

CAPITAL TRUST INC
Form 10-Q
November 14, 2012

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 September 30, 2012

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)

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

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

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

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

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Large accelerated filer
Non-accelerated filer (Do not check if a smaller
reporting company)

Accelerated filer
Smaller Reporting
Company

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 November 9, 2012 was 24,205,573.

CAPITAL TRUST, INC.
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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

Capital Trust, Inc. and Subsidiaries
 Consolidated Balance Sheets
 September 30, 2012 and December 31, 2011
 (in thousands, except per share data)

	September 30, 2012 (unaudited)	December 31, 2011
Assets		
Cash and cash equivalents	\$38,867	\$34,818
Loans receivable, net	—	19,282
Equity investments in unconsolidated subsidiaries	18,710	10,399
Deferred income taxes	3,094	1,268
Prepaid expenses and other assets	2,096	4,533
Subtotal	62,767	70,300
Assets of Consolidated Entities		
CT Legacy REIT		
Restricted cash	16,145	12,985
Securities held-to-maturity	—	2,602
Loans receivable, net	—	206,514
Loans held-for-sale, net	—	30,875
Investment in CT Legacy Asset, at fair value	100,100	—
Accrued interest receivable and other assets	—	2,119
Subtotal	116,245	255,095
Securitization Vehicles		
Securities held-to-maturity	154,848	358,972
Loans receivable, net	214,457	612,598
Real estate held-for-sale	—	10,342
Accrued interest receivable and other assets	32,880	59,009
Subtotal	402,185	1,040,921
Total assets	\$581,197	\$1,366,316

See accompanying notes to consolidated financial statements.

Capital Trust, Inc. and Subsidiaries
Consolidated Balance Sheets
September 30, 2012 and December 31, 2011
(in thousands, except per share data)

	September 30, 2012 (unaudited)	December 31, 2011
Liabilities & Equity (Deficit)		
Liabilities:		
Accounts payable, accrued expenses and other liabilities	\$17,834	\$8,075
Secured notes	8,326	7,847
Participations sold	—	19,282
Subtotal	26,160	35,204
Non-Recourse Liabilities of Consolidated Entities		
CT Legacy REIT		
Accounts payable, accrued expenses and other liabilities	—	743
Repurchase obligations	—	58,464
Mezzanine loan, net of unamortized discount	—	55,111
Participations sold	—	97,465
Interest rate hedge liabilities	—	8,817
Subtotal	—	220,600
Securitization Vehicles		
Accounts payable, accrued expenses and other liabilities	559	3,102
Securitized debt obligations	497,423	1,211,407
Interest rate hedge liabilities	19,089	24,942
Subtotal	517,071	1,239,451
Total liabilities	543,231	1,495,255
Commitments and contingencies	—	—
Equity (Deficit):		
Class A common stock, \$0.01 par value, 100,000 shares authorized, 21,979 and 21,967 shares issued and outstanding as of September 30, 2012 and December 31, 2011, respectively ("class A common stock")	220	220
Restricted class A common stock, \$0.01 par value, 537 and 244 shares issued and outstanding as of September 30, 2012 and December 31, 2011, respectively ("restricted class A common stock" and together with	5	2

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class A common stock, "common stock")

Additional paid-in capital	597,866	597,049
Accumulated other comprehensive loss	(31,374)	(40,584)
Accumulated deficit	(591,276)	(667,111)
Total Capital Trust, Inc. shareholders' deficit	(24,559)	(110,424)
Noncontrolling interests	62,525	(18,515)
Total equity (deficit)	37,966	(128,939)
Total liabilities and equity (deficit)	\$581,197	\$1,366,316

See accompanying notes to consolidated financial statements.

Capital Trust, Inc. and Subsidiaries
Consolidated Statements of Operations
Three and Nine Months Ended September 30, 2012 and
2011
(in thousands, except share and per share data)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Income from loans and other investments:				
Interest and related income	\$6,944	\$25,642	\$28,423	\$95,187
Less: Interest and related expenses	5,147	21,838	33,902	80,381
Income from loans and other investments, net	1,797	3,804	(5,479)	14,806
Other revenues:				
Management fees from affiliates	1,546	1,753	4,741	4,927
Servicing fees	2,206	1,460	5,591	2,208
Total other revenues	3,752	3,213	10,332	7,135
Other expenses:				
General and administrative	7,141	4,941	16,193	19,868
Total other expenses	7,141	4,941	16,193	19,868
Total other-than-temporary impairments of securities	—	(30,687)	—	(35,620)
Portion of other-than-temporary impairments of securities recognized in other comprehensive income	—	173	(160)	(3,098)
Impairment of real estate held-for-sale	—	(1,055)	—	(1,055)
Net impairments recognized in earnings	—	(31,569)	(160)	(39,773)
Recovery of provision for loan losses	2,811	17,152	2,819	34,401
Valuation allowance on loans held-for-sale	—	—	—	(224)
Gain on extinguishment of debt	—	20,054	—	271,031
Fair value adjustment on investment in CT Legacy Asset	11,987	—	19,645	—
Gain on deconsolidation of subsidiary	—	—	146,380	—
Income from equity investments in unconsolidated subsidiaries	411	307	1,312	2,105
Income before income taxes	13,617	8,020	158,656	269,613
Income tax provision (benefit)	717	(236)	1,783	1,214
Net income	\$12,900	\$8,256	\$156,873	\$268,399
Net (income) loss attributable to noncontrolling interests	(5,901)	5,466	(81,038)	(1,935)
Net income attributable to Capital Trust, Inc.	\$6,999	\$13,722	\$75,835	\$266,464
Per share information:				
Net income per share of common stock:				
Basic	\$0.30	\$0.60	\$3.30	\$11.77
Diluted	\$0.28	\$0.57	\$3.10	\$11.08

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Weighted average shares of common stock outstanding:

Basic	23,173,426	22,730,080	22,969,103	22,630,672
Diluted	24,616,026	24,121,973	24,442,061	24,057,374

See accompanying notes to consolidated financial statements.

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Capital Trust, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income
Three and Nine Months Ended September 30, 2012 and
2011
(in thousands)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income	\$12,900	\$8,256	\$156,873	\$268,399
Other comprehensive income (loss):				
Unrealized gain (loss) on derivative financial instruments	2,103	(633)	5,853	2,912
Gain on interest rate swaps no longer designated as cash flow hedges	—	1,246	2,481	4,447
Amortization of unrealized gains and losses on securities	(4)	413	(770)	(93)
Amortization of deferred gains and losses on settlement of swaps	—	(28)	(56)	(75)
Other-than-temporary impairments of securities related to fair value adjustments in excess of expected credit losses, net of amortization	206	270	419	4,236
Other comprehensive income	2,305	1,268	7,927	11,427
Comprehensive income	\$15,205	\$9,524	\$164,800	\$279,826
Comprehensive (income) loss attributable to noncontrolling interests	(5,901)	5,466	(81,048)	(1,935)
Comprehensive income attributable to Capital Trust, Inc.	\$9,304	\$14,990	\$83,752	\$277,891

See accompanying notes to consolidated financial statements.

Capital Trust, Inc. and Subsidiaries
Consolidated Statements of Changes in Equity (Deficit)
For the Nine Months Ended September 30, 2012 and 2011
(in thousands)
(unaudited)

	Restricted Class A Common Stock	Class A Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Capital Trust, Inc. Shareholder Deficit	Noncontrolling Interests
Balance at January 1, 2011	\$219	\$—	\$559,411	(\$50,462)	(\$920,355)	(\$411,187)	\$—
Net income	—	—	—	—	266,464	266,464	1,935
Other comprehensive income	—	—	—	11,427	—	11,427	—
Allocation to noncontrolling interests	—	—	37,156	—	—	37,156	(12,623)
Purchase of noncontrolling interests	—	—	(142)	—	—	(142)	—
Consolidation of additional securitization vehicles	—	—	—	538	(4,898)	(4,360)	—
Restricted class A common stock earned, net of shares deferred	1	2	324	—	—	327	—
Deferred directors' compensation	—	—	150	—	—	150	—
Balance at September 30, 2011	\$220	\$2	\$596,899	(\$38,497)	(\$658,789)	(\$100,165)	(\$10,688)
Balance at January 1, 2012	\$220	\$2	\$597,049	(\$40,584)	(\$667,111)	(\$110,424)	(\$18,515)
Net income	—	—	—	—	75,835	75,835	81,038
Other comprehensive income	—	—	—	7,917	—	7,917	10
Deconsolidation of CT Legacy Asset	—	—	—	1,293	—	1,293	—
Distributions to noncontrolling interests	—	—	—	—	—	—	(8)
Restricted class A common stock earned, net of shares deferred	—	3	648	—	—	651	—
Deferred directors' compensation	—	—	169	—	—	169	—
Balance at September 30, 2012	\$220	\$5	\$597,866	(\$31,374)	(\$591,276)	(\$24,559)	\$62,525

See accompanying notes to consolidated financial statements.

Capital Trust, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
For the Nine Months Ended September 30, 2012 and
2011
(in thousands)
(unaudited)

	2012	2011
Cash flows from operating activities:		
Net income	\$156,873	\$268,399
Adjustments to reconcile net income to net cash provided by operating activities:		
Net impairments recognized in earnings	160	39,773
Recovery of provision for loan losses	(2,819)	(34,401)
Valuation allowance on loans held-for-sale	—	224
Gain on extinguishment of debt	—	(271,031)
Gain on deconsolidation of CT Legacy Asset	(146,380)	—
Fair value adjustment on CT Legacy Asset	(19,645)	—
Income from equity investments in unconsolidated subsidiaries	(1,312)	(2,105)
Distributions of income from unconsolidated subsidiaries	1,933	—
Employee stock-based compensation	675	411
Incentive awards plan expense	944	3,395
Deferred directors' compensation	169	150
Distributions from CT Legacy Asset	9,221	—
Amortization of premiums/discounts on loans and securities and deferred interest on loans	(669)	(969)
Amortization of deferred gains and losses on settlement of swaps	(56)	(75)
Amortization of deferred financing costs and premiums/discounts on debt obligations	10,747	9,304
Loss on interest rate swaps not designated as cash flow hedges	2,772	6,255
Changes in assets and liabilities, net:		
Accrued interest receivable	(4,765)	3,406
Deferred income taxes	(1,826)	(1,093)
Prepaid expenses and other assets	2,764	624
Accounts payable and accrued expenses	2,812	(2,931)
Net cash provided by operating activities	11,598	19,336
Cash flows from investing activities:		
Principal collections and proceeds from securities	40,344	70,929
Distributions from equity investments	—	4,345
Principal collections of loans receivable	91,889	1,879,041
Proceeds from disposition of loans	—	5,750
Contributions to unconsolidated subsidiaries	(4,030)	(3,413)
Distributions from unconsolidated subsidiaries	1,006	3,839
Increase in restricted cash	(3,160)	(13,715)
Net cash provided by investing activities	126,049	1,946,776
Cash flows from financing activities:		
Borrowings under repurchase obligations	123,977	—

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Repayments under repurchase obligations	(58,464)	(306,042)
Repayments under senior credit facility	—	(22,932)
Repayment of junior subordinated notes	—	(4,640)
Borrowing under mezzanine loan	—	83,000
Repayments under mezzanine loan	(63,000)	(20,000)
Repayment of securitized debt obligations	(136,078)	(1,679,970)
Payment of financing expenses	—	(11,126)
Purchase of and distributions to noncontrolling interests	(8)	(142)
Purchase of secured notes	—	(405)
Vesting of restricted Class A common stock	(25)	(85)
Net cash used in financing activities	(133,598)	(1,962,342)
Net increase in cash and cash equivalents	4,049	3,770
Cash and cash equivalents at beginning of period	34,818	24,449
Cash and cash equivalents at end of period	\$38,867	\$28,219

See accompanying notes to consolidated financial statements.

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

Note 1. Organization

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

We are a real estate finance company that specializes in credit sensitive financial products. To date, our investment programs have focused on loans and securities backed by commercial real estate assets. We invest for our own account directly on our balance sheet and for third-parties through a series of investment management vehicles. From the inception of our finance business in 1997 through September 30, 2012, we have completed approximately \$12.1 billion of commercial real estate investments. We conduct our operations as a real estate investment trust, or REIT, for federal income tax purposes. We are traded on the New York Stock Exchange, or NYSE, under the symbol “CT”, and are headquartered in New York City.

Sale of Investment Management Platform

On September 27, 2012, we announced our entry into a definitive purchase and sale agreement, or Purchase Agreement, with an affiliate, which we refer to as the Purchaser, of The Blackstone Group L.P., which we refer to as Blackstone. Pursuant to the Purchase Agreement, the Purchaser will acquire our investment management and special servicing businesses, operated through our subsidiary, CT Investment Management Co., LLC, or CTIMCO, and our related private investment fund co-investments for \$20.6 million. The Purchaser will also purchase for \$10.0 million, or \$2.00 per share, 5,000,000 shares of our class A common stock that will represent approximately 17.1% of our common stock outstanding following consummation of the transactions contemplated by the Purchase Agreement, which we refer to as the Transactions. The Purchase Agreement also contemplates that we will enter into a new management agreement pursuant to which a Blackstone affiliate, which we refer to as the New CT Manager, will manage Capital Trust, Inc. following the consummation of the Transactions. Pursuant to the new management agreement, the New CT Manager will manage Capital Trust, Inc. in accordance with investment guidelines and policies approved by our board of directors. Stephen D. Plavin, Geoffrey G. Jervis and Thomas C. Ruffing will continue to serve in their current executive management roles post-transaction. Consummation of the Transactions is subject to customary closing conditions, including the approval of the Transactions by the affirmative vote of the holders of a majority of the outstanding shares of common stock at a special meeting of shareholders that will be called to approve the Transactions. W. R. Berkley and its affiliated entities, holders of approximately 15.9% of our class A common stock, have entered into a voting agreement to support the transaction.

If the Transactions are consummated, we will pay a \$2.00 per share special cash dividend to holders of our class A common stock, which will be payable as soon as practicable following closing of the Transactions to shareholders of record as of the close of business on November 12, 2012.

In accordance with NYSE procedures, from November 7, 2012 through the special dividend payment date, our class A common stock will trade with “due-bills” representing an assignment of the right to receive the special dividend. Our class A common stock will not trade ex-dividend until the first business day after the special dividend payment date. Shareholders who sell their shares on or before the special dividend payment date will not be entitled to receive the special dividend.

The sources of funds for the special dividend will be cash on hand prior to the Transactions and the proceeds from the sale of CTIMCO and our private investment fund co-investments. The Purchaser will not receive the special dividend given that its investment in our class A common stock will close after the special dividend record date.

Following the Transactions, we will continue to own our existing cash balances (as reduced to fund expenses of the Transactions and the special dividend), our interest in CT Legacy REIT (as defined below), our carried interest in CT Opportunity Partners I, LP, as well as our retained subordinate interests in our three CT CDOs.

March 2011 Restructuring

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

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

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

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

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

CT Legacy Asset Deconsolidation

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

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

Note 2. Summary of Significant Accounting Policies

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP, for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. The accompanying unaudited consolidated interim financial statements should be read in conjunction with the consolidated financial statements and the related management's discussion and analysis of financial condition and results of operations filed with our Annual Report on Form 10-K for the fiscal year ended December 31, 2011. In our opinion, all material adjustments (consisting of normal, recurring accruals) considered necessary for a fair presentation, in accordance with GAAP, have been included. The results of operations for the nine months ended September 30, 2012 are not necessarily indicative of results that may be expected for the entire year ending December 31, 2012.

Principles of Consolidation

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

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

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

information on our investments in VIEs.

Balance Sheet Presentation

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

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

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

Equity Investments in Unconsolidated Subsidiaries and Fair Value Option

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

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

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

Revenue Recognition

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

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

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

distributions.

Cash and Cash Equivalents

We classify highly liquid investments with original maturities of three months or less from the date of purchase as cash equivalents. We place our cash and cash equivalents with high credit quality institutions to minimize credit risk exposure. As of, and for the periods ended, September 30, 2012 and December 31, 2011, we had bank balances in excess of federally insured amounts. We have not experienced any losses on our demand deposits, commercial paper or money market investments.

Restricted Cash

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

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

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

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

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

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

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

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

In conjunction with our quarterly loan portfolio review, management assesses the performance of each loan, and assigns a risk rating based on several factors including risk of loss, loan-to-value ratio, or LTV, collateral

performance, structure, exit plan, and sponsorship. Loans are rated one through eight, which are defined as follows:

- 1 -Low Risk: A loan that is expected to perform through maturity, with relatively lower LTV, higher in-place debt yield, and stable projected cash flow.
- 2 -Average Risk: A loan that is expected to perform through maturity, with medium LTV, average in-place debt yield, and stable projected cash flow.
- 3 Acceptable Risk: A loan that is expected to perform through maturity, with relatively higher LTV, acceptable in-place debt yield, and some uncertainty (due to lease rollover or other factors) in projected cash flow.
- 4 - Higher Risk: A loan that is expected to perform through maturity, but has exhibited a material deterioration in cash flow and/or other credit factors. If negative trends continue, default could occur.
- 5 -Low Probability of Default/Loss: A loan with one or more identified weakness that we expect to have a 15% probability of default or principal loss.

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Capital Trust, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)
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- 6 -Medium Probability of Default/Loss: A loan with one or more identified weakness that we expect to have a 33% probability of default or principal loss.
- 7 High Probability of Default/Loss: A loan with one or more identified weakness that we expect to have a 67% or - higher probability of default or principal loss.
- 8 - In Default: A loan which is in contractual default and/or which has a very high likelihood of principal loss.

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

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

Real Estate Held-for-Sale

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

Deferred Financing Costs

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

Repurchase Obligations

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

Interest Rate Derivative Financial Instruments

In the normal course of business, we use interest rate derivative financial instruments to manage, or hedge, cash flow variability caused by interest rate fluctuations. Specifically, we currently use interest rate swaps to effectively convert floating rate liabilities that are financing fixed rate assets to fixed rate liabilities. The differential to be paid or received on these agreements is recognized on the accrual basis as an adjustment to the interest expense related to the attendant liability. The interest rate swap agreements are generally accounted for on a held-to-maturity basis, and, in cases

where they are terminated early, any gain or loss is generally amortized over the remaining life of the hedged item. These swap agreements must be effective in reducing the variability of cash flows of the hedged items in order to qualify for the aforementioned hedge accounting treatment. Changes in value of effective cash flow hedges are reflected on our consolidated financial statements through accumulated other comprehensive income (loss) and do not affect our net income (loss). To the extent a derivative does not qualify for hedge accounting, and is deemed a non-hedge derivative, the changes in its value are included in net income (loss).

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

Income Taxes

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

Capital Trust, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)
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Accounting for Stock-Based Compensation

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

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

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

Comprehensive Income (Loss)

Total comprehensive income was \$164.8 million and \$279.8 million for the nine months ended September 30, 2012 and 2011, respectively. The primary components of comprehensive income other than net income are the unrealized gains and losses on derivative financial instruments and the component of other-than-temporary impairments of securities related to the Valuation Adjustment.

Earnings per Share of Common Stock

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

Use of Estimates

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

Reclassifications

Certain reclassifications have been made in the presentation of the prior period consolidated financial statements to conform to the September 30, 2012 presentation.

Segment Reporting

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

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

Fair Value of Financial Instruments

The “Fair Value Measurements and Disclosures” Topic of the Financial Accounting Standards Board, or FASB, Accounting Standards Codification, or the Codification, defines fair value, establishes a framework for measuring fair value, and requires certain disclosures about fair value measurements under GAAP. Specifically, this guidance defines fair value based on exit price, or the price that would be received upon the sale of an asset or the transfer of a liability in an orderly transaction between market participants at the measurement date. Our assets and liabilities which are measured at fair value are discussed in Note 12.

Capital Trust, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)
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Recent Accounting Pronouncements

In April 2011, the FASB issued Accounting Standards Update 2011-02, "Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring," or ASU 2011-02. ASU 2011-02 primarily clarifies when creditors should classify loan modifications as troubled debt restructurings and provides examples and factors to be considered. Loan modifications which are considered troubled debt restructurings could result in additional disclosure requirements and could impact the related provision for loan losses. ASU 2011-02 is effective for the first interim or annual period beginning after June 15, 2011, with retrospective application to the beginning of the year. The adoption of ASU 2011-02 did not have a material impact on our financial statements, however will impact how we account for loan modifications, and may result in an increase in the loan modifications we classify as troubled debt restructurings, and therefore our provision for loan losses.

In April 2011, the FASB issued Accounting Standards Update 2011-03, "Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements," or ASU 2011-03. ASU 2011-03 primarily removes certain criteria from the consideration of effective control over assets subject to repurchase agreements. The removal of these criteria will generally result in asset transfers pursuant to repurchase agreements being accounted for as secured borrowings, with both the transferred assets and repurchase liability recorded on the transferor's balance sheet. ASU 2011-03 is effective for the first interim or annual period beginning after December 15, 2011, and is to be applied prospectively to transactions which occur subsequent to the effective date. The adoption of ASU 2011-03 did not have a material impact on our financial statements.

In May 2011, the FASB issued Accounting Standards Update 2011-04, "Fair Value Measurement (Topic 860): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs," or ASU 2011-04. ASU 2011-04 amends existing guidance on fair value measurements related to (i) instruments held in a portfolio, (ii) instruments classified within shareholders' equity, (iii) application of the "highest and best use" concept to nonfinancial assets, (iv) application of blockage factors and other premiums and discounts in the valuation process, and (v) other matters. In addition, ASU 2011-04 expanded the required disclosures around fair value measurements including (i) reporting the level in the fair value hierarchy used to value assets and liabilities which are not measured at fair value, but where fair value is disclosed, and (ii) qualitative disclosures about the sensitivity of Level 3 fair value measurements to changes in unobservable inputs used. ASU 2011-04 is effective for the first interim or annual period beginning after December 15, 2011. The adoption of ASU 2011-04 did not have a material impact on our financial statements, however it did expand our disclosures related to fair value measurements.

In June 2011, the FASB issued Accounting Standards Update 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income," or ASU 2011-05. ASU 2011-05 does not change the items that must be reported in other comprehensive income, however it eliminates the option to present other comprehensive income on the statement of shareholders' equity and instead requires either (i) a continuous statement of comprehensive income which would replace the current statement of operations, or (ii) an additional statement of other comprehensive income, which would immediately follow the statement of operations, and would report the components of other comprehensive income. In December 2011, the FASB issued Accounting Standards Update 2011-12, "Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassification Items Out of Accumulated Comprehensive Income in Accounting Standards Update 2011-05," or ASU 2011-12. ASU 2011-12 maintained the presentation requirements for comprehensive income under ASU 2011-05, however deferred the requirement to present certain reclassification adjustments into and out of accumulated other comprehensive income on a gross basis. ASU 2011-05 and ASU 2011-12 are both effective for the first interim or annual period beginning after December 15, 2011, and should be applied retrospectively to all periods reported after the effective date. Our early adoption, as permitted, of ASU 2011-05 and ASU 2011-12 as of December 31, 2011 did not have a material

impact on our financial statements, other than the change in presentation of comprehensive income as a separate financial statement.

Note 3. Loans Receivable, Net and Loan Participations Sold

As described in Note 1, in conjunction with our March 2011 restructuring of our recourse debt obligations, a significant portion of our assets, including all of our loans, were transferred to a majority-owned subsidiary, CT Legacy REIT. Our only remaining loan was one which had previously been sold to a third-party and recorded as a participation sold asset and liability. In addition, as described in Note 2, our consolidated balance sheets separately state our direct assets and liabilities and certain assets and liabilities of consolidated subsidiaries. See Note 6 for disclosures regarding loans receivable that have been transferred to CT Legacy REIT, and see Note 7 for comparable disclosures regarding loans receivable that are held in consolidated securitization vehicles, as separately stated on our consolidated balance sheets.

Capital Trust, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (continued)
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Participations sold represent interests in certain loans that we originated and subsequently sold to one of our investment management vehicles or to third-parties. We have historically presented these participations sold as both assets and non-recourse liabilities because these arrangements do not qualify as sales under GAAP. Generally, participations sold are recorded as assets and liabilities in equal amounts on our consolidated balance sheets, and an equivalent amount of interest income and interest expense is recorded on our consolidated statements of operations. We have no economic exposure to these liabilities.

During September 2012, our one remaining loan participation sold was repaid.

Note 4. Equity Investments in Unconsolidated Subsidiaries

Our equity investments in unconsolidated subsidiaries consist of our co-investments in investment management vehicles that we sponsor and manage. As of September 30, 2012, we had a co-investment in two such vehicles, CT Opportunity Partners I, LP, or CTOPI, and CT High Grade Partners II, LLC, or CT High Grade II.

In December 2007, we made a commitment to invest up to \$25.0 million in CTOPI, or 4.6% of CTOPI's total capital commitments. We have funded \$17.1 million of our commitment as of September 30, 2012 and received \$6.9 million as a return of capital, resulting in a \$10.2 million funded and a \$14.8 million unfunded commitment balance. Subsequent to the expiration of CTOPI's investment period in September 2012, our obligation to fund additional capital to CTOPI is limited.

In accordance with the CTOPI management agreement, CTIMCO may earn incentive compensation in an amount equal to 17.7% of the fund's profits, after a 9% preferred return and 100% return of capital to the CTOPI partners. While we have not yet received any incentive distributions from CTOPI, we have been allocated \$5.9 million of incentive compensation based on a hypothetical liquidation of the fund at its net asset value as of September 30, 2012. Accordingly, we have recognized this allocation as part of our equity investment in CTOPI, however we have deferred the recognition of income until cash is collected or appropriate contingencies have been eliminated.

In April 2012, we purchased a 0.44% interest in CT High Grade II from an existing investor for \$2.8 million, representing our initial co-investment in CT High Grade II. Our co-investment represents a \$2.9 million total capital commitment to CT High Grade II, of which our unfunded commitment is \$480,000 as of September 30, 2012. As CT High Grade II's investment period expired in May 2011, our obligation to fund additional capital to CT High Grade II is limited.

Activity relating to our equity investments in unconsolidated subsidiaries for the nine months ended September 30, 2012 was as follows (in thousands):

	CTOPI	CT High Grade II	Total
December 31, 2011	\$10,399	\$—	\$10,399
Contributions	1,241	2,789	4,030
Income from equity investments in unconsolidated subsidiaries (1)	7,068		