ALLIED CAPITAL CORP
Form 497
December 04, 2006

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

Filed Pursuant to Rule 497
Registration Statement No. 333-133755

Subject to Completion, dated December 4, 2006

Preliminary Prospectus Supplement
December , 2006
(To Prospectus dated June 22, 2006)

$250,000,000

% Notes due 2012

We are offering $250,000,000 of % notes due 2012, which we refer to as the Notes. The Notes will mature on April 1, 2012. We will pay interest on the Notes on April 1 and October 1 of each year. The first interest payment on the Notes will be made on April 1, 2007. We may redeem the Notes in whole at any time or in part from time to time at the redemption price discussed under the caption Specific Terms of the Notes and the Offering Optional Redemption in this prospectus supplement.

The Notes will be our direct unsecured obligations and rank *pari passu* with all of our outstanding and future unsecured indebtedness.

Please read this prospectus supplement, and the accompanying prospectus, before investing, and keep it for future reference. The prospectus supplement and the accompanying prospectus contain important information about us that a prospective investor should know before investing in our Notes. We file annual, quarterly and current reports, proxy statements and other information about us with the Securities and Exchange Commission. This information is available free of charge by contacting us at 1919 Pennsylvania Avenue, NW, Washington, DC, 20006, or by telephone at (202) 721-6100 or on our website at www.alliedcapital.com. The information on our website is not incorporated by reference into this prospectus supplement and the accompanying prospectus. The SEC also maintains a website at www.sec.gov that contains such information.

See Risk Factors beginning on page 9 of the prospectus attached to this prospectus supplement to read about risks relating to an investment in us or the Notes.

	Per Note	Total
Initial public offering price	%	$
Underwriting discounts and commissions	%	$
Proceeds, before expenses, to us[1]	%	$

[1] Expenses payable by us are estimated to be approximately $780,000.

The initial public offering price set forth above does not include accrued interest, if any. Interest on the Notes will accrue from December , 2006, and must be paid by the purchaser if the Notes are delivered after December , 2006.

Delivery of the notes in book-entry form only through The Depository Trust Company will be made on or about December , 2006.

THE NOTES ARE NOT DEPOSITS OR OTHER OBLIGATIONS OF A BANK AND ARE NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION OR ANY OTHER GOVERNMENT AGENCY.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy of this prospectus supplement or the accompanying prospectus. Any representation to the contrary is a criminal offense.

Banc of America Securities LLC

You should rely only on the information contained in this prospectus supplement and the accompanying prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriter is not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus supplement and the accompanying prospectus is accurate only as of their respective dates. Our business, financial condition and results of operations may have changed since those dates. This prospectus supplement supersedes the accompanying prospectus to the extent it contains information that is different from or additional to the information in that prospectus.

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In this prospectus supplement, unless otherwise indicated, Allied Capital, Company, we, us or our refer to Allied Capital Corporation.

Information contained in this prospectus supplement and the accompanying prospectus may contain forward-looking statements, which can be identified by the use of forward-looking terminology such as may, will, expect, intend, anticipate, estimate, or continue or the negative thereof or other variations thereon or comparable terminology. The matters described in Risk Factors in the accompanying prospectus and certain other factors noted throughout this prospectus supplement and the accompanying prospectus constitute cautionary statements identifying important factors with respect to any such forward-looking statements, including certain risks and uncertainties, that could cause actual results to differ materially from those in such forward-looking statements.

SPECIFIC TERMS OF THE NOTES AND THE OFFERING

This prospectus supplement sets forth certain terms of the Notes that we are offering pursuant to this prospectus supplement and supplements the prospectus that is attached to the back of this prospectus supplement.

This section outlines the specific legal and financial terms of the Notes that are more generally described in the prospectus attached to this prospectus supplement under the heading Description of Notes . You should read this section together with the more general description of the Notes in the prospectus before investing in the Notes. Capitalized terms not defined in this prospectus supplement shall have the meanings ascribed to them in the accompanying prospectus or in the indenture.

Issuer	Allied Capital Corporation
Title of the securities	% Notes due 2012
Initial aggregate principal amount being offered	$250,000,000
Initial public offering price	% of the aggregate principal amount
Net proceeds to us	% of the aggregate principal amount
Principal payable at maturity	100% of the aggregate principal amount; the principal amount of each Note will be payable on its stated maturity date at the office of the Paying Agent, Registrar and Transfer Agent for the Notes or at such other office in The City of New York as we may designate.
Type of Note	Fixed Rate Note
Interest rate	% per year
Day count basis	360-day year of twelve 30-day months
Original issue date	December , 2006
Stated maturity date	April 1, 2012
Date interest starts accruing	December , 2006
Interest payment dates	Every April 1 and October 1, commencing April 1, 2007. If an interest payment date falls on a non-business day, the applicable interest payment will be made on the next business day and no additional interest will accrue as a result of such delayed payment.
Interest periods	The initial interest period will be the period from and including December , 2006, to, but excluding, the initial interest payment date, and the subsequent interest periods will be the periods from and including an interest payment date to, but excluding, the next interest payment date or

	the stated maturity date, as the case may be.
Regular record dates for interest	Every March 15 and September 15, commencing March 15, 2007
Specified currency	U.S. Dollars

Place of payment	New York City
Ranking of Notes	The Notes will be our direct unsecured obligations and rank *pari passu* with our other outstanding and future unsecured indebtedness. The Notes will be subordinated to any secured indebtedness of ours as to assets securing such indebtedness.
Denominations	We will issue the Notes in denominations of $1,000 and integral multiples of $1,000.
Business day	Means each Monday, Tuesday, Wednesday, Thursday and Friday that is not a day on which banking institutions in New York City are authorized or required by law or executive order to close.
Optional redemption	The Notes may be redeemed in whole at any time or in part from time to time at our option, at a redemption price equal to accrued and unpaid interest on the principal amount being redeemed on the redemption date plus the greater of: 100% of the principal amount of the Notes to be redeemed, and the sum of the present values of the remaining scheduled payments of principal and interest on the Notes to be redeemed (not including any portion of such payments of interest accrued to the date of redemption) discounted to the date of redemption on a semi-annual basis at the Adjusted Treasury Rate, plus basis points. Adjusted Treasury Rate means, with respect to any date of redemption, the rate per year equal to the semiannual equivalent yield to maturity or the interpolated yield to maturity (on a date count basis) of the Comparable Treasury Issue, assuming a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for that date of redemption. Comparable Treasury Issue means the United States Treasury security selected by the Quotation Agent as having a maturity or interpolated maturity comparable to the remaining term of the Notes to be redeemed that would be used, at the time of selection and under customary financial practice, in pricing new issues of corporate debt securities of comparable maturity to the remaining term of the Notes. Comparable Treasury Price means, with respect to any date of redemption, the average of the Reference Treasury Dealer Quotations for that date of redemption, after excluding the highest and lowest Reference Treasury Dealer Quotations, or if the Trustee is provided fewer than three Reference Treasury Dealer Quotations, the average of all Reference Treasury Dealer Quotations.

Quotation Agent means one Reference Treasury Dealer appointed by us.

Reference Treasury Dealer means Banc of America Securities LLC and its successor and any other primary treasury dealer we select. If any of the foregoing ceases to be a primary U.S. Government securities dealer in New York City, we must substitute another primary treasury dealer.

Reference Treasury Dealer Quotations means, with respect to each Reference Treasury Dealer and any date of redemption, the average of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to us and the trustee by the Reference Treasury Dealer at 5:00 p.m., New York City time, on the third business day before the date of redemption.

Notice of any redemption will be mailed at least 20 days but not more than 50 days before the date of redemption to each Holder of the Notes to be redeemed. If we redeem only some of the Notes, the Trustee will determine the method for the selection of the particular Notes to be redeemed, in accordance with the Investment Company Act of 1940, as amended, and the rules and regulations promulgated thereunder, to the extent applicable. Unless we default in payment of the redemption price, on and after the date of redemption, interest will cease to accrue on the Notes called for redemption.

Any exercise of our option to redeem the Notes will be done in compliance with the Investment Company Act of 1940, as amended, and the rules and regulations promulgated thereunder, to the extent applicable.

Sinking fund	The Notes will not be subject to any sinking fund.
Repayment at option of Holders	Holders will not have the option to have the Notes repaid prior to the stated maturity date.
Defeasance	The Notes are subject to defeasance by us.
Covenant defeasance	The Notes are subject to covenant defeasance by us.
Form of Notes	The Notes will be represented by global securities that will be deposited and registered in the name of The Depository Trust Company or its nominee. This means that, except in limited circumstances, you will not receive certificates for the Notes.
Paying Agent, Registrar and Transfer Agent	The Bank of New York
CUSIP	01903Q AB 4

Other covenants	In addition to the covenants described in the prospectus attached to this prospectus supplement, the following covenants shall apply to the Notes: We agree that for the period of time during which the Notes are outstanding, we will not violate Section 18(a)(1)(A) as modified by Section 61(a)(1) of the Investment Company Act of 1940, as amended, or any successor provisions. If, at any time, we are not subject to the reporting requirements of Sections 13 or 15(d) of the Securities Exchange Act to file any periodic reports with the SEC, we agree to furnish to you, for the period of time during which the Notes are outstanding, our audited annual consolidated financial statements, within 90 days of our fiscal year end, and unaudited interim consolidated financial statements, within 45 days of our fiscal quarter end. All such financial statements will be prepared, in all material respects, in accordance with applicable generally accepted accounting principles.
Modifications to events of default	The following event of default, as described in the prospectus attached to this prospectus supplement: we fail to make any payment of principal of or any premium on any security when it is due at the maturity of the security, and we do not cure this default within five days; with respect to the Notes has been revised to read as follows: we fail to make any payment of principal of (or premium, if any, on) any Note when it is due at maturity.

USE OF PROCEEDS

We estimate that our net proceeds from the sale of the $250 million aggregate principal amount of Notes we are offering will be approximately $ million, assuming a public offering price of % of par and after deducting the underwriting discounts and commissions and estimated offering expenses payable by us. We may change the size of this offering based on demand and market conditions.

We expect to use the net proceeds from this offering to reduce borrowings under our revolving line of credit, to invest in debt or equity securities in primarily privately negotiated transactions, and for other general corporate purposes. Amounts repaid under our revolving line of credit will remain available for future borrowings. At November 30, 2006, the interest rate on our revolving line of credit was approximately 6.4% and there was approximately $382.5 million outstanding. This revolving line of credit expires on September 30, 2008. After giving effect to this offering of Notes, our asset coverage ratio, as calculated in accordance with the Investment Company Act of 1940, as amended, is estimated to be 255%.

UNITED STATES FEDERAL INCOME TAX CONSEQUENCES

The following discussion is a general summary of the material United States federal income tax considerations (and, in the case of a non-U.S. holder (as defined below), the material United States federal estate tax consequences) applicable to an investment in the Notes. This summary does not purport to be a complete description of the income tax considerations applicable to such an investment. The discussion is based upon the Internal Revenue Code of 1986, as amended (the Code), Treasury Regulations, and administrative and judicial interpretations, each as of the date of this prospectus supplement and all of which are subject to change, potentially with retroactive effect. You should consult your own tax advisor with respect to tax considerations that pertain to your purchase of our Notes.

This discussion deals only with Notes held as capital assets within the meaning of Section 1221 of the Code and does not purport to deal with persons in special tax situations, such as financial institutions, insurance companies, controlled foreign corporations, foreign personal holding companies, passive foreign investment companies and regulated investment companies (and shareholders of such corporations), dealers in securities or currencies, traders in securities, former citizens of the United States, persons holding the Notes as a hedge against currency risks or as a position in a straddle, hedge, constructive sale transaction or conversion transaction for tax purposes, entities that a tax-exempt for United States federal income tax purposes, retirement plans, individual retirement accounts, tax-deferred accounts, persons subject to the alternative minimum tax, pass-through entities (including partnerships and entities and arrangements classified as partnerships for United States federal income tax purposes) and beneficial owners of pass-through entities, or persons whose functional currency is not the U.S. dollar. It also does not deal with beneficial owners of the Notes other than original purchasers of the Notes who acquire the Notes in this offering for a price equal to their original issue price (as defined below). If you are considering purchasing the Notes, you should consult your own tax advisor concerning the application of the United States federal tax laws to you in light of your particular situation, as well as any consequences to you of purchasing, owning and disposing of the Notes under the laws of any other taxing jurisdiction.

For purposes of this discussion, the term U.S. holder means a beneficial owner of a Note that is, for United States federal income tax purposes, (i) an individual citizen or resident of the United States, (ii) a corporation or other entity treated as a corporation for United States federal income tax purposes, created or organized in or under the laws of the United States or of any political subdivision thereof, (iii) a trust (a) subject to the control of one or more United States persons and the primary supervision of a court in the United States, or (b) that has a valid election (under applicable Treasury Regulations) to be treated as a United States person, or (iv) an estate the income of which is subject to United States federal income taxation regardless of its source. The term non-U.S. holder means a beneficial owner of a Note that is not a U.S. holder. An individual may, subject to exceptions, be deemed to be a resident alien, as opposed to a non-resident alien, by, among other ways, being present in the United States (i) on at least 31 days in the calendar year, and (ii) for an aggregate of at least 183 days during a three-year period ending in the current calendar year, counting for such purposes all of the days present in the current year, one-third of the days present in the immediately preceding year, and one-sixth of the days present in the second preceding year. Resident aliens are subject to United States federal income tax as if they were United States citizens.

If a partnership holds any Notes, the United States federal income tax treatment of a partner of the partnership generally will depend upon the status of the partner and the activities of the partnership. Partners of partnerships holding Notes should consult their own tax advisors.

Taxation of Note Holders

Under present law, we are of the opinion that the Notes will constitute indebtedness of us for United States federal income tax purposes, which the below discussion assumes. We intend to treat all payments made with respect to the

Notes consistent with this characterization.

Payments or accruals of interest on a Note generally will be taxable to a U.S. holder as ordinary interest income at the time they are received (actually or constructively) or accrued, in accordance with the U.S. holder s regular method of tax accounting.

Special tax rules apply to debt securities issued with significant amounts of original issue discount, or OID. For United States federal income tax purposes, a debt security is considered to be issued for a significant amount of OID if its stated redemption price at maturity exceeds its issue price by an amount that equals or exceeds 0.25% of the stated redemption price at maturity multiplied by the number of complete years to its maturity. A debt security s stated redemption price at maturity is the sum of all payments on the debt security other than payments of qualified stated interest. Qualified stated interest generally means stated interest that is unconditionally payable in cash or property (other than debt instruments of the issuer) at least annually at a single fixed rate, provided that the rate appropriately takes into account the length of intervals between payments, or at certain variable rates of interest or certain combinations. The issue price of each debt security in an issuance of debt securities is the first price at which a substantial amount of the debt securities in that issuance has been sold for cash, excluding sales to bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers.

Although the issue price of the Notes will be less than their stated redemption price at maturity, the Notes will not be considered to be issued with OID for United States income tax purposes because the amount of the discount is considered to be de minimis under the foregoing rules.

Upon the sale, exchange, redemption or retirement of a Note, a U.S. holder generally will recognize capital gain or loss equal to the difference between the amount realized on the sale, exchange, redemption or retirement (excluding amounts representing accrued and unpaid interest, which are treated as ordinary income) and the U.S. holder s adjusted tax basis in the Note. A U.S. holder s adjusted tax basis in a Note generally will equal the U.S. holder s initial investment in the Note. Capital gain or loss generally will be long-term capital gain or loss if the Note was held for more than one year. Generally, for U.S. holders who are individuals, long-term capital gains are subject to a maximum tax rate of 15%, which maximum tax rate will increase to 20% for dispositions occurring during taxable years beginning on or after January 1, 2011. The distinction between capital gain or loss and ordinary income or loss is also important in other contexts; for example, for purposes of the limitations on a U.S. holder s ability to offset capital losses against ordinary income.

Taxation of Non-U.S. Holders. A non-U.S. holder generally will not be subject to United States federal income or withholding taxes on payments of principal or interest on a Note provided that (i) income on the Note is not effectively connected with the conduct by the non-U.S. holder of a trade or business within the United States, (ii) the non-U.S. holder is not a controlled foreign corporation related to the Company through stock ownership, (iii) in the case of interest income, the recipient is not a bank receiving interest described in Section 881(c)(3)(A) of the Code, (iv) the non-U.S. holder does not own (actually or constructively) 10% or more of the total combined voting power of all classes of stock of the Company, and (v) the non-U.S. holder provides a statement on an Internal Revenue Service (IRS) Form W-8BEN (or other applicable form) signed under penalties of perjury that includes its name and address and certifies that it is not a United States person in compliance with applicable requirements, or satisfies documentary evidence requirements for establishing that it is a non-U.S. holder.

A non-U.S. holder that is not exempt from tax under these rules generally will be subject to United States federal income tax withholding at a rate of 30% unless (i) the income is effectively connected with the conduct of a United States trade or business, in which case the interest will be subject to United States federal income tax on a net income basis as applicable to U.S. holders generally (unless an applicable income tax treaty provides otherwise), or (ii) an applicable income tax treaty provides for a lower rate of, or exemption from, withholding tax.

In the case of a non-U.S. holder that is a corporation and that receives income that is effectively connected with the conduct of a United States trade or business, such income may also be subject to a branch profits tax (which is generally imposed on a foreign corporation on the actual or deemed repatriation from the United States of earnings and profits attributable to a United States trade or business) at a 30% rate. The branch profits tax may not apply (or may apply at a reduced rate) if the non-U.S. holder is a qualified resident of a country with which the United States has an income tax treaty.

To claim the benefit of an income tax treaty or to claim exemption from withholding because income is effectively connected with a United States trade or business, the non-U.S. holder must timely provide the appropriate, properly executed IRS forms. These forms may be required to be periodically updated. Also, a non-U.S. holder who is claiming the benefits of a treaty may be required to obtain a United States taxpayer identification number and to provide certain documentary evidence issued by foreign governmental authorities to prove residence in the foreign country.

Generally, a non-U.S. holder will not be subject to United States federal income or withholding taxes on any amount that constitutes capital gain upon the sale, exchange, redemption or retirement of a Note, provided the gain is not effectively connected with the conduct of a trade or business in the United States by the non-U.S. holder. Certain other exceptions may be applicable, and a non-U.S. holder should consult its tax advisor in this regard.

A Note that is held by an individual who, at the time of death, is not a citizen or resident of the United States (as specially defined for United States federal estate tax purposes) generally will not be subject to the United States federal estate tax, unless, at the time of death, (i) such individual directly or indirectly, actually or constructively, owns ten percent or more of the total combined voting power of all classes of our stock entitled to vote within the meaning of Section 871(h)(3) of the Code and the Treasury Regulations thereunder or (ii) such individual s interest in the Notes is effectively connected with the individual s conduct of a United States trade or business.

Information Reporting and Backup Withholding. A U.S. holder (other than an exempt recipient, including a corporation and certain other persons who, when required, demonstrate their exempt status) may be subject to backup withholding at a rate of 28% (which rate will increase to 31% for taxable years beginning on or after January 1, 2011) on, and to information reporting requirements with respect to, payments of principal or interest on, and to proceeds from the sale, exchange, redemption or retirement of, the Notes. In general, if a non-corporate U.S. holder subject to information reporting fails to furnish a correct taxpayer identification number or otherwise fails to comply with applicable backup withholding requirements, backup withholding at the applicable rate may apply. Non-U.S. holders generally are exempt from information reporting and backup withholding, provided, if necessary, that they demonstrate their qualification for exemption.

You should consult your tax advisor regarding the qualification for an exemption from backup withholding and information reporting and the procedures for obtaining such an exemption, if applicable. Any amounts withheld under the backup withholding rules from a payment to a beneficial owner generally would be allowed as a refund or a credit against such beneficial owner s United States federal income tax provided the required information is furnished to the IRS.

You should consult your own tax advisor with respect to the particular tax consequences to you of an investment in our Notes, including the possible effect of any pending legislation or proposed regulations.

UNDERWRITING

Subject to the terms and conditions set forth in an underwriting agreement, we have agreed to sell to Banc of America Securities LLC, the underwriter, and the underwriter has agreed to purchase from us, the aggregate principal amount of the Notes offered by this prospectus supplement.

The underwriting agreement provides that the obligation of the underwriter to pay for and accept delivery of the Notes is subject to certain conditions precedent. The underwriter is obligated to take and pay for the entire amount of the Notes, if any of the Notes are purchased.

We have agreed not to issue, sell, offer or contract to sell, grant an option for the sale of, or otherwise transfer or dispose of, any registered debt securities or medium term debt securities for a period of 30 days after the date of this prospectus supplement without first obtaining the written consent of the underwriter. This consent may be given at any time without public notice.

The underwriting agreement provides that we will indemnify the underwriter against certain liabilities, including liabilities under the Securities Act of 1933, as amended, and will contribute to payments the underwriter may be required to make in respect thereof.

The Notes are new securities for which there currently is no market. We do not intend to list the Notes on any securities exchange. We have been advised by the underwriter that it intends to make a market in the Notes as permitted by applicable laws and regulations. The underwriter is not obligated, however, to make a market in the Notes and any such market-making may be discontinued at any time at the sole discretion of the underwriter. Accordingly, no assurance can be given as to the liquidity of, or development of a trading market for, the Notes.

The underwriter proposes to offer some of the Notes to the public at the public offering price set forth on the cover page of this prospectus supplement and some of the Notes to certain other National Association of Securities Dealers, Inc. (NASD) dealers at the public offering price less a concession of not in excess of % of the aggregate principal amount of the Notes. The underwriter may allow, and the dealers may reallow, a discount not in excess of % of the aggregate principal amount of the Notes. After the initial offering of the Notes to the public, the public offering price and such concessions may be changed. No such change shall change the amount of proceeds to be received by us as set forth on the cover page of this prospectus supplement.

The expenses of the offering, other than underwriting discounts and commissions referred to above, are estimated at approximately $780,000 and are payable entirely by us.

Other than in the United States, no action has been taken by us or the underwriter that would permit a public offering of the Notes offered by this prospectus supplement in any jurisdiction where action for that purpose is required. The Notes offered by this prospectus supplement may not be offered or sold, directly or indirectly, nor may this prospectus supplement or any other offering material or advertisements in connection with the offer and sale of any such Notes be distributed or published in any jurisdiction, except under circumstances that will result in compliance with the applicable rules and regulations of that jurisdiction. Persons into whose possession this prospectus supplement comes are advised to inform themselves about and to observe any restriction relating to the offering and the distribution of this prospectus supplement. This prospectus supplement and the accompanying prospectus do not constitute an offer to sell or a solicitation of an offer to buy the Notes offered by this prospectus supplement and the accompanying prospectus in any jurisdiction in which such an offer or a solicitation is unlawful.

In connection with the offering, the underwriter may purchase and sell Notes in the open market. These transactions may include overallotment, covering transactions and stabilizing transactions. Overallotment involves sales of securities in excess of the aggregate principal amount of securities to be purchased by the underwriter in the offering, which creates a short position for the underwriter. Covering transactions involve purchases of the securities in the open market after the distribution has been completed in order to cover short positions. Stabilizing transactions consist of certain bids or purchases of securities made for the purpose of preventing or retarding a decline in the market price of the securities while the offering is in progress.

Any of these activities may cause the price of the Notes to be higher than the price that otherwise would exist in the open market in the absence of such transactions. These transactions, if commenced, may be discontinued at any time without any notice relating thereto.

In the ordinary course of business, the underwriter or its affiliates have engaged and may in the future engage in various financing, commercial banking and investment banking transactions with, and provide financial advisory services to, us and our affiliates, for which they have received or may receive customary fees and expenses. An affiliate of Banc of America Securities LLC is a member of the lending syndicate for our unsecured revolving line of credit and may receive proceeds of this offering by reason of the repayment of amounts outstanding thereunder. Because more than 10% of the net proceeds of the offering may be received by members of the NASD participating in the offering or their affiliates, the offering is being conducted in accordance with NASD conduct rule 2710(h).

The principal business address of Banc of America Securities LLC is 9 West 57th Street, New York, New York.

LEGAL MATTERS

The validity and enforceability of the Notes offered hereby will be passed upon for us by Sutherland Asbill & Brennan LLP, Washington, D.C., and on behalf of the underwriter by Fried, Frank, Harris, Shriver & Jacobson LLP, Washington, D.C.

INTERIM MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following analysis of the financial condition and results of operations of the Company should be read in conjunction with the Company s Consolidated Financial Statements and the Notes thereto included herein, in the accompanying prospectus, and in the Company s annual report on Form 10-K for the year ended December 31, 2005. In addition, this prospectus supplement and the accompanying prospectus contain certain forward-looking statements. These statements include the plans and objectives of management for future operations and financial objectives and can be identified by the use of forward-looking terminology such as may, will, expect, intend, anticipate, estimate, or continue or the negative thereof or other variations thereon or comparable terminology. These forward-looking statements are subject to the inherent uncertainties in predicting future results and conditions. Certain factors that could cause actual results and conditions to differ materially from those projected in these forward-looking statements are set forth in the Risk Factors section in the accompanying prospectus. Other factors that could cause actual results to differ materially include:

- *changes in the economy and general economic conditions;*
- *risks associated with possible disruption in our operations due to terrorism;*
- *future changes in laws or regulations and conditions in our operating areas; and*
- *other risks and uncertainties as may be detailed from time to time in our public announcements and SEC filings.*

Financial or other information presented for private finance portfolio companies has been obtained from the portfolio companies, and the financial information presented may represent unaudited, projected or pro forma financial information, and therefore may not be indicative of actual results. In addition, the private equity industry uses financial measures such as EBITDA or EBITDAM (Earnings Before Interest, Taxes, Depreciation, Amortization and, in some instances, Management fees) in order to assess a portfolio company s financial performance and to value a portfolio company. EBITDA and EBITDAM are not intended to represent cash flow from operations as defined by U.S. generally accepted accounting principles and such information should not be considered as an alternative to net income, cash flow from operations or any other measure of performance prescribed by U.S. generally accepted accounting principles.

OVERVIEW

As a business development company, we are in the private equity business. Specifically, we provide long-term debt and equity investment capital to companies in a variety of industries. Our lending and investment activity has generally been focused on private finance and commercial real estate finance, which included primarily the investment in non-investment grade commercial mortgage-backed securities, which we refer to as CMBS, and collateralized debt obligation bonds and preferred shares, which we refer to as CDOs.

On May 3, 2005, we completed the sale of our portfolio of CMBS and real estate related CDO investments. Upon the completion of this transaction, our lending and investment activity has been focused primarily on private finance investments. Our private finance activity principally involves providing financing to middle market U.S. companies through privately negotiated long-term debt and equity investment capital. Our financing is generally used to fund growth, acquisitions, buyouts, recapitalizations, note purchases, bridge financings, and other types of financings. We generally invest in private companies though, from time to time, we may invest in companies that are public but lack access to additional public capital. Our investment objective is to achieve current income and capital gains.

Our portfolio composition at September 30, 2006 and 2005, and at December 31, 2005, was as follows:

	September 30, 2006	September 30, 2005	December 31, 2005
Private finance	97%	96%	96%
Commercial real estate finance	3%	4%	4%

Our earnings depend primarily on the level of interest and dividend income, fee and other income, and net realized and unrealized gains or losses on our investment portfolio after deducting interest expense on borrowed capital, operating expenses and income taxes including excise tax. Interest income results from the stated interest rate earned on a loan or debt security and the amortization of loan origination fees and discounts. The level of interest income is directly related to the balance of the interest-bearing investment portfolio outstanding during the period multiplied by the weighted average yield. Our ability to generate interest income is dependent on economic, regulatory, and competitive factors that influence new investment activity, interest rates on the types of loans we make, the level of repayments in the portfolio, the amount of loans and debt securities for which interest is not accruing and our ability to secure debt and equity capital for our investment activities.

Because we are a regulated investment company for tax purposes, we intend to distribute substantially all of our annual taxable income as dividends to our shareholders. See Other Matters below.

PORTFOLIO AND INVESTMENT ACTIVITY

The total portfolio at value, investment activity, and the yield on interest-bearing investments at and for the three and nine months ended September 30, 2006 and 2005, and at and for the year ended December 31, 2005, were as follows:

($ in millions)	At and for the Three Months Ended September 30, 2006	At and for the Three Months Ended September 30, 2005	At and for the Nine Months Ended September 30, 2006	At and for the Nine Months Ended September 30, 2005	At and for the Year Ended December 31, 2005
Portfolio at value	$ 4,119.6	$ 3,223.8	$ 4,119.6	$ 3,223.8	$ 3,606.4
Investments funded[(1)]	$ 629.5	$ 673.4	$ 1,880.8	$ 1,328.2	$ 1,675.8
Change in accrued or reinvested interest and dividends[(2)]	$ 7.2	$ 5.5	$ (1.8)	$ 1.9	$ 6.6
Principal collections related to investment repayments or sales	$ 116.3	$ 151.0	$ 885.9	$ 1,241.8	$ 1,503.4
Yield on interest-bearing investments[(3)]	12.3%	12.6%	12.3%	12.6%	12.8%

(1) Investments funded for the nine months ended September 30, 2006, included a $150 million subordinated debt investment in Advantage Sales & Marketing, Inc. received in conjunction with the sale of Advantage and a $30 million subordinated debt investment in STS Operating, Inc. received in conjunction with the sale of STS. See discussion below. Investments funded also include investments acquired through the issuance of our common stock as consideration totaling zero and $7.2 million for the nine months ended September 30, 2006 and 2005, respectively, and $7.2 million for the year ended December 31, 2005.

(2) Includes changes in accrued or reinvested interest of $1.3 million and $3.0 million for the three and nine months ended September 30, 2006, respectively, related to our investments in money market securities.

(3) The weighted average yield on interest-bearing investments is computed as the (a) annual stated interest on accruing loans and debt securities plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing loans and debt securities less the annual amortization of loan origination costs, divided by (b) total interest-bearing investments at value. The weighted average yield is computed as of the balance sheet date.

Private Finance

The private finance portfolio at value, investment activity, and the yield on loans and debt securities at and for the three and nine months ended September 30, 2006 and 2005, and at and for the year ended December 31, 2005, were as follows:

	At and for the Three Months Ended September 30,				At and for the Nine Months Ended September 30,				At and for the Year Ended December 31,	
	2006		2005		2006		2005		2005	
millions)	Value	Yield[2]	Value	Yield[2]	Value	Yield[2]	Value	Yield[2]	Value	Yiel
olio at value:										
s and debt ities:										
r loans	$ 342.4	8.7%	$ 255.9	8.6%	$ 342.4	8.7%	$ 255.9	8.6%	$ 239.8	9
anche debt	745.8	11.2%	197.2	11.8%	745.8	11.2%	197.2	11.8%	294.2	11
rdinated debt	1,817.0	13.7%	1,586.5	13.8%	1,817.0	13.7%	1,586.5	13.8%	1,560.9	13
loans and debt ities	$ 2,905.2	12.5%	$ 2,039.6	13.0%	$ 2,905.2	12.5%	$ 2,039.6	13.0%	$ 2,094.9	13
y securities	1,082.6		1,041.4		1,082.6		1,041.4		1,384.4	
portfolio	$ 3,987.8		$ 3,081.0		$ 3,987.8		$ 3,081.0		$ 3,479.3	
tments funded[1]	$ 629.2		$ 665.7		$ 1,866.6		$ 1,131.9		$ 1,462.3	
ge in accrued or ested interest and ends	$ 5.8		$ 5.9		$ (5.4)		$ 20.4		$ 24.6	
ipal collections d to investment ments or sales	$ 115.6		$ 146.5		$ 868.0		$ 476.5		$ 703.9	

(1) Investments funded for the nine months ended September 30, 2006, included a $150 million subordinated debt investment in Advantage Sales & Marketing, Inc. received in conjunction with the sale of Advantage and a $30 million subordinated debt investment in STS Operating, Inc. received in conjunction with the sale of STS. See discussion below.

(2) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing loans and debt securities less the annual amortization of loan origination costs, divided by (b) total loans and debt securities at value. The weighted average yield is computed as of the balance sheet date.

Our investment activity is focused on making long-term investments in the debt and equity of primarily private middle market companies. Debt investments may include senior loans, unitranche debt (a single debt investment that is a blend of senior and subordinated debt), or subordinated debt (with or without equity features). The junior debt that we invest in that is lower in repayment priority than senior debt is also known as mezzanine debt. Equity investments may include a minority equity stake in connection with a debt investment or a substantial equity stake in connection with a buyout transaction. In a buyout transaction, we generally invest in senior and/or subordinated debt and equity (preferred and/or voting or non-voting common) where our equity ownership represents a significant portion of the equity, but may or may not represent a controlling interest.

In addition, we may fund most or all of the debt and equity capital upon the closing of certain buyout transactions, which may include investments in lower-yielding senior debt. Subsequent to the closing, the portfolio company may refinance all or a portion of the lower-yielding senior debt, which would reduce our investment. Repayments include repayments of senior debt funded by us that was subsequently refinanced or repaid by the portfolio companies.

We intend to take a balanced approach to private equity investing that emphasizes a complementary mix of debt investments and buyout investments. The combination of these two types of investments provides current interest and related portfolio income and the potential for future capital gains. To address the current market, our strategy is to focus on buyout and recapitalization transactions where we can manage risk through the structure and terms of our debt and equity investments and where we can potentially realize more attractive total returns from both current interest and fee income and future capital gains. We are also focusing our debt investing on smaller middle market companies where we can provide both senior and subordinated debt or unitranche debt, where our combined current yield may be lower than traditional subordinated debt only. We believe that providing both senior and subordinated debt or unitranche debt provides us with greater protection in the capital structures of our portfolio companies.

Investments Funded. Investments funded and the weighted average yield on investments funded for the nine months ended September 30, 2006 and 2005, and for the year ended December 31, 2005, consisted of the following:

	For the Nine Months Ended September 30, 2006					
	Debt Investments		Buyout Investments		Total	
($ in millions)	**Amount**	**Weighted Average Yield[1]**	**Amount**	**Weighted Average Yield[1]**	**Amount**	**Weighted Average Yield[1]**
Loans and debt securities:						
Senior loans[4]	$ 202.4	9.4%	$ 167.3	8.8%	$ 369.7	9.1%
Unitranche debt[2]	348.7	10.6%	146.5	12.9%	495.2	11.3%
Subordinated debt[3]	508.0	13.1%	250.8	13.9%	758.8	13.3%
Total loans and debt securities	1,059.1	11.5%	564.6	12.1%	1,623.7	11.8%
Equity	62.9		180.0		242.9	
Total	$ 1,122.0		$ 744.6		$ 1,866.6	

	For the Nine Months Ended September 30, 2005					
	Debt Investments		Buyout Investments		Total	
($ in millions)	**Amount**	**Weighted Average Yield[1]**	**Amount**	**Weighted Average Yield[1]**	**Amount**	**Weighted Average Yield[1]**
Loans and debt securities:						
Senior loans	$ 50.7	10.6%	$ 186.8	6.0%	$ 237.5	7.0%
Unitranche debt[2]	154.9	10.5%			154.9	10.5%
Subordinated debt	239.0	12.6%	313.9	12.6%	552.9	12.6%
Total loans and debt securities	444.6	11.7%	500.7	10.2%	945.3	10.9%
Equity	23.9		162.7		186.6	
Total	$ 468.5		$ 663.4		$ 1,131.9	

(1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities, divided by (b) total loans and debt securities funded.

(2) Unitranche debt is a single debt investment that is a blend of senior and subordinated debt terms. The yield on a unitranche investment reflects the blended yield of senior and subordinated debt combined.

(3) Debt investments for the nine months ended September 30, 2006, included a $150 million, 12.0% subordinated debt investment in Advantage Sales & Marketing, Inc. received in conjunction with the sale of Advantage and a $30 million, 15.0% subordinated debt investment in STS Operating, Inc. received in conjunction with the sale of

STS. See discussion below.

(4) Senior loans funded for the nine months ended September 30, 2006, included $192.2 million that was repaid during the nine months ended September 30, 2006.

($ in millions)	For the Year Ended December 31, 2005					
	Debt Investments		Buyout Investments		Total	
	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)	Amount	Weighted Average Yield(1)
Loans and debt securities:						
Senior loans(3)	$ 76.8	10.0%	$ 250.2	6.4%	$ 327.0	7.2%
Unitranche debt(2)	259.5	10.5%			259.5	10.5%
Subordinated debt	296.9	12.3%	330.9	12.5%	627.8	12.4%
Total loans and debt securities	633.2	11.3%	581.1	9.9%	1,214.3	10.6%
Equity	82.5		165.5		248.0	
Total	$ 715.7		$ 746.6		$ 1,462.3	

(1) The weighted average yield on loans and debt securities is computed as the (a) annual stated interest on accruing loans and debt securities, divided by (b) total loans and debt securities funded.

(2) Unitranche debt is a single debt investment that is a blend of senior and subordinated debt terms. The yield on a unitranche investment reflects the blended yield of senior and subordinated debt combined.

(3) Buyout senior loans funded included $174.9 million that was repaid during 2005 and $14.1 million that was repaid during the nine months ended September 30, 2006.

We generally fund new investments using cash. In addition, we may acquire securities in exchange for our common equity. Also, we may acquire new securities through the reinvestment of previously accrued interest and dividends in debt or equity securities, or the current reinvestment of interest and dividend income through the receipt of a debt or equity security (payment-in-kind income). From time to time we may opt to reinvest accrued interest receivable in a new debt or equity security in lieu of receiving such interest in cash.

The level of investment activity for investments funded and principal repayments for private finance investments can vary substantially from period to period depending on the number and size of investments that we make or that we exit and many other factors, including the amount of debt and equity capital available to middle market companies, the level of merger and acquisition activity for such companies, the general economic environment, and the competitive environment for the types of investments we make. We believe that merger and acquisition activity in the middle market is strong, which has resulted in an increase in private finance investment opportunities, as well as increased repayments. We continue to have an active pipeline of new investments under consideration. We believe that merger and acquisition activity for middle market companies will remain strong for the remainder of 2006 and into 2007.

Through our wholly owned subsidiary, AC Finance LLC (AC Finance), we generally originate, underwrite and arrange senior loans. Senior loans originated and underwritten by AC Finance may or may not be funded by us at closing. When these senior loans are closed, we may fund all or a portion of the underwritten commitment pending sale of the loan to other investors, which may include loan sales to Callidus Capital Corporation (Callidus) or funds managed by Callidus, a portfolio company controlled by us. After completion of the sale process, we may or may not retain a position in these senior loans. AC Finance generally earns a fee on the senior loans originated and underwritten whether or not we fund the underwritten commitment.

Yield. The weighted average yield on private finance loans and debt securities was 12.5% at September 30, 2006, as compared to 13.0% at both September 30, 2005 and December 31, 2005. The weighted average yield on the private finance loans and debt securities may fluctuate from period to period, depending on the yield on new loans and debt securities funded, the yield on loans and debt securities repaid, the amount of loans and debt securities for which interest is not accruing (see Portfolio Asset Quality Loans and Debt Securities on Non-Accrual Status below) and the amount of lower-yielding senior or unitranche debt in the portfolio at the end of the period. The yield on the private finance portfolio has declined partly due to our strategy to pursue investments where our position in the portfolio company capital structure is more senior, such as senior debt and unitranche investments. These investments typically have lower yields than subordinated debt investments.

Outstanding Investment Commitments. At September 30, 2006, we had outstanding private finance investment commitments as follows:

($ in millions)	**Companies More Than 25% Owned**[1]	**Companies 5% to 25% Owned**	**Companies Less Than 5% Owned**	**Total**
Senior loans	$ 19.6	$ 12.6	$ 93.3	$ 125.5[2]
Unitranche debt			85.8	85.8
Subordinated debt	36.6	3.1	6.8	46.5
Total loans and debt securities	56.2	15.7	185.9	257.8
Equity securities	86.7	11.7	43.3	141.7[3]
Total	$ 142.9	$ 27.4	$ 229.2	$ 399.5

(1) Includes various commitments to Callidus Capital Corporation (Callidus), which owns 80% (subject to dilution) of Callidus Capital Management, LLC, an asset management company that structures and manages collateralized debt obligations (CDOs), collateralized loan obligations (CLOs), and other related investments as follows:

($ in millions)	**Committed Amount**	**Amount Drawn**	**Amount Available to be Drawn**
Subordinated debt to support warehouse facilities & warehousing activities[*]	$ 36.0	$	$ 36.0
Revolving line of credit for working capital	4.0		4.0
Purchase of preferred equity in future CLO transactions	77.0		77.0
Total	$ 117.0	$	$ 117.0

(*) Callidus has a secured warehouse credit facility with a third party for up to $240 million. The facility is used primarily to finance the acquisition of loans pending securitization through a CDO or CLO. In conjunction with this warehouse credit facility, we have agreed to designate our $36 million subordinated debt commitment for Callidus to draw upon to provide first loss capital as needed to support the warehouse facility.

(2) Includes $114.3 million in the form of revolving senior debt facilities to 22 companies.

(3)

Includes $55.0 million to 16 private equity and venture capital funds, including $5.9 million in co-investment commitments to Pine Creek Equity Partners, LLC.

In addition to these outstanding investment commitments at September 30, 2006, we may be required to fund additional amounts under earn-out arrangements primarily related to buyout transactions in the future if those companies meet agreed-upon performance targets. We also had commitments to private finance portfolio companies in the form of standby letters of credit and guarantees totaling $240.5 million. See Financial Condition, Liquidity and Capital Resources.

Our largest investment at value at September 30, 2006, was in Business Loan Express, LLC (BLX) and our largest investments at value at December 31, 2005, were in Advantage Sales & Marketing, Inc. (Advantage) and BLX.

Business Loan Express, LLC. At September 30, 2006, our investment in BLX totaled $295.1 million at cost and $284.9 million at value, or 6.2% of our total assets, which included unrealized depreciation of $10.2 million. We acquired BLX in 2000.

Total interest and related portfolio income earned from the Company s investment in BLX for the nine months ended September 30, 2006 and 2005, was as follows:

($ in millions)	**2006**	**2005**
Interest income	$ 11.9	$ 10.5
Dividend income		9.0
Fees and other income	6.3	7.0
Total interest and related portfolio income	$ 18.2	$ 26.5

Interest income from BLX for the nine months ended September 30, 2006 and 2005, included interest income of $5.7 million and $5.1 million, respectively, which was paid in kind. The interest paid in kind was paid to us through the issuance of additional Class A equity interests. Accrued interest and dividends receivable at September 30, 2006, included accrued interest due from BLX totaling $1.2 million, of which $0.7 million was paid in cash in October 2006.

Net change in unrealized appreciation or depreciation included a net decrease on our investment in BLX of $67.9 million for the nine months ended September 30, 2006, and a net increase on our investment in BLX of $15.9 million for the nine months ended September 30, 2005. See Results of Operations for a discussion of the net change in unrealized appreciation or depreciation related to this investment.

BLX is a national, non-bank lender that participates in the SBA s 7(a) Guaranteed Loan Program and is licensed by the SBA as a Small Business Lending Company (SBLC). BLX is a preferred lender, as designated by the SBA, and originates, sells, and services small business loans. In addition, BLX originates conventional small business loans and small investment real estate loans. BLX has offices across the United States and is headquartered in New York, New York. Changes in the laws or regulations that govern SBLCs or the SBA 7(a) Guaranteed Loan Program or changes in government funding for this program could have a material adverse impact on BLX and, as a result, could negatively affect our financial results.

As a limited liability company, BLX s taxable income flows through directly to its members. BLX s annual taxable income generally differs from its book income for the fiscal year due to temporary and permanent differences in the recognition of income and expenses. We hold all of BLX s Class A and Class B interests, and 94.9% of the Class C interests. BLX s taxable income is first allocated to the Class A interests to the extent that dividends are paid in cash or in kind on such interests, with the remainder being allocated to the Class B and C interests. BLX may declare dividends on its Class B interests. If declared, BLX would determine the amount of such dividend considering its estimated annual taxable income allocable to such interests.

At December 31, 2005, BLX had a three-year $275.0 million revolving credit facility provided by third party lenders that was scheduled to mature in January 2007. As the controlling equity owner in BLX, we had provided an unconditional guaranty to the revolving credit facility lenders in an amount equal to 50% of the total obligations (consisting of principal, letters of credit issued under the facility, accrued interest, and other fees) of BLX under the revolving credit facility. At December 31, 2005, the principal amount of loans outstanding on the revolving credit facility was $228.2 million and letters of credit issued under the facility were $41.7 million. The total obligation guaranteed by us at December 31, 2005, was $135.4 million.

On March 17, 2006, BLX closed on a new three-year $500.0 million revolving credit facility that matures in March 2009, which replaced the existing facility. The revolving credit facility may be expanded through new or additional commitments up to $600.0 million at BLX s option. This new facility provides for a sub-facility for the issuance of letters of credit for up to an amount equal to 25% of the committed facility. We have provided an unconditional guaranty to these revolving credit facility lenders in an amount equal to 50% of the total obligations (consisting of principal, letters of credit issued under the facility, accrued interest, and other fees) of BLX under this facility. At September 30, 2006, the principal amount outstanding on the revolving credit facility was $319.9 million and letters of credit issued under the facility were $55.9 million. The total obligation guaranteed by us at September 30, 2006, was $188.1 million. This guaranty can be called by the lenders only in the event of a default under the BLX credit facility, which includes certain defaults under our revolving credit facility. BLX has determined it was in compliance with the terms of this facility at September 30, 2006.

At September 30, 2006, we had also provided four standby letters of credit totaling $29.5 million in connection with four term securitization transactions completed by BLX. In consideration for providing the revolving credit facility guaranty and the standby letters of credit, BLX paid us fees of $4.6 million and $4.7 million for the nine months ended September 30, 2006 and 2005, respectively, which were included in fees and other income above.

Advantage Sales & Marketing, Inc. At December 31, 2005, our investment in Advantage totaled $257.7 million at cost and $660.4 million at value, or 16.4% of our total assets, which included unrealized appreciation of $402.7 million. We completed the purchase of a majority ownership in Advantage in June 2004.

On March 29, 2006, we sold our majority equity interest in Advantage. We were repaid our $184 million in subordinated debt outstanding and realized a gain at closing on our equity investment sold of $433.1 million, subject to post-closing adjustments. As consideration for the common stock sold in the transaction, we received a $150 million subordinated note, with the balance of the consideration paid in cash. Approximately $34 million of our cash proceeds from the sale of the common stock were placed in escrow at closing, subject to certain holdback provisions. In the second and third quarters of 2006, we realized additional gains resulting from post-closing adjustments totaling $1.3 million. In addition, there is potential for us to receive additional consideration through an earn-out payment that would be based on Advantage s 2006 audited results. Our realized gain of $434.4 million as of September 30, 2006, subject to post-closing adjustments, excludes any earn-out amounts. For tax purposes, the receipt of the $150 million subordinated note as part of our consideration for the common stock sold will allow us, through installment treatment, to defer the recognition of taxable income for a portion of our realized gain until the note is collected. In connection with the transaction, we retained an equity investment in the business valued at $15 million at closing as a minority shareholder.

Total interest and related portfolio income earned from our investment in Advantage while we held a majority equity interest was $14.1 million, which included a prepayment premium of $5.0 million, for the nine months ended September 30, 2006, and $28.2 million for the nine months ended September 30, 2005. In addition, we earned structuring fees of $2.3 million on our new $150 million subordinated debt investment in Advantage upon the closing of the sale transaction.

Our investment in Advantage at September 30, 2006, which was composed of subordinated debt and a minority equity interest, totaled $152.9 million at cost and $163.9 million at value, which included unrealized appreciation of $11.0 million. Subsequent to the completion of the sale transaction, our interest income from our subordinated debt investment in Advantage for the three and nine months ended September 30, 2006, was $4.6 million and $9.4 million, respectively.

Advantage is a sales and marketing agency providing outsourced sales, merchandising, and marketing services to the consumer packaged goods industry. Advantage has offices across the United States and is headquartered in Irvine, CA.

Commercial Real Estate Finance

The commercial real estate finance portfolio at value, investment activity, and the yield on interest-bearing investments at and for the three and nine months ended September 30, 2006 and 2005, and at and for the year ended December 31, 2005, were as follows:

	At and for the Three Months Ended September 30,				At and for the Nine Months Ended September 30,				At and for the Year Ended December 31,	
	2006		2005		2006		2005		2005	
($ in millions)	Value	Yield[(1)]	Value	Yield[(1)]	Value	Yield[(1)]	Value	Yield[(1)]	Value	Yield[(1)]
Portfolio at value:										
Commercial mortgage loans	$ 94.4	7.7%	121.2	6.6%	$ 94.4	7.7%	121.2	6.6%	102.6	7.6%
Real estate owned	15.3		15.1		15.3		15.1		13.9	
Equity interests	22.1		6.5		22.1		6.5		10.6	
Total portfolio	$ 131.8		$ 142.8		$ 131.8		$ 142.8		$ 127.1	
Investments funded	$ 0.3		$ 7.7		$ 14.2		$ 196.3		$ 213.5	
Change in accrued or reinvested interest	$ 0.1		$ (0.4)		$ 0.6		$ (18.5)		$ (18.0)	
Principal collections related to investment repayments or sales[(2)]	$ 0.7		$ 4.5		$ 17.9		$ 765.3		$ 799.5	

(1) The weighted average yield on the commercial mortgage loans is computed as the (a) annual stated interest on accruing loans plus the annual amortization of loan origination fees, original issue discount, and market discount on accruing loans less the annual amortization of origination costs, divided by (b) total interest-bearing investments at value. The weighted average yield is computed as of the balance sheet date.

(2) Principal collections related to investment repayments or sales for the year ended December 31, 2005, included $718.1 million related to the sale of our CMBS and CDO portfolio in May 2005.

Our commercial real estate investments funded for the nine months ended September 30, 2006 and 2005, and for the year ended December 31, 2005, were as follows:

($ in millions)	Face Amount	Discount	Amount Funded
For the Nine Months Ended September 30, 2006			
Commercial mortgage loans	$ 7.7	$	$ 7.7
Equity interests	6.5		6.5
Total	$ 14.2	$	$ 14.2

For the Nine Months Ended September 30, 2005			
CMBS bonds (4 new issuances)[1]	$ 211.5	$ (90.5)	$ 121.0
Commercial mortgage loans	73.5	(0.9)	72.6
Equity interests	2.7		2.7
Total	$ 287.7	$ (91.4)	$ 196.3
For the Year Ended December 31, 2005			
CMBS bonds (4 new issuances)[1]	$ 211.5	$ (90.5)	$ 121.0
Commercial mortgage loans	88.5	(0.8)	87.7
Equity interests	4.8		4.8
Total	$ 304.8	$ (91.3)	$ 213.5

(1) The CMBS bonds invested in during 2005 were sold on May 3, 2005.

At September 30, 2006, we had outstanding funding commitments related to commercial mortgage loans and equity interests of $9.1 million and commitments in the form of standby letters of credit and guarantees related to equity interests of $6.9 million.

Sale of CMBS Bonds and Collateralized Debt Obligation Bonds and Preferred Shares. On May 3, 2005, we completed the sale of our portfolio of commercial mortgage-backed securities (CMBS) and real estate related collateralized debt obligation (CDO) bonds and preferred shares to affiliates of Caisse de dépôt et placement du Québec (the Caisse) for cash proceeds of $976.0 million and a net realized gain of $227.7 million, after transaction and other costs of $7.8 million. Transaction costs included investment banking fees, legal and other professional fees, and other transaction costs. The CMBS and CDO assets sold had a cost basis at closing of $739.8 million, including accrued interest of $21.7 million. Upon the closing of the sale, we settled all the hedge positions relating to these assets, which resulted in a net realized loss of $0.7 million, which was included in the net realized gain on the sale.

Simultaneous with the sale of our CMBS and CDO portfolio, we entered into a platform assets purchase agreement with CWCapital Investments LLC, an affiliate of the Caisse (CWCapital), pursuant to which we agreed to sell certain commercial real estate related assets, including servicer advances, intellectual property, software and other platform assets, subject to certain adjustments. Under this agreement, we have agreed not to invest in CMBS and real estate-related CDOs and refrain from certain other real estate-related investing or servicing activities for a period of three years, or through May 2008, subject to certain limitations and excluding our existing portfolio and related activities.

The real estate securities purchase agreement, under which we sold the CMBS and CDO portfolio, and the platform asset purchase agreement contain customary representations and warranties, and require us to indemnify the affiliates of the Caisse that are parties to the agreements for certain liabilities arising under the agreements, subject to certain limitations and conditions.

Hedging Activities

We have invested in commercial mortgage loans, which were purchased at prices that were based in part on comparable Treasury rates. We have entered into transactions with one or more financial institutions to hedge against movement in Treasury rates on certain of these commercial mortgage loans. These transactions, referred to as short sales, involve receiving the proceeds from the short sales of borrowed Treasury securities, with the obligation to replenish the borrowed Treasury securities at a later date based on the then current market price, whatever that price may be. Risks in these contracts arise from movements in the value of the borrowed Treasury securities due to changes in interest rates and from the possible inability of counterparties to meet the terms of their contracts. If the value of the borrowed Treasury securities increases, we will incur losses on these transactions. These losses are limited to the increase in value of the borrowed Treasury securities; conversely, the value of the hedged commercial mortgage loans would likely increase. If the value of the borrowed Treasury securities decreases, we will incur gains on these transactions which are limited to the decline in value of the borrowed Treasury securities; conversely, the value of the hedged commercial mortgage loans would likely decrease. We do not anticipate nonperformance by any counterparty in connection with these transactions.

The total obligations to replenish borrowed Treasury securities, including accrued interest payable on the obligations, were $17.7 million at both September 30, 2006, and December 31, 2005. The net proceeds related to the sales of the borrowed Treasury securities plus or minus the additional cash collateral provided or received under the terms of the transactions were $17.7 million at both September 30, 2006, and December 31, 2005. The amount of the hedge will vary from period to period depending upon the amount of commercial mortgage loans that we own and have hedged as of the balance sheet date.

PORTFOLIO ASSET QUALITY

Portfolio by Grade. We employ a grading system for our entire portfolio. Grade 1 is used for those investments from which a capital gain is expected. Grade 2 is used for investments performing in

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accordance with plan. Grade 3 is used for investments that require closer monitoring; however, no loss of investment return or principal is expected. Grade 4 is used for investments that are in workout and for which some loss of current investment return is expected, but no loss of principal is expected. Grade 5 is used for investments that are in workout and for which some loss of principal is expected.

At September 30, 2006, and December 31, 2005, our portfolio was graded as follows:

	2006		2005	
Grade ($ in millions)	**Portfolio at Value**	**Percentage of Total Portfolio**	**Portfolio at Value**	**Percentage of Total Portfolio**
1	$ 1,082.1	26.3%	$ 1,643.0	45.6%
2	2,767.1	67.2	1,730.8	48.0
3	153.4	3.7	149.1	4.1
4	57.9	1.4	26.5	0.7
5	59.1	1.4	57.0	1.6
	$ 4,119.6	100.0%	$ 3,606.4	100.0%

The amount of the portfolio in each grading category may vary substantially from period to period resulting primarily from changes in the composition of the portfolio as a result of new investment, repayment, and exit activity, changes in the grade of investments to reflect our expectation of performance, and changes in investment values.

Total Grade 4 and 5 portfolio assets were $117.0 million and $83.5 million, respectively, or were 2.8% and 2.3%, respectively, of the total portfolio at value at September 30, 2006, and December 31, 2005. Grade 4 and 5 assets include loans, debt securities, and equity securities. We expect that a number of investments will be in the Grades 4 or 5 categories from time to time. Part of the private equity business is working with troubled portfolio companies to improve their businesses and protect our investment. The number and amount of investments included in Grade 4 and 5 may fluctuate from period to period. We continue to follow our historical practice of working with portfolio companies in order to recover the maximum amount of our investment.

Loans and Debt Securities on Non-Accrual Status. At September 30, 2006, and December 31, 2005, loans and debt securities at value not accruing interest for the total investment portfolio were as follows:

($ in millions)	**2006**	**2005**
Loans and debt securities in workout status (classified as Grade 4 or 5)(1)		
Private finance		
Companies more than 25% owned	$ 52.3	$ 15.6
Companies 5% to 25% owned	2.7	
Companies less than 5% owned	24.8	11.4
Commercial real estate finance	6.7	12.9
Loans and debt securities not in workout status		
Private finance		

Companies more than 25% owned	36.0	58.0
Companies 5% to 25% owned	7.2	0.5
Companies less than 5% owned	18.3	49.5
Commercial real estate finance	13.7	7.9
Total	$ 161.7	$ 155.8
Percentage of total portfolio	3.9%	4.3%

(1) Workout loans and debt securities exclude equity securities that are included in the total Grade 4 and 5 assets above.

Loans and Debt Securities Over 90 Days Delinquent. Loans and debt securities greater than 90 days delinquent at value at September 30, 2006, and December 31, 2005, were as follows:

($ in millions)	**2006**	**2005**
Private finance	$ 41.2	$ 74.6
Commercial mortgage loans	3.7	6.1
Total	$ 44.9	$ 80.7
Percentage of total portfolio	1.1%	2.2%

In general, interest is not accrued on loans and debt securities if we have doubt about interest collection or where the enterprise value of the portfolio company may not support further accrual. In addition, interest may not accrue on loans to portfolio companies that are more than 50% owned by us depending on such company s capital requirements. To the extent interest payments are received on a loan that is not accruing interest, we may use such payments to reduce our cost basis in the investment in lieu of recognizing interest income.

As a result of these and other factors, the amount of the portfolio that is greater than 90 days delinquent or on non-accrual status may vary from period to period. Loans and debt securities on non-accrual status and over 90 days delinquent should not be added together as they are two separate measures of portfolio asset quality. Loans and debt securities that are in both categories (i.e., on non-accrual status and over 90 days delinquent) totaled $44.9 million and $60.7 million at September 30, 2006, and December 31, 2005, respectively.

PORTFOLIO RETURNS

Since our merger on December 31, 1997, through September 30, 2006, our combined aggregate cash flow Internal Rate of Return (IRR) has been approximately 22% for private finance and CMBS/CDO investments exited during this period. The IRR is calculated using the aggregate portfolio cash flow for all investments exited over this period. For investments exited during this period, we invested capital totaling $3.8 billion. The weighted average holding period of these investments was 35 months. Investments are considered to be exited when the original investment objective has been achieved through the receipt of cash and/or non-cash consideration upon the repayment of our debt investment or sale of an equity investment, or through the determination that no further consideration was collectible and, thus, a loss may have been realized. The aggregate cash flow IRR for private finance investments was approximately 21% and for CMBS/CDO investments was approximately 24% for the same period. The weighted average holding period of the private finance and CMBS/CDO investments was 48 months and 22 months, respectively, for the same period. These IRR results represent historical results. Historical results are not necessarily indicative of future results.

OTHER ASSETS AND OTHER LIABILITIES

Other assets is composed primarily of fixed assets, assets held in deferred compensation trusts, deferred financing and offering costs, and accounts receivable, which includes amounts received in connection with the sale of portfolio companies, including amounts held in escrow, and other receivables from portfolio companies. At September 30, 2006, and December 31, 2005, other assets totaled $119.5 million and $87.9 million, respectively. The increase since year end was primarily the result of amounts received in connection with the sales of Advantage and STS Operating, Inc., that are being held in escrow. See Results of Operations below.

Accounts payable and other liabilities is primarily composed of the liabilities related to the deferred compensation trust and accrued interest, bonus and taxes, including excise tax. At September 30, 2006, and December 31, 2005, accounts payable and other liabilities totaled $133.1 million and $102.9 million, respectively. The increase since year end was primarily the result of an increase in accrued interest payable by $22.2 million. Accrued interest fluctuates from period to period depending on the amount of debt outstanding and the contractual payment dates of the interest on such debt. Interest on our debt is primarily due on a semi-annual basis, which results in fluctuations of the quarter-end liability.

RESULTS OF OPERATIONS

Comparison of Three and Nine Months Ended September 30, 2006 and 2005

The following table summarizes the Company s operating results for the three and nine months ended September 30, 2006 and 2005.

ousands, except per share amounts)	For the Three Months Ended September 30, 2006 (unaudited)	2005	Change	Percentage Change	For the Nine Months Ended September 30, 2006 (unaudited)	2005	Change	Perc Ch
and Related Portfolio Income								
and dividends	$ 98,668	$ 76,353	$ 22,315	29%	$ 282,982	$ 232,628	$ 50,354	
l other income	14,715	18,504	(3,789)	(20)%	51,868	43,355	8,513	
erest and related portfolio income	113,383	94,857	18,526	20%	334,850	275,983	58,867	
es								
	26,109	17,929	8,180	46%	72,455	57,483	14,972	
ee	25,228	13,969	11,259	81%	67,054	52,302	14,752	
ee stock options	3,649		3,649	100%	11,852		11,852	
trative	8,153	14,936	(6,783)	(45)%	29,348	58,563	(29,215)	
erating expenses	63,139	46,834	16,305	35%	180,709	168,348	12,361	
stment income before income taxes	50,244	48,023	2,221	5%	154,141	107,635	46,506	
tax expense (benefit), including excise	1,586	1,889	(303)	(16)%	13,988	7,482	6,506	
stment income	48,658	46,134	2,524	5%				