

CAPITAL TRUST INC  
Form 10-Q  
August 01, 2007

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2007

OR

**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)

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

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  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

**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 July 31, 2007 was 17,509,459.

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CAPITAL TRUST, INC.

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## Capital Trust, Inc. and Subsidiaries

## Consolidated Balance Sheets

June 30, 2007 and December 31, 2006

(in thousands)

|   | June 30,<br>2007<br>(unaudited) | December 31,<br>2006<br>(audited) |
|---|---------------------------------|-----------------------------------|
| <b>Assets</b>   |                                 |                                   |
| Cash and cash equivalents   | \$ 24,479                       | \$ 26,142                         |
| Restricted cash   | 3,787                           | 1,707                             |
| Commercial mortgage backed securities   | 891,367                         | 810,970                           |
| Loans receivable  | 2,197,529                       | 1,754,536                         |
| Total return swaps  |                                 | 1,815                             |
| Equity investment in unconsolidated subsidiaries  | 12,109                          | 11,485                            |
| Deposits and other receivables  | 6,565                           | 3,128                             |
| Accrued interest receivable   | 15,550                          | 14,888                            |
| Interest rate hedge assets  | 10,570                          | 2,565                             |
| Deferred income taxes   | 3,609                           | 3,609                             |
| Prepaid and other assets  | 23,151                          | 17,719                            |
| Total assets  | \$ 3,188,716                    | \$ 2,648,564                      |
| <b>Liabilities and Shareholders' Equity</b>   |                                 |                                   |
| Liabilities:  |                                 |                                   |
| Accounts payable and accrued expenses   | \$ 30,364                       | \$ 38,061                         |
| Repurchase obligations  | 964,807                         | 704,444                           |
| Collateralized debt obligations   | 1,199,748                       | 1,212,500                         |
| Participations sold   | 334,244                         | 209,425                           |
| Senior unsecured credit facility  | 75,000                          |                                   |
| Junior subordinated debentures  | 128,875                         | 51,550                            |
| Interest rate hedge liabilities   | 39                              | 1,688                             |
| Deferred origination fees and other revenue   | 3,550                           | 4,624                             |
| Total liabilities   | 2,736,627                       | 2,222,292                         |
| Commitments and contingencies   |                                 |                                   |
| Shareholders' equity:   |                                 |                                   |
| Class A common stock, \$0.01 par value, 100,000 shares authorized, 17,065 and 16,933 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively ( class A common stock )  | 171                             | 169                               |
| Restricted class A common stock, \$0.01 par value 445 and 481 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively ( restricted class A common stock and together with class A common stock, common stock ) | 5                               | 5                                 |
| Additional paid-in capital  | 421,764                         | 417,641                           |
| Accumulated other comprehensive gain  | 22,154                          | 12,717                            |
| Accumulated earnings/(deficit)  | 7,995                           | (4,260)                           |
| Total shareholders' equity  | 452,089                         | 426,272                           |
| Total liabilities and shareholders' equity  | \$ 3,188,716                    | \$ 2,648,564                      |

See accompanying notes to unaudited consolidated financial statements.



## Capital Trust, Inc. and Subsidiaries

## Consolidated Statements of Income

Three and Six Months Ended June 30, 2007 and 2006

(in thousands, except share and per share data)

(unaudited)

|  | Three Months Ended<br>June 30,<br>2007 |            | Six Months Ended<br>June 30,<br>2006 |            |
|--|--|------------|--------------------------------------|------------|
| <b>Income from loans and other investments:</b>      |  |            |                                      |            |
| Interest and related income                          | \$ 68,797                              | \$ 46,219  | \$ 126,247                           | \$ 77,851  |
| Less: Interest and related expenses                  | 40,192                                 | 26,267     | 76,293                               | 43,536     |
| Income from loans and other investments, net         | 28,605                                 | 19,952     | 49,954                               | 34,315     |
| <b>Other revenues:</b>                               |  |            |                                      |            |
| Management fees                                      | 582                                    | 627        | 1,331                                | 1,235      |
| Incentive management fees                            |  | 84         | 962                                  | 212        |
| Servicing fees                                       | 45                                     |            | 112                                  |            |
| Other interest income                                | 272                                    | 120        | 582                                  | 351        |
| Total other revenues                                 | 899                                    | 831        | 2,987                                | 1,798      |
| <b>Other expenses:</b>                               |  |            |                                      |            |
| General and administrative                           | 7,832                                  | 5,701      | 14,644                               | 10,826     |
| Depreciation and amortization                        | 60                                     | 2,063      | 1,388                                | 2,340      |
| Total other expenses                                 | 7,892                                  | 7,764      | 16,032                               | 13,166     |
| Recovery of provision for losses                     | 4,000                                  |            | 4,000                                |            |
| Income/(loss) from equity investments                | (230)                                  | 403        | (933)                                | 722        |
| Income before income taxes                           | 25,382                                 | 13,422     | 39,976                               | 23,669     |
| (Benefit)/provision for income taxes                 |  | (770)      | (254)                                | (1,471)    |
| Net income   | \$ 25,382                              | \$ 14,192  | \$ 40,230                            | \$ 25,140  |
| <b>Per share information:</b>                        |  |            |                                      |            |
| Net earnings per share of common stock:              |  |            |                                      |            |
| Basic  | \$ 1.45                                | \$ 0.92    | \$ 2.29                              | \$ 1.63    |
| Diluted  | \$ 1.43                                | \$ 0.91    | \$ 2.27                              | \$ 1.62    |
| Weighted average shares of common stock outstanding: |  |            |                                      |            |
| Basic  | 17,558,493                             | 15,396,496 | 17,536,245                           | 15,388,326 |
| Diluted  | 17,728,180                             | 15,536,948 | 17,715,810                           | 15,525,586 |
| Dividends declared per share of common stock         | \$ 0.80                                | \$ 0.70    | \$ 1.60                              | \$ 1.30    |

See accompanying notes to unaudited consolidated financial statements.

## Capital Trust, Inc. and Subsidiaries

## Consolidated Statements of Changes in Shareholders' Equity

For the Six Months Ended June 30, 2007 and 2006

(in thousands)

(unaudited)

|  | Comprehensive<br>Income/(Loss) | Class A<br>Common<br>Stock | Restricted<br>Class A<br>Common<br>Stock | Additional<br>Paid-In<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Income/(Loss) | Accumulated<br>Deficit | Total      |
|--|--------------------------------|----------------------------|--|----------------------------------|--|------------------------|------------|
| Balance at January 1, 2006   |                                | \$ 149                     | \$ 4                                     | \$ 326,299                       | \$ 14,879  | \$ (2,481)             | \$ 338,850 |
| Net income   | \$ 25,140                      |                            |  |                                  |  | 25,140                 | 25,140     |
| Unrealized gain on derivative<br>financial instruments                     | 13,206                         |                            |  |                                  | 13,206   |                        | 13,206     |
| Amortization of unrealized gain<br>on securities                           | (814)                          |                            |  |                                  | (814)  |                        | (814)      |
| Sale of shares of class A common<br>stock under stock option<br>agreements |                                |                            |  | 219                              |  |                        | 219        |
| Deferred gain on settlement of<br>swap, net of amortization                |                                |                            |  |                                  | 1,100  |                        | 1,100      |
| Restricted class A common stock<br>earned                                  |                                |                            |  | 1,831                            |  |                        | 1,831      |
| Dividends declared on class A<br>common stock                              |                                |                            |  |                                  |  | (19,918)               | (19,918)   |
| Balance at June 30, 2006   | \$ 37,532                      | \$ 149                     | \$ 4                                     | \$ 328,349                       | \$ 28,371  | \$ 2,741               | \$ 359,614 |
| Balance at January 1, 2007   |                                | \$ 169                     | \$ 5                                     | \$ 417,641                       | \$ 12,717  | \$ (4,260)             | \$ 426,272 |
| Net income   | \$ 40,230                      |                            |  |                                  |  | 40,230                 | 40,230     |
| Unrealized gain on derivative<br>financial instruments                     | 9,644                          |                            |  |                                  | 9,644  |                        | 9,644      |
| Unrealized gain on available for<br>sale security                          | 110                            |                            |  |                                  | 110  |                        | 110        |
| Amortization of unrealized gain<br>on securities                           | (837)                          |                            |  |                                  | (837)  |                        | (837)      |
| Currency translation adjustments   | 810                            |                            |  |                                  | 810  |                        | 810        |
| Issuance of stock relating to asset<br>purchase                            |                                |                            |  | 707                              |  |                        | 707        |
| Sale of shares of class A common<br>stock under stock option<br>agreements |                                |                            |  | 952                              |  |                        | 952        |
| Deferred gain/(loss) on settlement<br>of swap, net of amortization         |                                |                            |  |                                  | (290)  |                        | (290)      |
| Restricted class A common stock<br>earned                                  |                                | 2                          |  | 2,464                            |  |                        | 2,466      |
| Dividends declared on class A<br>common stock                              |                                |                            |  |                                  |  | (27,975)               | (27,975)   |
| Balance at June 30, 2007   | \$ 49,957                      | \$ 171                     | \$ 5                                     | \$ 421,764                       | \$ 22,154  | \$ 7,995               | \$ 452,089 |

See accompanying notes to unaudited consolidated financial statements.





## Capital Trust, Inc. and Subsidiaries

## Consolidated Statements of Cash Flows

Six months ended June 30, 2007 and 2006

(in thousands)

(unaudited)

|  | Six Months Ended<br>June 30, |            |
|--|------------------------------|------------|
|  | 2007                         | 2006       |
| <b>Cash flows from operating activities:</b>   |                              |            |
| Net income   | \$ 40,230                    | \$ 25,140  |
| Adjustments to reconcile net income to net cash provided by operating activities:        |                              |            |
| Depreciation and amortization  | 1,388                        | 2,340      |
| (Income)/loss from equity investments  | 933                          | (722 )     |
| Distributions from equity investments  | 320                          | 633        |
| Restricted class A common stock earned   | 2,464                        | 1,831      |
| Amortization of premiums and accretion of discounts on loans, CMBS, and debt, net        | (1,022 )                     | (635 )     |
| Amortization of deferred gains on interest rate hedges                                   | (137 )                       | (86 )      |
| Stock based compensation   |                              | (45 )      |
| Changes in assets and liabilities, net:  |                              |            |
| Deposits and other receivables   | 1,616                        | 5,236      |
| Accrued interest receivable  | (662 )                       | (2,462 )   |
| Deferred income taxes  |                              | (692 )     |
| Prepaid and other assets   | 1,930                        | 960        |
| Deferred origination fees and other revenue  | (1,074 )                     | 2,104      |
| Accounts payable and accrued expenses  | 2,676                        | (2,073 )   |
| Net cash provided by operating activities  | 48,662                       | 31,529     |
| <b>Cash flows from investing activities:</b>   |                              |            |
| Purchases of commercial mortgage-backed securities                                       | (110,550 )                   | (359,280 ) |
| Principal collections on and proceeds from sale of commercial mortgage-backed securities | 29,968                       | 11,344     |
| Origination and purchase of loans receivable   | (1,005,084 )                 | (453,559 ) |
| Principal collections on loans receivable  | 442,442                      | 181,992    |
| Equity investments in unconsolidated subsidiaries  | (3,919 )                     |            |
| Return of capital from investments in unconsolidated subsidiaries                        | 1,616                        | 2,295      |
| Purchase of total return swaps   |                              | (4,138 )   |
| Proceeds from total return swaps   | 1,815                        | 4,000      |
| Purchases of equipment and leasehold improvements  | (307 )                       |            |
| Payments for business purchased  | (2,560 )                     |            |
| Payment of capitalized costs   | (115 )                       |            |
| Decrease/(increase) in restricted cash   | (2,080 )                     | (2,080 )   |
| Net cash used in investing activities  | (648,774 )                   | (619,426 ) |
| <b>Cash flows from financing activities:</b>   |                              |            |
| Proceeds from repurchase obligations   | 1,163,636                    | 534,529    |
| Repayment of repurchase obligations  | (903,272 )                   | (570,403 ) |
| Proceeds from credit facilities  | 100,000                      |            |
| Repayment of credit facilities   | (25,000 )                    |            |
| Issuance of junior subordinated debentures   | 77,325                       | 51,550     |
| Purchase of common equity in CT Preferred Trust I & CT Preferred Trust II                | (2,325 )                     | (1,550 )   |
| Proceeds from issuance of collateralized debt obligations                                |                              | 429,398    |
| Repayments of collateralized debt obligations  | (12,598 )                    | (2,632 )   |
| Proceeds from participations sold  | 239,742                      | 155,950    |
| Settlement of interest rate hedges   | (153 )                       | 1,186      |
| Payment of deferred financing costs  | (2,218 )                     | (3,799 )   |
| Sale of shares of class A common stock under stock option agreements                     | 952                          | 219        |

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|  |           |           |
|--|-----------|-----------|
| Reimbursement of offering expenses             |           | 123       |
| Stock issuance for business purchased          | 707       |           |
| Dividends paid on class A common stock         | (38,347 ) | (21,415 ) |
| Net cash provided by financing activities      | 598,449   | 573,156   |
| Net decrease in cash and cash equivalents      | (1,663 )  | (14,741 ) |
| Cash and cash equivalents at beginning of year | 26,142    | 24,974    |
| Cash and cash equivalents at end of period     | \$ 24,479 | \$ 10,233 |

*See accompanying notes to unaudited consolidated financial statements*

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## Capital Trust, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

(unaudited)

#### 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 finance and investment management company that specializes in credit sensitive structured 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. From the commencement of our finance business in 1997 through June 30, 2007, we have completed over \$10.0 billion of investments in the commercial real estate debt arena. We conduct our operations as a real estate investment trust, or REIT, for federal income tax purposes and we are headquartered in New York City.

#### 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 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 footnotes required by accounting principles generally accepted in the United States for complete financial statements. The accompanying unaudited consolidated interim financial statements should be read in conjunction with the financial statements and the related management 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, 2006. In our opinion, all material adjustments (consisting of normal, recurring accruals) considered necessary for a fair presentation have been included. The results of operations for the three and six months ended June 30, 2007 are not necessarily indicative of results that may be expected for the entire year ending December 31, 2007. Our accounting and reporting policies conform in all material respects to accounting principles generally accepted in the United States.

#### Principles of Consolidation

The accompanying unaudited consolidated interim financial statements include, on a consolidated basis, our accounts, the accounts of our wholly-owned subsidiaries and our interests in variable interest entities in which we are the primary beneficiary. All significant intercompany balances and transactions have been eliminated in consolidation. Our interests in CT Preferred Trust I and CT Preferred Trust II, the issuers of our junior subordinated debentures, are accounted for using the equity method and their assets and liabilities are not consolidated into our financial statements due to our determination that CT Preferred Trust I and CT Preferred Trust II are variable interest entities in which we are not the primary beneficiary under Financial Accounting Standards Board, or FASB, Interpretation No. 46, or FIN 46. We account for our co-investment interest in a private equity fund we co-sponsored and continue to manage, CT Mezzanine Partners III, Inc., or Fund III, under the equity method of accounting. We also account for our investment in Bracor Invetimentos Imobiliarios Ltda., or Bracor, under the equity method of accounting. As such, we report a percentage of the earnings of Fund III and Bracor equal to our ownership percentage on a single line item in the consolidated statement of operations as income from equity investments.

#### 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 in connection 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. Fees on commitments that expire unused are recognized at expiration. For loans where we have unfunded commitments, we amortize the appropriate items on a straight line basis. Income recognition 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, a full recovery of income and principal becomes doubtful. Income recognition is resumed when the loan becomes contractually current and performance is demonstrated to be resumed.

Fees from special servicing and asset management services are recognized as services are rendered. We account for incentive fees we can potentially earn from our investment management business in accordance with Method 1 of Emerging Issues Task Force Topic D-96. Under Method 1, no incentive income is recorded until all contingencies have been eliminated.



## Capital Trust, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

(unaudited)

#### 2. Summary of Significant Accounting Policies, continued

##### 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. At June 30, 2007 and December 31, 2006, a majority of the cash and cash equivalents consisted of overnight investments in commercial paper. As of, and for the periods ended, June 30, 2007 and December 31, 2006, 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

Restricted cash is comprised of \$3.8 million that is on deposit with the trustee for our collateralized debt obligations, or CDOs, and is expected to be used to pay contractual interest and principal and to purchase replacement collateral for our reinvesting CDOs during their respective reinvestment periods.

##### Commercial Mortgage Backed Securities

We classify our commercial mortgage backed securities, or CMBS, investments pursuant to FASB Statement of Financial Accounting Standards No. 115, or FAS 115, on the date of acquisition of the investment. On August 4, 2005, we made a decision to change the accounting classification of our CMBS investments from available for sale to held to maturity. Held to maturity investments are stated at cost plus the amortization of any premiums or discounts and any premiums or discounts are amortized through the consolidated statements of income using the level yield method. Other than in the instance of impairment, these held to maturity investments are shown in our financial statements at their adjusted values pursuant to the methodology described above.

We may also invest in CMBS and certain other 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. Many of these investments are relatively illiquid and management must estimate their values. In making these estimates, management utilizes market prices provided by dealers who make markets in these securities, but may, under certain circumstances, adjust these valuations based on management's judgment. Changes in the valuations do not affect our reported income or cash flows, but impact shareholders' equity and, accordingly, book value per share.

Income on these securities is recognized based upon a number of assumptions that are subject to uncertainties and contingencies. 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 our reported interest income on our mortgage backed securities include interest payment shortfalls due to delinquencies on the underlying mortgage loans and the timing and magnitude of credit losses on the mortgage loans underlying the securities that 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.

We account for CMBS under Emerging Issues Task Force 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets, or EITF 99-20. Under EITF 99-20, when significant changes in estimated cash flows from the cash flows previously estimated occur due to actual prepayment and/or credit loss experience and the present value of the revised cash flows using the current expected yield is less than the present value of the previously estimated remaining cash flows, adjusted for cash receipts during the intervening period, an other-than-temporary impairment is deemed to have occurred. Accordingly, the security is written down to fair value with the resulting change being included in income and a new cost basis established with the original discount or premium written off when the new cost basis is established. In accordance with this guidance, on a quarterly basis, when significant changes in estimated cash flows from the cash flows previously estimated occur due to actual prepayment and/or credit loss experience, we calculate a revised yield based upon the current amortized cost of the investment, including any other-than-temporary impairments recognized to date, and the revised cash flows. The revised yield is then applied prospectively to recognize interest income. Management must also assess whether unrealized losses on securities reflect a decline in value that is other-than-temporary, and, accordingly, write down the impaired security to its fair value, through a charge to earnings.



## Capital Trust, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

(unaudited)

#### 2. Summary of Significant Accounting Policies, continued

Significant judgment of management is required in this analysis that includes, but is not limited to, making assumptions regarding the collectibility of the principal and interest, net of related expenses, on the underlying loans.

During the fourth quarter of 2004, we concluded that two of our CMBS investments had incurred other than temporary impairment and we incurred a charge of \$5.9 million through the income statement. At June 30, 2007 we believe there has not been any adverse change in cash flows since December 31, 2004, therefore we did not recognize any additional other than temporary impairment on any CMBS investments. Significant judgment of management is required in this analysis that includes, but is not limited to, making assumptions regarding the collectibility of the principal and interest, net of related expenses, on the underlying loans.

From time to time we purchase CMBS and other investments in which we have a level of control over the issuing entity; we refer to these investments as controlling class investments, or Controlling Class Investments. The presentation of Controlling Class Investments in our financial statements is governed in part by FIN 46. FIN 46 could require that certain Controlling Class Investments be presented on a consolidated basis. Based upon the specific circumstances of certain of our CMBS investments that are Controlling Class Investments and our interpretation of FIN 46, specifically the exemption for qualifying special purpose entities as defined under FASB Statements of Financial Accounting Standard No. 140, or FAS 140, we have concluded that the entities that have issued the Controlling Class Investments should not be presented on a consolidated basis. We are aware that FAS 140 is currently under review by standard setters and that, as a result of this review, our current interpretation of FIN 46 and FAS 140 may change.

#### Loans Receivable and Reserve for Possible Credit Losses

We purchase and originate commercial real estate debt and related instruments, or Loans, to be held as long term investments at amortized cost. Management must 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 were determined to be permanently impaired, we would write down the Loan through a charge to the reserve for possible credit losses. Given the nature of our Loan portfolio and the underlying commercial real estate collateral, significant judgment on the part of management is required in determining the permanent impairment and the resulting charge to the reserve, which includes but is not limited to making assumptions regarding the value of the real estate that secures the loan. Each Loan in our portfolio is evaluated at least quarterly using our loan risk rating system which considers loan-to-value, debt yield, cash flow stability, exit plan, loan sponsorship, loan structure and other factors deemed necessary by management to assess the likelihood of delinquency or default. If we believe that there is a potential for delinquency or default, a downside analysis is prepared to estimate the value of the collateral underlying our Loan, and this potential loss is multiplied by the default likelihood to determine the size of the reserve. Actual losses, if any, could ultimately differ from these estimates.

#### Deferred Financing Costs

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

#### Repurchase Obligations

In certain circumstances, we have financed the purchase of investments from a counterparty through a repurchase agreement with that same counterparty. We currently record these investments in the same manner as other investments financed with repurchase agreements, with the investment recorded as an asset and the related borrowing under any repurchase agreement as a liability on our consolidated balance sheet. Interest income earned on the investments and interest expense incurred on the repurchase obligations are reported separately on the consolidated statements of income. There is a position under consideration by standard setters, based upon a technical interpretation of FAS 140, that these transactions will not qualify as a purchase by us. We believe, consistent with industry practice, that we are accounting for these transactions in an appropriate manner; however, if these investments do not qualify as a purchase under FAS 140, we would be required to present the net investment (asset balance less the repurchase obligation balance) on our balance sheet together with an embedded derivative with the corresponding change in fair value of the derivative being recorded in the consolidated statements of income.





## Capital Trust, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

(unaudited)

#### 2. Summary of Significant Accounting Policies, continued

The value of the derivative would reflect not only changes in the value of the underlying investment, but also changes in the value of the underlying credit provided by the counterparty. Income from these arrangements would be presented on a net basis. Furthermore, hedge instruments related to these assets and liabilities, currently deemed effective, may no longer be effective and may have to be accounted for as non-hedge derivatives. As of June 30, 2007 we had entered into 23 such transactions, with a book value of the associated assets of \$630.6 million financed with repurchase obligations of \$451.7 million. Adoption of the aforementioned treatment would result in a reduction in total assets and liabilities on our consolidated balance sheet of \$451.7 million and \$395.8 million at June 30, 2007 and December 31, 2006, respectively.

#### 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 variable 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 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 in our financial statements through accumulated other comprehensive income/(loss) and do not affect our net income. 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.

To determine the fair value of derivative instruments, we use third parties to periodically value 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, do not expect to pay substantial corporate level taxes (other than taxes payable by our taxable REIT subsidiaries which are accounted for in accordance with FASB Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, or FAS 109). 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 we may also be subject to penalties.

In June 2006, the FASB issued Financial Interpretation No. 48, or FIN 48. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FAS 109. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This interpretation was effective January 1, 2007 for the company. The adoption of FIN 48 did not have a material impact on our financial results.

#### Accounting for Stock-Based Compensation

We account for stock based compensation in accordance with FASB Statement of Financial Accounting Standards No. 123(R). We have elected to utilize the modified prospective method, and there was no material impact from this adoption. Compensation expense for the time vesting of stock based compensation grants is recognized on the accelerated attribution method under FASB Interpretation No. 28, and compensation expense for performance vesting of stock based compensation grants is recognized on a straight-line basis.

#### Comprehensive Income

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We comply with the provisions of the FASB Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income, or FAS 130, in reporting comprehensive income and its components in the full set of general-purpose financial statements. Total comprehensive income was \$50.0 million and \$37.5 million, for the periods ended June 30, 2007 and 2006, respectively. The primary component of comprehensive income other than net income was the unrealized gain/(loss) on derivative financial instruments and CMBS. At June 30, 2007,

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## Capital Trust, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

(unaudited)

#### 2. Summary of Significant Accounting Policies, continued

accumulated other comprehensive income was \$22.2 million, comprised of unrealized gains on CMBS of \$9.2 million, unrealized gains on cash flow swaps of \$10.5 million, \$1.6 million of deferred realized gains on the settlement of cash flow swaps, and \$812,000 of currency translation adjustments.

#### Earnings per Share of Common Stock

Earnings per share of common stock are presented based on the requirements of the FASB Statement of Accounting Standards No. 128, or FAS 128. Basic EPS is computed based on the income applicable to common stock and stock units divided by weighted average number of shares of common stock and stock units outstanding during the period. Diluted EPS is based on the net earnings applicable to common stock and stock units, divided by weighted average number of shares of common stock and stock units and potentially dilutive common stock options.

#### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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.

#### Reclassifications

Certain reclassifications have been made in the presentation of the prior periods consolidated financial statements to conform to the June 30, 2007 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 all of our activities related to direct loan and investment activities (including our co-investments in investment management vehicles and our investment in Bracor) and the financing thereof.

The Investment Management segment includes the activities related to investment management services provided by CT Investment Management Co., LLC, or CTIMCO, and its subsidiaries. CTIMCO is a taxable REIT subsidiary and is our special servicer and the investment manager of Capital Trust, Inc., and all of our investment management vehicles.

#### Related Party Transactions

On November 9, 2006, we commenced our CT High Grade Mezzanine<sup>SM</sup> investment management initiative and entered into three separate account agreements with affiliates of W. R. Berkley Corporation, or WRBC, for an aggregate of \$250 million. On July 25, 2007, we amended the agreements to increase the aggregate commitment of the WRBC affiliates to \$350 million. Pursuant to these agreements, we invest, on a discretionary basis, capital on behalf of WRBC in low risk commercial real estate mortgages, mezzanine loans and participations therein. WRBC beneficially owns approximately 14.2% of our outstanding class A common stock as of July 29, 2007 and a member of our board of directors is an employee of WRBC. The separate accounts are entirely funded with committed capital from WRBC and are managed by a subsidiary of our wholly-owned investment management subsidiary, CT Investment Management Co. LLC, or CTIMCO. Each separate account has a one-year investment period with extension provisions. CTIMCO will earn a management fee equal to 0.25% per annum on invested assets.

On April 27, 2007, we purchased a \$20 million subordinated interest in a mortgage from a dealer. Proceeds from the original mortgage financing provide for the construction and leasing of an office building in Washington, D.C. The mortgage borrower is a joint venture between

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two parties, one of which is 80% controlled by W.R. Berkley Corporation, or WRBC. WRBC beneficially owns approximately 14.2% of our outstanding class A common stock as of July 29, 2007 and a member of our board of directors is an employee of WRBC.

We believe that the terms of the foregoing transactions are no less favorable than could be obtained by us from unrelated parties on an arm's length basis.

### **Business Combination**

On June 15, 2007, the company purchased a healthcare loan origination platform with 18 employees, located in Birmingham, Alabama. The company paid a \$2.6 million initial purchase price (\$1.9 million in cash and \$707,000 in stock) and has a contingent obligation to pay an additional \$1.8 million (\$1.1 million in cash and \$700,000 in stock) on March 15, 2009 if the acquired business meets certain performance criteria. The company has recorded \$2.1 million of goodwill associated with the initial purchase price.

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

(unaudited)

**3. Commercial Mortgage Backed Securities**

Activity relating to our CMBS investments for the six months ended June 30, 2007 was as follows (\$ values in thousands):

| Asset Type                                     | Face Value | Book Value | Number of Securities | Number of Issue | Weighted Average |           | Yield(2) | Maturity (Years) (3) |
|--|------------|------------|----------------------|-----------------|------------------|-----------|----------|----------------------|
|  |            |            |                      |                 | Rating (1)       | Coupon(2) |          |                      |
| <b>December 31, 2006</b>                       |            |            |                      |                 |                  |           |          |                      |
| Floating Rate                                  | \$ 86,012  | \$ 84,807  | 11                   | 9               | BBB-             | 7.42 %    | 7.51 %   | 2.0                  |
| Fixed Rate                                     | 764,607    | 726,163    | 66                   | 48              | BB+              | 6.68 %    | 7.13 %   | 8.5                  |
| Total/Average                                  | 850,619    | 810,970    | 77                   | 57              | BB+              | 6.75 %    | 7.17 %   | 7.8                  |
| <b>Originations - Six Months</b>               |            |            |                      |                 |                  |           |          |                      |
| Floating Rate                                  | 109,621    | 109,617    | 7                    | 4               | BB-              | 9.66 %    | 9.66 %   | 3.8                  |
| Fixed Rate                                     | 1,000      | 933        | 1                    | 1               | BB+              | 6.13 %    | 6.57 %   | 3.3                  |
| Total/Average                                  | 110,621    | 110,550    | 8                    | 5               | BB-              | 9.63 %    | 9.63 %   | 3.8                  |
| <b>Repayments &amp; Other (4) - Six Months</b> |            |            |                      |                 |                  |           |          |                      |
| Floating Rate                                  | 19,605     | 19,627     | 4                    |                 | N/A              | N/A       | N/A      | N/A                  |
| Fixed Rate                                     | 10,369     | 10,526     | 1                    | 1               | N/A              | N/A       | N/A      | N/A                  |
| Total/Average                                  | 29,974     | 30,153     | 5                    | 1               | N/A              | N/A       | N/A      | N/A                  |
| <b>June 30, 2007</b>                           |            |            |                      |                 |                  |           |          |                      |
| Floating Rate                                  | 176,028    | 174,797    | 14                   | 13              | BB               | 8.87 %    | 8.92 %   | 2.9                  |
| Fixed Rate                                     | 755,238    | 716,570    | 66                   | 48              | BB+              | 6.67 %    | 7.13 %   | 8.1                  |
| Total/Average                                  | \$ 931,266 | \$ 891,367 | 80                   | 61              | BB+              | 7.09 %    | 7.48 %   | 7.0                  |

(1) Weighted average ratings are based on the lowest rating published by Fitch Ratings, Standard & Poor's or Moody's Investors Service for each security and exclude \$37.4 million of unrated equity investments in collateralized debt obligations.

(2) Calculations based on LIBOR of 5.32% as of June 30, 2007 and LIBOR of 5.32% as of December 31, 2006.

(3) Represents the maturity of the investment assuming all extension options are executed.

(4) Includes full repayments, sale, partial repayments, mark-to-market adjustments, and the impact of premium and discount amortization and losses, if any. The figures shown in Number of Securities and Number of Issues represent the full repayments/sales, if any.

We acquire rated and unrated subordinated investments in CMBS. As detailed in Note 2, on August 4, 2005, pursuant to the provisions of FAS 115, we made a decision to change the accounting classification of our then portfolio of CMBS investments from available for sale to held to maturity.

While we typically account for our CMBS investments on a held to maturity basis, under certain circumstances we will account for CMBS on an available for sale basis. At June 30, 2007, we had one CMBS investment that we designated and account for on an available for sale basis with a face value of \$10.0 million. The security earns interest at a fixed rate of 7.87%. As of June 30, 2007, the security was carried at its fair market value of \$10.5 million. The investment matures in February 2010.

Quarterly, we reevaluate our CMBS portfolio to determine if there has been an other-than-temporary impairment based upon our assessment of future cash flow receipts. For the six months ended June 30, 2007, we believe that



**Capital Trust, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (continued)**

(unaudited)

**3. Commercial Mortgage Backed Securities, continued**

there has not been any adverse change in cash flows for our CMBS portfolio and, therefore, did not recognize any other-than-temporary impairments. Significant judgment of management is required in this analysis that includes, but is not limited to, making assumptions regarding the collectibility of principal and interest, net of related expenses, on the underlying loans.

Certain of our CMBS investments are carried at values in excess of their market values. This difference can be caused by, among other things, changes in interest rates, changes in credit spreads, realized/unrealized losses and general market conditions. At June 30, 2007, 59 CMBS investments with an aggregate carrying value of \$591.3 million were carried at values in excess of their market values. Market value for these CMBS investments was \$571.2 million at June 30, 2007.

## Capital Trust, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(unaudited)

## 4. Loans Receivable

Activity relating to our loans receivable for the six months ended June 30, 2007 was as follows (\$ values in thousands):

| Asset Type                        | Face Value(1) | Book Value(1) | Number of Investments(1) | Weighted Average |           | Maturity (Years)(3) |
|-----------------------------------|---------------|---------------|--------------------------|------------------|-----------|---------------------|
|                                   |               |               |                          | Coupon(2)        | Yield (2) |                     |
| December 31, 2006                 |               |               |                          |                  |           |                     |
| Floating rate(4)                  |               |               |                          |                  |           |                     |
| Mortgage loans                    | \$ 234,419    | \$ 234,419    | 14                       | 7.85 %           | 8.47 %    | 4.0                 |
| Subordinate mortgage interests    | 669,532       | 668,365       | 28                       | 8.29 %           | 8.37 %    | 3.9                 |
| Mezzanine loans                   | 622,055       | 621,877       | 23                       | 9.57 %           | 9.76 %    | 4.3                 |
| Total/Average                     | 1,526,006     | 1,524,661     | 65                       | 8.75 %           | 8.96 %    | 4.1                 |
| Fixed rate                        |               |               |                          |                  |           |                     |
| Mortgage loans                    |               |               |                          |                  |           |                     |
| Subordinate mortgage interests    | 42,309        | 41,486        | 4                        | 7.78 %           | 7.85 %    | 16.0                |
| Mezzanine loans                   | 187,161       | 185,751       | 11                       | 9.07 %           | 9.25 %    | 4.9                 |
| Total/Average                     | 229,470       | 227,237       | 15                       | 8.80 %           | 8.96 %    | 7.2                 |
| Total/Average - December 31, 2006 | 1,755,476     | 1,751,898     | 80                       | 8.75 %           | 8.96 %    | 4.5                 |
| Originations(5) - Six Months      |               |               |                          |                  |           |                     |
| Floating rate                     |               |               |                          |                  |           |                     |
| Mortgage loans                    | 367,259       | 367,259       | 9                        | 7.69 %           | 8.01 %    | 3.9                 |
| Subordinate mortgage interests    | 221,342       | 221,192       | 9                        | 8.23 %           | 8.27 %    | 4.8                 |
| Mezzanine loans                   | 416,632       | 416,632       | 9                        | 8.69 %           | 8.68 %    | 3.4                 |
| Total/Average                     | 1,005,233     | 1,005,083     | 27                       | 8.22 %           | 8.35 %    | 4.0                 |
| Fixed rate                        |               |               |                          |                  |           |                     |
| Mortgage loans                    |               |               |                          |                  |           |                     |
| Subordinate mortgage interests    |               |               |                          |                  |           |                     |
| Mezzanine loans                   |               |               |                          |                  |           |                     |
| Total/Average                     |               |               |                          |                  |           |                     |
| Total/Average                     | 1,005,233     | 1,005,083     | 27                       | 8.22 %           | 8.35 %    | 4.0                 |
| Repayments & Other(6)- Six Months |               |               |                          |                  |           |                     |
| Floating rate                     |               |               |                          |                  |           |                     |
| Mortgage loans                    | 13,817        | 13,817        | 1                        | N/A              | N/A       | N/A                 |
| Subordinate mortgage interests    | 298,830       | 297,918       | 8                        | N/A              | N/A       | N/A                 |
| Mezzanine loans                   | 231,968       | 231,950       | 9                        | N/A              | N/A       | N/A                 |
| Total/Average                     | 544,615       | 543,685       | 18                       | N/A              | N/A       | N/A                 |
| Fixed rate                        |               |               |                          |                  |           |                     |
| Mortgage loans                    |               |               |                          |                  |           |                     |
| Subordinate mortgage interests    | 40            | (26)          |                          | N/A              | N/A       | N/A                 |
| Mezzanine loans                   | 15,119        | 15,793        | 2                        | N/A              | N/A       | N/A                 |
| Total/Average                     | 15,159        | 15,767        | 2                        | N/A              | N/A       | N/A                 |
| Total/Average                     | 559,774       | 559,452       | 20                       | N/A              | N/A       | N/A                 |
| June 30, 2007                     |               |               |                          |                  |           |                     |
| Floating rate                     |               |               |                          |                  |           |                     |
| Mortgage loans                    | 587,861       | 587,861       | 22                       | 7.75 %           | 8.07 %    | 4.1                 |
| Subordinate mortgage interests    | 592,044       | 591,639       | 29                       | 8.02 %           | 8.01 %    | 3.9                 |



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|                                |              |              |    |      |   |      |   |      |
|--------------------------------|--------------|--------------|----|------|---|------|---|------|
| Mezzanine loans                | 806,719      | 806,559      | 23 | 9.18 | % | 9.24 | % | 3.7  |
| Total/Average                  | 1,986,624    | 1,986,059    | 74 | 8.41 | % | 8.53 | % | 3.9  |
| Fixed rate                     |              |              |    |      |   |      |   |      |
| Mortgage loans                 |              |              |    |      |   |      |   |      |
| Subordinate mortgage interests | 42,269       | 41,512       | 4  | 7.72 | % | 7.80 | % | 17.7 |
| Mezzanine loans                | 172,042      | 169,958      | 9  | 8.99 | % | 9.13 | % | 4.5  |
| Total/Average                  | 214,311      | 211,470      | 13 | 8.74 | % | 8.87 | % | 7.1  |
| Total/Average - June 30, 2007  | \$ 2,200,935 | \$ 2,197,529 | 87 | 8.44 | % | 8.56 | % | 4.2  |

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- (1) December 31, 2006 values do not include one non performing loan that was successfully resolved in the second quarter of 2007.
- (2) Calculations based on LIBOR of 5.32% as of June 30, 2007 and LIBOR of 5.32% as of December 31, 2006.
- (3) Represents the maturity of the investment assuming all extension options are executed.
- (4) During the period one subordinate mortgage interest with a book value of \$6,866 switched from a fixed rate to a floating rate.
- (5) Includes additional fundings on prior period originations. The figures shown in Number of Investments represent the actual number of originations during the period.
- (6) Includes full repayments, sales, partial repayments and the impact of premium and discount amortization and losses, if any. The figures shown in Investments represent the full repayments/sales, if any.

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

(unaudited)

**4. Loans Receivable, continued**

During the second quarter of 2007, we successfully resolved our only non performing loan. The loan was a first mortgage with an original principal balance of \$8.0 million that reached maturity on July 15, 2000. In December 2002, the loan was written down to \$4.0 million. From 2002 to March 31, 2007 we had received \$1.4 million in cash collections, which further reduced the carrying value of the loan to \$2.6 million. During the second quarter of 2007, we received net proceeds of \$10.9 million which resulted in reducing the carrying value of the loan to zero and recording \$4.0 million of a recovery of provision for losses and \$4.3 million of interest income.

In some instances, we have a further obligation to fund additional amounts under our loan arrangements, or Unfunded Loan Commitments. At June 30, 2007, we had 15 such Unfunded Loan Commitments for a total future funding obligation of \$277.5 million.

In connection with the aforementioned loans, at June 30, 2007, we have deferred origination fees, net of direct costs of \$3.5 million which are being amortized into income over the life of the loans.

At June 30, 2007, we had \$5.1 million included in deposits and other receivables which represented loans that were satisfied and repaid prior to June 30, the proceeds of which had not been remitted to us by our servicers at quarter end.

Quarterly, management reevaluates the reserve for possible credit losses based upon our current portfolio of loans. Each loan in our portfolio is evaluated using our loan risk rating system which considers loan to value, debt yield, cash flow stability, exit plan, loan sponsorship, loan structure and any other factors necessary to assess the likelihood of delinquency or default. If we believe that there is a potential for delinquency or default, a downside analysis is prepared to estimate the value of the collateral underlying our loan, and this potential loss is multiplied by the default likelihood. At June 30, 2007, a detailed review of the entire portfolio was completed, and we concluded that a reserve for possible credit losses was not warranted.

**5. Total Return Swaps**

Total return swaps are derivative contracts in which one party agrees to make payments that replicate the total return of a defined underlying asset, typically in return for another party agreeing to bear the risk of performance of the defined underlying asset. Under our current total return swaps, we bear the risk of performance of the underlying asset and receive payments from our counterparty as compensation. In effect, these total return swaps allow us to receive the leveraged economic benefits of asset ownership without our acquiring, or our counterparty selling, the actual underlying asset. Our total return swaps reference commercial real estate loans and contain a put provision whereby our counterparty has the right to require us to buy the entire reference loan at its par value under certain reference loan performance scenarios. The put obligation imbedded in these arrangements constitutes a recourse obligation for us to perform under the terms of the contract.

Activity relating to our total return swaps for the six months ended June 30, 2007 was as follows (\$ values in thousands):

|                          | Fair Market Value<br>(Book Value) | Cash<br>Collateral | Reference/Loan<br>Participation | Number of<br>Investments | Weighted Average<br>Maturity |             |
|--------------------------|-----------------------------------|--------------------|---------------------------------|--------------------------|------------------------------|-------------|
|                          |                                   |                    |                                 |                          | Yield(1)                     | (Years) (2) |
| December 31, 2006        | \$ 1,815                          | \$ 1,815           | \$ 40,000                       | 2                        | 20.55 %                      | 1.4         |
| Originations- Six Months |                                   |                    |                                 |                          |                              |             |
| Repayments- Six Months   | 1,815                             | 1,815              | 20,000                          | 1                        | N/A                          | N/A         |
| June 30, 2007(3)         | \$                                | \$                 | \$ 20,000                       | 1                        | N/A                          | N/A         |

(1) Calculations based on LIBOR of 5.32% as of June 30, 2007 and LIBOR of 5.32% as of December 31, 2006.

(2) Maturity (years) based on initial maturity date of the commitments.

(3) The total return swaps currently have no outstanding balance and a \$3.0 million unfunded commitment exists.

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The total return swaps are treated as non-hedge derivatives for accounting purposes and, as such, changes in their market value are recorded through the consolidated statements of income. At June 30, 2007, our total return swaps were valued at par and no such consolidated statement of income impact was recorded.

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

(unaudited)

**6. Equity Investment in Unconsolidated Subsidiaries**

Pursuant to a venture agreement with a joint venture partner, or the Venture Agreement, entered into in 2000 and subsequently amended in 2003, we have co-sponsored two private equity funds: CT Mezzanine Partners II LP and CT Mezzanine Partners III, Inc., or Fund II and Fund III. On March 30, 2007, Fund II was liquidated and as of June 30, 2007, Fund III is the only active fund operating under the aforementioned joint venture. We are a co-investor in Fund III and our wholly-owned subsidiary, CTIMCO, serves as the investment manager to the fund. The fund has concluded its investment period and is liquidating in the ordinary course. In connection with entering into the Venture Agreement and the formation of the funds, we capitalized certain costs. These costs are being amortized over the expected life of the fund.

In September 2006, we made a founding investment in Bracor Investimentos Imobiliarios Ltda., or Bracor, a newly formed net lease commercial real estate company located and operating in Brazil. Our total commitment is \$15.0 million and at June 30, 2007, we had funded \$9.8 million of our commitment. Bracor is owned 24% by us, 47% by Equity International Properties, Ltd., or EIP, and 29% by third parties. Our chairman, Sam Zell, is the chairman of EIP and has an ownership position in EIP. Bracor's operations are conducted in Brazilian Reais and changes in the USD/Reais exchange rate will impact the carrying value of our investment. At June 30, 2007, the currency valuation adjustment for our investment was \$812,000 that included a \$810,000 change for the six months ended June 30, 2007 and was recorded as an adjustment to accumulated other comprehensive income/(loss) in shareholders' equity. Our share of profits and losses from Bracor will be reported one quarter subsequent to the period earned by Bracor.

Activity relating to our equity investment in unconsolidated subsidiaries for the six months ended June 30, 2007 was as follows (\$ values in thousands):

|                                   | <b>Fund II</b> | <b>Fund II GP</b> | <b>Fund III</b> | <b>Bracor(1)</b> | <b>Total</b> |
|-----------------------------------|----------------|-------------------|-----------------|------------------|--------------|
| <b>Equity Investment</b>          |                |                   |                 |                  |              |
| Beginning Balance                 | \$ 635         | \$ 573            | \$ 2,929        | \$ 5,675         | \$ 9,812     |
| Equity investment                 |                |                   |                 | 3,919            | 3,919        |
| Company portion of fund income    | (152 )         | (534 )            | 229             | (484 )           | (941 )       |
| Currency translation adjustments  |                |                   |                 | 810              | 810          |
| Amortization of capitalized costs |                |                   |                 |                  |              |
| Distributions from funds          | (483 )         |                   | (1,453 )        |                  | (1,936 )     |
| Ending Balance                    | \$             | \$ 39             | \$ 1,705        | \$ 9,920         | \$ 11,664    |
| <b>Capitalized Costs</b>          |                |                   |                 |                  |              |
| Beginning Balance                 | \$ 1,264       | \$                | \$ 368          | \$ 41            | \$ 1,673     |
| Capitalized costs                 |                |                   |                 | 114              | 114          |
| Amortization of capitalized costs | (1,264 )       |                   | (76 )           | (2 )             | (1,342 )     |
| Ending Balance                    | \$             | \$                | \$ 292          | \$ 153           | \$ 445       |
| <b>Total Balance</b>              | \$             | \$ 39             | \$ 1,997        | \$ 10,073        | \$ 12,109    |

(1) Includes \$258,000 of additional basis that represents a difference between our share of net assets at Bracor and our carrying value.

In conjunction with the liquidation of Fund II, we received our final payment of incentive fees from the fund of \$962,000, bringing total incentive fees paid to us from Fund II to \$10.6 million. In addition, during the first quarter of 2007, we expensed the remaining capitalized cost associated with Fund II, \$1.3 million from our balance sheet and \$384,000 through our equity interest in Fund II GP.

## Capital Trust, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

(unaudited)

## 7. Debt

At June 30, 2007 and December 31, 2006, we had \$2.4 billion and \$2.0 billion of total debt outstanding, respectively. The balances of each category of debt and their respective coupons and all in effective costs, including the amortization of fees and expenses were as follows (\$ values in thousands):

|                                  | June 30, 2007 |              |           |             | December 31, 2006 |              |           |             |
|----------------------------------|---------------|--------------|-----------|-------------|-------------------|--------------|-----------|-------------|
|                                  | Face Value    | Book Value   | Coupon(1) | All In Cost | Face Value        | Book Value   | Coupon(1) | All In Cost |
| Repurchase Obligations           | \$ 964,807    | \$ 964,807   | 6.25 %    | 6.47 %      | \$ 704,444        | \$ 704,444   | 6.34 %    | 6.53 %      |
| Collateralized Debt Obligations  |               |              |           |             |                   |              |           |             |
| CDO I (Floating)                 | 252,778       | 252,778      | 5.94 %    | 6.38 %      | 252,778           | 252,778      | 5.94 %    | 6.39 %      |
| CDO II (Floating)                | 298,913       | 298,913      | 5.81 %    | 6.03 %      | 298,913           | 298,913      | 5.81 %    | 6.04 %      |
| CDO III (Fixed)                  | 262,306       | 264,311      | 5.22 %    | 5.34 %      | 264,594           | 266,754      | 5.22 %    | 5.25 %      |
| CDO IV (Floating)(2)             | 383,746       | 383,746      | 5.74 %    | 5.81 %      | 394,055           | 394,055      | 5.74 %    | 5.81 %      |
| Total CDOs                       | 1,197,743     | 1,199,748    | 5.69 %    | 5.89 %      | 1,210,340         | 1,212,500    | 5.69 %    | 5.86 %      |
| Senior Unsecured Credit Facility | 75,000        | 75,000       | 6.82 %    | 7.12 %      |                   |              |           |             |
| Junior Subordinated Debentures   | 128,875       | 128,875      | 7.20 %    | 7.30 %      | 51,550            | 51,550       | 7.45 %    | 7.53 %      |
| Total                            | \$ 2,366,425  | \$ 2,368,430 | 6.03 %    | 6.24 %      | \$ 1,966,334      | \$ 1,968,494 | 5.97 %    | 6.15 %      |

(1) Calculations based on LIBOR of 5.32% as of June 30, 2007 and LIBOR of 5.32% as of December 31, 2006.

(2) Comprised of \$368.8 million of floating rate notes sold and \$14.9 million of fixed rate notes sold.

## Repurchase Obligations

At June 30, 2007, we were party to nine master repurchase agreements with seven counterparties that provide total commitments of \$1.6 billion. At June 30, 2007, we borrowed \$906.6 million under these agreements and had the ability to borrow an additional \$128.8 million without pledging additional collateral.

We were also a party to asset specific repurchase obligations. The term of these agreements are generally one year or less and advance rates are up to 75% with cash costs ranging from LIBOR plus 0.45% to LIBOR plus 2.50%. At June 30, 2007, these asset specific repurchase obligations represent borrowings of \$58.2 million and we had the ability to borrow an additional \$7.1 million without pledging additional collateral.

In total our borrowings at June 30, 2007 under repurchase agreements were \$964.8 million and we had the ability to borrow an additional \$135.9 million without pledging additional collateral.

In February 2007, we amended and restated our master repurchase agreements with Bear Stearns increasing the combined commitment by \$250 million to \$450 million. The agreements expire in August 2008 and are designed to finance, on a recourse basis, our general investment activity as well as assets designated for one or more of our CDOs. Under the agreements, advance rates are up to 85.0% and cash costs of funds range from LIBOR plus 0.55% to LIBOR plus 2.00%. At June 30, 2007, we had incurred borrowings under the agreements of \$323.4 million and had the ability to borrow an additional \$30.8 million against the assets collateralizing the borrowings under the agreement.

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In February 2007, we amended and restated one of our master repurchase agreements with Morgan Stanley increasing the commitment by \$100 million to \$300 million. The agreement expires in July 2009 and is designed to finance, on a recourse basis, our general investment activity. Under the agreement, advance rates are up to 85.0% and cash costs of funds range from LIBOR plus 0.40% to LIBOR plus 2.00%. At June 30, 2007, we had incurred borrowings under the agreements of \$147.7 million and had the ability to borrow an additional \$70.1 million against the assets collateralizing the borrowings under the agreements.

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**Capital Trust, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (continued)**

(unaudited)

**7. Debt, continued**

**Collateralized Debt Obligations**

At June 30, 2007, we had CDOs outstanding from four separate issuances with a total face value of \$1.2 billion. Our existing CDOs are financing vehicles for our assets and, as such, are consolidated on our balance sheet, representing the amortized sales price of the securities we sold to third parties. In total, our two reinvesting CDOs provide us with \$551.7 million of debt financing at a cash cost of LIBOR plus 0.55% (5.87% at June 30, 2007) and an all in effective interest rate (including the amortization of issuance costs) of LIBOR plus 0.87% (6.19% at June 30, 2007). Our two static CDOs provide us with \$648.1 million of financing with a cash cost of 5.53% and an all in effective interest rate of 5.62% at June 30, 2007. On a combined basis, our CDOs provide us with \$1.2 billion of non-recourse, non-mark-to-market, index matched financing at a weighted average cash cost of 0.49% over the applicable index (5.69% at June 30, 2007) and a weighted average all in cost of 0.69% over the applicable index (5.89% at June 30, 2007).

**Senior Unsecured Credit Facility**

In March 2007, we closed a \$50 million senior unsecured revolving credit facility with WestLB AG, which we amended in June 2007, increasing the size to \$100 million and adding new lenders to the syndicate. The facility has an initial term of one year (with a one year term out provision at our option) and a maximum term of four years (including extension options). The facility bears interest at LIBOR plus 1.50% and we expect to use the facility borrowings for general corporate purposes and working capital needs, including providing additional flexibility for funding loan originations. At June 30, 2007, we had borrowed \$75 million under this facility.

**Junior Subordinated Debentures**

At June 30, 2007, we had a total of \$128.9 million of junior subordinated debentures outstanding. Junior subordinated debentures are comprised of two issuances of debentures, \$77.3 million in March 2007 and \$51.6 million in February 2006. On a combined basis the securities provide us with financing at a cash cost of 7.20% and an all in effective rate of 7.30%.

In March 2007, we sold \$75 million of trust preferred securities through a subsidiary, CT Preferred Trust II. The trust preferred securities have a 30 year term, maturing in April 2037, are redeemable at par on or after April 30, 2012 and pay distributions at a fixed rate of 7.03% (7.14% including the amortization of fees and expenses) for the first ten years ending April 2017, and thereafter, at a floating rate of three month LIBOR plus 2.25%.

Our interests in CT Preferred Trust I and CT Preferred Trust II are accounted for using the equity method and the assets and liabilities are not consolidated into our financial statements due to our determination that CT Preferred Trust I and CT Preferred Trust II are variable interest entities under FIN 46 and that we are not the primary beneficiary of the entities. Interest on the junior subordinated debentures is included in interest expense on our consolidated statements of income while the junior subordinated notes are presented as a separate item in our consolidated balance sheet.

**8. Participations Sold**

Participations sold represent interests in loans that we originated and subsequently sold to third parties. We present these sold interests as secured borrowings in conformity with GAAP on the basis that these arrangements do not qualify as sales under FAS 140. At June 30, 2007, we had six such participations sold with a total book balance of \$334.2 million at a weighted average yield of LIBOR plus 3.24% (8.56% at June 30, 2007). The income earned on the loans is recorded as interest income and an identical amount is recorded as interest expense on the consolidated statements of income.





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

(unaudited)

**9. Derivative Financial Instruments**

To manage interest rate risk, we typically employ interest rate swaps or other arrangements, to convert a portion of our floating rate debt to fixed rate debt in order to index match our assets and liabilities. The net payments due under these swap contracts are recognized as interest expense over the life of the contracts.

During the six months ended June 30, 2007, we paid \$153,000 to counterparties in settlement of two interest rate swaps. Recognition of this settlement has been deferred and is being amortized over the remaining life of the previously hedged item using an approximation of the level yield basis.

The following table summarizes the notional and fair values of our derivative financial instruments as of June 30, 2007. The notional value provides an indication of the extent of our involvement in the instruments at that time, but does not represent exposure to credit or interest rate risk (\$ values in thousands):

| Hedge Swap             | Type            | Notional Value | Interest Rate | Maturity | Fair Value |
|------------------------|-----------------|----------------|---------------|----------|------------|
|                        | Cash Flow Hedge | \$ 320,713     | 5.10          | % 2015   | \$ 5,632   |
| Swap                   | Cash Flow Hedge | 73,942         | 4.58          | % 2014   | 2,380      |
| Swap                   | Cash Flow Hedge | 18,845         | 3.95          | % 2011   | 917        |
| Swap                   | Cash Flow Hedge | 18,301         | 5.14          | % 2014   | 272        |
| Swap                   | Cash Flow Hedge | 16,894         | 4.83          | % 2014   | 597        |
| Swap                   | Cash Flow Hedge | 16,377         | 5.52          | % 2018   | (38 )      |
| Swap                   | Cash Flow Hedge | 14,789         | 5.05          | % 2016   | 306        |
| Swap                   | Cash Flow Hedge | 12,310         | 5.02          | % 2009   | 46         |
| Swap                   | Cash Flow Hedge | 8,007          | 4.77          | % 2011   | 94         |
| Swap                   | Cash Flow Hedge | 7,062          | 5.10          | % 2016   | 177        |
| Swap                   | Cash Flow Hedge | 6,328          | 4.78          | % 2007   | 15         |
| Swap                   | Cash Flow Hedge | 5,104          | 5.18          | % 2016   | 104        |
| Swap                   | Cash Flow Hedge | 4,134          | 4.76          | % 2007   | 10         |
| Swap                   | Cash Flow Hedge | 3,325          | 5.45          | % 2015   | 1          |
| Swap                   | Cash Flow Hedge | 2,870          | 5.08          | % 2011   | 19         |
| Swap                   | Cash Flow Hedge | 780            | 5.31          | % 2011   | (1 )       |
| Total/Weighted Average |                 | \$ 529,781     | 4.98          | % 2014   | \$ 10,531  |

As of June 30, 2007, the derivative financial instruments were reported at their fair value of \$10.6 million as interest rate hedge assets and \$39,000 as interest rate hedge liabilities. Income and expense associated with these instruments is recorded as interest expense on the company's

consolidated statements of income. The amount of hedge ineffectiveness was not material during any of the periods presented.

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

(unaudited)

**10. Earnings Per Share**

The following table sets forth the calculation of Basic and Diluted EPS for the six months ended June 30, 2007 and 2006 (in thousands, except share and per share amounts):

|  | Six Months Ended June 30, 2007 |            |                  | Six Months Ended June 30, 2006 |            |                  |
|--|--------------------------------|------------|------------------|--------------------------------|------------|------------------|
|  | Net Income                     | Shares     | Per Share Amount | Net Income                     | Shares     | Per Share Amount |
| <b>Basic EPS:</b>  |                                |            |                  |                                |            |                  |
| Net earnings per share of common stock                         | \$ 40,230                      | 17,536,245 | \$ 2.29          | \$ 25,140                      | 15,388,326 | \$ 1.63          |
| <b>Effect of Dilutive Securities:</b>                          |                                |            |                  |                                |            |                  |
| Options outstanding for the purchase of common stock           |                                | 179,565    |                  |                                | 137,260    |                  |
| <b>Diluted EPS:</b>  |                                |            |                  |                                |            |                  |
| Net earnings per share of common stock and assumed conversions | \$ 40,230                      | 17,715,810 | \$ 2.27          | \$ 25,140                      | 15,525,586 | \$ 1.62          |

The following table sets forth the calculation of Basic and Diluted EPS for the three months ended June 30, 2007 and 2006 (in thousands, except share and per share amounts):

|  | Three Months Ended June 30, 2007 |            |                  | Three Months Ended June 30, 2006 |            |                  |
|--|----------------------------------|------------|------------------|----------------------------------|------------|------------------|
|  | Net Income                       | Shares     | Per Share Amount | Net Income                       | Shares     | Per Share Amount |
| <b>Basic EPS:</b>  |                                  |            |                  |                                  |            |                  |
| Net earnings per share of common stock                         | \$ 25,382                        | 17,558,493 | \$ 1.45          | \$ 14,192                        | 15,396,496 | \$ 0.92          |
| <b>Effect of Dilutive Securities:</b>                          |                                  |            |                  |                                  |            |                  |
| Options outstanding for the purchase of common stock           |                                  | 169,687    |                  |                                  | 140,452    |                  |
| <b>Diluted EPS:</b>  |                                  |            |                  |                                  |            |                  |
| Net earnings per share of common stock and assumed conversions | \$ 25,382                        | 17,728,180 | \$ 1.43          | \$ 14,192                        | 15,536,948 | \$ 0.91          |

**11. Income Taxes**

We made an election to be taxed as a REIT under Section 856(c) of the Internal Revenue Code of 1986, as amended, commencing with the tax year ending December 31, 2003. As a REIT, we generally are not subject to federal income tax except for the operations of our taxable REIT subsidiary, CTIMCO. To maintain qualification as a REIT, we must distribute at least 90% of our REIT taxable income to our shareholders and meet certain other requirements. If we fail to qualify as a REIT in any taxable year, we will be subject to federal, state and local income tax on our taxable income at regular corporate rates. Under certain circumstances, federal income and excise taxes may be due on our undistributed taxable income. At June 30, 2007, we were in compliance with all REIT requirements.

**12. Shareholders Equity**

On June 15, 2007, we declared a dividend of approximately \$14.0 million, or \$0.80 per share of common stock applicable to the three-month period ended June 30, 2007, which was paid on July 13, 2007 to shareholders of record on June 30, 2007. All dividends paid during the period presented were ordinary income.

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

(unaudited)

**12. Shareholders Equity, continued**

On February 28, 2007, we declared a dividend of approximately \$14.0 million, or \$0.80 per share of common stock applicable to the three-month period ended March 31, 2007, which was paid on April 13, 2007 to shareholders of record on March 31, 2007.

**13. Employee Benefit Plans**

We had four benefit plans in effect at June 30, 2007: (1) the second amended and restated 1997 long-term incentive stock plan, or 1997 Employee Plan, (2) the amended and restated 1997 non-employee director stock plan, or 1997 Director Plan, (3) the amended and restated 2004 long-term incentive plan, or 2004 Employee Plan and (4) the 2007 long-term incentive plan, or 2007 Plan. Activity under these four plans for the six month period ended June 30, 2007 is summarized in the chart below in share and share equivalents:

| Benefit Type                    | 1997 Employee Plan | 1997 Director Plan | 2004 Employee Plan | 2007 Long Term Incentive Plan | Total          |
|---------------------------------|--------------------|--------------------|--------------------|-------------------------------|----------------|
| <b>Options(1)</b>               |                    |                    |                    |                               |                |
| Beginning Balance               | 323,457            | 76,668             |                    |                               | 400,125        |
| Granted                         |                    |                    |                    |                               |                |
| Exercised                       | (47,979 )          | (8,334 )           |                    |                               | (56,313 )      |
| Canceled                        | (1,667 )           |                    |                    |                               | (1,667 )       |
| Ending Balance                  | 273,811            | 68,334             |                    |                               | 342,145        |
| <b>Restricted Stock(2)</b>      |                    |                    |                    |                               |                |
| Beginning Balance               |                    |                    | 480,967            |                               | 480,967        |
| Granted                         |                    |                    | 23,015             |                               | 23,015         |
| Vested                          |                    |                    | (59,118 )          |                               | (59,118 )      |
| Forfeited                       |                    |                    |                    |                               |                |
| Ending Balance                  |                    |                    | 444,864            |                               | 444,864        |
| <b>Stock Units(3)</b>           |                    |                    |                    |                               |                |
| Beginning Balance               |                    | 73,848             |                    |                               | 73,848         |
| Granted                         |                    | 6,169              |                    | 3,024                         | 9,193          |
| Converted                       |                    |                    |                    |                               |                |
| Ending Balance                  |                    | 80,017             |                    | 3,024                         | 83,041         |
| <b>Total Outstanding Shares</b> | <b>273,811</b>     | <b>148,351</b>     | <b>444,864</b>     | <b>3,024</b>                  | <b>870,050</b> |

(1) All options are fully vested as of June 30, 2007.

(2) Comprised of both performance based awards that vest upon the attainment of certain common equity return thresholds and time based awards that vest based upon an employee's continued employment on vesting dates.

(3) Stock units are given to certain members of our board of directors in lieu of cash compensation for services and in lieu of dividends earned on previously granted stock units.

At our 2007 annual meeting of shareholders held on June 7, 2007, the shareholders approved the adoption of the 2007 Plan. Under the 2007 Plan, a maximum of 700,000 shares of class A common stock may be issued. Effective upon the adoption of shareholders no future awards will occur under the company's prior plans. At June 30, 2007, there were 696,976 shares available under the 2007 Plan.

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Compensation expense for stock awards is recognized on the accelerated attribution method under FASB Interpretation No. 28.

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

(unaudited)

**13. Employee Benefit Plans, continued**

The following table summarizes the outstanding options as of June 30, 2007:

| Exercise Price<br>per Share | Options<br>Outstanding |                       | Weighted Average<br>Exercise Price per Share |                       | Weighted<br>Average Remaining Life |                       |
|-----------------------------|------------------------|-----------------------|--|-----------------------|------------------------------------|-----------------------|
|                             | 1997 Employee<br>Plan  | 1997 Director<br>Plan | 1997 Employee<br>Plan                        | 1997 Director<br>Plan | 1997 Employee<br>Plan              | 1997 Director<br>Plan |
| \$10.00 - \$15.00           | 43,530                 |                       | \$ 13.40                                     | \$                    | 3.51                               |                       |
| \$15.00 - \$20.00           | 143,613                |                       | 16.43  |                       | 3.84                               |                       |
| \$20.00 - \$25.00           |                        |                       |  |                       |                                    |                       |
| \$25.00 - \$30.00           | 86,668                 | 68,334                | 28.85  | 30.00                 | 0.80                               | 0.59                  |
| Total/W. Average            | 273,811                | 68,334                | \$ 19.88                                     | \$ 30.00              | 2.83                               | 0.59                  |

In addition to the equity interests detailed above, we have granted percentage interests in the incentive compensation received by us from certain investment management vehicles that we manage. At June 30, 2007, we had granted to employees, net of forfeitures, 43% of such incentive compensation received by us from Fund III.

**14. Supplemental Disclosures for Consolidated Statements of Cash Flows**

Interest paid on our outstanding debt during the six months ended June 30, 2007 and 2006 was \$74.8 million and \$41.6 million, respectively. Income taxes recovered (paid) by us during the six months ended June 30, 2007 and 2006 were \$1.5 million and (\$197,000), respectively. Non-cash investing and financing activity of \$114.9 million during the six months ended June 30, 2007 resulted from paydowns on the loans we classify as participations sold.

At June 30, 2007, we had \$5.1 million included in deposits and other receivables which represented loans that were satisfied and repaid prior to June 30, 2007, the proceeds of which had not been remitted to us by our servicers. The reclassification from loans receivable to deposits and other receivables resulted in a non-cash investing activity.

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

(unaudited)

**15. Segment Reporting**

We have 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 all activities related to direct investment activities (including direct investments in Funds) and the financing thereof.

The Investment Management segment includes all activities related to investment management services provided to us and third party funds under management and includes our taxable REIT subsidiary, CTIMCO and its subsidiaries.

The following table details each segment's contribution to our overall profitability and the identified assets attributable to each such segment for the six months ended, and as of, June 30, 2007, respectively (in thousands):

|   | <b>Balance Sheet<br/>Investment</b> | <b>Investment<br/>Management</b> | <b>Inter-Segment<br/>Activities</b> | <b>Total</b>        |
|---|-------------------------------------|----------------------------------|-------------------------------------|---------------------|
| <b>Income from loans and other investments:</b>     |                                     |                                  |                                     |                     |
| Interest and related income                         | \$ 126,247                          | \$                               | \$                                  | \$ 126,247          |
| Less: Interest and related expenses                 | 76,293                              |                                  |                                     | 76,293              |
| Income from loans and other investments, net        | 49,954                              |                                  |                                     | 49,954              |
| <b>Other revenues:</b>                              |                                     |                                  |                                     |                     |
| Management fees                                     |                                     | 9,124                            | (7,793)                             | 1,331               |
| Incentive management fees                           |                                     | 962                              |                                     | 962                 |
| Servicing fees                                      | 112                                 |                                  |                                     | 112                 |
| Other interest income                               | 792                                 | 46                               | (256)                               | 582                 |
| Total other revenues                                | 904                                 | 10,132                           | (8,049)                             | 2,987               |
| <b>Other expenses:</b>                              |                                     |                                  |                                     |                     |
| General and administrative                          | 10,193                              | 12,244                           | (7,793)                             | 14,644              |
| Other interest expense                              |                                     | 256                              | (256)                               |                     |
| Depreciation and amortization                       | 1,264                               | 124                              |                                     | 1,388               |
| Total other expenses                                | 11,457                              | 12,624                           | (8,049)                             | 16,032              |
| Recovery of provision for losses                    | 4,000                               |                                  |                                     | 4,000               |
| <b>Income/(loss) from equity</b>                    |                                     |                                  |                                     |                     |
| Investments   | (399)                               | (534)                            |                                     | (933)               |
| Income (loss) before income taxes                   | 43,002                              | (3,026)                          |                                     | 39,976              |
| (Benefit) provision for income taxes                | (254)                               |                                  |                                     | (254)               |
| Net (loss) income allocable to class A common stock | \$ 43,256                           | \$ (3,026)                       | \$                                  | \$ 40,230           |
| <b>Total Assets</b>                                 | <b>\$ 3,161,614</b>                 | <b>\$ 37,748</b>                 | <b>\$ (10,646)</b>                  | <b>\$ 3,188,716</b> |

All revenues, except for \$4.3 million included in interest and related income, were generated from external sources within the United States. The Investment Management segment earned fees of \$7.8 million for management of the Balance Sheet Investment segment and was charged \$256,000 for inter-segment interest for the six months ended June 30, 2007 which is reflected as offsetting adjustments to other revenues and other expenses in the inter-segment activities column in the table above.



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

(unaudited)

**15. Segment Reporting, continued**

The following table details each segment's contribution to our overall profitability and the identified assets attributable to each such segment for the six months ended, and as of, June 30, 2006, respectively (in thousands):

|   | <b>Balance Sheet<br/>Investment</b> | <b>Investment<br/>Management</b> | <b>Inter-Segment<br/>Activities</b> | <b>Total</b>        |
|---|-------------------------------------|----------------------------------|-------------------------------------|---------------------|
| <b>Income from loans and other investments:</b>     |                                     |                                  |                                     |                     |
| Interest and related income                         | \$ 77,851                           | \$                               | \$                                  | \$ 77,851           |
| Less: Interest and related expenses                 | 43,536                              |                                  |                                     | 43,536              |
| Income from loans and other investments, net        | 34,315                              |                                  |                                     | 34,315              |
| <b>Other revenues:</b>                              |                                     |                                  |                                     |                     |
| Management fees                                     |                                     | 5,242                            | (4,007)                             | 1,235               |
| Incentive management fees                           |                                     | 212                              |                                     | 212                 |
| Other interest income                               | 331                                 | 20                               |                                     | 351                 |
| Total other revenues                                | 331                                 | 5,474                            | (4,007)                             | 1,798               |
| <b>Other expenses:</b>                              |                                     |                                  |                                     |                     |
| General and administrative                          | 6,440                               | 8,393                            | (4,007)                             | 10,826              |
| Depreciation and amortization                       | 2,210                               | 130                              |                                     | 2,340               |
| Total other expenses                                | 8,650                               | 8,523                            | (4,007)                             | 13,166              |
| Income/(loss) from equity investments               | 772                                 | (50)                             |                                     | 722                 |
| Income before income taxes                          | 26,768                              | (3,099)                          |                                     | 23,669              |
| (Benefit)/provision for income taxes                |                                     | (1,471)                          |                                     | (1,471)             |
| Net income (loss) allocable to class A common stock | \$ 26,768                           | \$ (1,628)                       | \$                                  | \$ 25,140           |
| <b>Total Assets</b>                                 | <b>\$ 2,168,885</b>                 | <b>\$ 7,859</b>                  | <b>\$ (1,818)</b>                   | <b>\$ 2,174,926</b> |

All revenues were generated from external sources within the United States. The Investment Management segment earned fees of \$4.0 million for management of the Balance Sheet Investment segment and \$0 for inter-segment interest for the six months ended June 30, 2006.

**ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

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

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this Form 10 Q. Historical results set forth are not necessarily indicative of our future financial position and results of operations.

**Critical Accounting Policies**

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires our management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. Our accounting policies affect our more significant judgments and estimates used in the preparation of our financial statements. Actual results could differ from these estimates. There have been no material changes to our Critical Accounting Policies described in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 28, 2007.

**Introduction**

Our business model is designed to produce a mix of net interest margin from our balance sheet investments and fee income plus co-investment income from our investment management operations with our primary goals being the generation of stable net income and dividend growth. In managing our operations, we focus on originating investments, managing our portfolios and capitalizing our businesses.

**Originations**

We allocate investment opportunities between our balance sheet and investment management vehicles based upon our assessment of risk and return profiles, the availability and cost of capital, and applicable regulatory restrictions associated with each opportunity. The combination of balance sheet and investment management capabilities allows us to maximize the scope of opportunities upon which we can capitalize. The table below summarizes our gross originations and the allocation of opportunities between our balance sheet and the investment management business for the six month period ended June 30, 2007 and the year ended December 31, 2006.

| Gross Originations(1)(2)<br>(in thousands) | Six months ended<br>June 30, 2007 | Year ended<br>December 31, 2006 |
|--|-----------------------------------|---------------------------------|
| Balance sheet                              | \$ 1,164,257                      | \$ 2,054,233                    |
| Investment management                      | 842,315                           | 65,000                          |
| Total originations                         | \$ 2,006,572                      | \$ 2,119,233                    |

(1) Includes total commitments both funded and unfunded.

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(2) Includes \$204,654 and \$237,964 of participations sold recorded on our balance sheet relating to participations that we sold to CT Large Loan for the six months ended June 30, 2007 and the year ended December 31, 2006, respectively. We have included these originations in balance sheet originations and not in investment management originations in order to not double count these originations.

On our balance sheet, our investments include CMBS, commercial real estate debt and related instruments, or Loans, and total return swaps which we collectively refer to as our Interest Earning Assets. Originations of Interest Earning Assets for our balance sheet for the six months ended June 30, 2007 and the year ended December 31, 2006 are detailed in the table below:

| Balance Sheet Originations<br>(in thousands) | Six months ended June 30, 2007 |          |                 | Year ended December 31, 2006 |          |                 |
|--|--------------------------------|----------|-----------------|------------------------------|----------|-----------------|
|  | Originations(1)                | Yield(2) | LTV / Rating(3) | Originations(1)              | Yield(2) | LTV / Rating(3) |
| CMBS   | \$ 110,621                     | 9.63%    | BB-             | \$ 394,703                   | 6.45%    | BBB-            |
| Loans(4)                                     | 1,053,636                      | 8.35%    | 69.3%           | 1,655,392                    | 9.19     | 72.1%           |
| Total return swaps                           |                                |          |                 | 4,138                        | 19.55    | N/A             |
| Total / Weighted Average                     | \$ 1,164,257                   | 8.47%    |                 | \$ 2,054,233                 | 8.62%    |                 |

(1) Includes total commitments both funded and unfunded.

(2) Yield on floating rate originations assumes LIBOR at June 30, 2007 and December 31, 2006, of 5.32% and 5.32%, respectively.

(3) Weighted average ratings are based on the lowest rating published by Fitch Ratings, Standard & Poor's or Moody's Investors Service for each security and exclude \$37.4 million of unrated equity investments in collateralized debt obligations.

(4) Includes \$204,654 and \$237,964 of participations sold recorded on our balance sheet relating to participations that we sold to CT Large Loan for the six months ended June 30, 2007 and the year ended December 31, 2006, respectively. We have included these originations in balance sheet originations and not in investment management originations in order to not double count these originations.

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The table below shows our Interest Earning Assets at June 30, 2007 and December 31, 2006. In any period, the ending balance of Interest Earning Assets will be impacted not only by new balance sheet originations, but also by repayments, advances, sales and losses, if any. As the table below shows, we grew Interest Earning Assets by \$524 million, or 20%, from year end 2006 to June 30, 2007.

| Interest Earning Assets<br>(in thousands) | June 30, 2007 |          |                 | December 31, 2006 |          |                 |
|---|---------------|----------|-----------------|-------------------|----------|-----------------|
|   | Book Value    | Yield(1) | LTV / Rating(3) | Book Value(2)     | Yield(1) | LTV / Rating(3) |
| CMBS                                      | \$ 891,367    | 7.48 %   | BB+             | \$ 810,970        | 7.17 %   | BB+             |
| Loans                                     | 2,197,529     | 8.56 %   | 69.5            | 1,751,898         | 8.96 %   | 70.4 %          |
| Total return swaps                        |               |          |                 | 1,815             | 20.55    | N/A             |
| Total / Weighted Average                  | \$ 3,088,896  | 8.25 %   |                 | \$ 2,564,683      | 8.40 %   |                 |

(1) Yield on floating rate Interest Earning Assets assumes LIBOR at June 30, 2007 and December 31, 2006, of 5.32% and 5.32%, respectively.

(2) December 31, 2006 values do not including one non performing loan that was successfully resolved in the second quarter of 2007.

(3) Weighted average ratings are based on the lowest rating published by Fitch Ratings, Standard & Poor's or Moody's Investors Service for each security and exclude \$37.4 million of unrated equity investments in collateralized debt obligations.

Some of our originations are not fully funded at closing, creating an obligation for us to make future fundings, which we refer to as Unfunded Loan Commitments. Typically, Unfunded Loan Commitments are part of construction or transitional loans and, as the proportion of such loans has increased in our portfolio, so has the amount of our Unfunded Loan Commitments. At June 30, 2007, our gross Unfunded Loan Commitments were \$277.5 million and, net of in place financing commitments from our lenders, our net Unfunded Loan Commitments were \$57.8 million.

In addition to our investments in Interest Earning Assets, we have two equity investments in unconsolidated subsidiaries as of June 30, 2007. The first is an equity co-investment in a private equity fund that we manage, CT Mezzanine Partners III, Inc., or Fund III. The second is an equity investment we made in 2006 in a Brazilian net lease commercial real estate company, Bracor Investimentos Imobiliarios Ltda., or Bracor, that we helped co-found. The table below details the carrying value of those investments, as well as their capitalized costs.

| Equity Investments<br>(in thousands) | June 30, 2007 | December 31, 2006 |
|--------------------------------------|---------------|-------------------|
| Fund II                              | \$ 1,705      | \$ 1,208          |
| Fund III                             | 9,920         | 2,929             |
| Bracor                               | 484           | 5,675             |
| Capitalized costs/other              |               | (1) 1,673 (2)     |
| Total                                | \$ 12,109     | \$ 11,485         |

(1) Includes \$292,000 and \$153,000 of capitalized costs associated with Fund III and Bracor, respectively.

(2) Includes \$1.3 million, \$368,000 and \$41,000 associated with Fund II, Fund III and Bracor, respectively.

**Asset Management**

We actively manage our balance sheet portfolio and the assets held by our investment management vehicles. While our investments are primarily in the form of debt, which generally means that we have limited influence over the operations of the collateral securing our portfolios, we are aggressive in exercising the rights afforded to us as a lender. These rights can include collateral level budget approval, lease approvals, loan covenant enforcement, escrow/reserve management/collection, collateral release approvals and other rights that we may negotiate. The table below details balance sheet Interest Earning Assets loss experience and the percentage of non-performing investments at June 30, 2007 and December 31, 2006.

| Portfolio Performance<br>(in thousands) | June 30, 2007 | December 31, 2006 |
|---|---------------|-------------------|
| Interest Earning Assets                 | \$3,088,896   | \$2,564,683       |
| Losses                                  |               |                   |
| \$ Value                                | \$0           | \$0               |
| Percentage                              | 0.0%          | 0.0%              |
| Non-performing loans(1)                 |               |                   |
| \$ Value                                | \$0           | \$2,638           |
| Percentage                              | 0.0%          | 0.1%              |

(1) At December 31, 2006, our non-performing loans were comprised of one defaulted first mortgage with an original principal balance of \$8.0 million that has since been successfully resolved.

Commencing in 2005, we put in place a proprietary risk rating system to assess and track the risk of each of our loans. There was no material change to the weighted average risk rating of the portfolio between June 30, 2007 and December 31, 2006. Based upon the changes in conditions of these loans and the evaluations completed on the remainder of the portfolio, we concluded that a reserve for possible credit losses was not warranted on any of our loans for the six months ended June 30, 2007.

We actively manage our CMBS investments using a combination of quantitative tools and loan/property level analysis in order to monitor the performance of the securities and their collateral versus our original expectations. Securities are analyzed on a monthly basis for delinquency, transfers to special servicing, and changes to the servicer's watchlist population. Realized loan losses are tracked on a monthly basis and compared to our original loss expectations. On a periodic basis, individual loans of concern are also re-underwritten. Updated collateral loss projections are then compared to our original loss expectations to determine how each investment is performing. Based on our review of the portfolio, we concluded that no impairments were warranted in the six months ended June 30, 2007.

The ratings performance of our CMBS portfolio over the six months ended June 30, 2007 and the year ended December 31, 2006 is detailed below:

| CMBS Rating Activity(1) | Six months ended<br>June 30, 2007 | Year ended<br>December 31, 2006 |
|-------------------------|-----------------------------------|---------------------------------|
| Upgrades                | 13                                | 67                              |
| Downgrades              | 2                                 | 3                               |

(1) Represents activity from any of Fitch Ratings, Standard & Poor's and/or Moody's Investors Service.



## Capitalization

Our balance sheet investment activities are capital intensive and the availability and cost of capital is a critical component of our business. We capitalize our business with a combination of debt and equity. Our debt sources, which we refer to as Interest Bearing Liabilities, currently include repurchase agreements, CDOs, a senior unsecured credit facility, and junior subordinated debentures (which we also refer to as trust preferred securities). Our equity capital is currently comprised entirely of common equity. The chart below shows our capitalization mix as of June 30, 2007 and December 31, 2006:

### Capital Structure

| (in thousands)  | June 30, 2007 | December 31, 2006 |
|---|---------------|-------------------|
| Repurchase obligations  | \$ 964,807    | \$ 704,444        |
| Collateralized debt obligations                               | 1,199,748     | 1,212,500         |
| Senior unsecured credit facility                              | 75,000        |                   |
| Junior subordinated debentures                                | 128,875       | 51,550            |
| Total Interest Bearing Liabilities                            | \$ 2,368,430  | \$ 1,968,494      |
| Cost of debt(1)   | 6.24          | % 6.15 %          |
| Shareholders' Equity  | \$ 452,089    | \$ 426,272        |
| Ratio of Interest Bearing Liabilities to Shareholders' Equity | 5.2:1         | 4.6:1             |

(1) Floating rate liabilities assume LIBOR at June 30, 2007 and December 31, 2006, of 5.32% and 5.32%, respectively.

We use leverage to enhance our returns on equity, attempting to: (i) maximize the differential between the yield of our Interest Earning Assets and the cost of our Interest Bearing Liabilities, and (ii) optimize the amount of leverage employed. The use of leverage, however, adds risk to our business, magnifying our shareholders' exposure to asset level risk by subordinating our equity interests to our debt capital providers. The level of leverage we utilize is based upon the risk associated with our assets, as well as the structure of our liabilities. In general, we will apply greater amounts of leverage to lower risk assets and vice versa. In addition, structural features of our leverage, such as recourse, mark-to-market provisions and duration, factor into the amounts of leverage we are comfortable applying to our assets. Our sources of recourse financing generally require financial covenants, including restrictions on corporate guarantees, the maintenance of certain financial ratios (such as specified debt to equity and debt service coverage ratios) as well as the maintenance of a minimum net worth. A summary of selected structural features of our debt as of June 30, 2007 and December 31, 2006 is detailed in the table below:

### Interest Bearing Liabilities

| (in thousands)                | June 30, 2007 | December 31, 2006 |
|-------------------------------|---------------|-------------------|
| Weighted average maturity (1) | 4.0 yrs.      | 4.0 yrs.          |
| % Recourse                    | 46.5 %        | 36.9 %            |
| % Mark-to-market              | 40.7 %        | 35.8 %            |

(1) Based upon balances as of June 30, 2007 and December 31, 2006.

A prominent trend in our Interest Bearing Liabilities since 2004 is the increased use of CDOs to finance our portfolio. Our CDOs are non-recourse, non-mark-to-market, index matched financings that generally carry a lower cost of debt and allow for higher levels of leverage than our other financing sources. We expect to continue to utilize CDOs to finance both our balance sheet and our investment management businesses going forward. During the first half of 2007, we did not issue any new CDOs for our balance sheet, however, we continued contributing assets to our previously issued reinvesting CDOs, which have reinvestment periods extending through July 2008 for CDO I and April 2010 for CDO II. Our CDO liabilities as of June 30, 2007 and December 31, 2006 are described below:

### Collateralized Debt Obligations

| (in thousands) | Issuance Date | Type        | June 30, 2007<br>Book Value | All in Cost | December 31, 2006<br>Book Value | All in Cost |
|----------------|---------------|-------------|-----------------------------|-------------|---------------------------------|-------------|
| CDO I(1)       | 7/20/04       | Reinvesting | \$ 252,778                  | 6.38 %      | \$ 252,778                      | 6.39 %      |
| CDO II (1)     | 3/15/05       | Reinvesting | 298,913                     | 6.03        | 298,913                         | 6.04        |
| CDO III        | 8/04/05       | Static      | 264,311                     | 5.34        | 266,754                         | 5.25        |
| CDO IV(1)      | 3/15/06       | Static      | 383,746                     | 5.81        | 394,055                         | 5.81        |
| Total          |               |             | \$ 1,199,748                | 5.89 %      | \$ 1,212,500                    | 5.86 %      |

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(1) Floating rate CDO liabilities assume LIBOR at June 30, 2007 and December 31, 2006, of 5.32% and 5.32%, respectively.

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Repurchase obligation financings provide us with an important revolving component to our liability structure. Our repurchase agreements provide stand alone financing for certain assets and interim, or warehouse financing for assets that we plan to contribute to our CDOs. At any point in time, the amounts and the cost of our repurchase borrowings are based upon the assets being financed higher risk assets will attract lower levels of leverage at higher costs and vice versa. The table below summarizes our repurchase agreement liabilities as of June 30, 2007 and December 31, 2006:

### Repurchase Agreements

| (\$ in thousands)                 | June 30, 2007 | December 31, 2006 |
|-----------------------------------|---------------|-------------------|
| Repurchase commitments            | \$ 1,600,000  | \$ 1,200,000      |
| Counterparties                    | 7             | 7                 |
| Outstanding repurchase borrowings | \$ 964,807    | \$ 704,444        |
| All in cost                       | L + 1.15      | % L + 1.21 %      |

In March 2007, we closed a \$50 million senior unsecured revolving credit facility with WestLB AG, which we amended in June 2007, increasing the size to \$100 million and adding new lenders to the syndicate. The facility has an initial term of one year (with a one year term out provision at our option) and a maximum term of four years (including extension options). The facility has a cash cost of LIBOR plus 1.50% (7.12% on an all-in effective basis) and we expect to use the facility borrowings for general corporate purposes and working capital needs, including providing additional flexibility for funding loan originations. At June 30, 2007, we had borrowed \$75 million under this facility.

The most subordinated component of our debt capital structure is junior subordinated debentures or trust preferred securities. These securities represent long term, subordinated, unsecured financing and generally carry limited operational covenants. At June 30, 2007 we had issued \$128.9 million of junior subordinated debentures in two separate issuances. Junior subordinated debentures provide us with financing at a cash cost of 7.20% and an all in effective rate of 7.30%. In March 2007, we sold \$75 million of trust preferred securities through a subsidiary, CT Preferred Trust II. These trust preferred securities have a 30 year term, maturing in April 2037, are redeemable at par on or after April 30, 2012 and pay distributions at a cash cost of 7.03% and an all-in effective rate of 7.14% for the first ten years ending April 2017, and thereafter, at a floating rate of three month LIBOR plus 2.25%.

During the first six months of 2007 we did not raise new common equity. Changes in the number of shares were due to option exercises, restricted stock grants and vesting, and stock unit grants during the period.

### Shareholders Equity

|                           | June 30, 2007 | December 31, 2006 |
|---------------------------|---------------|-------------------|
| Book value (in thousands) | \$ 452,089    | \$ 426,272        |
| Shares                    |               |                   |
| Class A common stock      | 17,064,595    | 16,932,892        |
| Restricted stock          | 444,864       | 480,967           |
| Stock units               | 83,041        | 73,848            |
| Options(1)                | 122,658       | 230,399           |
| Total                     | 17,715,158    | 17,718,106        |
| Book value per share      | \$ 25.52      | \$ 24.06          |

(1) Dilutive shares issuable upon the exercise of outstanding options assuming a June 30, 2007 stock price and the treasury stock method.

At June 30, 2007, we had 17,509,459 of our class A common stock outstanding including unearned restricted stock.

### Interest Rate Exposure

We endeavor to manage a book of assets and liabilities that are matched with respect to interest rates, financing floating rate assets with floating rate liabilities and fixed rate assets with fixed rate liabilities. In some cases, we finance fixed rate assets with floating rate liabilities and, in those cases, we generally use interest rate derivatives, such as swaps, to effectively convert the floating rate debt to fixed rate debt. In such instances, the equity we have invested in fixed rate assets is not typically swapped, leaving a portion of our equity capital exposed to changes in value of the fixed rate assets due to interest rate fluctuations. The balance of our assets earn interest at floating rates and are financed with floating rate liabilities, leaving a portion of our equity capital exposed to cash flow variability from fluctuations in rates. Generally, these assets and liabilities earn interest at rates indexed to one month LIBOR.



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The table below details our interest rate exposure as of June 30, 2007 and December 31, 2006:

### Interest Rate Exposure

| (in thousands)                                 | June 30, 2007 | December 31, 2006 |
|--|---------------|-------------------|
| <b>Value Exposure to Interest Rates(1)</b>     |               |                   |
| Fixed rate assets                              | \$ 969,621    | \$ 1,000,942      |
| Fixed rate liabilities                         | (406,072 )    | (331,434 )        |
| Interest rate swaps                            | (529,781 )    | (560,240 )        |
| Net fixed rate exposure                        | \$ 33,768     | \$ 109,268        |
| Weighted average maturity (assets)             | 7.9yrs        | 8.2yrs            |
| Weighted average coupon (assets)               | 7.13%         | 7.18%             |
| <b>Cash Flow Exposure to Interest Rates(1)</b> |               |                   |
| Floating rate assets(2)                        | \$ 2,162,581  | \$ 1,606,969      |
| Floating rate debt less cash                   | (2,266,330 )  | (1,816,476 )      |
| Interest rate swaps                            | 529,781       | 560,240           |
| Net floating rate exposure                     | \$ 426,032    | \$ 350,733        |
| <br>   |               |                   |
| Net income impact from 100 bps change in LIBOR | \$ 4,260      | \$ 3,507          |

(1) All values are in terms of face or notional amounts.

(2) December 31, 2006 values do not including one non performing loan that was successfully resolved in the second quarter of 2007.

### Other Balance Sheet Items

From time to time we originate loans for our balance sheet and sell a participation in these loans (senior, junior or pari passu) to third parties or to one or more of our investment management vehicles. In accordance with GAAP, we record these sold participations as assets (as if we owned the participation we sold) and record a matching amount as a liability under the account Participations Sold. In addition, we record interest earned on these participations sold as interest income with a matching amount recorded as interest expense. On a net basis, these participations sold have no impact to our shareholder's equity or our net income. At June 30, 2007, we had \$334.2 million of participations sold, which accrued interest at a rate of LIBOR plus 3.24% (or 8.56%).

### Investment Management Overview

In addition to our balance sheet investment activities, we act as an investment manager for third parties. The purpose of our investment management business is to leverage our platform, generating fee revenue from investing third party capital and in certain instances co-investment income. Our third party investment management mandates are designed to be complementary to our balance sheet programs and are built around opportunities that we do not pursue directly on balance sheet due to their scale/concentration, risk/return profile and/or regulatory constraints. In some instances, we co-invest in our investment management vehicles (as described below). At June 30, 2007, we managed three private equity funds and one separate account through our wholly-owned, taxable, investment management subsidiary, CT Investment Management Co., LLC, or CTIMCO.

**Investment Management Mandates**

|               | Type       | Total Equity Commitments (in millions) | Co-Investment % | Base Management Fee | Incentive Management Fee (1) |                |
|---------------|------------|--|-----------------|---------------------|------------------------------|----------------|
|               |            |  |                 |                     | Company %                    | Employee % (2) |
| Fund III      | Fund       | \$ 425                                 | 4.71%           | 1.42% (Equity)      | 57%                          | 43%            |
| CT Large Loan | Fund       | \$ 325                                 | (4)             | 0.75% (Assets) (3)  | N/A                          | N/A            |
| CT High Grade | Sep. Acct. | \$ 250                                 | 0%              | 0.25% (Assets)      | N/A                          | N/A            |
| CTX Fund      | Fund       | \$ 50                                  | (4)             | (5)                 | (5)                          | (5)            |

(1) Fund III earns incentive management fees of 20% of profit after a 10% preferred return on capital and a 100% return of capital, subject to a catch up.

(2) Portions of the Fund III incentive management fees received by us have been allocated to our employees as long term performance awards.

(3) Capped at 1.5% of equity.

(4) Capital Trust, Inc. co-invests on pari passu, asset by asset basis with CT Large Loan Fund and CTX Fund.

(5) CTIMCO serves as collateral manager of the CDOs in which the CTX Fund invests and CTIMCO earns base and incentive management fees as CDO collateral manager.

Fund III is a co-sponsored vehicle with a joint venture partner. We have a co-investment in the fund and we split incentive management fees with our partner – our partner receives 37.5% of Fund III incentive management fees. The other funds, CT Large Loan and CTX Fund, and our separate account, CT High Grade, are exclusively sponsored by us and we do not co-invest in these vehicles. The table below describes the status of our investment management vehicles as of June 30, 2007 and December 31, 2006.

**Investment Management Snapshot**

| (in thousands)              | June 30, 2007 | December 31, 2006 |
|-----------------------------|---------------|-------------------|
| <b>Fund III</b>             |               |                   |
| Assets                      | \$ 121,262    | \$ 194,818        |
| Equity                      | 23,274        | 50,223            |
| Incentive fee collected     |               |                   |
| Incentive fees projected(1) | 8,078         | 7,511             |
| Status(2)                   | Liquidating   | Liquidating       |
| <b>CT Large Loan</b>        |               |                   |
| Assets                      | \$ 254,618    | \$ 157,262        |
| Equity                      | 130,349       | 79,416            |
| Status(3)                   | Investing     | Investing         |
| <b>CT High Grade</b>        |               |                   |
| Assets                      | \$ 207,839    | \$ 64,929         |
| Equity                      | 207,839       | 64,929            |
| Status(3)                   | Investing     | Investing         |
| <b>CTX Fund</b>             |               |                   |
| Assets(4)                   | \$ 490,315    | N/A               |
| Equity                      | \$ 7,362      | N/A               |
| Status(3)                   | Investing     | N/A               |

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- (1) Assumes assets were sold and liabilities were settled on July 1, 2007 at the recorded book value, and the fund's equity and income was distributed for the respective period ends.
- (2) Fund III's investment period ended in June 2005.
- (3) CT Large Loan, CT High Grade, and CTX Fund investment periods expire in May 2008, November 2007, and April 2008, respectively.
- (4) Represents the total notional cash exposure to CTX CDO I collateral.

We expect to continue to grow our investment management business, sponsoring additional investment vehicles consistent with the theme of developing mandates that are complementary to our balance sheet activities.

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**Comparison of Results of Operations: Three Months Ended June 30, 2007 to June 30, 2006**

(in thousands, except for per share data)

|   | 2007      | 2006      | \$ Change | % Change |   |
|---|-----------|-----------|-----------|----------|---|
| <b>Income from loans and other investments:</b> |           |           |           |          |   |
| Interest and related income                     | \$ 68,797 | \$ 46,219 | \$ 22,578 | 48.9     | % |
| Less: Interest and related expenses             | 40,192    | 26,267    | 13,925    | 53.0     | % |
| Income from loans and other investments, net    | 28,605    | 19,952    | 8,653     | 43.4     | % |
| <b>Other revenues:</b>                          |           |           |           |          |   |
| Management fees                                 | 582       | 627       | (45 )     | (7.2 )   | % |
| Incentive management fees                       |           | 84        | (84 )     | N/A      |   |
| Servicing fees                                  | 45        |           | 45        | N/A      |   |
| Other   | 272       | 120       | 152       | 126.7    | % |
| Total other revenues                            | 899       | 831       | 68        | 8.2      | % |
| <b>Other expenses:</b>                          |           |           |           |          |   |
| General and administrative                      | 7,832     | 5,701     | 2,131     | 37.4     | % |
| Depreciation and amortization                   | 60        | 2,063     | (2,003 )  | (97.1 )  | % |
| Total other expenses                            | 7,892     | 7,764     | 128       | 1.6      | % |
| Recovery of provision for losses                | 4,000     |           | 4,000     | N/A      |   |
| Income/(loss) from equity investments           | (230 )    | 403       | (633 )    | (157.1 ) | % |
| (Benefit)/provision for income taxes            |           | (770 )    | 770       | N/A      |   |
| Net income                                      | \$ 25,382 | \$ 14,192 | \$ 11,190 | 78.8     | % |
| Net income per share - diluted                  | \$ 1.43   | \$ 0.91   | \$ 0.52   | 57.1     | % |
| Dividends per share                             | \$ 0.80   | \$ 0.70   | \$ 0.10   | 14.3     | % |
| Average LIBOR                                   | 5.32      | % 5.09    | % 0.23    | % 4.5    | % |

*Income from loans and other investments*

Growth in Interest Earning Assets (\$1.0 billion or 50% from June 30, 2006 to June 30, 2007) and a \$4.3 million interest payment from the successful resolution of our only non performing loan, along with a 4.5% increase in average LIBOR, drove a \$22.6 million (49%) increase in interest income between the second quarter of 2006 and the second quarter of 2007. These same factors, combined with generally higher levels of leverage, resulted in a \$13.9 million, or 53%, increase in interest expense for the same period. On a net basis, net interest margin increased by \$8.7 million, or 43%, which was the primary driver of net income growth from the second quarter of 2006 to the second quarter of 2007.

*Management fees*

Base management fees from the investment management business were flat as management fees from CT Large Loan, CT High Grade and CTX Fund offset the decrease in the base management fees from Fund II and Fund III.

*Incentive management fees*

No incentive management fees were received during the second quarter of 2007. In the second quarter of 2006, we received \$84,000 of Fund II incentive management fees.

*General and administrative expenses*

General and administrative expenses include compensation and benefits for employees, operating expenses and professional fees. Total general and administrative expenses increased 37% between the second quarter of 2006 and the second quarter of 2007, primarily as a result of higher

levels of employment costs as well as increased professional fees.

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*Depreciation and amortization*

Depreciation and amortization decreased by \$2.0 million between the second quarter of 2006 and the second quarter of 2007 due primarily to the write off of \$1.8 million of capitalized costs in the second quarter of 2006 as we expensed all of the capitalized costs relating to an investment management joint venture.

*Recovery of provision for losses*

*The \$4.0 million recovery recorded in the second quarter of 2007 related to the successful resolution of our only non performing loan. We received net proceeds of \$10.9 million that resulted in the following: a) reduced the carrying value of the loan from \$2.6 million to zero b) recorded a \$4.0 million recovery of a provision for losses and c) recorded \$4.3 million of interest income.*

*Income/(loss) from equity investments*

The loss from equity investments in the second quarter of 2007 resulted primarily from a net loss of \$325,000 at Bracor, representing our share of operating losses for the period from January 1, 2007 through March 31, 2007 (we report Bracor's operating results on a one fiscal quarter lag). During the second quarter of 2006, income from equity investments was primarily comprised of co-investment income from Fund II and Fund III.

*Income taxes*

We did not pay any taxes at the REIT level in either second quarter 2006 or 2007. However, CTIMCO, our investment management subsidiary, is a taxable REIT subsidiary and subject to taxes on its earnings. In the second quarter of 2007, CTIMCO recorded an operating loss before income taxes of \$1.5 million, resulting in an income tax benefit which was fully reserved. In the second quarter of 2006, CTIMCO recorded an operating loss before income taxes of \$1.6 million, which resulted in an income tax benefit of \$770,000, which we recorded.

*Net income*

Net income grew by \$11.2 million or 79% from the second quarter of 2006 to the second quarter of 2007, based in large part upon increased net interest income generated by a higher level of Interest Earning Assets and \$8.3 million of income from the successful resolution of our only non performing loan. On a diluted per share basis, net income was \$1.43 and \$0.91 in the second quarter of 2007 and 2006, respectively, representing an increase of 57%.

*Dividends*

Our second quarter 2007 and 2006 dividends were \$0.80 and \$0.70 per share, respectively. The increase of \$0.10 per share (14%) was driven by growth in our recurring income from operations.



**Comparison of Results of Operations: Six Months Ended June 30, 2007 to June 30, 2006** (in thousands, except for per share data)

|   | 2007       | 2006      | \$ Change | % Change |    |
|---|------------|-----------|-----------|----------|----|
| <b>Income from loans and other investments:</b> |            |           |           |          |    |
| Interest and related income                     | \$ 126,247 | \$ 77,851 | \$ 48,396 | 62.2     | %  |
| Less: Interest and related expenses             | 76,293     | 43,536    | 32,757    | 75.2     | %  |
| Income from loans and other investments, net    | 49,954     | 34,315    | 15,639    | 45.6     | %  |
| <b>Other revenues:</b>                          |            |           |           |          |    |
| Management fees                                 | 1,331      | 1,235     | 96        | 7.8      | %  |
| Incentive management fees                       | 962        | 212       | 750       | 353.8    | %  |
| Servicing fees                                  | 112        |           | 112       | N/A      |    |
| Other   | 582        | 351       | 231       | 65.8     | %  |
| Total other revenues                            | 2,987      | 1,798     | 1,189     | 66.1     | %  |
| <b>Other expenses:</b>                          |            |           |           |          |    |
| General and administrative                      | 14,644     | 10,826    | 3,818     | 35.3     | %  |
| Depreciation and amortization                   | 1,388      | 2,340     | (952)     | (40.7)   | %  |
| Total other expenses                            | 16,032     | 13,166    | 2,866     | 21.8     | %  |
| Recovery of provision for losses                | 4,000      |           | 4,000     | N/A      |    |
| Income (loss) from equity investments           | (933)      | ) 722     | (1,655)   | (229.2)  | )% |
| (Benefit) provision for income taxes            | (254)      | ) (1,471) | ) 1,217   | (82.7)   | )% |
| Net income                                      | \$ 40,230  | \$ 25,140 | \$ 15,090 | 60.0     | %  |
| Net income per share - diluted                  | \$ 2.27    | \$ 1.62   | \$ 0.65   | 40.1     | %  |
| Dividends per share                             | \$ 1.60    | \$ 1.30   | \$ 0.30   | 23.1     | %  |
| Average LIBOR                                   | 5.32       | % 4.85    | % 0.47    | % 9.7    | %  |

*Income from loans and other investments*

Growth in Interest Earning Assets (\$1.0 billion or 50% from June 30, 2006 to June 30, 2007) and an \$4.3 million interest payment from the successful resolution of our only non performing loan, along with a 9.7% increase in average LIBOR, drove a \$48.4 million (62%) increase in interest income between 2006 and 2007. These same factors, combined with generally higher levels of leverage, resulted in an \$32.8 million, or 75%, increase in interest expense for the same period. On a net basis, net interest margin increased by \$15.6 million, or 46%, which was the primary driver of net income growth.

*Management fees*

Base management fees from the investment management business increased as management fees from CT Large Loan, CT High Grade, and CTX Fund offset the decrease in the base management fees from Fund II and Fund III. Fund II paid its final base management fee to us during the first quarter of 2007.

*Incentive management fees*

We received a final incentive management fee distribution from Fund II of \$962,000 in March 2007 as the fund's last investment repaid and the fund was liquidated. In 2006, we received \$212,000 of Fund II incentive management fees.

*General and administrative expenses*

General and administrative expenses include compensation and benefits for employees, operating expenses and professional fees. Total general and administrative expenses increased 35% between the six months ended June 30, 2006 and the six months ended June 30, 2007, primarily as a

result of higher levels of employment costs as well as increased professional fees.

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*Depreciation and amortization*

Depreciation and amortization decreased by \$952,000 between the six months ended June 30, 2006 and the six months ended June 30, 2007 due primarily to the write off of \$1.8 million of capitalized costs in the second quarter of 2006 as we expensed all of the capitalized costs relating to an investment management joint venture. This was partially offset by the write off of \$1.3 million of capitalized costs related to the liquidation of Fund II in the first quarter of 2007.

*Recovery of provision for losses*

The \$4.0 million recovery recorded in the second quarter of 2007 related to the successful resolution of our only non performing loan. We received net proceeds of \$10.9 million that resulted in the following: a) reduced the carrying value of the loan from \$2.6 million to zero b) recorded a \$4.0 million recovery of a provision for losses and c) recorded \$4.3 million of interest income.

*Income/(loss) from equity investments*

The loss from equity investments in the six months ended June 30, 2007 resulted primarily from the amortization of \$384,000 of capitalized costs passed through to us from the general partner of Fund II and a net loss of \$484,000 at Bracor, representing our share of operating losses for the period from October 1, 2006 through March 31, 2007 (we report Bracor's operating results on a one fiscal quarter lag). During the six months ended June 30, 2006, income from equity investments was primarily comprised of co-investment income from Fund II and Fund III.

*Income taxes*

The \$254,000 tax benefit recorded for the six months ended June 30, 2007 was a result of the reversal of a tax liability reserve at Capital Trust, Inc. We did not pay any taxes at the REIT level in either the six months ended June 30, 2006 or 2007. However, CTIMCO, our investment management subsidiary, is a taxable REIT subsidiary and subject to taxes on its earnings. In the six months ended June 30, 2007, CTIMCO recorded an operating loss before income taxes of \$3.0 million, resulting in an income tax benefit which was fully reserved. In the six months ended June 30, 2006, CTIMCO recorded an operating loss before income taxes of \$3.1 million, which resulted in an income tax benefit of \$1.4 million, which we recorded.

*Net income*

Net income grew by \$15.1 million or 60% from the six months ended June 30, 2006 to the six months ended June 30, 2007, based in large part upon increased net interest income generated by a higher level of Interest Earning Assets and \$8.3 million of income from the successful resolution of our only non performing loan. On a diluted per share basis, net income was \$2.27 and \$1.62 in the six months ended June 30, 2007 and 2006, respectively, representing an increase of 40%.

*Dividends*

Our dividends declared for the six months ended June 30, 2007 and 2006 were \$1.60 and \$1.30 per share, respectively. The increase of \$0.30 or 23% was driven by growth in our recurring income from operations.

**Liquidity and Capital Resources**

We expect to continue to use a significant amount of our available capital resources to originate or purchase new loans and investments for our balance sheet. We intend to continue to employ leverage on our balance sheet to enhance our return on equity. At June 30, 2007, our net liquidity was as follows:

| Net Liquidity<br>(\$ in thousands) | June 30, 2007 |
|------------------------------------|---------------|
| Available cash                     | \$ 24,479     |
| Available borrowings               | 160,905       |
| Net unfunded commitments           | (57,775 )     |
| Net liquidity                      | \$ 127,609    |

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At June 30, 2007, we had \$24.5 million in cash, \$3.8 million in restricted cash and \$135.9 million of immediately available liquidity from our repurchase agreements (\$128.8 million from master repurchase agreements and \$7.1 million from asset specific repurchase agreements) and \$25 million from our senior unsecured credit facility. Our

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primary sources of liquidity during the next 12 months are expected to be cash on hand, cash generated from operations, principal and interest payments received on loans and investments, additional borrowings under our repurchase agreements and senior unsecured credit facility, and funds raised through CDO issuances, stock offerings, junior subordinated debenture issuances and other capital raising activities. We believe these sources of capital will be adequate to meet both short term and long term cash requirements.

We experienced a net decrease in cash of \$1.7 million for the six months ended June 30, 2007, compared to a net decrease of \$14.7 million for the six months ended June 30, 2006. Cash provided by operating activities during the six months ended June 30, 2007 was \$48.7 million, compared to cash provided by operating activities of \$31.5 million during the same period of 2006. The change was primarily due to increased net interest income due to our increased investment originations. For the six months ended June 30, 2007, cash used in investing activities was \$648.8 million, compared to \$619.4 million during the same period in 2006. The change was primarily due to our receiving \$276.9 million more in principal repayments during the six months ended June 30, 2007 compared to the six months ended June 30, 2006, as well as originating \$298.7 million more in Interest Earning Assets. For the six months ended June 30, 2007, cash provided by financing activities was \$598.4 million, compared to \$573.2 million during the same period in 2006. The change was primarily due to our net borrowing activity on repurchase obligations and the proceeds in March 2006 from the issuance of CDO IV, and activity on other debt.

At June 30, 2007, under our repurchase agreements, we had pledged assets that enable us to borrow an additional \$135.9 million. We had \$643.4 million of credit available for the financing of new and existing unpledged assets pursuant to these sources of financing. Furthermore, at June 30, 2007, we had \$25 million of liquidity available under our senior unsecured credit facility. At June 30, 2007, we had outstanding borrowings under our CDOs of \$1.2 billion and outstanding repurchase obligations totaling \$964.8 million. The terms of these agreements are described in Note 7 of the consolidated financial statements. Additional liquidity will be generated when assets that are currently pledged under repurchase obligations are contributed to our CDOs. CDOs generally have higher borrowing advance rates than corresponding repurchase obligations. At June 30, 2007, we had additional liquidity of \$3.8 million in our CDOs in the form of restricted cash.

#### **Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements.

#### **Impact of Inflation**

Our operating results depend in part on the difference between the interest income earned on our interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities. Changes in the general level of interest rates prevailing in the economy in response to changes in the rate of inflation or otherwise can affect our income by affecting the spread between our interest-earning assets and interest-bearing liabilities, as well as, among other things, the value of our interest-earning assets and our ability to realize gains from the sale of assets and the average life of our interest-earning assets. Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations, and other factors beyond our control. We employ the use of correlated hedging strategies to limit the effects of changes in interest rates on our operations, including engaging in interest rate swaps and interest rate caps to minimize our exposure to changes in interest rates. There can be no assurance that we will be able to adequately protect against the foregoing risks or that we will ultimately realize an economic benefit from any hedging contract into which we enter.

#### **Note on Forward-Looking Statements**

Except for historical information contained herein, this quarterly report on Form 10-Q contains forward-looking statements within the meaning of the Section 21E of the Securities and Exchange Act of 1934, as amended, which involve certain risks and uncertainties. Forward-looking statements are included with respect to, among other things, our current business plan, business and investment strategy and portfolio management. These forward-looking statements are identified by their use of such terms and phrases as intends, intend, intended, goal, estimate, estimates, expects, expect, expected, project, projected, projections, plans, anticipates, anticipated, should, designed to, believe, believes and scheduled and similar expressions. Our actual results or outcomes may differ materially from those anticipated. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statement was made. We assume no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Important factors that we believe might cause actual results to differ from any results expressed or implied by these forward-looking statements are discussed in the cautionary statements contained in Exhibit 99.1 to this Form 10-Q, which are incorporated herein by reference. In assessing forward-looking statements contained herein, readers are urged to read carefully all cautionary statements contained in this Form 10-Q.

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**ITEM 3. Quantitative and Qualitative Disclosures About Market Risk**

The principal objective of our asset/liability management activities is to maximize net interest income, while managing levels of interest rate risk. Net interest income and interest expense are subject to the risk of interest rate fluctuations. In certain instances, to mitigate the impact of fluctuations in interest rates, we use interest rate swaps to effectively convert variable rate liabilities to fixed rate liabilities for proper matching with fixed rate assets. The swap agreements are generally held-to-maturity and we do not use interest rate derivative financial instruments for trading purposes. The differential to be paid or received on these agreements is recognized as an adjustment to the interest expense related to debt and is recognized on the accrual basis.

Our loans and investments, including our fund investments, are also subject to credit risk. The ultimate performance and value of our loans and investments depends upon the owner's ability to operate the properties that serve as our collateral so that they produce cash flows adequate to pay interest and principal due us. To monitor this risk, our asset management team continuously reviews the investment portfolio and in certain instances is in constant contact with our borrowers, monitoring performance of the collateral and enforcing our rights as necessary.

The following table provides information about our financial instruments that are sensitive to changes in interest rates at June 30, 2007. For financial assets and debt obligations, the table presents cash flows (in certain cases, face adjusted for expected losses) to the expected maturity and weighted average interest rates based upon the current carrying values of the remaining assets and liabilities. For interest rate swaps, the table presents notional amounts and weighted average fixed pay and variable receive interest rates by contractual maturity dates. Notional amounts are used to calculate the contractual cash flows to be exchanged under the contract. Weighted average variable rates are based on rates in effect as of the reporting date.

|                                  | Expected Maturity Dates |            |            |            |            |            | Total      | Fair Value   |
|----------------------------------|-------------------------|------------|------------|------------|------------|------------|------------|--------------|
|                                  | 2007                    | 2008       | 2009       | 2010       | 2011       | Thereafter |            |              |
|                                  | (dollars in thousands)  |            |            |            |            |            |            |              |
| <b>Assets:</b>                   |                         |            |            |            |            |            |            |              |
| CMBS                             |                         |            |            |            |            |            |            |              |
| Fixed Rate                       | \$ 7,706                | \$ 47,494  | \$ 7,026   | \$ 17,639  | \$ 76,233  | \$ 578,526 | \$ 734,624 | \$ 705,928   |
| Average interest rate            | 6.68                    | % 6.68     | % 6.69     | % 6.68     | % 6.64     | % 6.45     | % 6.49     | %            |
| Variable Rate                    | \$ 10,270               | \$ 25,501  | \$ 33,053  | \$ 86,961  |            | \$ 19,945  | \$ 175,730 | \$ 174,469   |
| Average interest rate            | 8.86                    | % 9.10     | % 9.55     | % 10.72    | %          | 11.70      | % 10.27    | %            |
| Loans receivable                 |                         |            |            |            |            |            |            |              |
| Fixed Rate                       | \$ 8,397                | \$ 61,468  | \$ 17,967  | \$ 1,997   | \$ 24,864  | \$ 99,618  | 214,311    | \$ 215,073   |
| Average interest rate            | 8.61                    | % 8.15     | % 7.67     | % 7.56     | % 7.48     | % 7.36     | % 7.68     | %            |
| Variable Rate                    | \$ 174,528              | \$ 992,594 | \$ 532,587 | \$ 92,970  | \$ 10,357  | \$ 183,588 | 1,986,624  | \$ 1,987,431 |
| Average interest rate            | 8.35                    | % 8.24     | % 8.91     | % 9.14     | % 9.17     | % 8.12     | % 8.47     | %            |
| Total return swaps               |                         |            |            |            |            |            |            |              |
| Variable Rate                    |                         |            |            |            |            |            |            |              |
| Average interest rate            |                         |            |            |            |            |            |            |              |
| Interest rate swaps              |                         |            |            |            |            |            |            |              |
| Notional amounts                 | \$ 16,738               | \$ 41,825  | \$ 49,553  | \$ 14,280  | \$ 50,023  | \$ 357,362 | \$ 529,781 | \$ 10,531    |
| Average fixed pay rate           | 4.84                    | % 5.08     | % 4.77     | % 5.04     | % 4.66     | % 5.04     | % 4.98     | %            |
| Average variable receive rate    | 5.32                    | % 5.32     | % 5.32     | % 5.32     | % 5.32     | % 5.32     | % 5.32     | %            |
| <b>Liabilities:</b>              |                         |            |            |            |            |            |            |              |
| Repurchase obligations           |                         |            |            |            |            |            |            |              |
| Variable Rate                    | \$ 351,524              | \$ 344,336 | \$ 247,697 | \$ 21,250  |            |            | \$ 964,807 | \$ 964,807   |
| Average interest rate            | 6.02                    | % 6.26     | % 6.55     | % 6.32     | %          |            | 6.25       | %            |
| CDOs                             |                         |            |            |            |            |            |            |              |
| Fixed Rate                       | \$ 8,120                | \$ 5,030   | \$ 4,396   | \$ 2,603   | \$ 38,609  | \$ 218,439 | \$ 277,197 | \$ 265,064   |
| Average interest rate            | 5.18                    | % 5.65     | % 5.69     | % 5.28     | % 5.10     | % 5.33     | % 5.31     | %            |
| Variable Rate                    | \$ 15,885               | \$ 121,226 | \$ 201,423 | \$ 151,803 | \$ 191,314 | \$ 238,895 | \$ 920,546 | \$ 912,674   |
| Average interest rate            | 5.69                    | % 5.66     | % 5.94     | % 5.72     | % 5.91     | % 5.78     | % 5.81     | %            |
| Senior unsecured credit facility |                         |            |            |            |            |            |            |              |
| Variable Rate                    |                         | \$ 75,000  |            |            |            |            | \$ 75,000  | \$ 75,000    |
| Average interest rate            |                         | 6.82       | %          |            |            |            | 6.82       | %            |
| Junior Subordinated Debentures   |                         |            |            |            |            |            |            |              |

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|                       |            |            |            |
|-----------------------|------------|------------|------------|
| Fixed Rate            | \$ 128,875 | \$ 128,875 | \$ 122,528 |
| Average interest rate | 7.20       | % 7.20     | %          |

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#### **ITEM 4. Controls and Procedures**

##### **Evaluation of Disclosure Controls and Procedures**

An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this quarterly report was made under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer. Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (a) are effective to ensure that information required to be disclosed by us in reports filed or submitted under the Securities Exchange Act is timely recorded, processed, summarized and reported and (b) include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in reports filed or submitted under the Securities Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

##### **Changes in Internal Controls**

There have been no significant changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act) that occurred during the period covered by this quarterly report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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## PART II. OTHER INFORMATION

ITEM 1: **Legal Proceedings**

None

ITEM 1A: **Risk Factors**

There have been no material changes to the risk factors previously disclosed in Item 1A of our annual report on Form 10-K for the year ended December 31, 2006, filed on February 28, 2007 with the Securities and Exchange Commission.

ITEM 2: **Unregistered Sales of Equity Securities and Use of Proceeds**

In connection with our purchase on June 15, 2007 of certain assets from PRN Marshall Capital, LLC ( PRNM ), The Survey Companies, LLC ( Survey ), and together with PRNM, the Company Sellers ), Richard J. Brockman and Lawrence D. Katz, among other things, we issued an aggregate of 16,275 shares of our class A common stock to the Company Sellers who subsequently transferred such shares to various owners of the Company Sellers (the Stock Issuance ). The Stock Issuance and subsequent transfers were exempt from registration in reliance on Sections 4(2) and 4(1) of the Securities Act of 1933, as amended, respectively.

ITEM 3: **Defaults Upon Senior Securities**

None

ITEM 4: **Submission of Matters to a Vote of Security Holders**

At the 2007 annual meeting of our shareholders held on June 7, 2007, shareholders considered and voted upon:

1. A proposal to elect nine directors (identified in the table below) to serve until the next annual meeting of shareholders and until such directors' successors are duly elected and qualify ( Proposal 1 );
2. A proposal to approve and adopt our 2007 long-term incentive plan ( Proposal 2 ); and
3. A proposal to ratify the appointment of Ernst & Young LLP as our independent auditors for the fiscal year ending December 31, 2007 ( Proposal 3 ).

The following table sets forth the number of votes in favor, the number of votes opposed, the number of abstentions (or votes withheld in the case of the election of directors) and broker non-votes with respect to each of the foregoing proposals.

| Proposal            | Votes in Favor    | Votes Opposed    | Abstentions (Withheld) | Broker Non-Votes |
|---------------------|-------------------|------------------|------------------------|------------------|
| <b>Proposal 1</b>   |                   |                  |                        |                  |
| Samuel Zell         | 15,448,914        |                  | 533,223                |                  |
| Thomas E. Dobrowski | 15,673,179        |                  | 308,958                |                  |
| Martin L. Edelman   | 13,266,179        |                  | 2,715,958              |                  |
| Craig M. Hatkoff    | 15,561,044        |                  | 421,093                |                  |
| Edward S. Hyman     | 15,674,519        |                  | 307,618                |                  |
| John R. Klopp       | 15,606,411        |                  | 375,726                |                  |
| Henry N. Nassau     | 15,674,825        |                  | 307,312                |                  |
| Joshua A. Polan     | 15,617,455        |                  | 364,682                |                  |
| Lynne B. Sagalyn    | 15,674,230        |                  | 307,907                |                  |
| <b>Proposal 2</b>   | <b>10,751,361</b> | <b>2,760,519</b> | <b>683,898</b>         | <b>1,786,359</b> |
| <b>Proposal 3</b>   | <b>15,520,294</b> | <b>444,297</b>   | <b>17,544</b>          |                  |

ITEM 5: **Other Information**

On November 9, 2006, we commenced our CT High Grade Mezzanine<sup>SM</sup> investment management initiative and entered into three separate account agreements with affiliates of W. R. Berkley Corporation, or WRBC, for an aggregate of \$250 million. On July 25, 2007, we amended the agreements to increase the aggregate commitment of the WRBC affiliates to \$350 million. Pursuant to these agreements, we invest, on a discretionary basis, capital on behalf of WRBC in low risk commercial real estate mortgages, mezzanine loans and participations therein. WRBC beneficially owns approximately 14.2% of our outstanding class A common stock as of July 29, 2007 and a member of our board of directors is an employee of WRBC. The separate accounts are entirely funded with committed capital from WRBC and are managed by a subsidiary of our wholly-owned investment management subsidiary, CT Investment Management Co. LLC, or CTIMCO. Each separate account has a one-year investment period with extension provisions. CTIMCO will earn a management fee equal to 0.25% per annum on invested assets.

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ITEM 6:

**Exhibits**

- 10.1 First Amendment to Credit Agreement, dated as of June 1, 2007, by and among Capital Trust, Inc., the lenders identified therein and WestLB AG, New York Branch.
- + 10.2 Capital Trust, Inc. 2007 Long-Term Incentive Plan (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 1-14788) filed on June 12, 2007 and incorporated herein by reference).
- 31.1 Certification of John R. Klopp, Chief Executive Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Geoffrey G. Jarvis, Chief Financial Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of John R. Klopp, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Geoffrey G. Jarvis, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99.1 Risk Factors

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- Filed herewith

- + Represents a management contract or compensatory plan or arrangement

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CAPITAL TRUST, INC.

July 31, 2007  
Date

/s/ John R. Klopp  
John R. Klopp  
Chief Executive Officer

July 31, 2007  
Date

/s/ Geoffrey G. Jervis  
Geoffrey G. Jervis  
Chief Financial Officer

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