CAPITAL TRUST INC
Form 10-Q
May 08, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2012

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____________ to _____________

Commission File Number 1-14788

Capital Trust, Inc.
(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	94-6181186 (I.R.S. Employer Identification No.)
410 Park Avenue, 14th Floor, New York, NY (Address of principal executive offices)	10022 (Zip Code)

(212) 655-0220
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller Reporting Company ý

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of outstanding shares of the registrant's class A common stock, par value $0.01 per share, as of April 18, 2012 was 22,245,517.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

Capital Trust, Inc. and Subsidiaries
Consolidated Balance Sheets
March 31, 2012 and 2011
(in thousands, except per share data)

	March 31, 2012 (unaudited)	December 31, 2011
Assets		
Cash and cash equivalents	$37,198	$34,818
Loans receivable, net	17,230	19,282
Equity investments in unconsolidated subsidiaries	16,983	10,399
Deferred income taxes	2,691	1,268
Prepaid expenses and other assets	1,916	4,533
Subtotal	76,018	70,300
Assets of Consolidated Entities		
CT Legacy REIT		
Restricted cash	12,512	12,985
Securities held-to-maturity	—	2,602
Loans receivable, net	—	206,514
Loans held-for-sale, net	—	30,875
Investment in CT Legacy Asset, at fair value	91,800	—
Accrued interest receivable and other assets	—	2,119
Subtotal	104,312	255,095
Securitization Vehicles		
Securities held-to-maturity	173,330	358,972
Loans receivable, net	241,838	612,598
Real estate held-for-sale	—	10,342
Accrued interest receivable and other assets	10,060	59,009
Subtotal	425,228	1,040,921
Total assets	$605,558	$1,366,316

See accompanying notes to consolidated financial statements.

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Capital Trust, Inc. and Subsidiaries
Consolidated Balance Sheets
March 31, 2012 and 2011
(in thousands, except per share data)

	March 31, 2012 (unaudited)	December 31, 2011
Liabilities & Equity (Deficit)		
Liabilities:		
Accounts payable, accrued expenses and other liabilities	$14,022	$8,075
Secured notes	8,010	7,847
Participations sold	17,230	19,282
Subtotal	39,262	35,204
Non-Recourse Liabilities of Consolidated Entities		
CT Legacy REIT		
Accounts payable, accrued expenses and other liabilities	—	743
Repurchase obligations	—	58,464
Mezzanine loan, net of unamortized discount	—	55,111
Participations sold	—	97,465
Interest rate hedge liabilities	—	8,817
Subtotal	—	220,600
Securitization Vehicles		
Accounts payable, accrued expenses and other liabilities	544	3,102
Securitized debt obligations	525,597	1,211,407
Interest rate hedge liabilities	23,157	24,942
Subtotal	549,298	1,239,451
Total liabilities	588,560	1,495,255
Commitments and contingencies	—	—
Equity (deficit):		
Class A common stock, $0.01 par value, 100,000 shares authorized, 21,969 and 21,967 shares issued and outstanding as of March 31, 2012 and December 31, 2011, respectively ("class A common stock")	220	220
Restricted class A common stock, $0.01 par value, 277 and 244 shares issued and outstanding as of March 31, 2012 and December 31, 2011, respectively ("restricted class A common stock" and together with class A common stock, "common stock")	3	2

Additional paid-in capital	597,230	597,049
Accumulated other comprehensive loss	(35,461)	(40,584)
Accumulated deficit	(600,558)	(667,111)
Total Capital Trust, Inc. shareholders' deficit	(38,566)	(110,424)
Noncontrolling interests	55,564	(18,515)
Total equity (deficit)	16,998	(128,939)
Total liabilities and equity (deficit)	$605,558	$1,366,316

See accompanying notes to consolidated financial statements.

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Capital Trust, Inc. and Subsidiaries
Consolidated Statements of Operations
Three Months Ended March 31, 2012 and 2011
(in thousands, except share and per share data)
(unaudited)

	Three Months Ended March 31, 2012	2011
Income from loans and other investments:		
Interest and related income	$14,716	$36,991
Less: Interest and related expenses	23,342	26,247
Income from loans and other investments, net	(8,626)	10,744
Other revenues:		
Management fees from affiliates	1,585	1,580
Servicing fees	2,020	310
Total other revenues	3,605	1,890
Other expenses:		
General and administrative	4,312	10,280
Total other expenses	4,312	10,280
Total other-than-temporary impairments of securities	—	(4,933)
Portion of other-than-temporary impairments of securities recognized in other comprehensive income	(160)	(3,271)
Net impairments recognized in earnings	(160)	(8,204)
Recovery of loan losses	8	9,161
Gain on extinguishment of debt	—	250,040
Fair value adjustment on investment in CT Legacy Assets	3,954	—
Gain on deconsolidation of subsidiary	146,380	—
Income from equity investments	696	955
Income before income taxes	141,545	254,306
Income tax provision	923	389
Net income	$140,622	$253,917
Less: Net (income) loss attributable to noncontrolling interests	(74,069)	668
Net income attributable to Capital Trust, Inc.	$66,553	$254,585
Per share information:		
Net income per share of common stock:		
Basic	$2.91	$11.35
Diluted	$2.74	$11.04
Weighted average shares of common stock outstanding:		
Basic	22,837,413	22,435,551

Diluted	24,301,465	23,068,385

See accompanying notes to consolidated financial statements.

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Capital Trust, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income
For the Three Months Ended March 31, 2012 and 2011
(in thousands)
(unaudited)

	2012	2011
Net income	$140,622	$253,917
Other comprehensive income (loss):		
Unrealized gain on derivative financial instruments	2,267	4,544
Gain on interest rate swaps no longer designated as cash flow hedges	1,998	—
Amortization of unrealized gains and losses on securities	(756)	(229)
Amortization of deferred gains and losses on settlement of swaps	(56)	(24)
Other-than-temporary impairments of securities related to fair value adjustments in excess of expected credit losses, net of amortization	387	3,850
Other comprehensive income	3,840	8,141
Comprehensive income	$144,462	$262,058
Less: Comprehensive (income) loss attributable to noncontrolling interests	(74,079)	668
Comprehensive income attributable to Capital Trust, Inc.	$70,383	$262,726

See accompanying notes to consolidated financial statements.

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Capital Trust, Inc. and Subsidiaries
Consolidated Statements of Changes in Equity (Deficit)
For the Three Months Ended March 31, 2012 and 2011
(in thousands)
(unaudited)

	Class A Common Stock	Restricted Class A Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Capital Trust, Inc. Shareholders' Deficit	Noncontrolling Interests	Total
Balance at January 1, 2011	$219	$—	$559,411	($50,462)	($920,355)	($411,187)	$—	($411,187)
Net income (loss)					254,585	254,585	(668)	253,917
Other comprehensive income	—	—	—	8,141	—	8,141	—	8,141
Allocation to noncontrolling interests	—	—	37,156	—	—	37,156	(12,623)	24,533
Restricted class A common stock earned, net of shares deferred	—	3	212	—	—	215	—	215
Deferred directors' compensation	—	—	47	—	—	47	—	47
Balance at March 31, 2011	$219	$3	$596,826	($42,321)	($665,770)	($111,043)	($13,291)	($124,334)
Balance at January 1, 2012	$220	$2	$597,049	($40,584)	($667,111)	($110,424)	($18,515)	($128,939)
Net income	—	—	—	—	66,553	66,553	74,069	140,622
Other comprehensive income	—	—	—	3,830	—	3,830	10	3,840
Deconsolidation of CT Legacy Asset	—	—	—	1,293	—	1,293	—	1,293
Restricted class A common stock earned, net of shares deferred	—	1	125	—	—	126	—	126
Deferred directors' compensation	—	—	56	—	—	56	—	56
Balance at March 31, 2012	$220	$3	$597,230	($35,461)	($600,558)	($38,566)	$55,564	$16,998

See accompanying notes to consolidated financial statements.

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Capital Trust, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
For the Three Months Ended March 31, 2012 and 2011
(in thousands)
(unaudited)

	2012	2011
Cash flows from operating activities:		
Net income	$140,622	$253,917
Adjustments to reconcile net income to net cash provided by operating activities:		
Net impairments recognized in earnings	160	8,204
Recovery of provision for loan losses	(8)	(9,161)
Gain on extinguishment of debt	—	(250,040)
Gain on deconsolidation of subsidiary	(146,380)	—
Fair value adjustment on investment in CT Legacy Assets	(3,954)	—
Income from equity investments	(696)	(955)
Distributions of income from unconsolidated subsidiaries	61	395
Employee stock-based compensation	129	223
Incentive awards plan expense	(282)	2,579
Deferred directors' compensation	56	47
Distributions from CT Legacy Assets	1,830	—
Amortization of premiums/discounts on loans and securities and deferred interest on loans	(171)	619
Amortization of deferred gains and losses on settlement of swaps	(56)	(24)
Amortization of deferred financing costs and premiums/discounts on debt obligations	8,813	2,360
Ineffectiveness of cash flow hedges recognized in earnings	2,772	—
Changes in assets and liabilities, net:		
Accrued interest receivable	(2,999)	685
Deferred income taxes	(1,423)	—
Prepaid expenses and other assets	2,986	(800)
Accounts payable and accrued expenses	(182)	(3,784)
Net cash provided by operating activities	1,278	4,265
Cash flows from investing activities:		
Principal collections and proceeds from securities	21,496	8,372
Principal collections of loans receivable	83,000	224,625
Contributions to unconsolidated subsidiaries	(324)	(231)
Distributions from unconsolidated subsidiaries	677	204
Proceeds from disposition of loans held-for-sale	—	5,750
Decrease (increase) in restricted cash	473	(4,213)
Net cash provided by investing activities	105,322	234,507
Cash flows from financing activities:		
Borrowings under repurchase obligations	123,977	—
Repayments under repurchase obligations	(58,464)	(67,929)
Repayments under senior credit facility	—	(22,932)
Repayments under senior credit facility	—	(4,640)

Borrowing under mezzanine loan	—	83,000
Repayments under mezzanine loan	(63,000)	—
Repayment of securitized debt obligations	(106,729)	(211,823)
Payment of financing expenses	—	(11,118)
Vesting of restricted Class A common stock	(4)	—
Net cash used in financing activities	(104,220)	(235,442)
Net increase in cash and cash equivalents	2,380	3,330
Cash and cash equivalents at beginning of period	34,818	24,449
Cash and cash equivalents at end of period	$37,198	$27,779

See accompanying notes to consolidated financial statements.

Capital Trust, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(unaudited)

Note 1. Organization

References herein to “we,” “us” or “our” refer to Capital Trust, Inc. and its subsidiaries unless the context specifically requires otherwise.

We are a fully integrated, self-managed, real estate finance and investment management company that specializes in credit sensitive financial products. To date, our investment programs have focused on loans and securities backed by commercial real estate assets. We invest for our own account directly on our balance sheet and for third parties through a series of investment management vehicles. Our business model is designed to produce a mix of net interest margin from our balance sheet investments, and fee income and co-investment income from our investment management vehicles. In managing our operations, we focus on originating investments, managing our portfolios and capitalizing our businesses. From the inception of our finance business in 1997 through March 31, 2012, we have completed approximately $12.0 billion of commercial real estate debt investments. We conduct our operations as a real estate investment trust, or REIT, for federal income tax purposes. We are traded on the New York Stock Exchange, or NYSE, under the symbol “CT”, and are headquartered in New York City.

March 2011 Restructuring

On March 31, 2011, we restructured, amended, or extinguished all of our outstanding recourse debt obligations, which we refer to as our March 2011 restructuring. Our March 2011 restructuring involved: (i) the contribution of certain of our legacy assets to a newly formed subsidiary, CT Legacy REIT Mezz Borrower, Inc., or CT Legacy REIT, (ii) the assumption of our legacy repurchase obligations by CT Legacy REIT, and (iii) the extinguishment of the remainder of our recourse obligations, our senior credit facility and junior subordinated notes. The restructuring was financed with a new $83.0 million mezzanine loan obtained by CT Legacy REIT from an affiliate of Five Mile Capital Partners LLC, or Five Mile, and the issuance of equity interests in the common stock of CT Legacy REIT to the former lenders under our senior credit facility and our former junior subordinated noteholders, as well as to an affiliate of Five Mile.

Following the completion of our March 2011 restructuring, we no longer have any recourse debt obligations, and retain unencumbered ownership of 100% of (i) our investment management platform, CT Investment Management Co., LLC, (ii) our co-investment in CT Opportunity Partners I, LP, (iii) our residual ownership interests in three of the CDOs that we issued, CT CDOs I, II, and IV, and (iv) our tax-basis net operating losses. Furthermore, we have a 52% equity interest in the common stock of CT Legacy REIT. Our economic interest in CT Legacy REIT is, however, subject to (i) the secured notes, which are non-recourse obligations that are collateralized by certain of our retained equity interests in the common stock of CT Legacy REIT, (ii) incentive awards that provide for the participation in amounts earned from our retained equity interests in the common stock of CT Legacy REIT, and (iii) the subordinate class B common stock of CT Legacy REIT owned by our former junior subordinate noteholders.

See Note 5 for further discussion of the secured notes, Note 9 for further discussion of the management incentive awards plan, and Note 6 for further discussion of the class B common stock.

In addition to our interest in the common stock of CT Legacy REIT, we also own 100% of its outstanding class A preferred stock. The class A preferred stock initially entitles us to cumulative preferred dividends of $7.5 million per annum, which dividends will be reduced in January 2013 to the greater of (i) 2.5% of certain of CT Legacy REIT’s assets, and (ii) $1.0 million per annum.

CT Legacy Assets Deconsolidation

On February 10, 2012, we refinanced CT Legacy REIT's mezzanine loan and repurchase facility with a single, new $124.0 million repurchase facility with JPMorgan. The borrower under the new JP Morgan facility, CT Legacy Asset, LLC, or CT Legacy Assets, is a wholly owned subsidiary of CT Legacy REIT and owns all of its assets, other than cash. As a result of the refinancing, CT Legacy REIT ceased to be the primary beneficiary of CT Legacy Assets and, therefore, discontinued the consolidation of CT Legacy Assets. As a result, its assets and liabilities were deconsolidated from our financial statements as of February 10, 2012.

See Note 6 for a further discussion of CT Legacy REIT and CT Legacy Assets.

Note 2. Summary of Significant Accounting Policies

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP, for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. The accompanying unaudited consolidated interim financial statements should be read in conjunction with the consolidated financial statements and the related management's discussion and analysis of financial condition and results of operations filed with our Annual Report on Form 10-K for the fiscal year ended December 31, 2011. In our opinion, all material adjustments (consisting of normal, recurring accruals) considered necessary for a fair presentation, in accordance with GAAP, have been included. The results of operations for the three months ended March 31, 2012 are not necessarily indicative of results that may be expected for the entire year ending December 31, 2012.

Principles of Consolidation

The accompanying financial statements include, on a consolidated basis, our accounts, the accounts of our wholly-owned subsidiaries, and variable interest entities, or VIEs, in which we are the primary beneficiary. All significant intercompany balances and transactions have been eliminated in consolidation.

VIEs are defined as entities in which equity investors (i) do not have the characteristics of a controlling financial interest, and/or (ii) do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The entity that consolidates a VIE is known as its primary beneficiary, and is generally the entity with (i) the power to direct the activities that most significantly impact the VIE's economic performance, and (ii) the right to receive benefits from the VIE or the obligation to absorb losses of the VIE that could be significant to the VIE.

Capital Trust, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)
(unaudited)

Our consolidated subsidiaries include: (i) CT Legacy REIT, and (ii) five securitization vehicles, including our three CT CDOs which were sponsored and issued by us and two other similar vehicles. See Note 6 and Note 7 for additional information on our investments in VIEs.

Balance Sheet Presentation
Our consolidated balance sheets separately present: (i) our direct assets and liabilities, (ii) the direct assets and liabilities of CT Legacy REIT, and (iii) the assets and liabilities of consolidated securitization vehicles, some of which are subsidiaries of CT Legacy REIT. Assets of all consolidated VIEs can generally only be used to satisfy the obligations of those VIEs, and the liabilities of consolidated VIEs are non-recourse to us.

We have aggregated all the assets and liabilities of the consolidated securitization vehicles due to our determination that these entities are substantively similar and therefore a further disaggregated presentation would not be more meaningful. Similarly, the notes to our consolidated financial statements separately describe (i) our direct assets and liabilities, (ii) the direct assets and liabilities of CT Legacy REIT, and (iii) the assets and liabilities of consolidated securitization vehicles, some of which are subsidiaries of CT Legacy REIT.

Equity Investments in Unconsolidated Subsidiaries and Fair Value Option
Our co-investment interests in the private equity funds we manage are accounted for using the equity method. These entities' assets and liabilities are not consolidated into our financial statements due to our determination that (i) these entities are not VIEs, and (ii) the investors have sufficient rights to preclude consolidation by us. As such, we report our allocable percentage of the earnings or losses of these entities on a single line item in our consolidated statements of operations as income from equity investments.

One such fund, CT Opportunity Partners I, LP, or CTOPI, maintains its financial records at fair value in accordance with GAAP. We have applied such accounting relative to our investment in CTOPI, and include any adjustments to fair value recorded at the fund level in determining the income we record on our equity investment in CTOPI.

We have elected the fair value option of accounting for CT Legacy REIT's investment in CT Legacy Assets, pursuant to which we record this investment at fair value rather than at our historical cost investment amount. Additionally, changes in the fair value of this investment are recognized in our consolidated statement of operations. We made this election due to our determination that the fair value of the investment in CT Legacy Assets, as a net liquidating portfolio of assets subject to a non-recourse repurchase obligation, is more meaningful and indicative of our interests in CT Legacy Assets than equity method accounting. See Note 6 for additional discussion of CT Legacy REIT and CT Legacy Assets.

Revenue Recognition
Interest income from our loans receivable is recognized over the life of the investment using the effective interest method and is recorded on the accrual basis. Fees, premiums, discounts and direct costs associated with these investments are deferred until the loan is advanced and are then recognized over the term of the loan as an adjustment to yield. For loans where we have unfunded commitments, we amortize these fees and other items on a straight line basis. Fees on commitments that expire unused are recognized at expiration. Income accrual is generally suspended for loans at the earlier of the date at which payments become 90 days past due or when, in the opinion of management, recovery of income and principal becomes doubtful. Income is then recorded on the basis of cash received until accrual is resumed when the loan becomes contractually current and performance is demonstrated to be resumed.

Interest income from our securities is recognized using a level yield with any purchase premium or discount accreted through income over the life of the security. This yield is calculated using cash flows expected to be collected which are based on a number of assumptions on the underlying loans. Examples include, among other things, the rate and timing of principal payments, including prepayments, repurchases, defaults and liquidations, the pass-through or coupon rate, and interest rates. Additional factors that may affect reported interest income on our securities include interest payment shortfalls due to delinquencies on the underlying mortgage loans and the timing and magnitude of expected credit losses on the mortgage loans underlying the securities. These are impacted by, among other things, the general condition of the real estate market, including competition for tenants and their related credit quality, and changes in market rental rates. These uncertainties and contingencies are difficult to predict and are subject to future events that may alter the assumptions.

Capital Trust, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)
(unaudited)

Fees from special servicing and asset management services are recorded on an accrual basis as services are rendered under the applicable agreements, and when receipt of fees is reasonably certain. We do not recognize incentive income from our investment management business until contingencies have been eliminated. Recognition of incentive income allocated or paid to us prior to that date is deferred and recorded as deferred incentive income liability under accounts payable, accrued expenses and other liabilities on our consolidated balance sheet. Depending on the structure of our investment management vehicles, certain incentive fees may be in the form of carried interest or promote distributions.

Cash and Cash Equivalents
We classify highly liquid investments with original maturities of three months or less from the date of purchase as cash equivalents. We place our cash and cash equivalents with high credit quality institutions to minimize credit risk exposure. As of, and for the periods ended, March 31, 2012 and December 31, 2011, we had bank balances in excess of federally insured amounts. We have not experienced any losses on our demand deposits, commercial paper or money market investments.

Restricted Cash
We classify the cash balances held by CT Legacy REIT as restricted because, while these cash balances are available for use by CT Legacy REIT for operations, debt service, or other purposes, they cannot be used by us until our allocable share is distributed from CT Legacy REIT, and cannot be co-mingled with any of our other, unrestricted cash balances. See Note 6 for additional discussion of CT Legacy REIT.

Securities
We classify our securities as held-to-maturity, available-for-sale, or trading on the date of acquisition of the investment. Held-to-maturity investments are stated at cost, adjusted for the amortization of any premiums or discounts, which are amortized through our consolidated statements of operations using the level yield method described above. Other than in the instance of an other-than-temporary impairment, as discussed below, these held-to-maturity investments are carried on our consolidated financial statements at their amortized cost basis.

We may also invest in securities which may be classified as available-for-sale. Available-for-sale securities are carried at estimated fair value with the net unrealized gains or losses reported as a component of accumulated other comprehensive income (loss) in shareholders' equity. Changes in the valuations do not affect our reported income or cash flows, but do impact shareholders' equity and, accordingly, book value per share. On August 4, 2005, we changed the accounting classification of certain of our securities from available-for-sale to held-to-maturity. We have not designated any securities as available-for-sale since that time.

Further, as required under GAAP, when, based on current information and events, there has been an adverse change in the cash flows expected to be collected from those previously estimated for one of our securities, an other-than-temporary impairment is deemed to have occurred. A change in expected cash flows is considered adverse if the present value of the revised cash flows (taking into consideration both the timing and amount of cash flows expected to be collected) discounted using the security's current yield is less than the present value of the previously estimated remaining cash flows, adjusted for cash receipts during the intervening period.

Should an other-than-temporary impairment be deemed to have occurred, the security is written down to fair value. The total other-than-temporary impairment is bifurcated into (i) the amount related to expected credit losses, and (ii) the amount related to fair value adjustments in excess of expected credit losses, or the Valuation Adjustment. The portion of the other-than-temporary impairment related to expected credit losses is calculated by comparing the amortized cost basis of the security to the present value of cash flows expected to be collected, discounted at the security's current yield, and is recognized through earnings in the consolidated statement of operations. The remaining other-than-temporary impairment related to the Valuation Adjustment is recognized as a component of accumulated other comprehensive income (loss) in shareholders' equity. A portion of other-than-temporary impairments recognized through earnings is accreted back to the amortized cost basis of the security through interest income, while amounts recognized through other comprehensive income (loss) are amortized over the life of the security with no impact on earnings.

Loans Receivable, Provision for Loan Losses, Loans Held-for-Sale and Related Allowance

We purchase and originate commercial real estate debt and related instruments, or Loans, generally to be held as long-term investments at amortized cost. Management is required to periodically evaluate each of these Loans for possible impairment. Impairment is indicated when it is deemed probable that we will not be able to collect all amounts due according to the contractual terms of the Loan. If a Loan is determined to be impaired, we write down the Loan through a charge to the provision for loan losses. Impairment on these loans is measured by comparing the estimated fair value of the underlying collateral to the book value of the respective loan. These valuations require significant judgments, which include assumptions regarding capitalization rates, leasing, creditworthiness of major tenants, occupancy rates, availability of financing, exit plan, loan sponsorship, actions of other lenders and other factors deemed necessary by management. Actual losses, if any, could ultimately differ from these estimates.

Capital Trust, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)
(unaudited)

In conjunction with our quarterly loan portfolio review, management assesses the performance of each loan, and assigns a risk rating based on several factors including risk of loss, loan-to-value ratio, or LTV, collateral performance, structure, exit plan, and sponsorship. Loans are rated one through eight, which are defined as follows:

1 - Low Risk: A loan that is expected to perform through maturity, with relatively lower LTV, higher in-place debt yield, and stable projected cash flow.

2 - Average Risk: A loan that is expected to perform through maturity, with medium LTV, average in-place debt yield, and stable projected cash flow.

3 - Acceptable Risk: A loan that is expected to perform through maturity, with relatively higher LTV, acceptable in-place debt yield, and some uncertainty (due to lease rollover or other factors) in projected cash flow.

4 - Higher Risk: A loan that is expected to perform through maturity, but has exhibited a material deterioration in cash flow and/or other credit factors. If negative trends continue, default could occur.

5 - Low Probability of Default/Loss: A loan with one or more identified weakness that we expect to have a 15% probability of default or principal loss.

6 - Medium Probability of Default/Loss: A loan with one or more identified weakness that we expect to have a 33% probability of default or principal loss.

7 - High Probability of Default/Loss: A loan with one or more identified weakness that we expect to have a 67% or higher probability of default or principal loss.

8 - In Default: A loan which is in contractual default and/or which has a very high likelihood of principal loss.

In addition, for certain pools of smaller loans which have similar credit characteristics, primarily loans with an outstanding principal balance of $10.0 million or less in our consolidated securitization vehicles, we have recorded a general provision for loan losses in lieu of the asset-specific provisions we record on all other loans. This general provision is based on macroeconomic data with respect to historic loan losses, vintage, property type, and other factors deemed relevant for such loan pools. These loans do not undergo the same level of asset management as our larger investments.

In certain cases, we may classify loans as held-for-sale based upon the specific facts and circumstances of particular Loans, including known or expected transactions. Loans held-for-sale are carried at the lower of their amortized cost basis and fair value. A reduction in the fair value of loans held-for-sale is recorded as a charge to our consolidated statement of operations as a valuation allowance on loans held-for-sale.

Real Estate Held-for-Sale
Loan investments where we have foreclosed upon the underlying collateral and own an equity interest in real estate are categorized as real estate owned. We generally do not intend to hold such foreclosed assets for long-term operations and therefore classify such assets as real estate held-for-sale on our consolidated balance sheets. Real estate held-for-sale are carried at the lower of our basis in the real estate and fair value, less cost to sell, with reductions in fair value recorded as an impairment of real estate-held-for-sale on our consolidated statements of operations.

Deferred Financing Costs

The deferred financing costs which are included in prepaid expenses and other assets on our consolidated balance sheets include issuance costs related to our debt obligations, and are amortized using the effective interest method, or a method that approximates the effective interest method, over the life of the related obligations.

Repurchase Obligations

In certain circumstances, we have financed the purchase of investments from a counterparty through a repurchase obligation with that same counterparty. We currently record these investments in the same manner as other investments financed with repurchase obligation, with the investment recorded as an asset and the related borrowing under any repurchase agreement recorded as a liability on our consolidated balance sheets. Interest income earned on the investments and interest expense incurred on the repurchase obligations are reported separately on our consolidated statements of operations.

Capital Trust, Inc. and Subsidiaries
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Interest Rate Derivative Financial Instruments

In the normal course of business, we use interest rate derivative financial instruments to manage, or hedge, cash flow variability caused by interest rate fluctuations. Specifically, we currently use interest rate swaps to effectively convert floating rate liabilities that are financing fixed rate assets to fixed rate liabilities. The differential to be paid or received on these agreements is recognized on the accrual basis as an adjustment to the interest expense related to the attendant liability. The interest rate swap agreements are generally accounted for on a held-to-maturity basis, and, in cases where they are terminated early, any gain or loss is generally amortized over the remaining life of the hedged item. These swap agreements must be effective in reducing the variability of cash flows of the hedged items in order to qualify for the aforementioned hedge accounting treatment. Changes in value of effective cash flow hedges are reflected on our consolidated financial statements through accumulated other comprehensive income (loss) and do not affect our net income (loss). To the extent a derivative does not qualify for hedge accounting, and is deemed a non-hedge derivative, the changes in its value are included in net income (loss).

To determine the fair value of interest rate derivative financial instruments, we use a third-party derivative specialist to assist us in periodically valuing our interests.

Income Taxes

Our financial results generally do not reflect provisions for current or deferred income taxes on our REIT taxable income. Management believes that we operate in a manner that will continue to allow us to be taxed as a REIT and, as a result, we generally do not expect to pay substantial corporate level taxes other than those payable by our taxable REIT subsidiaries. Many of these requirements, however, are highly technical and complex. If we were to fail to meet these requirements, we may be subject to federal, state and local income tax on current and past income, and penalties. See Note 10 for additional information.

Accounting for Stock-Based Compensation

Stock-based compensation expense is recognized in net income using a fair value measurement method, which we determine with the assistance of a third-party appraisal firm. Compensation expense for the time vesting of stock-based compensation grants is recognized on the accelerated attribution method and compensation expense for performance vesting of stock-based compensation grants is recognized on a straight line basis.

The fair value of the performance vesting restricted common stock is measured on the grant date using a Monte Carlo simulation to estimate the probability of the market vesting conditions being satisfied. The Monte Carlo simulation is run approximately 100,000 times. For each simulation, the payoff is calculated at the settlement date, and is then discounted to the grant date at a risk-free interest rate. The average of the values over all simulations is the expected value of the restricted common stock on the grant date. The valuation is performed in a risk-neutral framework, so no assumption is made with respect to an equity risk premium. Significant assumptions used in the valuation include an expected term and stock price volatility, an estimated risk-free interest rate and an estimated dividend growth rate.

Estimates of fair value are not intended to predict actual future events or the value ultimately realized by employees who receive equity awards, and subsequent events are not indicative of the reasonableness of the original estimates of fair value made by us.

Comprehensive Income (Loss)

Total comprehensive income was $144.5 million and $262.1 million for the three months ended March 31, 2012 and 2011, respectively. The primary components of comprehensive income other than net income are the unrealized gains and losses on derivative financial instruments and the component of other-than-temporary impairments of securities related to the Valuation Adjustment.

Earnings per Share of Common Stock

Basic earnings per share, or EPS, is computed based on the net earnings allocable to common stock and stock units, divided by the weighted average number of shares of common stock and stock units outstanding during the period. Diluted EPS is determined using the treasury stock method, and is based on the net earnings allocable to common stock and stock units, divided by the weighted average number of shares of common stock, stock units and potentially dilutive common stock options and warrants. See Note 8 for additional discussion of earnings per share.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may ultimately differ from those estimates.

Capital Trust, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)
(unaudited)

Reclassifications
Certain reclassifications have been made in the presentation of the prior period consolidated financial statements to conform to the March 31, 2012 presentation.

Segment Reporting
We operate in two reportable segments. We have an internal information system that produces performance and asset data for the two segments along service lines.

The Balance Sheet Investment segment includes our consolidated portfolio of interest earning assets and the financing thereof. The Investment Management segment includes the investment management activities of our wholly-owned investment management subsidiary, CT Investment Management Co., LLC, or CTIMCO, and its subsidiaries, as well as our co-investments in investment management vehicles. CTIMCO is a taxable REIT subsidiary and serves as the investment manager of Capital Trust, Inc., all of our investment management vehicles and CT CDOs, and serves as senior servicer and special servicer for certain of our investments and for third parties.