the future. We expect the market to and have already begun to see, certainly with the transactions we did in 2007, on average smaller deals, on average lower advance rates and on average higher costs.

Just a word on the Residential Mortgage business, which John has alluded to. Again, this is the portfolio that we use to optimize our REIT structure and really facilitate our compliance with all the REIT rules. And our strategy with respect to this has been pretty simple. Number one, we want to meet or exceed the targets we have for the amount of assets to really optimize the REIT structure. We want to focus on high quality assets and we want to manage the interest rate risk in the business very intensively.

We've done all that and we've had very good success. The strategy is, in a word, working very well for CapitalSource. The chart at the bottom shows you the size of this portfolio which has been plus or minus $6 billion since we set it up back in the first quarter of 2006. And our expectation for 2008 is that this portfolio will run off and reduce in size throughout 2008. And we've set it up in a very capital efficient way. Here you can see that the residential portfolio provides about 35% of our assets, so it gives us that real estate intensiveness that we seek as a REIT, but does so in a capital efficient way, requiring less than 12% of the capital of the Company.

And the most important thing for me has been the focus on the high quality of assets in that portfolio, really been a major reason why we have not had any issues with respect to this portfolio. Again, just to review the assets that exist in that portfolio come in primarily two large classes -- our agency mortgage backed securities and then what we call mortgage related receivables. Underlying the agency securities, which is the lion's share of the portfolio, about $4 billion, are Fannie and Freddie guaranteed securities. So there's not an issue here with respect to credit whatsoever.

And then the mortgage related receivables are very high quality whole loans that we've securitized and financed with non-recourse permanent term debt. And the underlying credit quality of those whole loans has been very good, very high FICO scores, low loan to value. I mean, really the best of the best of jumbo whole loans that could be found in the market.

And the risk management, we manage this portfolio very intensively within very tight duration and convexity limits. We have both an internal team, headed by Chris Harms, as well as our external portfolio manager, BlackRock. And this slide that we've shown several times, if you look at the red line, this is effectively the net effective duration of the entire portfolio, which we've managed within very tight bands and of course have had ample funding capacity and not a single funding issue in this portfolio.

Now I want to spend a couple minutes on financial performance. And this slide shows three things here -- first our top-line revenue, our net investment income on the left, in the middle is our bottom-line adjusted earnings and on the right is our consolidated adjusted ROE, so the adjusted ROE for the entire business. And when I look at this slide, I have two thoughts that run through my head.

The first is, number one, can't help but feel very proud of the performance that this company has achieved. If you look at the net investment income in the business since 2004, we've grown it from $320 million to $690 million last year. The adjusted earnings in the business reached almost $450 million last year. And from a returns perspective we've been able to produce a high teens to over 20% adjusted ROEs in the business. So very, very strong financial performance. So that's one thing and certainly a track record that all of us at CapitalSource are very proud of.

The second thing is you can't help but notice that 2007 was a tougher year, did not grow the adjusted earnings as much as we had done in previous years and in terms of the overall profitability or the adjusted ROE in the business, was down a little bit from 2006 levels. And that is entirely due to the difficult market conditions that really presented themselves in the second half of 2007 and are continuing.

To think about the performance of the business I think it's really helpful to think about it in terms of a simple business model. And here what we've shown is the fourth quarter results for the Commercial Finance business, as illustrated by this simple model. And just to review the numbers very quickly, yield on the portfolio, this is interest earning assets, 11%. We had other income from an adjusted earnings view here of 41 basis points, credit costs or charge offs 21 basis points and operating expenses as a percentage of assets of about 1.7% or so. Cost of funds of about 6% with a modest degree of leverage, 3.86 times on average, gives a 23% pretax return on equity.

On the chart on the right you can see the history of our historical pretax ROEs in the business and whereas the fourth quarter was certainly improved from the third quarter's level, it is below what we have done historically. And again due to the challenging market conditions that prevailed in the second half of 2007. So as John has laid out, an important objective for us is how do we position the business.

Can we position the business to return to our historical levels of profitability? I think that we can and we're clearly working on that. And to use again this simple illustration, we can walk through an example of the potential earnings power of the Company and our ability to return to those historical levels. And by historical levels we're talking about a pretax adjusted return on assets -- or, excuse me, a equity of around 30%.

This slide, potential earnings power of the business, walks through an example of what it would take to get there. It's a hypothetical example, but we'll talk about this. First would be start with a yield of about 10.5%, which in today's day in age with LIBOR of about 310 basis points or so, that represents a core lending spread to LIBOR, if you will, of 690 basis points plus 50 basis points for prepayment fees. Other income, 50 basis points in this example, charge offs 75 basis points in this example, higher than our historical levels for sure, but something that seems prudent, given what's going on in the market today.

And then operating expenses of 1.5% with a cost of funds of [4.25%] and a leverage of 4.5 times would give us a pretax return on equity of almost 30%. So the question is how realistic is this example? Can we get there? These are, I will tell you, all levels that we have achieved at various points in the past. So certainly the potential exists for the Company to achieve that.

Looking at some of the high level drivers specifically, I've started off with core lending spreads, I also talked about our cost of funds or borrowing spreads, here is putting those numbers in perspective for you. On this slide, on the left-hand side, we've got our core lending spread in fees, that is our yield minus LIBOR and excluding prepayment fees. So the core lending spread of the Company, which has started off in 2006, close to 7%. In the fourth quarter we were 5.67%. The downward trajectory of that is something which was part of our plan, something we were managing the business to as we were taking advantage of the pre-tax pricing power of the REIT, et cetera.

But in my example, my hypothetical example, we laid out 6.9%. Well can we get back to 6.9%? Well we were there in the first quarter of '06 and certainly market conditions today for new assets that we generate and also opportunities to reprice assets in the portfolio exist. So the market conditions are favorable to increasing this core lending spread from what we have seen in the most recent quarters.

Our cost of funds, our borrowing spreads. We talked about a number in the hypothetical example that was 1.25% above LIBOR. That's from the adjusted earnings view. So we're -- we don't include in that number the amortization of deferred financing fees. That's another 45 basis points or so. So you're talking about a number of -- a borrowing spread of all in of about 160 basis points to LIBOR. The fourth quarter of 2007 was 157 basis points.

Market conditions certainly put pressure on that metric because as we go forward, incrementally do new financings, they're going to be more expensive than what we've done in the past. And then as our credit facilities come up for renewal and we choose to renew them, I'm confident they'll be at higher spreads as well. But can the market improve and can we get back to levels in -- at the range of that hypothetical example? I think we can.

Prepayment fees, always a lumpy area of the business, so we gave it its own slide this year to talk about a couple of these things. First on the left-hand side is the pay-off volume. We talk about prepayment fees being lumpy in a couple of different respects. First is just in the volume of loans that pay off in any particular quarter. So you can see on the left-hand side here the number has moved around quite a bit. Prepayment related fee income for us was very low in the third quarter, rebounded. Part of that was due to just seeing a rebound in the volume of loans that paid off.

On the right-hand side, you can see the prepayment related fee income expressed in basis points as opposed to percentage of our interest earning assets. Again, the hypothetical example I used was 50 basis points. That's the number we had for a long time in terms of a basic modeling number and it is a lumpy statistic that does move around. But there are certainly many quarters where we're in excess of that level. I think in today's market, the potential clearly exists to see slower payoffs in the portfolio and therefore a lower prepayment related fee income. But the market conditions are also very favorable for building into the portfolio, future prepayment fees through yield maintenance and other types of terms and conditions. So 50 basis points doesn't seem like a very unrealistic assumption for the business as a long term number.

And then other income, again the hypothetical model, which we walked through, had 50 basis points. We have several different sources of other income in the business, including gains and dividends on our equity investment portfolio, loan syndication fees, et cetera. It is a very lumpy part of the business. On the right-hand side of this slide you can see our other income from an adjusted earnings perspective expressed as a percentage of our average total assets and you can see that we have been many quarters ahead of that 50 basis point number that's in that hypothetical example.

And then finally, would be our operating efficiency or our operating expenses as a percentage of assets. Excuse me. The biggest driver of that, candidly, for us is headcount. CapitalSource went through a very strong growth phase in the business as we were building out our platform, building out our infrastructure and you can see how the headcount ramped up in the business, ending in the first quarter of 2006 at 548 people and then through 2006 and 2007, we've seen relatively flat headcount. So that is the single biggest reason that we have been able to see some operating efficiencies in the business as we've kept that headcount relatively flat because we have a fully built-out platform.

This slide shows you operating expenses as a percentage of our average commercial assets and the gray bar is the piece of operating expense that runs through adjusted earnings, if you will. And you can see how that number has continued to come down from [$236 million] in the first quarter to [$167 million] in the fourth quarter of '07. So as I've laid out, a 1.5% long-term target for that, if you will, it doesn't seem like that's an unrealistic number, we've been moving towards it and I think we'll continue to see movement towards it. So with that, we'll turn it over to Bryan to talk about credit.

Bryan Corsini - *CapitalSource - Chief Credit Officer*

Thank you. It was interesting, at lunch today, somebody mentioned a 4.5 hour investor conference, you're going to talk about credit for 20 minutes, which if credit statistics and our performance wasn't as consistent and as strong as it was, I'd probably be up here talking much longer than 20 minutes, which is a good thing. I think as I go through these slides, three main things really -- to really keep in mind is that we've been focused, disciplined and proactive throughout our history.

And by that I mean being focused at -- we're a middle-market, senior focused lender, we maintain that discipline since inception, we're disciplined. Our ability to underwrite, to structure, to monitor loans is, literally, the Company has been built on a credit-by-credit basis with that discipline and keeping that discipline throughout the entire time the Company has been around.

And the last thing, being proactive. And by being proactive, knowing when to pull out of different markets, when to get out of the business lines entirely, or even on individual credit, where you're looking at different trends and trying to get ahead of the game from a credit and from a work-out perspective in order to minimize impact. So probably not as exciting as David and Goliath, but we'll muddle through.

The last -- the first slide is really the last slide that we left with the last time we had a conference, which was our key take-aways in credit. What we felt would happen back then, which is coming to fruition now, is that CapitalSource would be well positioned for a turn in the credit cycle, and again, keeping these things in mind, in terms of being focused, disciplined, proactive. Very basic premise, it's what we do day in and day out and again my colleagues will come up and talk a little bit about the underwriting processes and their businesses. Again, very consistently applied since inception.

Credit loan management process, again, very deep, very granular, very specialized and as I get further into the deck, talk a little bit about some of the metrics that the different businesses employ from a credit perspective. Talking about our credit focus and market position should lead to outcomes that compare favorably. And again, as I go through the various credit metrics, as you can see, in terms of measuring non-accruals and charge-offs, again, I -- we believe that we compare very favorable to our peers and to the market in general.

And a credit correction should lead to increased lending opportunities as both John and Dean talked about, there was a big influx of lenders and again we talked when we met about 18 months ago, a lot of different funds, alternative lenders coming into the business, which really tended to, I call it, mess up the game if you will, drive down spreads, increase leverage. A lot of that seems to be reversing itself and having a book of loans that are in good shape from a credit perspective, of an infrastructure to manage and monitor those loans leaves us ready for the next opportunity.

The portfolio trends, largely, what we've talked about in the past, is a key driver for us in looking at the credit quality of the book as the non-accrual levels. If you look at the blue line on the top, that peak back at the end of '06, as I'll get into a little bit further, that was really driven by three different factors.

We had two business lines that did cause us some credit issues and again I mentioned about being proactive. We looked at the credit trends and the performance of those businesses, we literally shut them down. One was the -- a business credit service line that we had talked about in the past, which the attempt, really try to do asset-based loans look for a really a value-added slant to that, trying to figure out where there was hidden value, where to lend additional dollars and honestly, as it turns out, it was a difficult play and we proactively shut the business down, most of the management's gone, and we've actually worked through those situations. And as you see, the non-accrual levels come down, I'll get into more detail later in the chart, a lot of that has been resolved either through pay-offs and some charge-offs.

Another business that we are in was part of a purchased portfolio, which we called an enhanced mezzanine product, which the best way to think about it is think about it in the -- as an example, an individual house, where you've got somebody building that house, you've got a senior loan and we really provide the gap between the equity and the senior debt, which primarily brought us up full loan to costs in the '90s. Again being very reliant on housing prices as that downturn experience, we ran the credit losses in that business and we also shut that down. Interesting to note, despite the credit losses, we still ended up with about a 14% return on the business, but again, long term we didn't feel it was sustainable, proactively exited that business.

Credit environment. As Dean mentioned, we think there's an ongoing dislocation and correction in the credit and capital markets. We've seen not only a disruption on the funding side, we are beginning to see now a retreat out of the market. Whether it's alternative funds, hedge funds, CLO type of vehicles, the sheer number of competitors on a deal-by-deal basis, anecdotally, is much less than it was 18 months ago. And again much of what we thought would happen as folks came in in the simply supply and demand dynamic took place. You saw spreads getting compressed, leverage going higher in the transaction. Again, we maintained our discipline throughout that time, so what you sacrifice a little bit in volume translates into better credit performance long term.

Credit availability, again, has contracted measurably out there. The numerous new entrants and existing lenders, again as I've referred to, have left the market. We anticipate seeing an increase in delinquency across the market in terms of middle market loans in general. Again, I think that has to do with the type of structuring and the leverage placed on different credit. So if you have higher leverage and your cash flow gets depressed, you're going to have delinquencies and you're going to have debt service issues. And as we've gone through and again, constructed our portfolio, literally deal by deal, we're certainly not going to be totally immune from that, but we think the shock of that will be very small.

Risk assessment by product, what we've tried to do here is give you a summary of the different types of products across the different lending groups that we're involved with. Very similar chart from the last time we had a conference, it's kind of difficult to put it all in one page. I think the highlights is really what's changed since the last time. And if you look at it on the cash flow side, we think our business will begin to stabilize. If we were to pull that chart up from 18 months ago, we felt that that business was starting to get riskier.

And by riskier, we're seeing increased leverage multiples, decreased pricing and really towards the end, what we started to see is what I call structural deficiency, so low covenant, no covenant, toggle pick, one of my favorite things, where a borrower can literally decide not to pay you and it won't be in default or what we would call event defaults.

In other words, you're not in default unless the borrower doesn't pay you. But with a toggle pick, that means never. So there were a lot of things that we saw creeping into our space, again, kept the discipline, we didn't get into those loans and we'll compromise volume in certain spaces, again, to try to maintain our discipline and resulting in a strong credit book.

The other place where we noted in terms of risk increasing, which a year and a half ago we thought was somewhat stable was on the commercial real estate side. And we have a pretty diverse book of business in commercial real estate. One example of being proactive is about 18 months ago, as we started looking at developments on the condominium space, realizing that the residential takeout, possibly, would get soft, as you saw loan to values from a residential mortgage perspective getting pretty high, we began to ratchet it back.

We probably peaked about $500 million in book, we're down to about $300 million. And of that, about 50% are actually completed units, contracted for sale that we expect to be settled over the next couple of months. So again, a spot that certainly got our attention, the discipline to sort of pull back through just good underwriting and sound portfolio management to reduce the risk. If you look at the CapitalSource portion on the right side, again, very consistent from 18 months ago. So I go back in terms of talking about being focused and disciplined, it -- as boring as it sounds, it's really the key.

CapitalSource [posture], right now we feel that the Company continues to perform well in an unstable environment. Again, in terms of being disciplined and focused, 89% of the commercial book is senior loans and leases, maintaining, as you saw from the previous page, very prudent, consistent loan-to-values and all structuring. High touch portfolio management. My colleagues will go into that in a little bit more detail later in the afternoon, but the metric of 12 relationships per loan officer, there are some fluctuations, business to business, but in general, it's been pretty tight, it's been very consistent for the last eight years and it's the whole key to lending in the space, is knowing the borrower, being able to track deviations from underwriting, performance to loan covenants, et cetera.

The last section here in terms of specific portfolio quality monitoring metrics, what's difficult in a middle market book such as ours, which is so diverse, it's difficult to go back and pick one or two metrics and say this is how you can measure the whole book. So again it's very specialized, I call it more of a cylinder analysis. You've got to look at these different lines of businesses and understand what metrics drive it.

So as an example, looking at leverage and liquidity on a cash flow loan is key, but on a healthcare, real estate loan, we're really paying attention to debt service coverage, things like [stenches], literally how many patients are in the beds, the condition of the home. So different metrics all looking for maintaining value, which will maintain our good loan-to-value spreads, but different metrics, which again, as my colleagues will explain, differ slightly business-by-business, but it's been very disciplined and very consistent throughout.

Credit stats continue to be very strong and stable, as I pointed out on the second chart. What this chart basically just tries to do in a summary form and to show on a proactive basis, how CapitalSource does monitor and manage its book. Convent -- what we're calling conventional lending, and I don't want to tell you who does what, but in a lot of institutions that I've seen, you sort of lend and monitor your portfolio based on delinquencies.

So someone stops paying or their ability to pay starts slowing down, you start focusing on the credit, figuring out your rights and remedies and try to do something in the situation. We're much more proactive, as evidenced by the -- our published stats. Historically our non-accruals generally are about double what delinquency are.

So we'll get a non-accrual statistic, or rather a company, and if we determine that we're -- the loan-to-value is starting to get too tight and bring interest into income is no longer prudent, we'll put a loan on non-accrual. So we're very proactive, we get our restructuring folks involved in loans far ahead of a loan becoming delinquent, which again really does drive the superior credit performance.

Diverse asset portfolio, I won't spend a lot of time on this chart, but if you pull up charts from previous presentations or other information that we've either published or gone through individually at different meetings, it's a very diverse book of business, which again, in terms of downturns, whether it's a credit cycle, downturns in the economic cycle, diversity gives you some shield from an impact perspective, so softness in one sector may not necessarily translate to other sectors. And again, long term, it provides strong credit performance.

More focused look at recoveries, the recovery statistic that a lot of folks talk about, always intrigues me, in terms of how do you really measure that? We've had a lot of loans, and if you look at since inception, we've funded 2,515 loans, we've got roughly 1,100 loans on the books. They say, well, you've had 1,400 loans pay off, a lot of those have been paid off at 100%, so is your recovery really as high as you may think it is? What we decided to do is take a look strictly at loans that went to non-accrual bucket.

And as we said in the past, we think the non-accrual bucket is the key driver to future credit losses. So we isolate everything else out and just focus on the non-accruals. And as the chart shows, in 2,500 loans since inception, we've originated, 47 loans have gone non-accrual, which is a fairly manageable percentage. Less than 3% of what we've originated.

What's interesting, when you dig in deeper, and I referred to a couple of business lines that we shut down, which again trying to be proactive and as disciplined as possible, 20 of the loans -- I'm sorry, excuse me, 17 loans of these 47 loans are actually in businesses that we've shut down that we've gotten out of. Peak at $181 million, which is about 34% of the non-accruals.

And again, peak balance is an important thing to note, to detail about what we tried to measure, again, is the peak balance of outstandings, since the entire relationship, not measuring a loan, when it went on non-accrual versus ultimate resolution because we could have protective advances or funds in a revolver. So we tried to use the peak balance. And again, 61% have been recovery to date of the $321 million that's been resolved.

Next page, it gives you a little bit deeper comparative shot on a credit basis. And again, if you can highlight the business credit service, the commercial real estate, where you'll really see improvement in the non-accrual stat. And again, primarily driven by those two business clients I mentioned previously.

Charge-off history, again, digging deep into this, we've had charge offs to 66 loans to 30 -- spread across 32 borrowers. So since inception, that's a total of $129 million. Again, the high point on the two businesses that we have exited, that's $46 million on 24 loans, so 13 borrowers over that time frame. So again, not to give ourselves [what I like to] to the underwriting guys like to call an EBIT add-back, but you've actually got losses in a part of the business that we exited back in '06 and again have shut it down and working out the remaining part of the portfolio.

So we haven't really seen any systemic losses in the other lines. One interesting -- one item of note is we did have two major cash flow loans that result in $51 million of remaining charge-off, so that's the business we're in, which is true, but again, over the course of time, we've altered how we've run that business from both an underwriting perspective, I think we've tightened a lot of different things up, we've reduced our whole size.

Again, you've got two loans here, which are actually pretty large balances, so what -- it become a law of averages, that the severity of a loss ends up being a lot more traumatic versus selling a loan down. So we've maintained a lot of discipline in the whole sizes, Dan Duffy will be talking a little bit later about our syndication efforts. And if you look at the remaining part of the business, over 50% of our commercial assets have experienced virtually no credit losses. Which again I think is important.

If you look at the 69% of losses, again, expressed in originations to date, and backing these things out, you'd be at about a 47% loss rate, again, backing out the two businesses that we've exited. And I always go back and try to take a look at actual performance versus the reserve levels and at 128 bps, sorry I keep saying percentages versus bp, but at 128 bps. We think from a reserve perspective, and where things go in the future, we feel pretty good.

Last page is the like-to-date performance and really what we're trying to get to, this is the crystal ball page and for the analysts out there, you see how many numbers are written down. Because it's really a difficult thing to predict, where losses are going to go, where your charge-offs are going to be in the future. What you do know is there are going to be different segments that are certainly going to be affected. We have, again, business lines we've identified and proactively shut down, but you've got an economic downturn that is definitely here and I suspect will be getting a little bit worse.

So what we try to do is break down a portfolio, look at where we could be affected and what kind of effect we'd have on the losses. Again, the top of the list here, you're looking at corporate finance business. It's a diverse book of companies, a lot of consumer product companies, there's retail companies, manufacturing companies, a large mix of different types of assets. Not having concentration in any place, diverse geographically, diverse by sponsor, but again, you're in kind of mainstream businesses and certainly you're going to experience issues in a recession.

We think there could be some impact on -- from a charge-off perspective. Again, difficult to predict exactly where, we haven't seen any evidence of it yet, we haven't seen a pick up. And again, if you look at the first couple of charts, non-accruals are actually down and delinquencies are in check. So we haven't seen it yet, but being pragmatic, you'd suspect it could get a little bit worse.

If you look at the healthcare businesses, healthcare real estate, we won't expect much of any impact nor any future impact on credit losses in those sectors. Commercial real estate, as I mentioned, you could see some economic headwind that could affect the business, property valuations I think largely get affected by the ability of capital in the markets, which really drive the value. So the longer the debt credit market is in disarray, the longer you have a chance to have a valuation decline. And again, you'd suspect you'd have it somewhere, again, delinquencies in that book, they're actually down year-over-year. We haven't seen it yet, but pragmatically, I would suspect we'd see some.

We just got into another space where the type of borrowers we're lending on pools of consumer notes or real estate notes, you'd suspect you'd see an increase in delinquency and from that customer base, we've seen a little bit of that, but conversely what we've also seen is an increase in cash collections. We've seen some of those lines of businesses and books-to-businesses decline a little bit and again I think are structuring the way we organize these things around what I call a mini securitization, controlling the assets, controlling the cash. We don't expect it to translate into much of an impact from a credit loss perspective.

And again, I keep touting the same thing. If you look at the enhanced mezz and the business credit service, it has represented a large share of the loans. So the crystal ball would tell you that if everything else is well 47 bps, even on a doubling scenario, if I look at that, versus the reserves, look at where we've been, we feel we're adequately reserved and we think we've got a good handle on where things could go.

In Tom's presentation, I think we isolated a 75 bp posture, potentially for credit losses. I don't think it's out of the realm of possibility it could jump that high. It could be plus or minus a little bit more, it's hard to imagine based on what we see right now, being anything as drastic as doubling or going well beyond where our reserve levels are.

Our credit strategy, again, I will be brief here, but to build a balanced portfolio, manage whole size, continue being senior debt focused, never waiver from the dual-track, which Mike Sznajder's going to get into some detail a little later. But again, in terms of auditing and underwriting each loan individually and not looking for pools and not trying to build concentration buckets and keeping that discipline and going back to John's legacy business, I -- really a proven method of underwriting going back to the '90s.

Key take aways, again, our loan management process, disciplined, focused, proactive. We feel in the future we'll produce similar superior credit results. We haven't seen any systematic issues in the portfolio. We do think problems will arise. We think the key is early identification, contain the situation, getting loans proactively restructured and worked out. Lines of businesses or products within a line, as I demonstrated, trying to get ahead of those curves way ahead of time and reducing exposure in those books to reduce impact, smaller hole sizes, et cetera. And again, I feel based on where we are historically, the reserves do seem to correlate to where we've had loss experience.

As credit and capital market corrections continue, we think that we're in a good position to be selective to do attractive deals and again take advantage of what we, as John mentioned, have been in the lending business a little bit longer than him, it's because I'm a little bit older, but I do see this as being a robust and a great market to be in.

John Delaney - *CapitalSource Inc - Chairman & CEO*

Okay. Thank you Bryan. I think we're going to -- the plan now is to open it up for questions for any of the four of us. Yes, sir?

QUESTIONS AND ANSWERS

Jim Shanahan - *Wachovia - Analyst*

(Inaudible)

John Delaney - *CapitalSource Inc - Chairman & CEO*

Okay.

Jim Shanahan - *Wachovia - Analyst*

Can you hear me? Can you hear me now?

John Delaney - *CapitalSource Inc - Chairman & CEO*

No, I think we need Tim to turn your microphone up.

Jim Shanahan - *Wachovia - Analyst*

Try it one more time? Oh there it is.

John Delaney - *CapitalSource Inc - Chairman & CEO*

Okay.

Jim Shanahan - *Wachovia - Analyst*

Thank you.

John Delaney - *CapitalSource Inc - Chairman & CEO*

Sure.

Jim Shanahan - *Wachovia - Analyst*

Jim Shanahan at Wachovia. Slide 43 was interesting to me. The compound annual growth rate and headcount that you cited there was 4% a year from year-end '05, it was 520 people to 562 people. However, the comp and benefits on the income statement has increased quite a bit more than that. By my math, it was 43% in '06 and 16% in '07. Can you discuss some of the dynamics there that would lead to those expense items going up quite so significantly while your headcount was essentially flat during this time period?

John Delaney - *CapitalSource Inc - Chairman & CEO*

What -- I didn't quite hear your question on the statute. I understand your focus on page 43, but you threw out some percentages, I couldn't follow them.

Jim Shanahan - *Wachovia - Analyst*

Yes, the percentages were increases in the actual expense, the comp and benefits, up 43% in '06 over '05 and comp and benefits -- 16% in '07 versus '06. Meanwhile, these headcounts are flat. Can you talk about the dynamics there?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Sure.

Jim Shanahan - *Wachovia - Analyst*

And what might be a reasonable assumption for a growth rate in '08 given the expectation here for a flat to lower headcount in this year.

John Delaney - *CapitalSource Inc - Chairman & CEO*

Well I think '06 and '05 is probably fairly straightforward to explain because the average headcount was up quite a bit from '06, from '05 to '06. And the increase from '07 to '06, I suspect, is a combination of factors. One, probably mix of employees changed. That's a big driver of compensation expense. Part of it, obviously, is just the raises that we provided across the board of the Company, 500 people, I don't remember what our raises were from '06 to '07, but just as a percentage of salary. Those are probably going to be my two. I don't know if any of you have any other insight?

Tom Fink - *CapitalSource Inc - SVP, Finance and CFO*

Yes, I think -- I would also say, I mean, we've talked about this going a ways back, but in terms of having built a very strong front-end of the business, in terms of the origination teams and a fair amount of compensation, which was established back in '05, '06 and early '07 comes in the form of long-term stock compensation. So you've seen the build up of that expense.

Tom Fink - *CapitalSource Inc - SVP, Finance and CFO*

Yes, and in fact that was the -- yes. I -- I'll just echo what Tom said, we went through a process whereby we handed out long-term stock compensation also in the form of employment agreements to lots of senior management. So if you were to take that out, for instance, I think comparing apples-to-apples it would look different.

Jim Shanahan - *Wachovia - Analyst*

Would you care to estimate then what that expense line item might look like in '08? Do you expect stock-based compensation awards again this year, for example?

Tom Fink - *CapitalSource Inc - SVP, Finance and CFO*

Yes, they'll be --.

Bryan Corsini - *CapitalSource - Chief Credit Officer*

No, I think the short answer is no. Because what he was focused on was stock-based compensation around specific employment agreements among a pretty deep number of senior managers --

Tom Fink - *CapitalSource Inc - SVP, Finance and CFO*

Right.

Bryan Corsini - *CapitalSource - Chief Credit Officer*

-- which are -- and then the list is a dozen or so people. And I think that's -- those are all done basically.

Tom Fink - *CapitalSource Inc - SVP, Finance and CFO*

Yes.

Jim Shanahan - *Wachovia - Analyst*

Thank you.

John Delaney - *CapitalSource Inc - Chairman & CEO*

I think this gentleman had the next and then -- yes.

Unidentified Audience Member

I think on page 55, you had some information about the charge off history. And I think the numbers you have are, I think historically, you were 69 basis points on an overall basis. But if I were to back out how much you lost on the exited businesses --.

John Delaney - *CapitalSource Inc - Chairman & CEO*

Yes.

Unidentified Audience Member

I think the charge off number is about 4.3%. I just backed that up from the numbers you have provided.

John Delaney - *CapitalSource Inc - Chairman & CEO*

Well I think it's 47 basis points on the -- did we show 47 basis points on the -- yes.

Dean Graham - *CapitalSource Inc - President & COO*

If you look at page --.

John Delaney - *CapitalSource Inc - Chairman & CEO*

Page 56. We had 47 bps.

Unidentified Audience Member

Thanks. But 47 is --.

John Delaney - *CapitalSource Inc - Chairman & CEO*

Yes.

Unidentified Audience Member

-- on the on the continuing businesses, right?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Yes.

Unidentified Audience Member

The businesses you exited, if you back out, you've probably got about -- I calculate about 4.3%? It's not there on the slide, but it's [practically up].

John Delaney - *CapitalSource Inc - Chairman & CEO*

Okay.

Unidentified Audience Member

I'm just wondering can you describe the characteristics of these businesses that you've exited --

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John Delaney - *CapitalSource Inc - Chairman & CEO*

Yes.

Unidentified Audience Member

-- which had such high loss rates and how do we know that none of your current businesses could have such a high loss rate [contract]?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Why I don't take it first and then you can chime in?

The enhanced [S and E] business that Bryan described was a business that we actually financed for several years. It provided kind of these gap mezzanine loans to home builders. And we had a rediscount line to this company for several years. And we like the business. And we acquired the portfolio when the principle investor was looking for a change of control transaction.

And you can see it's a small -- it was a small business. I think at its peak, the funded loans were maybe $90 million. So you -- the maximum peak. And it was essentially mezzanine loans in the residential sector. Principally to home builders. And they earned very high yields in these mezzanine loans, a 20% loss. And I think we saw softening in the residential market when we effectively exited the business. I think we have almost nothing outstanding in that portfolio. Yes, it's essentially paid down.

And I think if you look at that business across the long cycle, it actually is -- it was a very good business. It's been around for 20 years, it had obviously ups and downs with the housing cycle. They charged very premium pricing for what they provided.

And I think, again, I think there's probably nothing wrong with that business now actually, on -- if you're making these loans based on all of the adjustments that are occurring to values, it's just that we didn't feel that, considering the size of the business, it was a business that we'd want to continue. It's a pretty small business and it was becoming a bit more of distraction than anything else.

The business credit business was a slightly different story. What happened in business credit is we had a view, we had sure seen a lot of opportunities to provide kind of asset-based loans to companies that were going through some form of restructuring or turnaround. So it's kind of tougher credits, kind of highly-structured asset-based loans. And -- which I still think would be a good business. I think what happened to us there is we just didn't have a good kind of team in place to execute against the strategy. And we just -- they essentially got caught with a few frauds where they were defrauded in their underwriting, which is something we don't tolerate.

So I would say that the reason that we think that that performance won't happen in the other businesses is because we've had these other businesses for a long time. And they've shown nothing but good credit performance. And they're run by very talented people and very strong teams. And so I think what happened in business credit is we just had the wrong team running the business. And we made the decision not to retool the team. We made the decision to exit the business and essentially terminate all the employees that were involved in that front end underwriting of the business and move on.

So I think the best answer I can give you as to why we think that won't happen in the other business is because we've been in the other businesses for quite a long time. So -- and the problems in business credit kind of started to emerge within a year of starting the business.

I don't know, Bryan, would you add anything to that?

Bryan Corsini - *CapitalSource - Chief Credit Officer*

No, no.

John Delaney - *CapitalSource Inc - Chairman & CEO*

I think this gentleman --

Sameer Gokhale - *KBW - Analyst*

Hi. Sameer Gokhale from KBW. I had a question about commercial real estate, given that people lately have become increasingly concerned about that part of the industry overall. And you made some comments about it, but I was wondering if maybe you could give us some more specifics as to what percentage of that loan portfolio was originated between '05 and '07, specifically. And then also the fact that I think a lot of your loans are kind of bullets -- bullet and balloon kind of debt, so if those assets are going to be refinanced in a couple of years, would that potentially have implications for loans that are going to impairment, for example? Just your thoughts on that would be helpful. Thank you.

John Delaney - *CapitalSource Inc - Chairman & CEO*

I mean, I don't want to speculate on the specific kind of static pool around when the loans are originated. We can get you the answer to that question or I think we can get you the answer. I mean, I know we have the data and I'm sure we can share it with you, about what the kind of vintage of the loans are.

Yes, some of the loans are, obviously, or a large percentage of the loans are structured as bullets. That's what you do -- most of what we do in this business is kind of a bridge product where you provide financing against an asset. We're real estate investors buying the asset, and looking to reposition it in some way across a couple of years and either sell it or refinance it.

So clearly the collapse of the real estate capital markets is kind of a bit of an enemy to that business because part of it you would take out as a refinance potentially. But a large part of your take out is to sell the asset. Once the repositioning is accomplished.

I think the thing that's important about the business is it's not as much a per cap rate dependent business as it is a execution dependent business. And what I mean by that is what we're doing is typically going in at a fairly prudent loan-to-cost and our borrowers are putting up real cash equity in front of us. And they typically have some plan where they'll improve the asset and sell it or refinance it.

And so if you have kind of cap rate expansion, if you will, which is really what's going on, you have an inherent cushion in your deal. You have a cushion in two ways. One, the hard equity, the one in the deal to begin with. And number two, whether their repositioning strategy is correct. Because again the profile is something's being bought for $100 and the sponsor puts $25 in and we lend $75, most of these sponsors are looking for ROEs on that 25. And so they have a repositioning strategy that they believe will add value.

If that's successful, there's even a much greater cushion in terms of your loan-to-value, even though when we go into these deals, we look at loan-to-cost. So I think while there is bullet refinancing risk on some of these transactions, I think the real question is what's really the loan-to-value? And will the sponsor defend the project? Because increasingly, a lot of our business in this portfolio is with real estate private investors who have substantial pools of capital and will -- we think will defend the equity.

So clearly as Bryan indicated, we raised commercial real estate as an area that has, for lack of a better word, headwinds, for the reasons you're talking about. And I think the thing to remember is it's not a big part of our portfolio. I think we've been very disciplined in it. For example, we had a condo, as Bryan indicated, we had a -- we used to provide condo financing. I mean, we really backed away from that a few years ago and really started looking at that business, I think, very differently in that we developed something that we called internally this red-black analysis. Where we would provide financing for someone acquiring a building and converting it to a condo.

That used to be a really good business because people were buying multi-family assets at normal cap rates and you were providing an, 80%, 85% loan-to-value loan and then they were going to turn it into condo, which had a lot of equity upside. So it would work for you as a lender whether it converted or not. Meaning, if it stayed as a multi-family, you'd still be okay.

Obviously if that market became hot, what happened was people started paying kind of very high prices for these assets. So they were buying multi-families at two or three cap rates and then converting them to condo and all of their profit was in the condo conversion. If a condo conversion failed, you'd be left with a multi-family that you way overpaid for. So as the lender became an increasingly hard business to finance because you would make a -- even a 70% loan-to-cost loan with a good equity sponsor, but your loan would still only be a five cap rate. And so you are uncomfortable that you could recover value if the market corrected and they had to sell it as a multi-family.

So what we started to do is to develop this red-black analysis, where we basically said when you make a loan, the real estate team, you've got to say, on the credit committee memo how much is that loan in the red, day one? Meaning if the next day when the thing closed, if the market crashed and you had to sell it as a multi-family, how much would we lose on our loan?

As the projects sold out, because they effectively -- because of the way these things work, they hyperamortize, the loans would actually go from the red to the black. So we had a portfolio of these condo loans and we essentially said to the team, You can have $20 million in the red, that's all you can have. We're not going to bet when this market's going to end, but what we're going to do is we're going to manage how much exposure we have in the portfolio.

So sometimes they'd only have one or two deals that would amount to the $20 million in red, sometimes if the deals were all sold out, they could have $4 million or $5 million. And so that was our approach to managing the condo business for example. And it's one of the reasons why I think our condo exposure is actually quite low. And then about a year or so ago, we just said let's forget about the red-black analysis and let's just not do any more of these deals.

So I think we've had a pretty proactive approach to real estate. We've managed the size of the portfolio, had the senior debt orientation, it's focused on a bridge product, which generally has more equity in it, is less cap rate dependent and puts us in a reasonable position to handle this bullet risk, which we're talking about, which is a real risk. But I think that bullet risk won't be that big of an issue for us if our loan-to-values are good. Because I think the nature of our borrowers are such that they can typically defend their equity. And they will, provided there's equity to defend.

Sameer Gokhale - *KBW - Analyst*

Thanks.

John Delaney - *CapitalSource Inc - Chairman & CEO*

Sure.

Dean Graham - *CapitalSource Inc - President & COO*

Steve?

Steve Grangee - *Grangee Capital Management - Analyst*

[Steve Grangee] with Grangee Capital Management. John, you talked a little earlier, in terms of a goal, about -- because of all of the dislocations in the market, of the ability to buy loans.

John Delaney - *CapitalSource Inc - Chairman & CEO*

Yes.

Steve Grangee - *Grangee Capital Management - Analyst*

To buy loans. Could you talk a little bit more about that in terms of size? More specifically, to exactly what it is that you're thinking about doing in that area?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Well the opportunity to buy loans in the secondary market is obviously very attractive. And what that, at a minimum, does is inform the view as to how you should price loans in the new origination market. Because you obviously should be pricing new loans at at least as wide as wide a spread in the middle market as some of these large credits. Many of these large credits are very good credits and are trading at very wide spreads. Some of them aren't such great credits, but the ones that are good credits are also trading at wide spreads. So it clearly informs the view on how you price loans. And we've looked at that quite hard in terms of how we price the loans.

I think to the extent we've played into the secondary market, deals which we have, we've tended to do it on a limited basis because our main business is to -- I mean, our main business is this middle market franchise that we believe to be very valuable and we have to preserve our liquidity to -- for that business to some extent in light of what's going on. But we have selectively played in the secondary market repurchases , but we've tended to focus on industries where we have more expertise, like healthcare.

Because the problem with the secondary market purchase is you can't do a lot of credit work. You get a book and you look at it and you have a view and it's a huge company and you don't need management and you don't know much about it. So whereas when you do one of our typical deals, you meet management, you go in and you look at the books and records, you rip through their accounts receivable, you can do this whole very thorough underwriting, which gives you more confidence in making the loan.

So I think what we've done on the secondary side, recognizing we have -- we don't have unlimited capital, I think it's fair to say that no one has unlimited capital these days except countries other than ours, and that we wanted to be focused about it, we wanted to take advantage of it in areas where we have more expertise, but by and large, preserve our capital for our core business. But hold our core business to a very high standard because when there's things that are available in the secondary market at certain prices, you'd better make just as much on your new

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Bryan Corsini - *CapitalSource - Chief Credit Officer*

We probably should shift over here for our next question.

Carl Drake - *SunTrust - Analyst*

Hello, Carl Drake, SunTrust. John, on page 49, or Bryan, there's some LTVs by product. Is that primarily focused on transactions going forward or is that all sort of reflective of the current portfolio in terms of LTVs.

Bryan Corsini - *CapitalSource - Chief Credit Officer*

Look, it's really both. I mean what we're trying to illustrate is where we've consistently lend. And of course loans that have deteriorated, from a credit perspective, certainly might be out of whack from those parameters. But in general, the bulk of the book is within where we underwrote.

Carl Drake - *SunTrust - Analyst*

Okay. And just one other question on the tax rate, Tom. You had mentioned in the hypothetical scenario where tax rates could go and I know that might be a little uncertain for tax with tier one. But is there any directional comments you can make on the tax rate?

Tom Fink - *CapitalSource Inc - SVP, Finance and CFO*

Directionally, I mean, I would certainly hope the tax rate would be lower in '08 than '07. But I think the thing about the tax rate is it's a bit of a difficult statistic or metric to try to track or forecast. Just due to the way that the Company's set up. I mean, we are a REIT, but a fair amount of our business is conducted in our taxable REIT subsidiary. And that's where we've made a fair amount of profits. And it's really only the earnings of the taxable REIT subsidiary that are subject to tax. And so if one were to look at the effective tax rate as a taxable REIT subsidiary, you would see that it's a number close to 40% just the way that it always has been. 39.2% I think was the number for '07. And that's been very steady. And you would expect it to be very steady.

What drives the tax rate sort of all over the place is the fact that we're trying to express our, and are required to, provide for income taxes on the consolidated earnings, which include the REIT, including the residential mortgage portfolio. We also spent a fair amount of time in the quarter call talking about the hedging activity we did in the commercial segment, which -- for which we don't employ hedge accounting. That's done in -- on the REIT side of the house, it primarily is where we've seen the mark-to-market losses on the hedge, which has the effect of really sending the tax rate as a statistic all over the place.

So I tend to think more about the tax expense of the business and the tax expense of the business was in line with our expectations in the fourth quarter. And we would certainly, I think, expect that the tax expense grow, if earnings in the taxable REIT subsidiary grow, but how it gets expressed as a percentage really will depend on some of these unrealized mark-to-market changes where we're not using hedge accounting, if that makes sense.

Carl Drake - *SunTrust - Analyst*

Okay. Thank you.

Tom Fink - *CapitalSource Inc - SVP, Finance and CFO*

Yes.

John Hecht - *JMP Securities - Analyst*

Yes. John Hecht, JMP Securities. I assume this is a question for Tom and it's pertaining to [the] slides of 30 to 31. But given the jump in the borrowing spreads, Tom, that took place in Q3 and Q4 of '07 and given where you are in talking to some of your lenders about renewing credit facilities, what would you expect borrowing spreads to do over the next few quarters? That's question one.

Question two was could you give us some details about where pricing is going on some of your more popular lending products right now?

And third is do we have any floors in place on some of your customers and when would we trigger some of those? Thanks.

Tom Fink - *CapitalSource Inc - SVP, Finance and CFO*

I'll take the first and the third and I'll let Dean or John, someone talk, if they want, about the spreads on new assets that we're making. But your first question about the borrowing spreads, and I think we had another slide somewhere in here about that. But we certainly see expansion of our borrowing spread to LIBOR in the fourth quarter from 103 basis points as a spread to LIBOR to 157 basis points in the first quarter.

I spent a little bit of time in the commentary on the call about this and John alluded to it, but the disruption that we've seen in the capital markets has had some really extreme effects in the short end of the market, where historically prime -- LIBOR has had a relationship to Fed funds or prime, which has not held up. LIBOR being a market rate, there is other forces at work there with the various banks and we're -- so LIBOR really expanded relative to the Fed funds rate.

We also, as we were doing the financings and raising new capital, some of our funding comes from credit facilities that are -- their cost of funds is based on CP. CP gapped out relative to LIBOR. So it's not our CP, but it's the conduit CP. So they were able to raise all the capital, raise all the funding, but came at wider spreads and that flows through this metric as a wider spread to LIBOR.

That amount of market noise, we estimate it to be about 40 basis points or 50 basis points in the fourth quarter. I certainly expect that to abate through 2008. In fact, the historical spread of LIBOR to the Fed funds rate or to prime has really come back to normal, for example. So we expect that short-term or short end of the market noise to abate through 2008. But the main thing that's going to take over is as we renew financings and as we renew our credit facilities, I do expect them to come at higher spreads.

Where that could all end, and this will be higher credit spreads of course, is that I would expect our cost of funds and our spread to LIBOR to move up a little bit more throughout 2008 as we do -- exercise those -- or renew those facilities or as we raise new capital. And then in terms of your - It's [in the morning].

John Delaney - *CapitalSource Inc - Chairman & CEO*

The floors.

Tom Fink - *CapitalSource Inc - SVP, Finance and CFO*

Oh, the floors. And we do have floors in the loans. And to some extent, we've always had floors in our loans and certainly with LIBOR coming down to very low levels here, about three -- the low threes, the floors are becoming active. I don't have a figure off the top of my head, but it is definitely helpful in yield and I think you'll see some of that in the first quarter statistics as LIBOR dropped in the first quarter already and we'll see some positive impact on floors.

John Delaney - *CapitalSource Inc - Chairman & CEO*

Yes, in terms of pricing and structure, I think in general we're just dividing the different buckets. I think we're seeing leverage has come down a half to a full term. I think we're seeing pricing anywhere from 100 basis points to 200 basis points higher. It really depends on your frame of reference. I'll use my frame of reference to sort of pre-last August. And I think we've seen tighter structures across the board. Really across all of our businesses. Even seeing advanced rates probably down anywhere from 5% to 15% as well. So in terms of advanced rates, in terms of overall leverage, as multiples of debt and pricing, you're seeing those types of changes. And it's really changing every day. Changing every week, every month, depending on the situation.

Brian Hogan - *Piper Jaffray - Analyst*

This is Brian Hogan with Piper Jaffray. The question is on your positive funding strategy. Obviously you probably can't comment much on your tier one, but last March, I believe, you had approval for an industrial bank charter in Utah. And I was just wondering how much time is left on that? Just your overall strategy, assuming tier one does not get done?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Well, yes, we did have approval for an industrial loan corporation that was subject to a variety of agreements being entered into and documents being signed by CapitalSource, et cetera. And we requested an extension of that approval, which I think is the accurate way of describing. And if anyone at CapitalSource and in the audience, maybe Bryan or Steve, correct me if I'm wrong, but we've requested an extension of that, which I think is the formal request. And so I don't think we can comment any more than saying that. Which I think expresses our intentions.

And there was a sequencing question we had with the IOC in tier one. And in our judgment it was better to have tier one closed first at the time and then have the IOC potentially be part of tier one. And there's some reasons that are somewhat technical and regulatory in nature of why that would make sense.

That doesn't mean it has to be done that way, but at the time, all things being equal, that was more the ideal scenario, which is why we didn't pursue the IOC in light of tier one and pursuit of tier one initially.

Brian Hogan - *Piper Jaffray - Analyst*

And then next on the -- on page 52, 11% of your loans are in the construction. Just wondering what type of construction and how much are the residential construction exposure?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Yes, I mean some of that is residential. A lot of our condo portfolio, which Bryan referred to, which isn't that large and will be a lot smaller soon, it has been getting smaller with each passing month, is in that bucket. As is construction portfolio across all asset classes, including some healthcare real estate and some, obviously, non-residential construction.

Brian Hogan - *Piper Jaffray - Analyst*

Thanks. Just a follow-up on that last question. I was a little surprised to see the -- in light of the cost of funds issue, the request for the extension of the IOC. And so I was wondering, what is it that's preventing you from complying with their conditions? And what would you do if they deny the request?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Well, if they deny the request, we'd probably talk to them about it. I don't know why they would do that. Potentially we appeal to the Supreme Court. No, I'm kidding.

But -- so the -- there's a variety of things that are inherent in this IOC approval, particularly, just to go back on the IOC, what happened was we had applied for an IOC prior to Wal-Mart applying for an IOC. And Wal-Mart applying for the IOC, as everyone knows, kind of changed the focus around IOCs and made people think that we shouldn't have these things or at least if we have these things, they should be regulated much more intensely. Because the thing about an IOC is that it really -- there's no holding company regulation around an IOC. And that was really the issue because if you own a thrift, you're subject to the controlling company rules. If you own a bank, you're subject to a bank holding company rules. Each of those kind of set of rules. And I'm grossly generalizing here.

But each of those set of rules essentially prohibit non-financial activities. And the IOC, since there is no holding company regulations, you technically could own one of these things and engage in all kinds of non-financial activity at the holding company, which people who own IOCs do. And so that was really the heart of the issue. And so in the absence of coming up with holding company regulations, which they didn't do, they came up with a variety of restrictions on what you could do with an IOC, ranging from capital maintenance agreements to other kind of restrictions on your activities.

So there are those that we have to make sure that we can work through. And then we have some large shareholders, which we think is a positive, but as regulators don't always view it as quite as positively as we do. Because they think that maybe these large shareholders are getting around these holding company or these non-financial limitations by owning us, but doing other things at the same time. So there certainly are what are called passivity agreements that these shareholders have to enter into. And there's a lot of devil in the details of those things that have to be worked through. So a lot of the issues around that kind of stuff. And more kind of plumbing issues, I would say.

Brian Hogan - *Piper Jaffray - Analyst*

A little bit of additional weakening in values of mortgage securities, highlighted today by Thornberg. And I was just wondering, if you're seeing any spread widening in your non-agency securities?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Well our non-agency security is essentially kind of one large securitized portfolio where we bought the portfolio of kind of super prime mortgages from Wells Fargo that had been originated in their kind of private client group. And I think the vintage, which is the most important thing when you talk about mortgage, I mean I think that the vintage of this stuff is mostly '05, and we immediately securitized it. So it's fully match funded. So while those mortgage assets are probably worth less than they were when we bought them, those liabilities are obviously worth much more than they were at the time that we put them in place.

And we continue to see very good performance in the underlying value of the collateral in that portfolio. Underlying value of the collateral being these mortgages. Now, I think what is helping us there is that these are relatively seasoned, again, say 2005. There's some '04 stuff in there, but I'd say 2005. They were pretty low loan-to-cost to begin with, 72, 3% I think was the loan-to-cost when the mortgages were put on. And they came out of Wells Fargo client group so I think the FICOs are 743 or something like that. So these were about as high-quality jumbo loans as you could have. Which doesn't mean there's not pressure on that, because there's pressure on all mortgage collateral right now, but on a relative basis, it's pretty darn good stuff. And since it's match funded, we don't mark it to market. The charge offs have been consistent with our underwriting thus far and in fact had been kind of outperforming our underwriting for most of the time that we've owned the portfolio.

So I think it's, for us, it's -- since it's match funded, we have very little equity in it and it's more of almost a placeholder on our balance sheet. Some of the market pressure that you're referring to doesn't really affect that part of the business. In other words, we're not owning mortgages -- we're not owning long-term mortgages, advancing them with short-term finance, right? Which is the heart of the issue here.

We're -- we own these mortgages that are performing really well, they're seasoned, the loan-to-cost and FICOs were very good when we bought them. And we've got them match funded to duration. So if we had to sell the assets, they'd be worth less than we paid for them and if we could sell the liabilities, they'd be worth quite a bit more. It probably nets out to be about the same.

Omotayo Okusanya - *UBS - Analyst*

Yes. Omotayo Okusanya from UBS. A couple of questions. Going back to the whole issue of the refi bullet risk, could you talk a little bit about just how many or what proportion of your loans currently have some type of bullet provision in them or they're set up as bullets and what the maturity schedule of those loans are?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Do we have -- I don't think we have the bullet breakdown yet. We -- a lot of the loans we make are bullet. The loans -- we make a lot of asset-based revolvers and those are bullet loans by definition, there's no other type of asset-based revolver to make other than a full-lit revolver. So most of the cash flow loans amortize down and have fairly aggressive amortization schedules, both fixed and free cash flow suites. And they largely self-amortize. Our healthcare sale lease-back business, we own that to maturity. Our healthcare real estate lending book has bullets. Part of our commercial real estate book has bullets and our asset-based loan portfolio has bullets.

Omotayo Okusanya - *UBS - Analyst*

A follow-up question. In regards to -- John, you talk a lot about, in the market right now, you're seeing attractive opportunities to finance at very attractive spreads. You guys have very good liquidity, but at this point, you're still not putting it to work. I'm just wondering, how you think about the process of when you do decide to put some of this to work. And currently what's preventing you from putting some of this liquidity to work?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Well I think there's a couple of things. The opportunities continue to get better, so not putting some liquidity to work has proven to be a reasonably good strategy. I wouldn't say that's informed -- that's entirely informed our approach, but we generally thought things would get a little choppier. And there was a big disconnect in the market where across default, some of our competitors kind of saw this as a short-term opportunity where they could jump in and take some market share and get 50 basis points more. We saw it as a much more systemic issue and paused a little bit. Now I would say the market's starting to come our way.

But obviously you have to balance playing very aggressive offense in the market, which would be ideal to do with the overall liquidity position in the Company. Which is good. And we're very pleased that it's good. And we're fairly jealous with abandoning that good liquidity position. So balancing those two things, I can tell you, has been difficult. And we're trying to do our best to strike the right chord there between taking advantage of the market opportunity and preserving our solid liquidity.

Omotayo Okusanya - *UBS - Analyst*

And just one last question. If you have three factors, basically, working against you, rising funding costs, credit and I think margin only gets worse, and the fee income you get from prepayments, also likely to come down going forward, given extension risk and your adjusted earnings right now are not covering the dividend. I'm trying to figure out in 2008 where the upside comes from to get you comfortable that you can continue to cover the dividend?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Well I think we -- what we've discussed, and I know I discussed this in my remarks here today and I discussed it at the conference call, we view this current market opportunity -- what's happened in the market, there's kind of one positive and there's two negatives, right? The negatives are we've had to delever the business and the funding costs are higher. And that's getting at the dynamic you're talking about.

The positive is lending spreads are much wider and we're benefiting not only on new originations, which we're doing, but also on a lot of our portfolio activities, because our portfolio companies always need a variety of modifications, additional advances for attractive acquisitions they make, et cetera. And we're using this market as an opportunity to reprice a lot of our loans at higher spreads, which we're able to do successfully.

So I think in the short-term our view is, first of all around pre-payments, it's not so clear to us that there will be a dramatic change in pre-payment rates. Clearly we've got some high pieces in the past, but from the third quarter to the fourth quarter, we saw that recover to a more normalized level.

So I think it's a little premature to draw that conclusion because while prepayment fees could be down marginally, there's other fee opportunities in this market that could easily offset that. As Bryan talked about, it's fair to say that there's some economic headwinds in the economy. We think it affects a part of our business, but certainly not all of it and we think the effect it'll have in that part of our business is not significant. So I wouldn't put that as a significant negative for this company. I would again focus on the things I stressed, which is that new lending spreads are much -- spreads on new loan opportunities are much wider. We've had a delever and we've had some higher cost of funds and we think that dynamic will start working in our favor, probably more in '09 than in '08.

Unidentified Audience Member

Hi. You've been through these credit cycles before. I'm interested in your perspective on when you think the multi -- the traditional multi-buyer securitization market will come back? And is this cycle is different than other cycles you've seen before?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Well I think it's different because it's more concentrated on the AAA buyer than on the junior buyer. Oftentimes we have the cycles where capital has credit concerns, or there's credit pain and the more credit sensitive bonds, if you will, come under stress and those -- one of two things happen. Either you can't access that part of the securitization, meaning you have to have lower leverage securitizations. Or it comes at a much higher cost. This is different because it's very much focused on the short-end and AAA investor.

And so I think what will -- the return of the securitization markets, I think if you take a step back and you think about what's really happened is that the people who invested in these structures, these AAA investors, let's just talk about them for a minute, because I do think that that's really the root of the problem. Meaning if we just had a AAA market now and we're strong and we didn't have a junior bond market, I wouldn't be that conservative at all because we don't sell that deep in our securitizations and AAAs are the biggest part of our securitization.

I think there's obviously an unbelievable lack of confidence around what people own. Either because they don't understand the value of the collateral or they don't even quite understand the structures. So the first solution there will be the people who invest in kind of more straightforward, more sensible, kind of simpler structures where they understand the deal they're investing in and they understand the assets.

And the best way for people to understand the assets is for them to know that the people who is seeking financing has a lot of skin in the game. And that's really the kind of securitizations we do. So I tend to think what will happen is the securitization market will reopen for key people who are using the securitization markets as a financing technique, not as a risk transfer technique because investors will be more comfortable with that. In a time of uncertainty, what they want -- I think what they want is they want someone who has done all the work, to have a lot of money at risk for them to provide financing.

So I think the market will return in situations where people are not looking to kind of arbitrage or transfer risk, but they're looking to actually get financing. And they're going to want to see the originator or the issuer have a lot of skin in the game. And how much skin in the game varies upon the asset class. In some asset classes, having 5% or 10% skin in the game. It's a lot, some asset classes, they'll want to see 30% skin in the game.

So I think it'll return in those situations and in those situations only where that exists. And I think the way you'll start having broad securizations again is you'll do something -- a hybrid between what we did in the fall and what we used to do, what we did in the fall is negotiated with one buyer, who knew the assets and were comfortable with us and knew we had skin in the game. What we used to do is have these things sold broadly off the basket of one of the major banks to investors who both really understood us, but also new investors who were kind of arbitraging where they could buy our bond and how they could repackage them and enhance them.

I think the first version, or version 1.0 of these markets opening up again, will be some kind of almost club transaction where you have five, six, seven, eight, whatever the number is, but it's not 50 investors that you kind of negotiate a deal with. And then you kind of place the deal, like a private placement, and it feels like a broadly syndicated deal, but it's somewhat of a negotiated deal with a few parties. And I think that'll be how these things return.

Because those investors then will say, Hey, I can negotiate the kind of deals that I want. I won't have them sold to me, books where people come around and say buy 2 million, 3 million of this thing. And it'll be much more of sitting across the table, borrower to lender and you'll get people back in the markets that way.

And I think that's happen to CapitalSource, I think that'll happen to other issuers who have similar profiles to what we do. But I think it'll take quite some time before it's really broad and I -- and I think it'll take a very, very long time before it's broad and it's viewed as a risk transfer. I think we're going to have our break now. And then I'll -- we'll -- I think it's, [Dennis], 15 minutes? Yes.

Unidentified Company Representative

Be back at 2:30.

John Delaney - *CapitalSource Inc - Chairman & CEO*

Okay. Great.

(BREAK)

PRESENTATION

Jim Pieczynski - *CapitalSource Inc - Co-President, Healthcare & Specialty Finance*

Hi. Thanks, everybody, for showing up. My name is Jim Pieczynski, I'm the Co-President of the Healthcare & Specialty Finance group and in that role what I do is I head up all of our healthcare real estate lending, which includes the mortgage loans that we make on healthcare facilities along with the Healthcare Net Lease segment. I'm going to go through my presentation and then I'll leave some time at the end for questions that anybody could have. Although my presentation is going to focus on the Net Lease segment, feel free to ask me anything about the mortgage side of our portfolio as well.

To give you a little background, I've been at CapitalSource since 2001 and we've grown the portfolio to $2.4 billion as of today. The Healthcare Net Lease segment is roughly $1 billion of our portfolio. Prior to being a CapitalSource I was at a long-term care REIT where I'd spent eight years there as well. So I've been in this space for roughly 15 years.

If you look at our Net Lease segment the Healthcare Net Lease is a new business that we were able to do once we elected REIT status. The ability to be able to pass through the earnings to our shareholders without having to pay taxes made this business an attractive business for us and one that we would not have been able to do had we not elected our REIT status. The nice part about this is that the same customer base that we had for our real estate lending arm is exactly the same customer base that we're still catering to for this space.

And what it really did was gave us an opportunity to extend our relationships and expand our relationships with people that we have. And I'll talk about it a little later on, but you'll see that we are a one-stop shop in that we can provide all types of financing for people, including mortgages, accounts receivable, cash flow lending and beginning in 2006 we were also able to offer sale leasebacks.

If you look at our assets you'll see that the Healthcare Net Lease segment represents roughly 6% of our total assets, yet you'll see that there's roughly 14% of our capital allocated to that business. And the reason is that this is a business that typically runs on a lower leverage ratio and you'll see that we have allocated roughly 60% leverage to this space, which is lower than the 80% that you would see throughout the rest of our businesses.

Giving you an overview of what we own, we have 186 owned long-term care facility that has a balance of roughly $1 billion that are leased out to 41 different operators. We own a total of 22,500 beds which works out to be an average investment per bed of $46,000. Our current average annual lease rate that we have, which is the cash rate that we're getting on our facilities, is roughly just over 9.25%. All of our leases have escalators in them, some of the leases have escalators that are fixed escalators which are in the 2.5% to 3% zone, some of them are annual escalators that are based on increases in the CPI and some of them have annual escalators that are based on the higher of the increase the CPI or a fixed rent payment.

The current annual run rate that we have on our facilities is $99 million, that's currently the cash that we're receiving. If you take a look at healthcare REITs and say what are their portfolios trading at, you'll generally see that the portfolios are trading at anywhere from an 8% to 8.5% cap rate. If we valued our portfolio at an 8% cap rate it would give us a value just slightly under $1.25 billion, which we like to believe is the value that we've created by having this portfolio. We paid roughly $1 billion for the portfolio but we fully believe that this portfolio is work $1.25 billion. The rent coverage that we have on our portfolio is 2 times before management fee and 1.3 times after management fee. And that's pretty much in line, if you looked at statistics for other healthcare REITs, you would see that's pretty comparable.

The other thing that I'd like to point out is we believe that our portfolio is a very safe and solid portfolio. As I mentioned up above, our average investment per bed is $46,000. If you look at recent transactions that have happened in 2007, we compare very, very favorably to that. The Genesis transaction, which was a large transaction that closed in the summer, was done at roughly $100,000 per bed. The Manor Care deal, which was the last of the big deals really to be done in this space, was closed recently and that was closed at an average of $135,000 per bed. So feel that our portfolio has significant upside still built into it.

In terms of the benefits of the sale leasebacks, it's really important to point out that all of our leases are triple net leases. And what I mean by triple net leases is the operators are responsible for all expenses associated with operating the building. They pay all real estate taxes, they pay all repairs, they provide all capital expenditures that need to be done. So when you're looking at that rent payment that we're getting, that truly is a net-net rent payment that we are able to keep the funds from. So there's no other upkeep or anything that we have to pay associated with it.

The other nice part of this portfolio is that we do get a steady growth in rental income. All of our leases have escalation clauses in there so we've got our stable base of portfolio with continually increasing rents. The other nice part of it is, you know I know everybody has been looking at our commercial mortgage side and seeing that we have our portfolio run off and a lot of times everybody is worried about, well gees, as loans roll off you've got to make new loans in order to keep your asset base up there.

The nice part about a sale leaseback portfolio is that we don't have any run offs in that portfolio, it's a long-term asset, it's an asset we plan to keep for a long time and we don't have to worry about run off with that, which gives us a nice core group of assets with which we continue to grow on. By virtue of ownership, we have the ability to realize the appreciation in the property value and nursing homes are generally a very, very stable operating environment. I'll give you some statistics later on, talking about occupancy and limitations in supply coupled with the growing demand, and you'll find that nursing homes are actually a very stable operating environment.

In terms of our target market, our target market is the small owner in the regional private chain which represents roughly 85% of the market. We focus on operators that have a very, very solid management team and our area of strength is in financing opportunistic acquisitions. What we tend to do is align ourselves with good operators who know their business and who are looking to do acquisitions in the area that they operate. They may be focusing on a city, they may be focusing on a geographic part of the country, but we tend to be there to provide them financing for those acquisitions.

Our strategic strengths are our speed and expert industry expertise and market knowledge. As I said, I've been in the business for 15 years, the number two in my group has been in the business for 12 years, we've got another person with ten years experience and two other people with five years experience. So what we find in this space is it's ultimately a very niche business and what we find is generally every operator that we deal with we either know the operator from dealing with them in the past or we know somebody who knows that operator.

So the key part about our team, and this has been exemplified when you look at our credit loss history, is we haven't had any credit losses because of the fact that we know who we lend to and that's very, very important in our business. And having that knowledge and knowing what deals to do and what deals to not do has really served us well.

If you look at the market that we're looking at, in the United States there's roughly 16,000 nursing facilities and 7,100 assisted living facilities. The nursing number is basically stable, that number has been roughly 16,000 for several years now and really isn't changing dramatically. Assisted living facilities, there's growth in that because that is kind of a new product where you've got a lot of growth. The other area is independent living and if you count that, there are a lot more independent living facilities out there. But you'll find when you look through our portfolio that the majority of our stuff is in the nursing home segment.

There's a question as to why do skilled nursing assets retain their value. The first two bullet points are really key to this. Typically, in order to operate a skilled nursing facility you generally need one of two things, you either need a Certificate of Need in order to build that facility, and that varies on a State-by-State basis. And typically the way it works with Certificates of Need is a State will not give you a Certificate of Need unless there is a demonstrated need in that area. And a demonstrated need is going to be that all the facilities in the area are operating at or above a 95% occupancy. So that's typically one of the barriers you need to get through in order to obtain a Certificate of Need.

The other thing is a Medicaid contract. Typically, although Medicare is the high margin part of the skilled nursing business, Medicaid is the bread and butter of the business. You'll find on average roughly 65% of the residents in a nursing facility are Medicaid and operators need that long-term Medicaid contract in order to provide revenue stability. Again, since States are the ones that are on the hook for it and States are the ones that are giving the Medicaid contract, they're generally reluctant to give out these contracts unless there is a demonstrated need.

There is also a limited availability of land and there are limitations with respect to zoning. So people can't just plunk down a nursing home wherever they want, there's limited space where they can do it and that, along with the rising constructions costs, has really reduced the supply. Nursing facilities are generally a local business. The administrators are from the community, the people who work there are from the community and what we've found is that the facility is very integral to the operating of the business. That facility is part of the community, it's been there for years and having that franchise there is often quite valuable.

From a valuation perspective, cap rates have ranged from 12% to 14% over the years. And when you look at that, that 12 to 14% is based on the operations of the facility, which is different than what I was talking about before when I was taking a cap rate based on the underlying rent. In the last years you've seen that number drop down into the 10% and 11% zone, but generally the range has been 12% to 14%. The other part about skilled nursing facilities is they're located nationwide, which gives us the ability to have high diversity from both a geographic perspective and an operator perspective.

In terms of the favorable industry operating trends, as I said, the supply of nursing homes has been roughly 16,000 facilities over the last several years. And if you look at the demographic that is going to be the user of nursing homes, it's generally your over 85 population. And to give you an idea of where that's going, in 2000 there were 4 million people in this country that were over the age of 85, that number is expected to grow by 50% to 6 million in 2010 going to 10 million people in 2030 and 15 million people in 2040.

So from a standpoint of the demographics, the demographics are there. And when we've look at that and we've got the nice move with demographics and the relatively stable supply, it gives us great confidence that these facilities are going to continue to be used an be used for the long haul. If you take that and you couple that with the stable reimbursement that we have in this space, Medicare generally is giving inflationary increases as is Medicaid, so you're operating in a stable reimbursement environment and naturally the rapid growth in healthcare spending is something that we view as a benefit to the skilled nursing side.

If you look at all the healthcare facilities that are out there, the nursing home is typically your lowest cost provider. And as a result, you're finding that Medicare for patients that are recovering out of an acute care setting, Medicare wants to get those patients out of an acute care setting and into a nursing facility for rehabilitation. So you're finding that reigning that they're trying to on growing healthcare spending is actually channeling more people into the skilled nursing facilities.

Again talking about reimbursement, Medicare this last October gave a 3.3% cost of living increase, which is generally what they've been doing over the years. There's proposed legislation out there where they're looking to limit increases and maybe not do it for the full amount of the change in inflation, but in general those inflationary rates come along every year. The same thing happens with Medicaid, Medicaid rates are up year over year. As we mentioned earlier in the conference, we do have our in-house reimbursement experts who are keeping an eye in terms of what's happening with respect to each State. Some States are going up more than others, some States may have moderate declines, but in general operators are looking at a 2 to 3% inflationary increases across-the-board.

I talked about the limited supply. As I said, there's 16,000 SNFs in the United States. The median occupancy for nursing homes is 89%. Again as I mentioned, there are limits on new nursing home construction and it's particularly so in the Certificate of Need States. Reiterating what I talked about with respect to the growing demand, the 85 plus years population is the fastest growing segment.

And again, I want to highlight that in the year 2000 there were 4 million people that were over 85 and in the year 2010 there will be 6 million. So you've got a 50% growth in that population just over the last ten years. And as I mentioned, the healthcare policy favors SNFs and again reiterating that this is a low-cost operating environment and healthcare, from a governmental perspective, are trying to get more and more people channeled into the skilled nursing facilities.

Looking at our portfolio on a geographic basis, this pie chart's a little busy but if you look to the far right you'll see that Florida, not surprisingly, is where our largest concentration of our portfolio is. And that represents roughly 34%. And that's naturally because Florida is definitely where there is a lot of retirees and naturally that's a prime State for nursing facilities. Our next largest State would be Texas and Texas is just a large State and as a result it's got a large elderly population. And you'll see 20% of our portfolio is in Texas. After that our next highest State is Tennessee with 10% and then after that you're going to see that our portfolio is just spread among many States with the next highest total being 6%.

This is a map that kind of shows on a dot basis, you can look at where our facilities are located. What you'll see when you look at this is that the lion's share of our facilities are in the southeastern part of the country along with Texas. It doesn't mean that we're not going to do facilities on the western part of the country. And it's interesting because my office is based on the west coast and that's where most of my team is based, but generally the deals that we've found that we've thought have been the best deals for us have been facilities that are in the southeastern part of the country.

For those of you who have looked at our 10-K, this was the first year that we had actually started reporting the segment results for our Healthcare Net Lease segment. And if you look at it you'll see that for both the year and for the quarter we had interest income in there. And people have asked me, well gees, how can you have interest income on sale leasebacks. The reason is because generally all of our leases require security deposits and they also require escrows for taxes, insurance and the like. So that cash that we get from our tenants, we're able to invest and as a result it gives us a little extra juice in terms of yield that we can earn on our assets.

Our operating lease income is the revenue that we're recording from our leases. You'll see that we're at $97 million for the year and $27 million for the quarter. Our interest expense that you see there is what I had mentioned earlier, which is a function of we utilize roughly 60% of debt financing on the portfolio. So if you look at that number, at the end of the year that interest expense number is derived from a year-end balance of $611 million, which is bearing -- we've used a fixed rate financing on that, that's roughly over 7%.

And that's a combination of the financing that we've put on and to the extent where we've entered into variable financing, we've put in the cost of the interest rate swaps that we entered into to fix that. But generally our interest expense is fixed at roughly 7%. The depreciation expense is truly, truly a non-cash charge, that is just a GAAP charge that we're required to make in order to show the depreciation of our assets over their lives.

If you look at the next two line items together, which is our other admin expenses and then our other income expense, you'll see for the year our expenses were just under $9.1 million. And if you look at that number, that represents just under 1% of our total assets. If you looked at it for the quarter, you'll see that our number was just over $3.8 million. And again, that number represents just around 1.3% of our total assets. So when we look at this business and say what do we think we can run this business at, we expect to be in that 1% to 1.3% of assets. Again that's probably lower than what we at CapitalSource have been doing on an overall basis, but in the Net Lease segment you're able to get a significant amount of properties that actually can be managed very efficiently by our loan officers.

The noncontrolling interest expense that you see there is a minority interest that we issued in connection with an acquisition that we did in 2006. That was a minority for interest that for us was a great way of financing the property, because instead of giving cash to the operators of the property we actually gave them minority interest, which are convertible into our stock and it was our way of making sure they were still invested in the portfolio that we acquired. Then we get to our net income number and then what I look at as adding back our depreciation and amortization. You'll see that our adjusted earnings for the year were $41.8 million and just under $13 million for the quarter.

Now again, people try and focus on this portfolio and say, well gees, what's it worth? And the way I look at it is, if you look at our last quarters where we were just under $13 million, if you annualize that number, that works out to be roughly $51.9 million of adjusted earnings on an annualized basis. I've got a slide that I'm going to show in a little while, but you'll see that healthcare

REITs in general are trading at a [12.5 multiple] of FFO. Some are above, some are below, but the median is roughly at about a 12.5 multiple. If you take that, that gives you an equity value on that portfolio of roughly $650 million.

Now up above when I talked about interest expense I talked about the debt that we had allocated to the portfolio, which is roughly $611 million. So take the $611 million of debt, you add that to the $649 million of equity and you get a value on that portfolio of $1.26 billion which is very much in line with what I talked about relative to the run rate on our revenue. If you look at that, again, I want to highlight that the portfolio that we're talking about is a portfolio that we bought for roughly $1 billion. So we believe we've got a 25% increase in the value of the portfolio since we've acquired it. And remember, we acquired this portfolio, we didn't start doing it until 2006. So everything that you're seeing in here was done in 2006 and 2007.

If you compare us to our peers, there are several healthcare REITs out here, I've got two slides showing this, one has Omega, LTC Properties and Ventas. You'll see, as I mentioned, our portfolio is 98% skilled nursing, which is of these three we're most similar to Omega which has mostly skilled nursing facilities. Again if you look at our assets, our assets are at the $1 billion level. The other thing that I think is important to note is, if you look at our return on our assets which is right now roughly at 10%, that's slightly less than what you're seeing with respect to these other healthcare REITs.

The reason for that is two-fold. One, these are newer leases that we've entered into so we have not had the escalators in the leases like the other healthcare REITs have had. But what it also has is the other REITs are older so, as a result, they've reflected more depreciation expense over time so their asset number is declining. So if you sit there and say where do we think we're going to be, we think we're going to be gravitating up to that 13% to 15% zone as time goes on.

The other that I want to point out on here is our return on equity, which has roughly been at 14.5% which compares above LTC's and certainly very reasonable relative to the other two REITs. And that's a number when we look and say what kind of return on equity are we looking to have, my goal is to be in that 12% to 15% zone when we do a deal. So [D&F's] 14.5% zone is a very reasonable number for us to be at.

The next slide just compares to three other REITs, Nationwide Health Properties, Health Care REIT and Senior Housing Properties Trust. Again these are larger REITs, you can see their asset size is much larger than ours. But again, if you focus on the return on assets, we're at the 10% level which is very much in line with these larger REITs. Again focusing on our return on equity, you're seeing that our 14.5% compares very favorably to these. And I think that's just because they're larger REITs, they've got more assets, it's just a little more difficult for them to grow as they continue to get bigger.

I mentioned earlier that multiples that healthcare REITs trade at and again you'll see this band that shows the stock price relative to FFO. As I'd mentioned before, the median is 12.5 times. That number has change a little bit over the years but if you look at 2007, that number stayed pretty much in that 12.5 times band. The other thing that's really important to focus on is the dividend yield. Healthcare REITs in general command a much lower dividend yield than a commercial finance company demands. And healthcare REITs in general have been trading at yields in the 6% to 7% range. So we believe that ultimately if this were to operate as its own stand alone REIT, the cost of capital associated with it would be lower than what we've got in the Commercial Finance segment.

Again in terms of I really want to highlight where I think our opportunity is in healthcare real estate. My presentation is really focused on the Net Lease segment, but it's important to note that our total portfolio size is $2.4 billion. And that $2.4 billion includes the $1 billion real estate portfolio that I talked about, along with $1.4 billion of mortgages. In the slide that Bryan had showed you had seen that our total originations in this space have been $3.5 billion. So we've had $3.5 billion of originations, meaning we've had $1.1 billion of pay offs. And one of the things that I'm very proud of is that we've had no losses in this space at all.

If you look at the size of our portfolio of $2.4 billion, that puts us right in the middle of where the other healthcare REITs are from a size perspective. So we think we've got certainly the size to compete with those other REITs. But the other thing that is really important to focus on in here is that we are the one-stop shop. I've talked a lot about the sale leaseback and I've mentioned our mortgage financing, but in addition to that we are a HUD map lender. And by being a HUD map lender it gives us the ability to underwrite and process for HUD long-term financing for our borrowers.

So what we can do is a borrower can come in and we can be a one-stop shop where we can first provide them a bridge loan on a mortgage if they want that, ultimately get that property seasoned and take it to HUD where they can get long-term fixed rate financing. In addition to that we can give them A/R financing and cash flow financing. None of the other healthcare REITs have that product offering out there.

If you look at non-REIT offerings that are out there, you'll see GE and CapMark are there. CapMark is the old GMAC and if I would have done this slide six months ago I would have also had on there Merrill Lynch and Credit Suisse who have exited the business. They were competitors of ours, they've exited the business now and we believe that, relative to the market that we can have, it really opens it up for us.

When I started this business six years ago at CapitalSource, on our loan side we would be doing deals at LIBOR plus 500, LIBOR plus 600 and being able to do them all day long. As the years have gone on those spreads have kind of dipped back down. But I'll tell you now, I'm talking to people and talking about LIBOR plus 500, LIBOR plus 600 loans.

In September people were looking at me and saying, gees, how could I charge such outrageous rates, now people are looking at me and saying, okay I understand where you're coming from. And I think we've definitely migrated back to where we were back in 2001. And when I started this in 2001 I considered it the low-hanging fruit days where we were able to do very good deals at very nice yields very little competition. And that's where I see us going today.

So with that I'd like to open it up for any questions that anybody may relative to the Net Lease segment or any part of the healthcare real estate portfolio.

QUESTIONS AND ANSWERS

Unidentified Audience Member

Thanks. Some might understand this a little better than I do, but can you just help explain the leverage component? I mean I know it's what about two times, considerably lower than the rest of the business, maybe if you could just help us understand why that is?

Jim Pieczynski - *CapitalSource Inc - Co-President, Healthcare & Specialty Finance*

Right. Well what we've done with this is some of this is an allocation of our capital, but when we spread out this segment some of the properties we went and had specific debt that was associated with the properties. And then on other properties that didn't have specific debt associated with it we had an allocation of debt.

And what we did was we just kind of made a blanket determination that the leverage that we would be allocating to this portfolio was 60% and the reason we did that is that's about what healthcare REITs are operating at. So in order to be able to compare ourselves apples-to-apples with respect to other REITs in the sector, we allocated 60% of the debt to the Healthcare Net Lease segment. And so it's really just an allocation of our debt.

Unidentified Audience Member

Is that something that could be changed down the road depending on where you see the business?

Jim Pieczynski - *CapitalSource Inc - Co-President, Healthcare & Specialty Finance*

You know it could change. I think 60% is that right zone. If you ask me what the range it could be, it could probably be ranging between 50% and 75%. But you wouldn't really be going much more than that. It's a stable business and it's just not a business that gets as highly levered as our other businesses do.

Unidentified Audience Member

Thank you. There's always chatter, or recently more chatter, but there's always chatter in the marketplace about healthcare assets that are available in the marketplace. There might be an opportunity then for CapitalSource to dramatically increase the size of their Net Lease portfolio in one fell swoop. Do you have interest in that? Or is there an interest internally in growing by acquisition?

Jim Pieczynski - *CapitalSource Inc - Co-President, Healthcare & Specialty Finance*

Absolutely. And the portfolio that we've grown, some of that has been through acquisitions and some of that has been through de novo transactions that we've done. The answer is that absolutely we would be interested in looking at acquisitions. And when we know of things that do come available, we do look at them and we do look at them very, very seriously. So yes I would consider us to be a very active buyer in this space. This is a space, as I said, that we've done very well in, we've had great credit history, we've got great expertise in this space, we know the players, we know the operators and so the answer is absolutely we would consider doing a large acquisition. Yes sir?

Unidentified Audience Member

Are there any things we should be aware of in terms of anything any of the candidates are talking about after the election that could change payments, or Medicare, Medicaid or anything else that could impact the business? And then the geography, the map, California, west coast, can you talk about opportunities there? It seems like you don't have any presence there. Thanks.

Jim Pieczynski - *CapitalSource Inc - Co-President, Healthcare & Specialty Finance*

Relative to the election, and that's the thing, everybody always likes to say that if you get a democratic President that that's going to bode well for the industry because they're going to be more into social spending. What I've found is over the years, whether it was a democrat, whether it was a republican, it actually doesn't have that big of an impact. And the reason I think that is is because the skilled nursing business on its own is generally a relatively low margin business to begin with. You don't see outrageous profits being made or anything like that.

And I think that politicians in particular are very reluctant to be out there saying they're cutting funds for the elderly. You know of all the things that you want to do, that's kind of the last place that they'll do it. So what I've found is that you've had inflationary increases over time and generally you're not -- I just don't see that having a big impact. Some people may recall in the late '90s there was a huge cut in reimbursement on the nursing side and that totally had to do with the ancillary companies, which was you had operators that were creating therapy companies, rehab companies, pharmacy companies and they were taking that ancillary company and charging it through to the facility, which was then charging cost plus through Medicare.

Medicare doesn't do that any more. They said they go with what's called on a RUG rate system and they basically say for this person with this condition we're going to pay X dollars a day. We don't care what your cost structure is, that's just what we're going to pay you. And so I think that's brought a lot of the excess out of this system, which is why I don't see any change really going forward.

In terms of the geography and not doing it in California, it's interesting my office is based in California so you'd think I would do most of my stuff in California. We've not done a lot of sale leasebacks in California just because the opportunity hasn't arisen. We've done a fair amount of mortgage lending in California and we're very active in that State. So the answer is, would we do California, absolutely. Would I expect there to be new building in California? Probably not.

And the reason is just because the cost of land and the cost of construction in California is just so significant. I mean just to put in an example, if you were to build a facility in California it would probably cost $150,000 to $200,000 a bed to do that. You compare and contrast that with the State of Texas where it probably costs about $60,000 a bed to do it and I'll guarantee you that California's reimbursement is not three times what the State of Texas's is. So you're just finding that you're not going to have a lot of new building on in California where you do have some of it going on in Texas. So again the answer is yes we'd look at it and we're not shy from staying from that State.

Unidentified Audience Member

Not to offend anybody who is from Tennessee, however, you did say that about 10% was in Tennessee. That State's had all sorts of political and other issues over the years, I'm just curious about the origin, how you got to 10% there. And is it somehow different in your space than in so many others?

Jim Pieczynski - *CapitalSource Inc - Co-President, Healthcare & Specialty Finance*

No it's a fair question. The way that that transaction came about was the properties that we acquired in Tennessee were largely operated by Kindred Corporation. And Kindred, quite frankly, was having some issues with the State of Tennessee, the State was coming down hard on them and Kindred had decided it just makes sense to divest these properties. And for us we considered that a great opportunity because we were able to come in and buy the property.

We were able to bring in a new operator who had some business in Tennessee but was not a large operator in Tennessee and was able to really kind of sell it to the State that, okay, we're going to buy the property, we're bringing in a new operator and we're going to go from there. So quite frankly it was Kindred's divestiture of those properties that brought about the opportunity for us to acquire that portfolio.

I think that takes care of my time. I'll certainly be around the rest of the day if anybody has any questions or has any follow-up questions, please feel free to stop me. I'd like to now turn it over to a panel that's going to talk about the CapitalSource lending process. That panel is going to be led by Mike Szwajkowski and he'll be joined by Keith Reuben, Mike Keller and Mike Sznajder. Thank you all very much.

PRESENTATION

Mike Szwajkowski - *CapitalSource Inc - President, Structured Finance*

Good afternoon, my name is Mike Szwajkowski and we do have two panels to really round out the day. We have some materials that we're going to go through and at the end of that we'll have some time for questions, so if you could just hold your questions until my colleagues finish. So the first panel is on the CapitalSource lending process itself and this is really an approach that was pioneered, if you will, back in 1993 at our predecessor company, Healthcare Financial Partners, which was founded and run by our current CEO, John Delaney. And that's a process that's been really constantly refined over the last 15 years.

At CapitalSource the lending process is about a lot more than just origination. It's really a holistic approach I would say, that involves origination, credit, loan management and even workouts. And this is a process that's been designed to accomplish really two primary objectives in an uncompromising fashion we believe. The first is to generate strong outcomes and with that attractive risk adjusted return on equity for our shareholders.

We do this by focusing on the middle market because it's in that middle market that we can provide non-commodity solutions to our clients. And as John mentioned at the beginning of our discussion today, it's in that market where qualitative actions translate into attractive results. So we focus our efforts on Specialized, specialization is key to our business at CapitalSource, and we focus our efforts on really the four critical building blocks of any real loan business. That's origination, underwriting, loan management and workouts.

And we believe that at CapitalSource we've got a well designed lending process which really separates us in the market. And that comes to life when we look at the dual track process. The people who have been around CapitalSource and followed it have undoubtedly seen this slide a number of times, but it still lives on.

But it's in this process, what's unique about it is that it really ensures that there is significant involvement from all the critical disciplines within CapitalSource from the moment that a potential transaction enters our shop. So right away we've got both front-end and back-end professionals, if you will, focusing on credit and considering all of the various elements that go into a good credit decision. And our Credit Committee sits at the middle of that and is ultimately the arbiter of credit.

So with me today, and to get a little deeper into this, are my colleagues Keith Reuben who is our Co-President of the Healthcare business and specifically runs a number of our specialty lending groups, Mike Sznajder who is the Chief Credit Officer of our Corporate Finance business and Michael Keller who runs our Restructuring Group. I'll turn it over to Keith.

Keith Reuben - *CapitalSource Inc - Co-President, Healthcare & Specialty Finance*

Thanks, Mike. My name is Keith Reuben, I've been with CapitalSource since early 2001, back to the beginning. I've held various positions within the Healthcare & Specialty Finance business, currently serving as the Co-President in charge of a number of the business lines, as Mike mentioned. Before that actually I was at both Heller and Healthcare Financial Partners with the prior businesses that have been mentioned today, so I've been working within this credit process and origination process for quite a while.

Today I'm going to talk about the loan origination platform and first what I'd like to talk about is actually how we originate. Each group and each subgroup within the business units has a highly specialized experienced team of professionals who originate deals. For example, in our LBO market and the markets that we troll like the LBO market, we've got teams that have deep ties into the private equity community. For instance we have a healthcare origination team that specifically targets healthcare private equity firms. Similarly in our real estate and accounts receivable businesses we've got teams with extensive relationships and experience in their respective businesses as well.

I'm going to walk through actually how our process works on the origination end. A deal comes in through one of our loan originators. That person develops the client and ensures that the term sheet is actually signed up. At that point, I think Mike mentioned this, the deal is turned over the underwriting team which underwrites processes and gets the deal approved and closed. And then at that point, once it's closed, it's passed off to our loan management team.

Origination is often distinct from underwriting, many times distinct from underwriting and always distinct from loan management. What this provides is not only greater checks and balances in the process but much greater efficiency than if we had one person basically having an assembly line of taking the deal through the process from beginning to end. It allows at every stage for more objective analysis.

Let's talk about how we actually process these originations. All of our origination teams are focused. They're focused both on industries and on products and in sectors. We have two broad categories of clients, both financial sponsors, i.e. private equity firms, and entrepreneurs. The process for financial sponsors stresses consistency, predictability and certainty. For example what does that mean? With respect to our initial client memo, before any deal is actually signed up with a private equity sponsor that deal is discussed with respect to pricing, with respect to structure, with respect to key due diligence items internally with the deal team and then between the deal team and the Credit Committee. That way we can ensure there's a consensus on the approach for each deal and provide certainty to that client.

With respect to the non-financial sponsors, i.e. the entrepreneurs, many times what we do is we'll get the deal signed up, we'll get a deposit and then we'll send in our specialized team of auditors from CapitalAnalytics and determine very, very quickly whether or not there are any issues that need to be vetted. If there are, we bring that up as quickly as possible with the entrepreneur so that they can make a reasonable decision with respect to how to do the loan and we can help structure the loan.

This slide, as you can see, you've probably seen this before if you've been following CapitalSource, as to how many loans in billions we look at. In blue, as you can see, every year we look at more and more loans, up to 181 billion loans through 2007. That being said, the yellow line which is actually the close rate, which means what percentage of these loans has stayed I would almost say dramatically consistent. It's always been between 5% and 6%.

Of note, if you look from '06 to '07, we've grown the pipeline by about 25% from $145 billion to $181.6 billion with a slight decrease in the close rate from 5.9% to 5.3%. This highlights not only our deal selectivity but the disciplined credit process that we've maintained particularly through the credit market dislocation. Furthermore, the consistent growth of our pipeline and the flat close rate over time is a further testament to the diversification of our businesses and even with the market dislocation, the sustainability of our platforms.

Now let's talk about why controlling originations is actually a better model. There are two principal reasons why it's a better model. First there is the quality of originations that come in the door and second, being able to price the originations that come in the door. And that results in our consistent CS branding.

With respect to quality, we control the quality of our borrowers by hiring seasoned individuals in our development teams, we train the individuals to the extent they don't have as much experience. And these individuals in their teams within each sub business sit through literally hundreds and thousands of deals, as you can see, with $181 billion of deals we've looked at. And they determine very quickly which deals are ones that we want to go forward with and which deals are ones that we should pass on.

What this avoids is adverse selection so that if we have sort of generalists who don't much about any business line, they're going to basically drag everything into the door and have the teams be much less efficient when they're looking at deals. As a result of being able to look at only the best transactions, we're able to not only proactively drive structure but also control all aspects of due diligence.

In respect to pricing, because the seasoned direct origination staff markets mostly really to industries and only products that they know very well. We avoid the problem of having to rely on brokers. When you rely on brokers not only does it increase your intermediary expense, either to you or your borrower, but you also, if you're not relying on brokers, are able to buy whole entire loans. They're not subject to third-party skim and most importantly in this process the clients are paying for not only the service we provide but the creativity we determine when we're structuring a loan.

And again, to reiterate on this slide which I think is really important to our origination model, by controlling the quality and the pricing originations in businesses we know really well and products we know really well, we ensure direct contact with clients, we control the message, we provide superlative service and execution and this results in probably the most important part of our business, which is repeat business from current customers and significant referrals from current customers. Ultimately, this branding enables us to build successful CapitalSource business development platforms which results in successful CapitalSource businesses overall. Now I'm actually going to turn it over to Mike Sznajder who is going to tell more than you probably ever want to know about underwriting loan management. Thanks.

Mike Sznajder - *CapitalSource Inc - Chief Credit Officer, Corporate Finance*

Thank you, Keith. Again my name is Mike Sznajder, I'm the Chief Credit Officer for the Corporate Finance business here at CapitalSource. Today I'm going to provide you with an overview of the type of credit work we do at the Company, the things that we focus on and how the process works. I'm going to talk about the fact that not only do we have more and better resources in the process, but those resources are highly specialized and they work together to create the checks and balances that are necessary to make effective credit decisions.

We talk a lot about our credit first approach and I think John was the first one to mention it today and I just want to make a couple of points about this. The first is it's more than just an approach, it's more like a mentality or a mind set that's engrained within the culture of the Company. And the second perhaps more important point is that we apply this approach throughout all credit cycles. So in 2006 and the first half of 2007, for example, when the markets were highly liquid and way more competitive than they are today, we would not compete on credit. And that's one of the many reasons that we were able to deliver the kinds of credit outcomes that Tom Fink and John talked about on our earnings call a couple of weeks ago.

With respect to loan structures, we follow minimum underwriting standards that are designed around the products that we provide in the industries that we provide financing for. These are established and maintained by Bryan Corsini and the office of the Chief Credit Officer. And they indicate acceptable ranges for the key credit criteria that surround a loan. There are situations where we have exceptions, and when those exceptions do occur the deal team is required to disclose those in the approval package so the Credit Committee can make a decision as to whether or not that loan remains an acceptable risk return opportunity for the Company.

When a deal is sourced a deal team is formed and a due diligence scope is outlined, facts and data are gathered and verified and this work is done with a view toward full disclosure of all the risks surrounding a deal, all the investment rationale that we're considering. Full disclosure is a very important aspect of the work that we do. On the resources side, as you know, CapitalSource is really a collection of specialty lending businesses and within each of these businesses we have people who have a tremendous amount of knowledge, experience and expertise in the industries that they provide financing for. I think this will be clearly demonstrated in the next panel when you hear from the leaders of a handful of our specialty lending businesses, not to put too much pressure on those guys.

We also have CapitalAnalytics, as you know. Within CapitalAnalytics we have significant financial due diligence, forensic accounting and technical capabilities that can be brought to bear in the due diligence and underwriting process. Despite all this expertise that we have internally, there are transactions that come about where we don't think we have the expertise and we think it is necessary to make an informed credit decision. In those cases we won't hesitate to hire outside experts to make sure that we have all the information that we need to make the right credit decision.

You also have heard a little bit about our private equity businesses and within those in a number of situations there is information, third-party diligence, that's readily available. And we will rely on third-party diligence to the extent that we're comfortable with the firm who did the work and we think the scope of their work is acceptable. When all this work is done it's all compiled and put together in an approval package and presented to our Credit Committee. I'm going to have a little bit more to say about the approval package and the Credit Committee process in a few moments.

The things that we focus on tend to vary by loan type but there are a number of things that we look at in every single transaction we look at. We look at the management team, do they have the quality experience, breadth and depth that we think are necessary for them to effectively manage the businesses that we're going to provide financing for. We look at ownership, do they have the capital, expertise or other resources that may need to be brought to bear in the future.

We look at historical and project financial performance to gain comfort that the borrower will have the ability to service the debt that's being proposed and we also look at the adequacy of financial reporting systems. Because if companies can't provide timely and adequate information it will compromise their portfolio management efforts which I'm going to talk about in a few moments.

On asset based loans we look at underlying asset values that are supported by third-party appraisals. We look at collection histories that help inform our view of appropriate liquidity factors and advance rates on accounts receivable based revolving lines of credit. In Mike's business on the real estate side we do extensive market analysis, we look at cap rates and we look at comparable property valuations.

On the cash flow side, as most of you know, senior secured cash flow loans are secured by substantially all the assets of the borrower. With all of that said, in a liquidation scenario, it's highly unlikely that the value of those assets will cover our loan and as a result we tend to look at enterprise value. And the reason we look at enterprise value is that companies that have a tremendous amount of enterprise value tend to generate predictable and sustainable cash flows that will support the loan.

There are a whole host of things we look at that inform our view of whether a business has enterprise value. Those include product and customer diversity, their historical financial performance, is it stable, do they have strong operating margins, is there critical mass, are there barriers to entry, are the industry dynamics favorable and a whole host of other things.

As promised, I'll give you a little bit more color on our approval package. But generally speaking it includes an underwriting memorandum and a Credit Committee memorandum. The underwriting memorandum comprises CapitalAnalytics assessment of the things that they look at in a transaction, historical financial performance, an assessment of management, their view of the systems and controls that are resident in a potential borrower and a whole host of other technical aspects of the transaction.

The Credit Committee memorandum provides the background of the borrower and the proposed transaction, describes the term of the prospective loans, also assesses the management teams and the financial performance and it describes the specific due diligence that was prepared for a loan amongst other things. This document is prepared by the deal team, generally an industry specific deal team. Now one of the things you'll notice on this slide is that there is a fair amount of overlap between the two reports, and that's really reflective of the dual track underwriting approach we have available to us here at the Company.

What do we look for in a deal? Well with regard to loan to value, not surprisingly, we're willing to go a little bit deeper on asset oriented structures versus cash flow loans because, as I just talked about, cash flow loans are generally structured around enterprise value which is somewhat less tangible in nature. Typical total debt service is comfortably above ten. There are some real estate transactions in transition where we'll structure in liquidity reserves to ensure the Company has liquidity through a transaction through a lease up phase, which will provide us comfort in those situations.

The other thing I wanted to mention here is that, as I said earlier, there are a number of things that we look at in every transaction. But the specific work that we do may vary by loan type and this slide is reflective of that. I won't take the time to go through each of the points and this list isn't certainly exhaustive, but it just will give you an idea of the different kinds of things that we look at based on the kinds of loans that we provide here at CapitalSource.

We're very selective, as we've talked about a number of times since inception. The Company has closed on less than 5.5% of the loans that we have originated. The one point I wanted to make in putting this slide in the presentation is that we would fully expect, based on all the discussions that you've heard today about the contraction in the market and the less competitive nature of it and the fact that there's far less liquidity, is that I would expect and I think everybody from CapitalSource would expect that these selectivity ratios will become even more favorable in the foreseeable future.

Our Credit Committee is comprised of John Delaney our Chairman and CEO, Dean Graham the President and Chief Operating Officer, Steve Museles our Chief Legal Officer and Bryan Corsini our Chief Credit Officer. The Credit Committee meets typically twice a week on Mondays and Thursdays, they'll meet more often if necessary based on specific transaction timing requirements. And these meetings are held in person.

And the reason we think this makes sense is it allows for direct and ongoing dialog between the Credit Committee and all three of the primary business units of the Company to ensure that the Credit Committee has real-time insight into things that are going on in the markets. And as we've talked about, the last six months have shown tremendous volatility in the markets. And I think having these meetings face to face twice a week, if not more, have been very instructive and helpful for the Credit Committee. Transactions require unanimous approval, as you've heard before. If any single member of the Credit Committee has a concern about a transaction, specifically issues will be addressed or the transaction will be declined.

The last thing I want to mention on this slide is not necessarily with respect to the Credit Committee itself but the post-approval process and the tight controls we put around this process. It is critical that the loan that was approved by the Credit Committee, its terms and its structure end up in the loan documents. To ensure that the loan documents are reflective of the deal that was approved, inside legal must sign off on every transaction to ensure that that's in fact the case prior to any funding.

You know I've talked about a number of things that have helped to deliver the kinds of credit outcomes we've had here at CapitalSource, our origination which allows us to be selective on a deal-by-deal basis, we've talked about our underwriting which is generally done internally by experts, it's thorough and it's balanced. But I don't think we would have the credit outcomes that we've been able to deliver without the portfolio management capabilities that we have.

I would describe these as proactive and hands on. Our portfolio management teams have regular interaction with our borrowers, they're always looking at collateral and financial performance information. There are ongoing meetings face to face and over the phone with our senior management or the borrowers that we provide financing for. There's also a tremendous amount of communication internally on the portfolio management side. So senior business leaders with each of the three businesses are aware of issues on specific transactions as well as overall portfolio trends.

The same is true for our more senior leadership in our Restructuring Group and Bryan Corsini, the Chief Credit Officer, has a number of opportunities to keep on top of both trends, risk ratings and specific issues in the portfolio. Despite all of our efforts on the origination side and on the underwriting side, we do have situations that require a higher degree of focus and restructuring expertise. And for that and more information I will turn it over to Mike Keller who runs our Restructuring Group.

Mike Keller - *CapitalSource Inc - Managing Director, Restructuring Group*

Thanks, Mike, appreciate the intro. I'm Mike Keller, I head up the Restructuring Group for CapitalSource. The Restructuring Group is responsible for the management's restructuring and monetization of all troubled loans within CapitalSource. Additionally we often consult with the various business units and portfolio management teams when issues arise in the ordinary course, things such as wavers, amendments, default situations we're often called on to add insights and value where we can.

Our main focus is the protection of the CapitalSource balance sheet. When we identify an issue we move quickly to resolve it in the most beneficial manner to CapitalSource. Speed and efficiency and execution are key elements to any successful restructuring and the whole group, the entire team is cognizant of that and we strive for such results. Troubled loans obviously represent CapitalSource's highest risk assets. As a result, identification of these loans early in the cycle is important to the effective management, restructuring and monetizing of such loans.

Once a loan is identified the Restructuring Group follows a rigorous workout process. We have a template put in place in which certain things happen at certain times within the process. Every loan within the workout portfolio goes through or adheres to this template and we have found through history that those groups that are most organized, particularly in stressed or distressed situations, generally prevail. And that's kind of an overriding theme with how we operate on the restructuring front.

Monitoring and management, one of our key responsibilities is to monitor the asset quality across the entire CapitalSource loan portfolio. We utilize various quantitative methodologies to identify potential issues. For example, we review and analyze systematic and non-systematic risk throughout the entire portfolio. We also perform Z-Score Analyses on the loans. Again, both of these methodologies are utilized to identify problems sooner rather than later. Again in the restructuring world the sooner and earlier you get into the process, the more likely you are to have an optimal outcome.

In addition to the quantitative methods we also have routine management meetings with all the business units and portfolio management teams. At these meetings we discuss credit quality and industry trends. In addition, we review macroeconomic factors that could impact certain industries or certain portfolios of assets. Through these three mechanisms, the quantitative review, the qualitative review, vis--vis the meetings, and the macroeconomic review we're able to identify potential problems early in the cycle and again be proactive in the management, restructuring and resolution of troubled areas.

Once the determination to transition a loan to the workout group is made a formal process, as I mentioned, is put in place. The first step of that process is the formal assessment of the situation. It is through this assessment that we determine and hone in on the value of the underlying borrower. We use this valuation as a driver to any strategy that we may or may not go with. We also sensitize any strategy with the legal ramifications of such strategy.

For instance we would view bankruptcy risk, out of court restructuring risk, we also look at Article IX foreclosure. We're always looking for the mechanism that will maximize the CapitalSource value. And with anything whether it be new business or work out restructuring execution is key. We could have any strategy in the world but if we can't execute in a quick expedited manner the likelihood for success is limited. So we do put a premium on speed and execution within the restructuring group.

Our philosophy is centered around maximization of value. We in the Restructuring Group utilize all areas within CapitalSource to maximize the value of the work out portfolio. We leverage off of our strong portfolio, Management Resources as well as our industry expertise particularly in health care and some of the other groups.

Clearly our priority is recovery and we often look to a longer term restructuring where we reengineer the economics, reprice the economics and potentially if need be assist management in the turnaround of the business. This could take time. It could take one to three years, sometimes longer. CapitalSource has proven to be disciplined, patient and pragmatic when it comes to restructuring again through experience we have seen that a long restructuring and having patience and discipline generally results in above average risk adjusted returns as compared to a quick sale where you generally face selling and discount.

Within our core philosophy of maximization of value we have bifurcated strategies if you will based on the asset class. With asset-based loans we have liquidation value to fall back on. This gives us a margin of safety that we can utilize in any type of restructuring and any type of strategy that we implement. On our cash flow side or our enterprise value side we often have an equity sponsor that we work with. We do what we can to encourage that equity sponsor to support the transaction. In the event that they don't CapitalSource is prepared to take more of a leadership role within the restructuring and optimize its economic return.

As you would expect the current market dynamics are providing a lot of opportunity particularly in the restructuring side. We find that we are more freely able to reengineer and reprice our risk. We're finding that a number of our competitors, such as the hedge fund, and even some of the financial institutions are exiting our markets. One of the things when you have known for awhile is that some of the hedge funds that we compete against certainly in the restructuring world do not have the bankruptcy expertise or the infrastructure to manage and execute on a complex restructuring.

All these factors enable CapitalSource to take more of a leadership role within the restructuring of any given credit. And I think over the long term will result in above average returns to CapitalSource. With that I'll turn it back to Mike Szwajkowski and we'll entertain any questions you may have.

Mike Szwajkowski - *CapitalSource Inc - President, Structured Finance*

Yes thanks. So now we'd like to open it up to any questions that any of you may have for our panel. Please?

QUESTIONS AND ANSWERS

Unidentified Audience Member

I just wondered if you'd like to comment just a little bit about how you align the incentives of the various people involved in the process because you've got people originating lines. You've got people they're making decisions as to whether those loans are of certain type, a certain quality. You've got people sorting out situations where lends go bad. How do you get people to be on the same -- ?

Mike Szwajkowski - *CapitalSource Inc - President, Structured Finance*

That's a good question. We have very rigorous compensation structure of the firm, which really ultimately is driven by profitability or return on equity. So in other words people who for instance are responsible for originating new business are not paid simply on volume. That would be a big flaw in a model and that's been obviously utilized in a number of other places.

So really people are incentivized to do not just business but profitable business and to the extent that, for instance, let's take the example of a front-end originator. If there was a big loss associated with a business that actually is something that they have to basically earn their way out of, if you would. Anyone have anything to add to that?

Mike Sznajder - *CapitalSource Inc - Chief Credit Officer, Corporate Finance*

Well I would just add I don't think it's anything different than what you said, Mike, but one of the ways I talk about it is, is that everybody in the Company should come to work thinking about how we're going to get the next loan. And they should also come to work thinking about once we book the loan ensuring that we're going to get the money back.

We've talked about credit first. We talk about it all the time. If you have originators on the front end who will get a book and that's their last concern, then you're going to have a big issue. So I try to tell people that everybody should be focused on credit no matter what your business card says. And my title has credit in it.

Unidentified Audience Member

I think this is a question for Keith. That term sheet proposed percentage is about 16% of overall loans that you look at. I think that's been sort of mid teens for awhile. The term sheets accepted on that has been about 7% in the exhibits in here. Given where you guys see competition going do you see greater term sheets accepted as a percentage of term sheets proposed?

Mike Szwajkowski - *CapitalSource Inc - President, Structured Finance*

You're talking about [591]?

Unidentified Audience Member

Correct.

Mike Szwajkowski - *CapitalSource Inc - President, Structured Finance*

It's interesting that you ask that question because we've had slide I believe since we've began or close to when we began. And I believe -- and again we'd have to check the numbers on this but I believe that the percentages have actually stayed very similar. I don't know Mike if you have anything to add?

Mike Sznajder - *CapitalSource Inc - Chief Credit Officer, Corporate Finance*

They've been pretty constant. Part of that I think is law of large numbers to some degree and then really our process has been pretty consistent.

Mike Szwajkowski - *CapitalSource Inc - President, Structured Finance*

The question?

Unidentified Audience Member

Do you envision a higher acceptance rate given the term sheets you've put out there?

Mike Szwajkowski - *CapitalSource Inc - President, Structured Finance*

Yes absolutely. Remembering that the price is also going to be significantly higher than it was before [its fall].

Unidentified Audience Member

I just have a question on the underwriting memoranda and then the credit committee memoranda. I mean those two streams of workflow if you will I mean is there a lot of interaction between capital and analytics? And then the lending business while developing those memoranda or is it separate flow and each group comes up with its individual conclusions?

And then the second question kind of unrelated though is in the Restructuring Group it seems like you're internally focused for other resources of the Restructuring Group ever use within the business to say, do some big financing or other types of financing within a lending business. Thanks.

Keith Reuben - *CapitalSource Inc - Co-President, Healthcare & Specialty Finance*

I'll take the piece on the underwriting package. There's some of both actually. Certainly when a transaction, due diligence scope is outlined, the due diligence folks from the capital analytics side are working in conjunction with the deal teams to ensure that everybody has a clear understanding of what the scope of the work should be. There is some independence, however.

You'll notice that there was intentionally a lot of duplication in the two reports. And the idea there is then I think a number of people have talked about, John talked about it, Bryan talked about it. Is that we're trying to get a number of people who come at the loan from a different perspective to come to the table with their view to ensure that we've really covered all aspects and we have a variety of opinions. And so some of the work is independent. The scopes are generated collectively on the front end so the answer is a little bit of both.

Mike Sznajder - *CapitalSource Inc - Chief Credit Officer, Corporate Finance*

I would just add it's important to remember too, and I think it's depicted on that slide, that the capital analytics are auditing people, don't report to a business unit. They actually report directly to our Chief Credit Officer so there is literally separation of church and state, if you will.

Unidentified Audience Member

That's helpful because often when you look at these kind of workloads if the two groups are already talking to each other and working too closely then it defeats the whole purpose of having a different workflow. But that's for the clarification. And then the other question is just if the Restructuring Group works within the business lines to maybe help provide source flow and sort of otherwise?

Mike Szwajkowski - *CapitalSource Inc - President, Structured Finance*

Let me see if I can answer the second question, which is a very good question. I would bifurcate it into two types of [dip loans]. The first kind are the ones that arise as a result of a current restructuring. That happens in a number of cases and in that case Mike's team and the Restructuring team really leads the transaction and utilizes as Mike mentioned in his slides a number of the resources to drop a firm whether it be a media transaction, you'd utilize the media resources, a health care transaction Mike would use the health care resources, et cetera.

Then there's the other side of the equation which are dip loans that we're actively seeking to do either directly originating them or otherwise. And then those transactions they're done out of specific lending units. But Mike is also significantly involved in that process as either an advisor or a team member in the deal -- in the deal process.

Unidentified Audience Member

Thank you.

Unidentified Audience Member

Can you comment on your expectation for net recoveries over the next couple of years versus the past two years? And then secondarily what about the propensity of your sponsors to lend their support towards deals on the books today looking forward versus in the past?

Unidentified Company Representative

Do you want to handle that Mike?

Mike Keller - *CapitalSource Inc - Managing Director, Restructuring Group*

I'll start with the second part of the question regarding sponsorship, sponsors supporting deals. You know, it's a deal by deal situation. Some deals we find the sponsors very willing to participate in a restructuring. Certainly they're cognizant that the economics need to be repriced. But in some cases if we do not -- if we can't encourage them to participate or if there seems to be a separation of alignment we're prepared to take more of a leadership role and restructure hopefully with the cooperation of the sponsor. But at CapitalSource we'll do generally what we can to maximize value, and sometimes we'll have an equity sponsor and the lender have different goals. So --

Mike Szwajkowski - *CapitalSource Inc - President, Structured Finance*

Let me see if I can answer your first question, which is on net recoveries. And I'm basically going to reiterate what Bryan and John have said earlier, which is we feel very good about our credit pipeline. We track it very closely and particularly non-accruals. And as Bryan said I think our net was 69% if you take out discontinued businesses for the on site, 69 basis points if you take out discontinued businesses 47 basis points. So we expect it to be within that family, it's probably higher, given the credit environment.

Keith Reuben - *CapitalSource Inc - Co-President, Healthcare & Specialty Finance*

Yes I would say without adjusting for the businesses that we exited they're actually going to get better. Because our credit will perform better across the business with the businesses that we have today relative to the two that we exited. So they should improve.

Unidentified Audience Member

So where fraud does slip through the capital analytics process this is by definition because there was fraud you just can't see those things or when that occurs you go back and you tweak the model and have ways of catching that. And then why haven't seen any -- I mean you only accept 5.4% of what you look at and where do those companies go that are not getting financing right now? It just seems like other than CDO and real estate we just haven't seen problems in the commercial economy and yet there's pretty widespread consensus we're in a recession already. What's your outlook on that and why we haven't seen more problems in the commercial side?

Mike Szwajkowski - *CapitalSource Inc - President, Structured Finance*

Sure, okay the first question was really about fraud. And I think hand in hand with that you're asking sort of do we learn lessons from these things? And I would say that where we've had issues with loans, and we've had them, that when, if all the dust settles and we've resolved the situation there's a very introspective process that takes place where you try to figure out if we missed something do we need to tweak our process. And again sometimes that's true and sometimes if someone wants to defraud you and they're sinister then sometimes there's really nothing you can do about that.

But I'd say that our process is constantly being refined and we're constantly learning more and better ways to approach our businesses. So we feel very good about our process and I would tell you we've never had a situation where we just miss something that we should have picked up in an underwriting.

Keith Reuben - *CapitalSource Inc - Co-President, Healthcare & Specialty Finance*

I'll add to that fraud is a very difficult thing to deal with. If somebody is going to defraud you there are ways to figure that out. But one of the things I had on one of my slides, and I didn't actually mention I think in my comments was the fact that we focus on the integrity of the people that we deal with whether it's on the borrower management side or the ownership side.

And one of the advantages you have as a specialty lender is not only do you have very good insight into the things that are going on in those markets but you also know a lot of people. And so everybody does background checks and credit checks and the standard reference checks that you get when somebody gives you a list of names that they want you to call.

But the fact that we're so specialized in the industries that we lend into it allows us to create our own network. And I would say that's one of the lessons learned for us is ensuring that the people we're dealing with both on the ownership side and on the borrower management side have a high degree of integrity. And if do a good job there I think you're going to decrease the chance that you'll have an issue with fraud.

Unidentified Company Representative

And I think we have time for one more, one more question. Do we have a microphone? In the front, thanks.

Unidentified Audience Member

We've heard a lot today about your competition exiting the business and the great opportunity that that provides for CapitalSource. So can you talk a little bit about what your origination teams are doing to get out in front of the market and say we know a lot of the people that you may have gotten your financing from are gone. We're here. We're ready to do business. I mean how are you approaching those new customers?

Keith Reuben - *CapitalSource Inc - Co-President, Healthcare & Specialty Finance*

That's a good question. You kind of answered it yourself too. That's part of what we're doing. We are continuing to leverage off of our platforms. We're certainly feeling the fact that our competition is not in business and ultimately and as a result of that we're seeing more deals.

So the answer is we're seeing a lot more deals that we otherwise, I think Jim mentioned it, I know in some of the healthcare businesses as a result of the competition going away the deal flow has been as great as we've seen it in the last four years particularly in the healthcare ABL business just because people have been exiting the business. So in some ways you don't have to say anything because everyone is coming to you. But in other ways we're certainly selling as much as we can. The point that you just made so it's a good question.

Mike Szwajkowski - *CapitalSource Inc - President, Structured Finance*

We also have very rigorous calling efforts. I mean we actually monitor how frequently for instance we talk to certain sponsors. So there is a quantitative methodology, if you will, behind our calling efforts, which had never changed. And then on top of that as Keith pointed out where actually the phone is ringing a lot more because there was fewer people to call frankly. So hopefully that answered your question. So with that I think we're going to move onto the next panel. I thank all of you. And we'll just give this a minute but we're going to move onto our Specialty Lending panel now.

PRESENTATION

Mike Szwajkowski - *CapitalSource Inc - President, Structured Finance*

Okay so having now discussed a bit more about the CapitalSource lending process what we wanted to do was try to provide some additional insight into some of our very specialized lending units and practices within the firm. So today with me I have Bill Polk who is Managing Director and runs our Security Alarm business. Chris Hague who is the Managing Director who runs our lender and rediscount finance practice, and Dan Duffy who is Co-President of our Corporate Finance business and today is going to discuss our syndication activities.

Within CapitalSource there are nine very specialized groups which offer effectively six core products within their select market. And these groups are listed on the slide but you can see that there's some pretty focused, pretty granular businesses. And this highly focused and selective approach to the market it's not random. It's far from random.

This has been a very conscious and earnest effort to position CapitalSource within a part of the market which demands a high degree of expertise and where consequently competition is light. And the green circles represent businesses that we're in and where we see very little competition on a relative basis.

And really it's in this part of the market where qualitative factors weigh heavily and where rigor and a specialized approach is awarded with high risk adjusted returns. But again it all starts with credit and to operate effectively we bring specialized credit skills to bear on our targeted niches. And this deep industry knowledge results in, we believe, more efficient structures, better relationships with our clients and better outcomes. And we have better outcomes because we do in fact bring more and better resources to bear on the credit process. We have dedicated, very specialized resources within our capital analytics unit and we have experts within each of these specialty groups with very specific industry knowledge.

And for example in our health care businesses we have professionals who are expert in reimbursement and clinical practices. In the Security business we have experts from federal, state and local government who are part of our team. And it doesn't stop there on the front end. In fact we continue to bring this to bear on our loan management capabilities and the continuing and ongoing management of these loans throughout the whole life cycle.

Because our goal is to bring these specialized credit skills to bear on every loan from the moment of origination until repayment. So today and we'll get more of this from my colleagues, we believe that the market is truly presenting extraordinary opportunities for these specialized businesses.

Many of our competitors have exited the business and particularly within these specialized businesses where a lot of our competition essentially roamed into the market and has now left. And these industries, these specialties were really always fairly under-served within the market on a relative basis and today that's even more striking. So within these specialties we believe it's speed and execution are rewarded more preciously than in the past.

We continue to see industry-specific knowledge command a real premium and looking across 2008 today we see very, very good core opportunities within our business and we expect that in the next quarter or two we'll see more distressed opportunities which should provide very attractive risk-adjusted opportunities for us. With that I'd like to bring Chris Hague up to the podium again who runs our Lender and Rediscount business.

Chris Hague - *CapitalSource Inc. - Managing Director, Rediscount Group*

Thank you, Mike. Good afternoon, my name is Chris Hague. I'm the Managing Director of our Lender Finance or Rediscount business. I'd like to spend a few minutes today to describe in greater detail what we do in this specialized asset-based lending niche. We are currently housed -- we are housed in the Structured Finance business and we represent approximately 50% of that division's funded portfolio and approximately 19% of our CapitalSource's overall commercial loan portfolio.

Our sole focus in this business is to provide loans to small and mid-size finance companies nationwide. Our clients or our prospects range in size from small family-run businesses that might have a finance arm to support a sales organization to larger pure play finance companies with multiple locations in a portfolio that's $100 million to $200 million. Our target or rather our average loan is approximately $9 million in this space so we're building a good-size business one brick at a time.

We also have desirable diversification across sub concentrations in time share, auto, what we call direct loan companies and commercial mortgage loan originators. The commonality across these businesses is that we're looking for companies that have been in business for a reasonable period of time preferably for multiple business cycles. We're interested in companies that have demonstrated positive receivable performance characteristics -- they're capable managers, companies that can provide us with adequate servicing and the reporting that we need to assess their business.

And significantly we're targeting companies who have a buy in type mentality and a vested interest in the ultimate performance of their portfolio as opposed to -- which prevents the hot potato problem that we've seen in recent months where a number of lenders would originate and look to move that loan off their book as quickly as possible and not really care how that loan ultimately performed.

Our sole product in the space is a -- or our primary product in the space, almost our sole product is a senior revolving warehouse facility with an initial term of three to five years and a renewal feature thereafter. We are secured by a first lien on our client's portfolio and we generally advance a conservative advance rate of 60 to 85% against the lesser of our clients' cost basis or UPB which is their basis in their portfolio.

This equates to an even lower CapitalSource advance rate relative to the ultimate portfolio value when you remember that our clients demand equity haircuts from their end obligors and that we further demand an equity haircut from our clients. So the sum of those two elements in our CapitalSource advance rates relative to the collateral value range from 50% to 70% before considering the benefit of any excess interest.

Our facilities are highly structured. We've spent a fair amount of time to access up front our clients' historical default and loss characteristics and we impose strict eligibility criteria on those loans that we'll fund to ensure that future production is roughly consistent with the history that we've seen and also to weed out what we perceive to be the riskiest forms that our clients that our clients might fund.

We also borrow from the securitization well to impose fairly rigid cash and collateral, note receivable controls to segregate our collateral from our smaller clients. We'll require third-party custodians to physically hold the loans. We'll use lock boxes. We'll frequently require back up services if not third-party services. This allows us to very tightly monitor the underlying receivable performance. And it also enables us to move quickly to seize collateral and liquidate it in the event that the portfolio performs in an unexpected manner.

Overall in this business we enjoy attractive pricing including commitment fees, unused line fees, collateral management fees, and a healthy spread over LIBOR to begin with all in our yields are comparable to the earlier example that you saw in Tom Finks' example.

The portfolio also benefits rather from being relatively sticky. It's fairly difficult to go out and find these small balance loans. It's even harder to convince our clients to move from their current lender but once you do the reward is that the client will generally stick with you. We make our portfolio administration staff becomes critical and functions so closely with our clients, servicing and funding capabilities that the switching costs are very high.

This allows us to maintain those relationships that we want to and provides a kind of built in growth mechanism in our business before even searching for new clients. Another attractive feature of this business is that there's relatively low or moderate competition in the space on the low end of our target loan range. We frequently compete against a local bank who may be less asset-based focused than we are, perhaps more interested in the recourse nature of the loan, or interested in deposits and a wider banking relationship. But once our clients and prospects exceed that local bank's lending limit we're off in the first or second call which is an enviable position to be in.

On the upper end of our target loan range we compete with a -- we've historically competed with a kind of rotating list of hedge funds. But our competitive advantage relative to those players is that we've made the investment in our portfolio staff in particular to provide better customer service. These are accounts that you need to fund, [Dale]. You've got to reconcile on basis of weekly. You've got to audit quarterly. And so we're able to do that. Most of our hedge fund competition is not -- the client gets a better service level and we get the ability to more closely monitor our collateral and to make a mid-course correction if we see any early in the performance.

Like to date, and we've been in this business for eight years. Nearly since the inception of CapitalSource. We've had a very positive performance history with few defaults and diminimist losses and in this credit environment the business is well situated. The current book of business is stable. We've been stress tested by the events of the summer and the fall and the first part of this year and we've past the test very well. We attribute that in large part to our focus on the buy and hold strategy and our early efforts to make sure we were diversified and had focused on what we believe to be more stable asset classes. So the stable base of existing business and reduced competition. We've had -- we've a very strong pipeline looking into the rest of 2008 and beyond.

Why is that? It's simple. If you think about it every bank has a few of these loans in their book, but as banks retrench either to reduce their lending activity or to focus on their core competencies they've left behind or are leaving behind very sound companies who we're happy to jump in there and take a look at.

This slide just graphically illustrates how we approach the business from lead generation through underwriting, enclosing. In many ways it echoes what's been said in the prior panel so I won't go into tremendous detail. But I will mention or I will highlight a couple of areas that I think speak to why our structure and our process are very well organized to take advantage of this current lending environment.

We do have a strong volume of inbound calls from these clients after eight years of focusing on a narrow business. And providing good client outcomes where again the first or second call in most of these asset classes, the top left box, but we don't rest on our laurels. We've developed a large business development network as Mike alluded to on the last panel that's actively seeking out and calling upon these customers. That's all they do. They're not generalists so they enable us to have a large volume of high quality leads.

Over the past eight years we've developed kind of a home grown capability of seasoned banker teams. These are investment officers who know how to sort through those leads and help us structure transactions and finally and almost more importantly we've put together one of the best portfolio groups out there to handle these accounts. We've populated the portfolio staff with seasoned executives from other finance companies and they generally have ten or fifteen years of experience in their respective asset class.

And not only do they have that background but they manage these accounts very intensively with an average focus on only ninefold accounts, which is the right number to manage these accounts intensively. So with that I hope I've given you a good overview of the Specialty business and I would turn the podium over to my colleague, Bill Polk, to walk you through another of our Specialty businesses.

Bill Polk - *CapitalSource Inc. - Managing*

Thanks, Chris. My name is Bill Polk and I'm the Managing Director for the Security Finance Group. The global security industry has witnessed extraordinary, almost unprecedented growth change and opportunity over the last number of years.

And it's an industry that in our view is ideally suited for CapitalSource's middle market, vertical market, customer focused orientation. As a group we concentrate on companies that broadly speaking protect life, property and information. And within that industry we focus on subsectors that are capital intensive and growing but that also produce predictable revenue streams and stable margins, and other positive risk characteristics.

CapitalSource formerly entered the security finance market in the spring of 2004 following the acquisition of SLP Capital a specialty finance company that focused on the security alarm market. And we've grown nicely since that point. We're as of the end of the year 2007 at $442 million in assets. The substantial majority of which are first lien senior debt loans, and we have no material credit concerns in the portfolio to date.

I'll discuss this more in a moment but the industry is witness dramatic growth and is being shaped by forces to some degree unaffected by the commercial business cycles. Within this $200 billion industry as we define it we focus on three broad sectors, the physical security industry, which for a lack of a better definition is the pre-9/11 traditional security industry comprised of companies that address intrusion detection, video surveillance, fire detection and suppression, man guard services, cash in transit and other industries that have been along for quite awhile that are growing nicely today.

The second market we've focused on is the Homeland Security market, a newer market developed really post-9/11. The government contractors who focus on the Department of Homeland Security, the Department of Defense, the State Department, the Department of Justice and other Federal agencies concerned with the national security missions. And the third sector is the public safety sector, which is that very broad highly fragmented market comprised of companies that sell products and services to police, fire, emergency medical services and corrections.

Stepping back a bit before 9/11 the security industry was driven primarily by individual criminal activity, crime syndicates and natural disasters and fires. Critical infrastructure protection, WMD screening, ports and border security, disaster response and recovery. These were not markets that were on the security landscape the way they are today.

But following the events of 9/11, the hurricanes of 2005, the bombs that gone off in cities across Europe, the recent shootings on college campuses and other stunning developments like those, the market has expanded and broadened and deepened. And has also gotten some additional loft out of some of the macro trends like government outsourcing, the continued advanced of IT and IP technology, and the geopolitical threats that are arising out of regional conflicts like we're seeing in Afghanistan and Iraq.

The US government and other governments have recognized threats are addressing them with legislations and appropriations. And alongside of government spending is a considerable amount of private sector spending. It's estimated that 90% of the critical infrastructure of this country is in the hands of the private sector and those assets need protection. So a lot of tailwind is behind this market.

In addition strategic and financial buyers are still very interested in this market despite the current credit conditions. At this point the evidence suggests that public sector spending on security would be spared, the belt tightening that we're going to be seeing most likely in other Federal spending and state and local spending sectors, the perception of crime and the perception of the risk of crime is not diminishing. And as we have seen in the past real-time events will continue to drive spending priorities. If you want to know where the capital is going to be flowing going forward pay attention to the headlines.

This next slide breaks down our customer base on a more granular basis. The slide on the left shows you our customers by borrower type. As you can see slightly over 50% of our customers are security alarm companies. These companies have highly predictable revenue streams characterized by recurring revenue contracts, which themselves have a very active secondary market, which gives us a very good sense of our collateral position.

System integrators are companies that focus almost exclusively on large sophisticated, technically complex commercial installations. It's one of the fastest growing areas of the security market and it's the group of companies where we're seeing the convergence of IT and physical security coming together most dramatically. And the third sector are the Homeland Security borrowers who have, as I've mentioned, are focused on Federal, state and local homeland defense missions.

The slide on the right or the chart on the right I should say is a profile of our customers' customers. We pay very close attention to the source of our customer's revenues and this is a weighted average analysis of our loans by payer type. And at this point we're very pleased by the diversity you're seeing on that slide.

Going forward we are seeing continued strong opportunities, a theme that we've heard a lot about today. And we have a very active pipeline. First in our personal security market we're particularly focused on companies which themselves have a vertical market focus. Companies that are paying particular attention to the chemical industry, the transportation business, financial services, multi-tenant office buildings. These kinds of businesses are the most highly valued by strategic buyers and their expertise reinforces their technical competencies. And both of these things are important risk mitigates from our standpoint.

On the security alarm side we believe our customers will see some very attractive buying opportunities really arising out of the current market environment where certain companies have been over leveraged by other lenders. In the homeland security market we're going to continue to focus on the contractors that themselves are calling on the DHS and the DoD and Department of State. In this sense we'll be following the money. And in that market we're particularly attracted to companies that are providing critical infrastructure protection, counterintelligence services, port and cargo security and transportation security.

And in the public safety sector a particularly interesting area for us right now and actually a newer area but one that we're very excited about we're seeing opportunity to provide sale lease back financing for corrections facilities at the state and local level. And we're also seeing quite a bit of activity really coming out of the businesses focused on police and fire departments. These businesses continue to get a lot of attention following Hurricane Katrina, the wildfires of 2007 in California and the recent campus shootings. We're very excited about this market. It's extraordinarily dynamic and we feel very good about ability to address the opportunities. Dan?

Dan Duffy - *CapitalSource Inc. - Co-President, Corporate Finance*

Thanks, Bill. Just to wrap up for the day the final presentation, I'm Dan Duffy, Co-President of the Corporate Finance business at CapitalSource and we'll focus a very brief presentation on our syndication activity in that business.

The activity in syndications is generally corporate finance business activity. We also have a fair amount of cash flow activity out of that in some of the security-related businesses as well as health care and this team provides that syndication services for all those various deal teams.

It's a very integrated group working with the deal teams from day one to make sure we're highly coordinated in terms of the appropriate pricing and structuring of these deals and then obviously the specific syndication support to sell down those transactions. While it's been an extraordinarily volatile and uncertain market through the back half of '07 and into '08 we would expect it to continue to be that way through '08 we continue to believe that syndication will be a differentiator and an area where we can do two things. one help drive profitability with the fee income associative syndications as well as risk management to assure ourselves of having the appropriate granularity in our portfolio as we continue to look at larger transactions.

Finally, the team also provides literally ongoing real-time market insight that helps credit committee as it assesses risk reward and transactions throughout the Company and we obviously provide confidence opinions related to specific transactions so a credit committee can look at both the purse credit risk in a transaction as well as the balance sheet risk associated with syndication activity.

And reason where how volatile the market was in the back half of '07 we launched and closed nine deals in the back half of '07 and were successful in each of those in terms of selling down to the targeted hold size that the Company as well as generating the targeted or greater amount of [SKIM] income associated with those deals proving the value of associated with the risk we took in those deals.

At the end of the year there was a health care related transaction that we closed. It was our largest cash flow transaction to date in a very, very difficult market and we're happy we closed it in December of '07 instead of January of '08 because it would have been even harder.

A very successful, very profitable transaction for us. We are underwriting deals today on a very limited basis. Sort of the watch words these days are more anchor and arrange or best effort syndications. But we will on a very selective basis take balance sheet risk for the right pricing.

Clearly the spreads that we're getting on these deals, that we're coming to market with are significantly wider than they had been. The fees associated with taking underwriting risk are also significantly wider. So when we do take that risk we're being paid much more than we were in the last 12 months to 18 months.

There's also significantly more flex when you launch the deal both in terms of price flex and structural flex which can also in some cases include a non-flex. As an example if a sponsor is buying a company for seven times EBITDA and we're providing three and half times debt we may have a deal where we go to market with that leverage and if that's not acceptable and we need to reduce the leverage by a half turn and the equity needs to put more money in, in some of these cases and these days we have that ability to do that to protect ourselves, again much different than it was in '05, '06 and early '07.

Other things like Market MAC, language as we go into the transactions are commonplace today as well as many other features in terms of tighter covenants, and other things that both make it a safer credit for CapitalSource but also make it easier to sell the transaction to other investors.

Just in terms of activity levels '07 was a very strong year in terms of the numbers of deals we did versus '06. The total volume of those deals et cetera it all boils down to sort of where we wind up in lead table stats which I'll show you on the next page. But we went from [21%] in '06 to [11%] for the middle market league tables, which was reflected by the amount of activity that we did.

And when you look at those names that kind of went away in '07 from '06 it's mostly the investment banks that have pulled back from middle market and upper middle market transactions. They're obviously focusing largely on institutional investors many of whom decided to have some focus on middle market related collateral and their CLOs. When that market essentially went away it was really back to true middle market lenders that are able to club transaction and find more traditional balance sheet lenders to support their deals, which allowed us to move us as we did.

So what are the takeaways on syndications? Again well it's a very uncertain market and we believe that we will continue to use our best-in-class syndication capabilities to differentiate ourselves and drive profitability. As we are in credit selectivity has gone up significantly. We have much wider flex. We're really taking much less risk in the transactions that we do syndicate and we're being paid significantly more to do that.

Finally, in the middle market, which is a very clubby market deal reciprocity has always been important. It's increasingly important by having transactions we can bring to market with other lenders who have capital to put to work. We will be partnering back and forth on deals in a pretty significant way in '08 and '09 which is very similar to the way that larger middle market deals were done in the '02, '03 and early '04 timeframe. So we're very excited about that aspect of the business and we'll now open it up for questions.

QUESTIONS AND ANSWERS

Unidentified Audience Member

A question in the rediscount business I know your non-performers are under 1% and the effective advance rates are very low. When you look at the underlying borrowers at finance companies what do their metrics show over the last year? I mean it's a little bit of a loaded question in terms of I would assume their non-performers are starting to move up materially?

Chris Hague - *CapitalSource Inc. - Managing Director, Rediscount Group*

We're seen a moderate increase in their default rates and while severity thus far has held steady but we expect some additional deterioration there. And a response to that we have in our loan documents the ability to impose reserves and to reduce our advance rates within certain bands. And so we think there's a particular asset class that's more likely to have further erosion we simply restructure our advance rate for those existing facilities and obviously on a fall basis we tailor new transactions with current market realities in mind.

Unidentified Audience Member

But I think you referenced that there essentially have been no losses for the seven years you've been in the business. Longer term from a business model perspective what should we expect from the rediscount business in terms of average losses over a full business cycle?

Chris Hague - *CapitalSource Inc. - Managing Director, Rediscount Group*

I think we expect similar stable performance, again given our structure and the significant equity that's below us both from the obligors and then from the finance companies. It's our goal to stay a step ahead and to constantly tweak our advance rate and our eligibility criteria if our client is in a tougher environment hopefully the first thing they're going to react to that and they're going to structure their transactions differently and in any event we're going to be a backstop and we're going to impose on them reduced advance rates and tighter eligibility criteria. So I think we're going to see very stable results over a full cycle.

Unidentified Audience Member

I'm sorry, so over time it's effectively a zero loss business?

Chris Hague - *CapitalSource Inc. - Managing Director, Rediscount Group*

We're going to strive for zero and I think as an outside limit we look at something like 25 basis points or 50 basis points.

Unidentified Audience Member

Thanks, you know, the health care and the security lending groups have been highlighted as groups that are less cyclical, economically cyclical. Can you remind us again first of all what other areas you would kind of point to as somewhat less sensitive to the cycled downturn? And then also on the Security Lending Group can you help us understand this, maybe just size the market? We saw some of the stats that you talked about but as the LBO market and the commercial real estate and probably the residential construction it seems like you'll probably pull back to some extent on there. How much can be made up on the less sensitive businesses that might be attractive and growing?

Mike Szwajkowski - *CapitalSource Inc - President, Structured Finance*

I'll let Bill handle the question on the security lending market.

Bill Polk - *CapitalSource Inc. - Managing*

Well again we define the market pretty broadly. So we may see some slowdowns in say the security alarm market but the opportunity, for example, to move into the Homeland Security market where spending is really not bound by commercial cycles as well as the corrections market where we're seeing opportunities to do sale leaseback and correction facilities will allow us to grow, we think, on a very aggressive way.

Dan Duffy - *CapitalSource Inc. - Co-President, Corporate Finance*

Yes I think a couple of other areas that we focus in on that are less cyclical part of our technology practice is focused primarily on recurring revenue-driven software models that are very attractive obviously separate, apart from larger market deals and they have a larger, higher working component which is obviously much different and very cyclical. And parts of our media in telecommunications focus are also pretty resistant to recession particularly publishing, which is still a subscription and ad driven aspect that we focus on it's relatively non-cyclical at least in the areas that we focus on.

Mike Szwajkowski - *CapitalSource Inc - President, Structured Finance*

Anyone else?

Unidentified Audience Member

Chris, in the rediscount businesses there's certain sectors you're focusing more on for growth and areas you're pulling back on a little bit amongst the ones you listed Tom, [Jerado] et cetera?

Chris Hague - *CapitalSource Inc. - Managing Director, Rediscount Group*

Yes is the answer and it really it changes every year given either our perception of portfolio performance or the competitive landscape. This year one of the stronger asset classes for origination is the time share sector first because it tends to be a little more recession resilient than some of the others. And secondly because one of the larger traditional lenders in that space was GMAC who has a desirable portfolio but is not in active lending mode. So for the next quarter or two that will be an area of emphasis.

And it's interesting because we were very active in the segment. I know in 2001 for a similar reason, [Phil] at that time had gone bankrupt. They were in the process of divesting their time share portfolio and it took a little while until their book was absorbed by other lenders including CapitalSource. But for a two-year period thereafter so much competition came in that we kind of de-emphasized that, rotated into some others. So you see a constant rotation from one segment to the other, which is why we like to have those different segments and not just a single focus in any particular one. But I would say that's a pretty good area for us.

Mike Szwajkowski - *CapitalSource Inc - President, Structured Finance*

Anyone else? Okay I think with that, Dennis, we want to move to the executive Q&A and forego the break that was on the schedule if that's okay with everyone?

PRESENTATION

John Delaney - *CapitalSource Inc - Chairman & CEO*

Okay well we tried to stress a few things today. First we wanted to stress the credit performance of the Company which we described as being strong and positive and get behind why we think that's the case. Hopefully we've achieved that standard.

We also wanted to talk about the funding strategy for the business why our funding strategy has allowed us to kind of withstand this market disruption and hopefully we've achieved that standard as well. And then finally we wanted to give investors more insight into many of the senior managers at the Company and really show how we run the business. Why I like to say this is kind of a hands on credit first approach to the lending business and that we earn higher returns through sound lending and not through leverage.

And hopefully we've been able to without boring you too much give you some of those details. Because this is really a grinded out business at the end of the day. And we think we grind out pretty darn well and it's because of the people who run these various businesses.

So what I'd like to do now is just open it up for any questions that people may have, that you the think the cast of characters on this stage may be able to answer, and then we'll wrap it all up. Someone has to ask a question if we all got up on the stage here even if it's someone who works at CapitalSource.

QUESTIONS AND ANSWERS

Unidentified Audience Member

I'm just wondering though what areas that you're most focused on, most encouraged growth-wise, what's the most disappointing outlook I guess?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Yes. Well I think we're very encouraged with what's happening in our health care business because it's done really well. I mean we've been at the health care lending business for now, I hate to say it, 14 years, 15 years. And we've had terrific performance, never really lost money, always earned high returns. And I think once again the market is setting up nicely for that business. The pipeline is really deep in the health care credit side. The things we've been able to do on the real estate side. Because we are a REIT expand both the real estate lending business and the sale leaseback business is really very positive.

And so we're really excited about that. And some of the new areas, the security finance business we talked about, we're very pleased with the progress that Bill Polk and his team have made in that area and so that's clearly a bright spot. Clearly we're been cautious around commercial real estate and corporate finance not because of any issue with those businesses or those teams. We've got terrific players in those businesses but they're a little more cyclical. So we've tried to play the market based on what we'd seen unfold as best we can which is to back away and now it's probably the time to start thinking about stepping in a little bit. And so we're looking at that.

And then the rediscount business continues to kind of grind away. The rediscount business is a lot like our health care accounts receivable business. It's not a fancy business but it consistently puts up good numbers and Chris and his team have done a great job there. So I would say the way I look at the business we have two businesses that are cyclical and the other businesses generally are not. The cyclical businesses I think we've done a pretty darn good job backing away from when things were getting a little overly frothy and now is probably not the time to think about getting back in. I don't know if you guys would argue that.

Unidentified Audience Member

I'll try to help. Two things, first on the conference call, John, I thought we were talking throughout the -- [Meritel] talked about the securitization throughout the presentation. I thought did you all on the call sort of -- I felt that there was some maybe implication that you were fairly close to perhaps doing another one. And then I felt during the presentation that given the -- well you're being well received when you're out seeing the normal participants and buyers that perhaps you sort of backed off of that a little bit. Is there any change, I know it's just a couple of weeks, but any change at all in the way you're looking at that?

John Delaney - *CapitalSource Inc - Chairman & CEO*

No, I think what we implied on the conference call, which is true, is that we're preparing to do one. There's a certain amount of preparation that goes into doing one of these things, structuring the deal, dealing with the agencies even before you get to the really hard issue which is selling the bonds. So we're in the process of preparing that now and we'd like to try to do something, kind of start thinking about doing something before the end of the first quarter, whether we'll be able to meet that timing or not.

But we're in the process of preparing to do one and that's why -- Tom and I went out pretty extensively to talk to investors in anticipation of making the decision as to whether we should try or not and the conclusion from that meeting was, yes we should try. So that's kind of where we are. Tom, I don't know if you'd add anything to that?

Tom Fink - *CapitalSource Inc - SVP, Finance and CFO*

No, I agree. I mean this is obviously a lot of lead time involved and we're working diligently.

Unidentified Audience Member

And then I guess a second question, Tom, would be for you. And you talked a bit about the credit facilities and the thought of either obviously doing it either before or when they come to. Any thoughts -- are there any advantages, disadvantages to doing some of those, I think there's one coming -- one of them I remember comes up in August. So any -- are there any -- is there a disadvantage or advantage to doing it now, or are you hoping it gets betters. Or -- how are you thinking about the timing on renewing those or having the banks renew them?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Well we're certainly not hoping it gets better. We don't manage the liquidity hoping things turn around. We try to be as proactive as we can. I think, just one practical constraint the way these things are structured in order to get the best capital treatment by the lender, they had generally 12 month pricing periods, if you will. So it doesn't make sense to roll them too much in advance because you're not buying yourself that much time if you're looking at, really, 12 month increments.

So for example, we have a facility that rolls in August and we're certainly having conversations around that, but do you want to roll it now. Because, incrementally you just -- if you did it today you would be extending from August just to March. So is it really worth the effort? So those kind of things that we factor into the timing of all this. Yes, sir?

Unidentified Audience Member

Yes, I just wondered if you'd like to say where Europe fits into your plans. Your office mentioned very briefly early on today. Are there any comments that you would have in that regard?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Yes, I do have some comments. We have within our corporate finance business, we've established a European presence that really (inaudible) two areas of focus. One is many of our middle market sponsors set up operations in Europe to do the same thing in Europe. And we wanted to be able to follow them over there. And then also, increasingly so many of the companies we were financing both had U.S. and European operations, who were spending a decent amount of time over there. So we thought it was logical to set up a business. If you think about our corporate finance business as having some specially businesses retail, media technology, et cetera, we view it in that regard, which is to set up a European team.

And we have a team over there. They've done a nice job. Their portfolio is $300 million in size roughly. It performed really well, no credit issues. And they've done a nice job. That business is leveraged efficiently as it should be, or will be, meaning you need a little more resources when you're starting something like that over there relative to the size of the portfolio. And we've made that investment. And we view it as a complement -- we're not interested in this point at getting into any other businesses over there. Our view is let's do this one and let's make it work and prove that it's successful and then potentially roll out some of our other businesses.

But this is the most natural one to start with because you can follow some of your customers. Whereas, when we start to help your business over there you can't really follow your U.S. healthcare customers over there. You have to really start anew. So yes. It's part of out strategy. And it's one of those things you start doing because in a view, in three, four, five, six years it could actually be meaningful. But you have to start somewhere. Business on track.

Unidentified Audience Member

Growing nicely?

John Delaney - *CapitalSource Inc - Chairman & CEO*

We took one of our very senior people and he heads up the office.

Unidentified Audience Member

Yes. I was just wondering, you talked about -- we've heard about the opportunities in just about every one of the different business segments. Yet there's a finite amount of capital out there. If everybody's seeing competitors leave their areas and there's all sorts of growth opportunities, how do you prioritize who gets the capital?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Again, that finite amount of capital thing is a bummer. The -- so what we're trying to do is prioritize around where we think we have -- I mean, look at -- all of the CapitalSource businesses achieved standard. And standard means a high ROE, where you can -- which you can earn from sound lending as opposed to leveraging, et cetera. Some of them are way above standard, some of them are more closer to standard. I think it's fair to say that some of our businesses that have more of a cyclical feel to them are a little closer to standard and specialty businesses are way above standard.

So I think we're allocating capital in that regard, based on where we think we can earn the highest returns because generally speaking we are in the highest return on a healthcare credit deal. We earn the second highest return on a rediscount deal. We earn a third highest return on probably a healthcare real estate deal. And corporate finance and commercial real estate have been about the same. So we think about deploying capital along those lines.

Unidentified Audience Member

How much loan growth would you be comfortable with if you couldn't get a securitization done today? Or (inaudible)?

John Delaney - *CapitalSource Inc - Chairman & CEO*

That's an awfully poignant question. Just kidding. I don't know if we can comment specifically, Tom, I don't know. It's a really hard question, so I'm going to actually punt to you on it. And talk for a little bit while you have time to think about your answer. So I don't know if we can actually answer, Tom, I'm sure you'll --

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Tom Fink - *CapitalSource Inc - SVP, Finance and CFO*

No, it's a very difficult question to answer. But I think clearly if you look at how much we grew in '07, I think you would clearly be talking about less than that. And that's not much of a statement to begin with. But -- that's really probably the best way to answer it. There's plenty of opportunities, if one just looks at the left side of the balance sheet.

So if we wanted to grow the business, we certainly would have no trouble doing that in terms of finding the opportunities on the left side of the balance sheet, but we're spending a lot of time, as a company, it's thinking about how to fund that growth. And until such time as the securitization markets are more open than they are now, it's a question of how quickly do you want to be spending that liquidity and that's -- I think that question has been answered a couple of different times today and that's a really hard thing to do. But that's what we're spending time trying to balance.

Unidentified Audience Member

And then real quick with the REIT. Do you have plans in the future, in '08 maybe, to monetize that? Maybe take it public? What are your thoughts around that?

John Delaney - *CapitalSource Inc - Chairman & CEO*

We've discussed that in the past. Because it's kind of the -- it's a really good business. Jim runs it really well, which is one of the reasons it's such a good business. And it clearly, as a standalone business, would have a different cost of capital than CapitalSource has now. So there's lots of reasons to conclude that it's something we probably will do at some point. I've said in the past that it's not an if, but it's more of a when.

Now we reserve the right to, obviously, change our view on that, but we've been doing a lot lately with our depository strategy and I think our view is not to focus on anything like that right now. But the reason we would do it is less to realize the gain that Jim talked about, which we believe is there. Because we don't want to get out of the business, we don't want to sell the business. But to give that business a more effective cost of funds so that Jim and his team can continue to capitalize and leverage -- capitalize on the market opportunity and leverage their team.

So if it was so obvious that that business could be more successful and that the best -- if you viewed that business as its own enterprise and you made a decision that the best interest for that enterprise is for it to actually get a lower cost of capital, then we'd do it. We would really be compelled to do it I think.

Unidentified Audience Member

With bank and thrift stock having come down quite a bit, I know this has some correlation to what's going on with tier one and there's limits to what you can say about that, but can you just talk about your appetite? Suppose tier one doesn't happen, are there other attractive opportunities out there where you might consider acquiring some other bank or thrifts?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Well we think, as I said, we thought that -- we thought our strategy around deposit-based funding made a lot of sense and I think today's market supports that kind of strategic insight in that deposits would lower our cost of funds more materially than it would have. Because remember we were doing the analysis about deposit-based funding when our capital markets funding was pretty darn efficient. And now the delta's even much greater.

So the math on that is even more compelling. And then the stability/depth of market analysis is also more compelling because as I say, depositories have the unique benefit of raising, their liabilities are not tied to their assets. Their liabilities are tied to the government. And so that's a nice place to be when people have major asset quality questions.

So I think the thesis behind a depository continues to make a lot of sense for this business. And until we conclude otherwise, we are going to continue to pursue it. As I said in my report card, it was one of the disappointments that I had for '07 that we didn't get it done. And it's unfortunate because we would have gotten it done, I think it would have been better for our shareholders. And we weren't able to do that. For a whole variety of reasons, we've got all kinds of good excuses why we didn't get it done, but we didn't get it done. And so as we sit here today, we still think that makes sense. So we're going to continue to pursue it any way we can. [Bruce]?

Unidentified Audience Member

Thank you. On the page 47, the 60 plus day delinquencies and non-accrual numbers, I probably missed, but did you set any guidance for this year or did you not make any comment on setting expectations? And then I asked inarticulately before, but it seems amazing that we're having so many write-offs in the securities markets, yet Corporate America, not only your numbers, but from other banks, it seems like C&I lending and commercial lending continues to hold up very well. What are some of the maybe anecdotal or other things you're hearing from your corporate customers? Just what are they seeing? Are they not seeing a recession in their basic businesses and --?

John Delaney - *CapitalSource Inc - Chairman & CEO*

I'll turn -- I'll let Bryan start on this question.

Bryan Corsini - *CapitalSource - Chief Credit Officer*

Well I think certainly you're starting to see some slowdown, some sectors in any companies that are tied directly or even indirectly to consumer spend. You're starting to see the early indication of softness there. But I think the whole key in looking at our own metrics is where we are in the capital structure. As we mentioned on our slides, about 90% of the book is senior secured loans, so you could have companies that come under stress, have some kind of a debt service, it could be capital behind us or some other debt that's behind us, that potentially is at risk. But in general, the senior piece that we are in, from a trends perspective, remains steady.

Now it could worsen and we went through a number of different industries and groupings where we would suspect you could see some softening. I mean, at this juncture, we haven't seen it systemically across the portfolio. I've talked to different investors in phone calls and whatnot and folks in some bond traunches, a lot really depends on how deep you are. So again, we've seen traunches of debt out there that if they're leveraged in a capital structure, five, six, seven-times, the debt service on that would be compromised. So it's really a matter of where you are.

Unidentified Audience Member

Are we looking at last recession as a guide for (inaudible)?

Bryan Corsini - *CapitalSource - Chief Credit Officer*

Well we weren't public then and again, I think what you've got to point to is recessionary pressures are definitely going to be there. But I sort of look at where we have been historically and the big hiccup -- the biggest hiccup we've had are two businesses -- the primary drivers, honestly, are two businesses that aren't there. So I sort of back of the envelope, even if things sort of double, taking those out, you're kind of back to where you've been historically.

Again, it could be plus or minus that, I can't imagine on top of that, our credit performance, in looking at the negative, in terms of charge offs and that accrual would double again and be that much worse. Because we just don't see it in the book. And again, I think it goes back to granularity in the portfolio. We've got three different business units, it's very diverse, we don't have significant geographic or industry confidence concentration, except for the healthcare business, which is a design concentration.

So I think you're going to see pockets, certainly. And again, consumer spend type of businesses would be the first to experience the softness. But it's spread across our entire portfolio and again it's -- the portfolio is so granular, severity in one sector shouldn't affect the book in its entirety. And I think that's really the key.

I mean if we're a concentrated consumer lender or lending to businesses or direct consumers, all consumer spend, like retail, the whole book is retail, something like that, I obviously have much different comments to make. But I think the diversity should help keep it balanced.

Unidentified Audience Member

On slide 52, the finance and insurance, 50% of your portfolio. Is any of that tied to the bond insurers? And then related to that part of that, is any part of your business --

John Delaney - *CapitalSource Inc - Chairman & CEO*

No, the answer to that is no. I'm not even going to waste any time answering that question.

Unidentified Audience Member

That's fine then.

John Delaney - *CapitalSource Inc - Chairman & CEO*

Yes. What was your -- you had a second part of -- ?

Unidentified Audience Member

Well the second part is you presented as part of your business, anything related towards needing bond insurance?

John Delaney - *CapitalSource Inc - Chairman & CEO*

No.

Unidentified Audience Member

No?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Let me just think before I answer so quickly. I mean I'm sure there's some companies in our corporate finance group that get some bonding for some projects they pursue that might have some exposure there, but it's --

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Dan Duffy - *CapitalSource Inc. - Co-President, Corporate Finance*

Workman's comp bonds or something.

John Delaney - *CapitalSource Inc - Chairman & CEO*

Yes. But it's -- I would have to say it's inconsequential is probably an overstatement. Yes ma'am?

Unidentified Audience Member

We heard you mention at the very beginning, the need to or the focus on cost reduction to offset some of the margin compression, but we've also heard a great growth opportunity.

John Delaney - *CapitalSource Inc - Chairman & CEO*

Yes.

Unidentified Audience Member

So how do you balance those two objections -- objectives to make sure you have the people and the infrastructure in place to really capitalize on what's in front of you?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Well, again, it's a hard balance because we -- we think we're in an environment where there has been pressures on the return on equity in the business and the right thing to do is to really look hard at the operating expenses and see how much of that we can maybe transfer over to the return to the shareholders, the business continues to do well for all stakeholders.

And so we're trying to do that. We feel like the infrastructure is fully built out. We don't really need -- I mean, one of the issues with CapitalSource, this wouldn't have been the right thing to do from a risk management standpoint, but if across -- if we have seen 900 positions in the portfolio, we have more loans than that, but if you collapse affiliates down, we have about 900 loans in the portfolio. If we would have had the same 900 loans and twice the assets, we would have made a lot more money. Because we wouldn't have had increased the infrastructure. But that wouldn't have been the right answer from a risk management standpoint, right? Because we manage our hold sites and things like that.

So we're clearly focused on leveraging this infrastructure as much as we can and taking advantage of the market opportunity. And I think there are things you can do. Everyone can always tighten their belt, right? And so I think we're just focused on tightening our belt without really having any negative impact on the operations of the Company.

Unidentified Audience Member

If you keep your risk management metrics in place in terms of whole sizes, how big of a portfolio could the current infrastructure support?

John Delaney - *CapitalSource Inc - Chairman & CEO*

Well if you break the business down into a couple of different areas, you've got kind of the front-end, which are people that are involved in originating and underwriting new transactions. That's highly leverageable, because even if you originate at the same pace, the pile keeps getting bigger and bigger and bigger. I used to use the analogy of people digging a ditch. The same number of ditch diggers will produce a pile that gets bigger and bigger over time. Now you need people watching the pile to make sure it doesn't fall down and all those kind of things. So as the portfolio grows, you need more people on the loan management side.

It's -- you get some efficiencies, obviously, because you have senior people and they leverage themselves. But essentially, you get expenses as you grow the portfolio. You don't need to necessarily add more people on the front end to grow the portfolio.

And then in terms of some of the important departments of the Company, like financing, accounting, they need more people as the portfolio grows around financing a bigger portfolio, et cetera. But there's some efficiencies there, the legal department, the IT department, things like that, there's definitely efficiencies in. So most of the business is pretty darn leverageable, but generally the asset management side of the business is the servicing side of the business. We really can't leverage that as much because you simply need more people as we have a bigger portfolio. Sure.

Okay. Well thank you, everyone. We appreciate you carving out all this time to listen to what we have to say. And I think after this, there's going to be a kind of a reception where there's refreshments right outside the room. Thank you.