CAPITAL TRUST INC
Form 424B5
October 31, 2006

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The information in this preliminary prospectus supplement is not complete and may be changed. The registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus supplement and the accompanying prospectus are not an offer to sell these securities and are not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

Filed Pursuant to Rule 424(b)(5)
Registration No. 333-111261

Subject to Completion, Dated October 30, 2006

PROSPECTUS SUPPLEMENT
(To Prospectus dated December 29, 2003)

2,000,000 Shares

CLASS A COMMON STOCK

Capital Trust, Inc. is offering 2,000,000 shares of its class A common stock. Our shares of class A common stock are listed for trading on the New York Stock Exchange under the symbol "CT." The last reported sale price of our class A common stock on October 30, 2006 was $46.25 per share.

Investing in our class A common stock involves risks. See "Risk Factors" beginning on page S-6 of this prospectus supplement.

The underwriter will purchase the shares offered by this prospectus supplement from us at a price of $ per share, resulting in aggregate proceeds to us of $, before expenses.

The underwriter may offer the shares from time to time to purchasers directly or through agents, or through brokers in brokerage transactions on the New York Stock Exchange, or to dealers in negotiated transactions or in a combination of such methods of sale, at a fixed price or prices, which may be changed, or at market prices prevailing at the time of sale, at prices related to such prevailing market prices or at negotiated prices. The underwriter may receive a commission equivalent from investors in the amount of up to $ for each share sold to investors in this offering.

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

Delivery of the shares will be made on or about November 3, 2006.

Bear, Stearns & Co. Inc.

October , 2006

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ABOUT THIS PROSPECTUS SUPPLEMENT

Unless the context otherwise indicates, references in this prospectus supplement or the accompanying base prospectus to "we," "us," "our" or "Capital Trust" refer to Capital Trust, Inc., a Maryland corporation and its subsidiaries, but not our third-party managed funds.

This document has two parts. The first part is the prospectus supplement, which describes the specific terms of this offering and also adds to and updates information contained in the accompanying prospectus and the documents incorporated by reference. The second part is the accompanying prospectus, which gives more general information, some of which may not apply to this offering. ***To the extent there is a conflict between the information contained in this prospectus supplement, the information contained in the accompanying prospectus or the information contained in any document incorporated by reference herein or therein, the information contained in the most recently dated document shall control.***

It is important for you to read and consider all information contained in this prospectus supplement and the accompanying prospectus, including the documents incorporated by reference herein and therein, in making your investment decision. You should also read and consider the information in the documents we have referred you to in "Where You Can Find More Information" and "Incorporation by Reference."

You should rely only on the information contained, incorporated or deemed incorporated by reference in this prospectus supplement and the accompanying prospectus. We have not authorized anyone to give any information or to make any representation not contained, incorporated or deemed incorporated by reference in this prospectus supplement or the accompanying prospectus in connection with the offering of shares of class A common stock in this offering. You should not assume that the information contained in this prospectus supplement and the accompanying prospectus is correct as of any date after the respective dates of this prospectus supplement and the accompanying prospectus, even though this prospectus supplement and the accompanying prospectus are delivered or these shares of class A common stock are offered or sold on a later date.

This prospectus supplement and the accompanying prospectus are not an offer to sell any security other than the class A common stock and they are not soliciting an offer to buy any security other than the class A common stock. This prospectus supplement and the accompanying prospectus are not an offer to sell the class A common stock to any person, and they are not soliciting an offer from any person to buy the class A common stock, in any jurisdiction where the offer or sale to that person is not permitted.

PROSPECTUS SUPPLEMENT SUMMARY

This summary highlights information contained elsewhere in this prospectus supplement and the accompanying prospectus. This summary does not contain all the information that you should consider before investing in our class A common stock. This prospectus supplement and the accompanying prospectus contain forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from the results anticipated in these forward-looking statements. You should read this entire prospectus supplement and the accompanying prospectus carefully, including the risk factors and financial statements included or incorporated by reference herein or therein before making an investment decision.

The per share information presented in this prospectus supplement and the accompanying prospectus has been adjusted to give effect to the one for three reverse stock split of our outstanding shares of class A common stock effected on April 2, 2003 as though the reverse stock split was in effect for all periods presented.

Capital Trust, Inc.

We are a fully integrated, self-managed finance and investment management company that specializes in credit-sensitive structured financial products. We invest in loans, debt securities and related instruments for our own account and on behalf of funds that we manage. To date, our investment programs have focused on loans and securities backed by commercial real estate assets with the objective of achieving attractive risk-adjusted returns with low volatility. We conduct our operations to qualify as a real estate investment trust, or REIT, for federal income tax purposes and we elected REIT status commencing with the tax year ended December 31, 2003. We generally intend to distribute each year substantially all of our taxable income, which does not necessarily equal net income as calculated in accordance with generally accepted accounting principles, to our shareholders so as to comply with the REIT provisions of the Internal Revenue Code. We have declared total dividends of $2.05 per share for the first, second and third quarters of 2006.

Since we commenced our finance business in July 1997 and through September 30, 2006, we have completed approximately $7.2 billion of commercial real estate-related investments in 345 separate transactions both directly and on behalf of our managed funds. Our investment strategies are designed to generate high current returns coupled with substantial downside protection. We implement these strategies by applying a disciplined, rigorous process founded on four key elements:

- intense credit underwriting;
- creative financial structuring;
- efficient use of leverage; and
- aggressive asset management.

Our current investment programs emphasize mezzanine loans, junior interests in first mortgage loans, known as B Notes, subordinate tranches of commercial mortgage-backed securities, known as CMBS, first mortgages and total return swaps. We employ leverage to enhance returns on equity, but seek to minimize interest rate exposure by matching the duration and interest rate index of our assets and liabilities and by using derivatives to hedge risk. Our objective is to create leveraged portfolios of high-yield structured investments that are diversified and have limited exposure to changes in interest rates. Since we commenced our finance business in 1997 and through September 30, 2006, our loss experience on the entire portfolio has totaled less than 1% of our investments.

We make investments both for our own balance sheet and for funds that we manage on behalf of institutional and high net worth individual investors. As of September 30, 2006, our balance sheet assets totaled $2.3 billion, comprised primarily of loans receivable, mortgage-backed securities, total return swaps and co-investments in our managed funds. We currently manage, through our wholly-owned, taxable, investment management subsidiary, CT Investment Management Co., LLC, three private equity

funds, CT Mezzanine Partners II LP and CT Mezzanine Partners III, Inc., which we refer to as Fund II and Fund III, respectively, and CT Large Loan 2006, Inc., which we refer to as Large Loan Fund. Fund II and Fund III commenced investing in 2001 and 2003, respectively, and both funds have completed their two-year investment periods. Fund II and Fund III each originated $1.2 billion of investments and as of September 30, 2006, total remaining assets were $47.9 million and $216.3 million, respectively. We have co-invested 5.88% and 4.71% of the equity capital in Fund II and Fund III, respectively, with the balance from third parties. Large Loan Fund commenced operations in May 2006, has an extendable one-year investment period and as of September 30, 2006 had $325 million of equity commitments that can be leveraged to invest in $975 million of assets. As of September 30, 2006, Large Loan Fund had $195.2 million of investments. We do not have a co-investment in the Large Loan Fund.

Our balance sheet investments generate net interest income, while our investment management business produces base management fees, and, if certain performance thresholds are exceeded, incentive management fees representing our share of the funds' profits.

Our business strategy is to continue to grow our balance sheet investment programs and our third-party assets under management. We expect the growth of our business to be driven primarily by the following activities:

- we will continue to make balance sheet commercial real estate debt and related investments;
- we will continue to use collateralized debt obligations, or CDOs, and other structured finance methods to finance our investments;
- we will expand our commercial real estate investment management business through additional offerings of managed vehicles; and
- we may acquire or pursue other balance sheet and investment management businesses that leverage our core skills in credit underwriting and financial structuring.

As we continue to grow our business, we seek to create the most efficient capital structure for our activities. Our success in the development and implementation of liability structures that offer attractive economic terms while affording us the necessary flexibility to execute our investment programs has and is expected to continue to be an integral factor in our business growth. We believe the use of structured financial products, such as CDOs, represents a major improvement in the way we finance our business and we expect to continue to develop CDO technology and other structured financial products that will become a more important portion of our capital structure in the future.

Recent Developments Unaudited Financial Information for the Three and Nine Months ended September 30, 2006.

On October 30, 2006, we announced our results for the three months and nine months ended September 30, 2006. We reported net income of $13.4 million for the three months ended September 30, 2006, an increase of $3.6 million, or 37%, from net income of $9.8 million for the three months ended September 30, 2005. For the nine months ended September 30, 2006, we reported net income of $38.6 million, an increase of $10.8 million, or 39%, from net income of $27.8 million for the nine months ended September 30, 2005. At September 30, 2006, total assets were $2.3 billion, an increase of $712.1 million, or 46%, from year end 2005. At September 30, 2006, total liabilities were $1.9 billion, an increase of $703.4 million, or 58%, from year end 2005.

For additional information, please see our quarterly report on Form 10-Q for the quarterly period ended September 30, 2006 which is incorporated by reference herein.

We were incorporated in Maryland on April 7, 1998 as a successor to a business trust organized in 1966. We commenced our balance sheet finance business in 1997 and our investment management

business in 2000. Our principal executive offices are located at 410 Park Avenue, 14th Floor, New York, New York 10022, and our telephone number is (212) 655-0220. Our website address is *http://www.capitaltrust.com*. Information included or referred to on our website is not incorporated by reference nor is it otherwise a part of this prospectus supplement or the accompanying prospectus. Our website address is included in this prospectus supplement as an inactive textual reference only.

THE OFFERING

Issuer	Capital Trust, Inc.
Class A common stock offered by us	2,000,000 shares (1)
Class A common stock to be outstanding after this offering	17,397,525 shares
Use of proceeds	We intend to use the net proceeds to us from this offering for general corporate purposes, including funding our balance sheet investment activity, the repayment of indebtedness, working capital and potential business acquisitions.
New York Stock Exchange Symbol	CT
Risk Factors	You should carefully consider all of the information in this prospectus supplement and the accompanying prospectus. In particular, you should evaluate the information set forth under "Risk Factors" beginning on page S-6 of this prospectus supplement before deciding whether to invest in our class A common stock.

(1) We have not granted the underwriter an over-allotment option.

Unless we specifically provide otherwise, all share information in this prospectus supplement is as of October 30, 2006 and excludes 416,459 shares of our class A common stock issuable upon the exercise of options with a weighted average exercise price of $21.05 per share and 72,679 class A common stock units which convert to shares of our class A common stock on a one-for-one basis outstanding under our second amended and restated 1997 long-term incentive stock plan and our amended and restated 1997 non-employee director stock plan as of such date.

SUMMARY FINANCIAL DATA

The following summary consolidated financial data as of and for each of the years ended December 31, 2005, 2004 and 2003 was derived from our audited consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2005 filed with the Securities and Exchange Commission, or the SEC. The following summary consolidated financial data as of and for each of the three months and the nine months ended September 30, 2006 and 2005 was derived from our unaudited consolidated financial statements included in our Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2006, filed with the SEC, which, in the opinion of our management, have been prepared on the same basis as our audited consolidated financial statements and reflect all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of our results of operations and financial position for such periods. Results for the three months and the nine months ended September 30, 2006 and 2005 are not necessarily indicative of results that may be expected for the entire year.

You should read the following information together with "Risk Factors" and the consolidated financial statements and the notes thereto incorporated by reference in this prospectus supplement.

	Years Ended December 31,			Three months Ended September 30,		Nine months Ended September 30,	
	2005	2004	2003	2006	2005	2006	2005
					(unaudited)		
				(in thousands, except for per share data)			
Income from loans and other investments:							
Interest and related income	$ 86,200	$ 46,561	$ 38,524	$ 46,011	$ 22,751	$ 123,862	$ 57,359
Less: Interest and related expenses	37,229	20,141	19,575	28,838	10,325	72,374	23,709
Income from loans and other investments, net	48,971	26,420	18,949	17,173	12,426	51,488	33,650
Other revenues:							
Management and advisory fees	13,124	7,853	8,020	748	1,517	2,196	12,144
Income/(loss) from equity investments	(222)	2,407	1,526	328	467	1,050	(835)
Gain on sales of investments	4,951	300					
Special servicing fees		10					
Other interest income	553	78	53	440	137	790	374
Total other revenues	18,406	10,648	9,599	1,516	2,121	4,036	11,683
Other expenses:							
General and administrative	21,939	15,229	13,320	5,879	5,316	16,706	16,384
Depreciation and amortization	1,114	1,100	1,057	357	278	2,696	837
Unrealized loss on available-for-sale securities for other-than-temporary impairment		5,886					
Repurchase of allowance for possible credit losses		(6,672)					
Total other expenses	23,053	15,543	14,377	6,236	5,594	19,402	17,221
Income before income taxes	44,324	21,525	14,171	12,453	8,953	36,122	28,112
(Benefit)/provision for income taxes	213	(451)	646	(984)	(846)	(2,455)	315

	Years Ended December 31,			Three months Ended September 30,		Nine months Ended September 30,	
Net income allocable to class A common stock	$ 44,111	$ 21,976	$ 13,525	$ 13,437	$ 9,799	$ 38,577	$ 27,797
Per share information:							
Net earnings per share of class A common stock:							
Basic	$ 2.92	$ 2.17	$ 2.27	$ 0.88	$ 0.65	$ 2.52	$ 1.84
Diluted	$ 2.88	$ 2.14	$ 2.23	$ 0.86	$ 0.64	$ 2.48	$ 1.81
Weighted average shares of class A common stock outstanding:							
Basic	15,124,187	10,141,380	5,946,718	15,337,325	15,125,443	15,327,855	15,110,227
Diluted	15,335,914	10,276,886	10,287,721	15,585,880	15,358,943	15,542,306	15,339,533
Dividends declared per share of class A common stock	$ 2.45	$ 1.85	$ 1.80	$ 0.75	$ 0.55	$ 2.05	$ 1.65

	As of December 31,			As of September 30,	
	2005	2004	2003	2006	2005
BALANCE SHEET DATA:					
Total assets	$ 1,557,530	$ 877,766	$ 399,926	$ 2,269,665	$ 1,332,755
Total liabilities	1,218,680	561,269	303,909	1,922,072	1,000,148
Shareholders' equity	338,850	316,497	96,017	347,593	332,607

RISK FACTORS

An investment in our class A common stock involves various risks. You should carefully consider the following risk factors in conjunction with the other information contained and incorporated by reference into this prospectus supplement and the accompanying prospectus before purchasing our class A common stock. If any of the risks discussed in this prospectus supplement actually occur, our business, operating results, prospects and/or financial condition could be adversely impacted. This could cause the market price of our class A common stock to decline and could cause you to lose all or part of your investment.

In connection with the forward-looking statements that appear in this prospectus supplement and the accompanying prospectus, you should also carefully review the cautionary statement referred to under "Cautionary Statement Regarding Forward-Looking Statements" on page S-22.

Risks Related to Our Investment Program

Our existing loans and investments expose us to a high degree of risk associated with investing in commercial real estate-related assets.

Real estate historically has experienced significant fluctuations and cycles in performance that may result in reductions in the value of our real estate-related investments. The performance and value of our loans and investments once originated or acquired by us depends on many factors beyond our control. The ultimate performance and value of our investments is subject to the varying degrees of risk generally incident to the ownership and operation of the commercial properties which collateralize or support our investments. The ultimate performance and value of our loans and investments depends upon the commercial property owner's ability to operate the property so that it produces cash flows necessary to pay the interest and principal due to us on our loans and investments. Revenues and cash flows may be adversely affected by:

- changes in national economic conditions;
- changes in local real estate market conditions due to changes in national or local economic conditions or changes in local property market characteristics;
- competition from other properties offering the same or similar services;
- changes in interest rates and in the availability of mortgage financing;
- the ongoing need for capital improvements, particularly in older building structures;
- changes in real estate tax rates and other operating expenses;
- adverse changes in governmental rules and fiscal policies, civil unrest, acts of God, including earthquakes, hurricanes and other natural disasters, acts of war or terrorism, which may decrease the availability of or increase the cost of insurance or result in uninsured losses;
- adverse changes in zoning laws;
- the impact of present or future environmental legislation and compliance with environmental laws; and
- other factors that are beyond our control and the control of the commercial property owners.

In the event that any of the properties underlying our loans or investments experiences any of the foregoing events or occurrences, the value of, and return on, such investments, our profitability and the market price of our class A common stock would be negatively impacted.

We may change our investment strategy without shareholder consent, which may result in riskier investments than our current investments.

As part of our strategy, we may seek to expand our investment activities beyond real estate-related investments. We may change our investment activities at any time without the consent of our shareholders, which could result in our making investments that are different from, and possibly riskier than, our current real estate investments. New investments we may make outside of our area of historical expertise may not perform as well as our current portfolio of real estate investments.

We are exposed to the risks involved with making subordinated investments.

Our subordinated investments involve the risks attendant to investments consisting of subordinated loan positions. In many cases, management of our investments and our remedies with respect thereto, including the ability to foreclose on or direct decisions with respect to the collateral securing such investments, is subject to the rights of senior lenders and the rights set forth in inter-creditor or servicing agreements.

We may not be able to obtain the level of leverage necessary to optimize our return on investment.

Our return on investment depends, in part, upon our ability to grow our balance sheet portfolio of invested assets and those of our managed funds through the use of leverage at interest rates that are lower than the interest rates earned on our investments. We generally obtain leverage through the issuance of CDOs, repurchase agreements and other borrowings. Our ability to obtain the necessary leverage on attractive terms ultimately depends upon the quality of the portfolio assets that are collateral for our indebtedness. Our failure to obtain and/or maintain leverage at desired levels, or to obtain leverage on attractive terms, could have a material adverse effect on our performance or that of our funds. Moreover, we are dependent upon a few lenders to provide repurchase agreements for our origination or acquisition of loans and investments. Our ability to obtain financing through CDOs is subject to conditions in the debt capital markets, which may be adverse from time to time, that affect the level of investor demand for such securities, which are impacted by factors beyond our control.

We are subject to the risks of holding leveraged investments.

Leverage creates an opportunity for increased return on equity, but at the same time creates risk. For example, leveraging magnifies changes in the net worth of our managed funds. We and our funds will leverage assets only when there is an expectation that leverage will enhance returns, although we cannot assure you that the use of leverage will prove to be beneficial. Increases in credit spreads in the market generally may adversely affect the market value of our investments. Because borrowings under our repurchase agreements are secured by our investments, the borrowings available to us may decline if the market value of our investments decline. Moreover, we cannot assure you that we and our funds will be able to meet debt service obligations and, to the extent such obligations are not met, there is a risk of loss of some or all of our co-investments and their assets through foreclosure or a financial loss if we or they are required to liquidate assets at a commercially inopportune time to satisfy our debt obligations.

Our success depends on the availability of attractive investments and our ability to identify, structure, consummate, manage and realize returns on attractive investments.

Our operating results are dependent upon the availability of, as well as our ability to identify, structure, consummate, manage and realize returns on, credit-sensitive investment opportunities. In general, the availability of desirable credit sensitive investment opportunities and, consequently, our balance sheet returns and our funds' investment returns, will be affected by the level and volatility of interest rates, by conditions in the financial markets, by general economic conditions, by the market

and demand for credit-sensitive investment opportunities, and by the supply of capital for such investment opportunities. We cannot assure you that we will be successful in identifying and consummating investments which satisfy our rate of return objectives or that such investments, once consummated, will perform as anticipated.

In addition, if we are not successful in investing all available equity capital for our funds, the potential revenues we earn will be reduced. We may expend significant time and resources in identifying and pursuing targeted investments, some of which may not be consummated.

The real estate investment business is highly competitive. Our success depends on our ability to compete with other providers of capital for real estate investments.

Our business is highly competitive. We compete for attractive investments with traditional lending sources, such as insurance companies and banks, as well as other REITs, specialty finance companies and private equity funds with similar investment objectives, which may make it more difficult for us to consummate our target investments. Many of our competitors have greater financial resources than us, which provides them with greater operating flexibility.

Our loans and investments may be subject to fluctuations in interest rates which may not be adequately protected, or protected at all, by our hedging strategies.

Our current balance sheet investment program emphasizes loans with both "floating" interest rates and fixed interest rates. The fixed interest rate investments are subject to the risk of fluctuations in interest rates. Depending on market conditions, fixed rate assets may become a greater portion of our new loan originations. In such cases, we may employ various hedging strategies to limit the effects of changes in interest rates, including engaging in interest rate swaps, caps, floors and other interest rate derivative products. No strategy can completely insulate us or our funds from the risks associated with interest rate changes and there is a risk that they may provide no protection at all. Hedging transactions involve certain additional risks such as counterparty risk, the legal enforceability of hedging contracts, the early repayment of hedged transactions and the risk that unanticipated and significant changes in interest rates may cause a significant loss of basis in the contract and a change in current period expense. We cannot assure you that we will be able to enter into hedging transactions or that such hedging transactions will adequately protect us or our funds against the foregoing risks. In addition, cash flow hedges which are not perfectly correlated with a variable rate financing will impact our reported income as gains, and losses on the ineffective portion of such hedges will be recorded.

Our loans and investments may be illiquid which will constrain our ability to vary our portfolio of investments.

Our real estate investments are relatively illiquid. Such illiquidity may limit our ability to vary our portfolio or our funds' portfolios of investments in response to changes in economic and other conditions. Illiquidity may result from the absence of an established market for investments as well as the legal or contractual restrictions on their resale. In addition, illiquidity may result from the decline in value of a property securing one of our or our funds' investments. We cannot assure you that the fair market value of any of the real property serving as security will not decrease in the future, leaving our or our funds' investments under-collateralized or not collateralized at all, which could impair the liquidity and value, as well as our return on such investments.

We may not have control over certain of our loans and investments.

Our ability to manage our portfolio of loans and investments may be limited by the form in which they are made. In certain situations, we or our funds may:

- acquire investments subject to rights of senior classes and servicers under inter-creditor or servicing agreements;
- acquire only a participation in an underlying investment;
- co-invest with third parties through partnerships, joint ventures or other entities, thereby acquiring non-controlling interests; or
- rely on independent third party management or strategic partners with respect to the management of an asset.

Therefore, we may not be able to exercise control over the loan or investment. Such financial assets may involve risks not present in investments where senior creditors, servicers or third party controlling investors are not involved. Our rights to control the process following a borrower default may be subject to the rights of senior creditors or servicers whose interests may not be aligned with ours. A third party partner or co-venturer may have financial difficulties resulting in a negative impact on such asset, may have economic or business interests or goals which are inconsistent with ours and those of our funds, or may be in a position to take action contrary to our or our funds' investment objectives. In addition, we and our funds may, in certain circumstances, be liable for the actions of our third party partners or co-venturers.

We may not achieve our targeted rate of return on our investments.

We originate or acquire investments based on our estimates or projections of overall rates of return on such investments, which in turn are based on, among other considerations, assumptions regarding the performance of assets, the amount and terms of available financing to obtain desired leverage and the manner and timing of dispositions, including possible asset recovery and remediation strategies, all of which are subject to significant uncertainty. In addition, events or conditions that we have not anticipated may occur and may have a significant effect on the actual rate of return received on an investment.

As we acquire or originate investments for our balance sheet portfolio, whether as new additions or as replacements for maturing investments, there can be no assurance that we will be able to originate or acquire investments that produce rates of return comparable to rates on our existing investments.

We may not be able to acquire suitable investments for a CDO issuance, or we may not be able to issue CDO securities on attractive terms, which may require us to utilize more costly financing for our investments.

We intend to capitalize on opportunities to finance certain of our investments through the issuance of CDOs. During the period that we are acquiring these investments, we intend to finance our purchases through repurchase agreements. We use these repurchase agreements to finance our acquisition of investments until we have accumulated a sufficient quantity of investments, at which time we may refinance these lines through a securitization, such as a CDO issuance. As a result, we are subject to the risk that we will not be able to acquire a sufficient amount of eligible investments to maximize the efficiency of a CDO issuance. In addition, conditions in the capital markets may make the issuance of CDOs less attractive to us when we do have a sufficient pool of collateral. If we are unable to issue a CDO to finance these investments, we may be required to utilize other forms of potentially less attractive financing.

We may not be able to find suitable replacement investments for CDOs with reinvestment periods.

Some of our CDOs have periods where principal proceeds received from assets securing the CDO can be reinvested for a defined period of time, commonly referred to as a reinvestment period. Our ability to find suitable investments during the reinvestment period that meet the criteria set forth in the CDO documentation and by rating agencies may determine the success of our CDO investments. Our potential inability to find suitable investments may cause, among other things, lower returns, interest deficiencies, hyper-amortization of the senior CDO liabilities and may cause us to reduce the life of our CDOs and accelerate the amortization of certain fees and expenses.

The use of CDO financings with over-collateralization and interest coverage requirements may have a negative impact on our cash flow.

The terms of CDOs will generally provide that the principal amount of investments must exceed the principal balance of the related bonds by a certain amount and that interest income exceeds interest expense by a certain amount. Generally, CDO terms provide that, if certain delinquencies and/or losses or other factors cause a decline in collateral or cash flow levels, the cash flow otherwise payable on our retained subordinated classes may be redirected to repay classes of CDOs senior to ours until the issuer or the collateral is in compliance with the terms of the governing documents. Other tests (based on delinquency levels or other criteria) may restrict our ability to receive net income from assets pledged to secure CDOs. We cannot assure you that the performance tests will be satisfied. With respect to future CDOs we may issue, we cannot assure you, in advance of completing negotiations with the rating agencies or other key transaction parties as to the actual terms of the delinquency tests, over-collateralization and interest coverage terms, cash flow release mechanisms or other significant factors upon which net income to us will be calculated. Failure to obtain favorable terms with regard to these matters may adversely affect the availability of net income to us. If our investments fail to perform as anticipated, our over-collateralization, interest coverage or other credit enhancement expense associated with our CDO financings will increase.

We may be required to repurchase loans that we have sold or to indemnify holders of our CDOs.

If any of the loans we originate or acquire and sell or securitize through CDOs do not comply with representations and warranties that we make about certain characteristics of the loans, the borrowers and the underlying properties, we may be required to repurchase those loans or replace them with substitute loans. In addition, in the case of loans that we have sold instead of retained, we may be required to indemnify persons for losses or expenses incurred as a result of a breach of a representation or warranty. Repurchased loans typically require a significant allocation of working capital to carry on our books, and our ability to borrow against such assets is limited. Any significant repurchases or indemnification payments could adversely affect our financial condition and operating results.

The commercial mortgage and mezzanine loans we originate or acquire and the commercial mortgage loans underlying the CMBS in which we invest are subject to delinquency, foreclosure and loss, which could result in losses to us.

Our commercial mortgage and mezzanine loans are secured by commercial property and are subject to risks of delinquency and foreclosure, and risks of loss that are greater than similar risks associated with loans made on the security of single-family residential property. The ability of a borrower to repay a loan secured by an income-producing property typically is dependent primarily upon the successful operation of the property rather than upon the existence of independent income or assets of the borrower. If the net operating income of the property is reduced, the borrower's ability to repay the loan may be impaired. Net operating income of an income-producing property can be affected by, among other things: tenant mix, success of tenant businesses, property management

decisions, property location and condition, competition from comparable types of properties, changes in laws that increase operating expenses or limit rents that may be charged; any need to address environmental contamination at the property; changes in national, regional or local economic conditions and/or specific industry segments; declines in regional or local real estate values and declines in regional or local rental or occupancy rates; increases in interest rates, real estate tax rates and other operating expenses; and changes in governmental rules, regulations and fiscal policies, including environmental legislation, acts of God, terrorism, social unrest and civil disturbances.

Our investments in subordinated CMBS and similar investments are subject to losses.

In general, losses on an asset securing a mortgage loan included in a securitization will be borne first by the equity holder of the property, then by a cash reserve fund or letter of credit, if any, and then by the most junior security holder. In the event of default and the exhaustion of any equity support, reserve fund, letter of credit and any classes of securities junior to those in which we invest, we may not be able to recover all of our investment in the securities we purchase. In addition, if the underlying mortgage portfolio has been overvalued by the originator, or if the values subsequently decline and, as a result, less collateral is available to satisfy interest and principal payments due on the related mortgage-backed securities, the securities in which we invest may incur significant losses.

The prices of lower credit quality CMBS are generally less sensitive to interest rate changes than more highly rated investments, but more sensitive to adverse economic downturns and underlying borrower developments. A projection of an economic downturn, for example, could cause a decline in the price of lower credit quality CMBS because the ability of borrowers to make principal and interest payments on the mortgages underlying the mortgage-backed securities may be impaired. In such event, existing credit support in the securitization structure may be insufficient to protect us against loss of our principal on these securities.

We may invest in troubled assets that are subject to a higher degree of financial risk.

We may make investments in non-performing or other troubled assets that involve a higher degree of financial risk. We cannot assure you that our investment objectives will be realized or that there will be any return on our investment. Furthermore, investments in properties subject to work-out conditions or under bankruptcy protection laws may, in certain circumstances, be subject to additional potential liabilities that could exceed the value of our original investment, including equitable subordination and/or disallowance of claims or lender liability.

The impact of the events of September 11, 2001 and the resulting effect on terrorism insurance expose us to certain risks.

The terrorist attacks on September 11, 2001 disrupted the U.S. financial markets, including the real estate capital markets, and negatively impacted the U.S. economy in general. Any future terrorist attacks, the anticipation of any such attacks, and the consequences of any military or other response by the U.S. and its allies may have a further adverse impact on the U.S. financial markets and the economy generally. We cannot predict the severity of the effect that such future events would have on the U.S. financial markets, the economy or our business.

In addition, the events of September 11, 2001 created significant uncertainty regarding the ability of real estate owners of high profile assets to obtain insurance coverage protecting against terrorist attacks at commercially reasonable rates, if at all. With the enactment of the Terrorism Risk Insurance Act of 2002, or TRIA, and the subsequent enactment of the Terrorism Risk Insurance Extension Act of 2005, which extended the TRIA through the end of 2007, insurers must make terrorism insurance available under their property and casualty insurance policies, but this legislation does not regulate the pricing of such insurance. The absence of affordable insurance coverage may adversely affect the

general real estate lending market, lending volume and the market's overall liquidity and may reduce the number of suitable investment opportunities available to us and the pace at which we are able to make investments. If the properties that we invest in are unable to obtain affordable insurance coverage, the value of those investments could decline and in the event of an uninsured loss, we could lose all or a portion of our investment.

The economic impact of any future terrorist attacks could also adversely affect the credit quality of some of our loans and investments. Some of our loans and investments will be more susceptible to such adverse effects than others, such as hotel loans, which may experience a significant reduction in occupancy rates following any future attacks. We may suffer losses as a result of the adverse impact of any future attacks and these losses may adversely impact our results of operations.

We are subject to risks related to our international investments.

We make investments in foreign countries. Investing in foreign countries involves certain risks that may not exist when investing in the United States. The risks involved in foreign investments include:

- exposure to local economic conditions, foreign exchange restrictions and restrictions on the withdrawal of foreign investment and earnings, investment restrictions or requirements, expropriations of property and changes in foreign taxation structures;
- potential adverse changes in the diplomatic relations of foreign countries with the United States and government policies against investments by foreigners;
- changes in foreign regulations;
- hostility from local populations, potential instability of foreign governments and risks of insurrections, terrorist attacks, war or other military action;
- fluctuations in foreign exchange rates;
- changes in social, political, legal and other conditions affecting our international investment;
- logistical barriers to our timely receiving the financial information relating to our international investments that may need to be included in our periodic reporting obligations as a public company; and
- lack of uniform accounting standards (including availability of information in accordance with U.S. generally accepted accounting principles).

Unfavorable legal, regulatory, economic or political changes such as those described above could adversely affect our financial condition and results of operations.

There are increased risks involved with construction lending activities.

We originate loans for the construction of commercial and residential use properties. Construction lending generally is considered to involve a higher degree of risk than to other types of lending due to a variety of factors, including generally larger loan balances, the dependency on successful completion or operation of the project for repayment, the difficulties in estimating construction costs and loan terms which often do not require full amortization of the loan over its term and, instead, provide for a balloon payment at stated maturity.

Some of our investments and investment opportunities are in synthetic form.

Synthetic investments are contracts between parties whereby payments are exchanged based upon the performance of an underlying reference obligation. These investments can take the form of either a total return swap, contracts in which one party agrees to make payments that replicate the total return

of a defined underlying asset, typically in return for an upfront payment from the counterparty who essentially bears the risk of performance of the referenced asset, or a credit default swap, where one counterparty receives payments in return for assuming the risk of defaults and losses corresponding to the reference obligation. In addition to the performance of the reference obligation, these synthetic interests carry the risk of the counterparty not performing its contractual obligations. Market standards, the GAAP accounting methodology and tax regulations related to these investments are evolving, and we cannot be certain that their evolution will not adversely impact the value or sustainability of these investments.

Furthermore, our ability to invest in synthetic investments, other than through a taxable REIT subsidiary, may be severely limited by the REIT qualification requirements because total return swaps and other synthetic investment contracts generally are not qualifying assets and do not produce qualifying income for purposes of the REIT asset and income tests.

Risks Related to Our Investment Management Business

We are subject to risks and uncertainties associated with operating our investment management business, and we may not achieve from this business the investment returns that we expect.

We will encounter risks and difficulties as we operate our investment management business. In order to achieve our goals as an investment manager, we must:

- manage our funds successfully by investing a majority of our funds' capital in suitable investments that meet the respective fund's specified investment criteria;
- actively manage the assets in our portfolios in order to realize targeted performance;
- incentivize our management and professional staff to the task of developing and operating the investment management business; and
- structure, sponsor and capitalize future funds and other investment products under our management that provide investors with attractive investment opportunities.

If we do not successfully operate our investment management business to achieve the investment returns that we or the market anticipates, our results of operations may be adversely impacted.

We may pursue fund management opportunities related to other classes of investments where we do not have prior investment experience.

We may expand our fund management business to involve other investment classes where we do not have prior investment experience. We may find it difficult to attract third party investors without a performance track record involving such investments. Even if we attract third party investment, there can be no assurance that we will be successful in deploying the capital to achieve targeted returns on the investments.

We face substantial competition from established participants in the private equity market as we offer mezzanine and other funds to third party investors.

We face significant competition from large financial and other institutions that have proven track records in marketing and managing private equity investment funds and otherwise have a competitive advantage over us because they have access to pre-existing third party investor networks into which they can channel competing investment opportunities. If our competitors offer investment products that are competitive with the mezzanine and other fund investments offered by us, we will find it more difficult to attract investors and to capitalize our mezzanine and other funds.

Our funds are subject to the risk of defaults by third party investors on their capital commitments.

The capital commitments made by third party investors to our funds represent unsecured promises by those investors to contribute cash to the funds from time to time as investments are made by the funds. Accordingly, we are subject to general credit risks that the investors may default on their capital commitments. If defaults occur, we may not be able to close loans and investments we have identified and negotiated which could materially and adversely affect the funds' investment program or make us liable for breach of contract, in either case to the detriment of our franchise in the private equity market.

Risks Related to Our Company

We are dependent upon our senior management team to develop and operate our business.

Our ability to develop and operate our business depends to a substantial extent upon the experience, relationships and expertise of our senior management and key employees. We cannot assure you that these individuals will remain in our employ. The employment agreement with our chief executive officer, John R. Klopp, expires on December 31, 2008, unless further extended. The employment agreement with our chief operating officer, Stephen D. Plavin, expires on December 28, 2008, unless further extended by us to 2009. The employment agreement with our chief financial officer, Geoffrey G. Jervis, expires on December 31, 2009, unless further extended by us to 2010. The loss of the services of our senior management and key employees could have a material adverse effect on our operations.

There may be conflicts between the interests of our third party investment management vehicles and us.

We are subject to a number of potential conflicts between our interests and the interests of our third party investment management vehicles. We are subject to potential conflicts of interest in the allocation of investment opportunities between our balance sheet and our third party investment management vehicles. In addition, we may make investments that are senior or junior to, participations in, or have rights and interests different from or adverse to, the investments made by our third party investment management vehicles. Our interests in such investments may conflict with the interests of our third party investment management vehicles in related investments at the time of origination or in the event of a default or restructuring of the investment. Finally, our officers and employees may have conflicts in allocating their time and services among us and our third party investment management vehicles.

We must manage our portfolio in a manner that allows us to rely on an exclusion from registration under the Investment Company Act of 1940 in order to avoid the consequences of regulation under that Act.

We rely on an exclusion from registration as an investment company afforded by Section 3(c)(5)(C) of the Investment Company Act of 1940. Under this exclusion, we are required to maintain, on the basis of positions taken by the SEC staff in interpretive and no-action letters, a minimum of 55% of the value of the total assets of our portfolio in "mortgages and other liens on and interests in real estate," which we refer to as "Qualifying Interests," and a minimum of 80% in Qualifying Interests and real estate-related assets. Because registration as an investment company would significantly affect our ability to engage in certain transactions or to organize ou