ALLIED CAPITAL CORP
Form 497
May 03, 2001

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PROSPECTUS SUPPLEMENT FILED PURSUANT TO RULE 497
(TO PROSPECTUS DATED MARCHAR 30, 2001) REGISTRATION STATEMENT NO. 333-43534

4,000,000 SHARES

[ALLIED CAPITAL LOGO]

COMMON STOCK

We are an internally managed closed-end management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940, as amended. Our investment objective is to achieve current income and capital gains.

We are offering for sale 4,000,000 shares of our common stock. Our common stock is traded on the Nasdaq National Market under the symbol "ALLC." The last reported sales price for our common stock on May 2, 2001 was $22.78 per share.

YOU SHOULD REVIEW THE INFORMATION, INCLUDING THE RISK OF LEVERAGE, SET FORTH UNDER "RISK FACTORS" ON PAGE 8 OF THE PROSPECTUS BEFORE INVESTING IN COMMON STOCK OF THE COMPANY.

	PER SHARE	TOTAL
Public offering price..................................	$22.78	$91,120,000
Underwriting discount..................................	$1.14	$4,560,000
Proceeds to Allied Capital Corporation(1)...............	$21.64	$86,560,000

(1) Before deducting expenses payable by us estimated at $350,000.

Please read this prospectus supplement, and the prospectus, before investing, and keep it for future reference. It contains important information about the Company. To learn more about the Company, you may want to look at the Statement of Additional Information dated March 30, 2001 (the "SAI"), which is available free of charge by contacting Allied Capital Corporation at 1919 Pennsylvania Avenue, N.W., Washington, DC 20006 (1-888-818-5298).

We have filed the SAI with the U.S. Securities and Exchange Commission and have incorporated it by reference into the prospectus. The SAI's table of contents appears on page 70 of the prospectus.

The Commission maintains an Internet website (http://www.sec.gov) that contains the SAI, material incorporated by reference and other information about the Company.

We have granted the underwriters a 30-day option to purchase up to 600,000 additional shares of common stock to cover over-allotments. If the underwriters exercise the option in full, the public offering price, the underwriting discount and proceeds to us would be $104,788,000, $5,244,000 and $99,544,000, respectively.

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

The shares of common stock will be ready for delivery on or about May 8, 2001.

MERRILL LYNCH & CO. U.S. BANCORP PIPER JAFFRAY

The date of this prospectus supplement is May 2, 2001.

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You should rely only on the information contained or incorporated by reference 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 underwriters are 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, the accompanying prospectus and the documents incorporated by reference is accurate only as of their respective dates. Our business, financial condition, results of operations and prospects may have changed since those dates.

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Information contained or incorporated by reference in this prospectus supplement, and the 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 prospectus and certain other factors noted throughout this prospectus supplement and the prospectus, and in any exhibits to the registration statement of which this prospectus supplement and the prospectus are a part, 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. In this prospectus supplement and the prospectus, unless otherwise indicated, the "Company," "we," "us" or "our" refer to Allied Capital Corporation and its subsidiaries.

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FEES AND EXPENSES

This table describes the various costs and expenses that an investor in our securities will bear directly or indirectly.

SHAREHOLDER TRANSACTION EXPENSES	
Sales load (as a percentage of public offering price)(1)..	5.0%
Dividend reinvestment plan fees(2)....................	None
ANNUAL EXPENSES (AS A PERCENTAGE OF CONSOLIDATED NET ASSETS ATTRIBUTABLE TO COMMON SHARES)(3)	
Operating expenses(4)................................	3.4%
Interest payments on borrowed funds(5)................	5.6%
Total annual expenses(6).........................	9.0%

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(1) The underwriting discounts and commissions with respect to the shares sold by the Company in this offering are the only sales load paid in connection with this offering.

(2) The expenses of the Company's DRIP plan are included in "Operating expenses." The Company has no cash purchase plan. The participants in the DRIP plan will bear a pro rata share of brokerage commissions incurred with respect to open market purchases, if any. See "Dividend Reinvestment Plan" in the prospectus.

(3) "Consolidated net assets attributable to common shares" equals net assets (i.e., total assets less total liabilities and preferred stock) at December 31, 2000.

(4) "Operating expenses" represent all operating expenses of the Company for the year ended December 31, 2000 excluding interest on indebtedness. Operating expenses exclude the formula and cut-off awards. See "Management -- Compensation Plans" in the prospectus.

(5) The "Interest payments on borrowed funds" percentage is based on interest payments for the year ended December 31, 2000 divided by consolidated net assets attributable to common stock at December 31, 2000. The Company had outstanding borrowings of $786.6 million at December 31, 2000. See "Risk Factors" in the prospectus.

(6) "Total annual expenses" as a percentage of consolidated net assets attributable to common stock are higher than the total annual expenses percentage would be for a company that is not leveraged. The Company borrows money to leverage its net assets and to increase its total assets. The Securities and Exchange Commission requires that the "Total annual expenses" percentage be calculated as a percentage of net assets, rather than the total assets, including assets that have been funded with borrowed monies. If the "Total annual expenses" percentage were calculated instead as a percentage of consolidated total assets, "Total annual expenses" for the Company would be 5.0% of consolidated total assets.

EXAMPLE

The following example, required by the Securities and Exchange Commission, demonstrates the projected dollar amount of total cumulative expenses that would be incurred over various periods with respect to a hypothetical investment in the Company. In calculating the following expense amounts, we assumed we would have no additional leverage and that our operating expenses would remain at the levels set forth in the table above.

	1 YEAR	3 YEARS	5 YEARS	10 YEA
You would pay the following expenses on a $1,000 investment, assuming a 5.0% annual return..........................	$138	$313	$489	$927

Although the example assumes (as required by the Commission) a 5.0% annual return, our performance will vary and may result in a return of greater or less than 5.0%. In addition, while the example assumes reinvestment of all dividends and distributions at net asset value, participants in the DRIP plan may receive shares of common stock that we issue at or above net asset value or are purchased by the administrator of the DRIP plan, at the market price in effect at the time, which may be higher than, at, or below net asset value. See "Dividend Reinvestment Plan" in the prospectus.

THE EXAMPLE SHOULD NOT BE CONSIDERED A REPRESENTATION OF FUTURE EXPENSES, AND THE ACTUAL EXPENSES MAY BE GREATER OR LESS THAN THOSE SHOWN.

RECENT DEVELOPMENTS

OPERATING RESULTS

Net operating income before net realized and unrealized gains was $39.7 million, or $0.46 per share for the first quarter of 2001, a 35% increase over net operating income of $22.6 million, or $0.34 per share, for the first quarter of 2000. The increase in net operating income stemmed from growth in the investment portfolio, and increased structuring and management fee income.

For the three months ended March 31, 2001, the Company reported net income of $52.0 million, or $0.60 per share, a 33% increase over net income of $29.6 million, or $0.45 per share, for the three months ended March 31, 2000. The significant increase in net income resulted from strong operating income and realized and unrealized net gains in the portfolio.

Total net realized and unrealized gains totaled $12.3 million, or $0.14 per share, for the first quarter of 2001 as compared to $7.0 million, or $0.11 per share, for the first quarter of 2000. Net realized gains totaled $1.2 million; net unrealized gains totaled $11.1 million. Net realized and unrealized gains can vary substantially from quarter to quarter.

During the three months ended March 31, 2001, the Company invested a total of $150.8 million. After total repayments of $26.6 million, sales of $35.2 million, and valuation changes during the quarter, the Company's investment portfolio increased to $1.9 billion at March 31, 2001.

At March 31, 2001, total assets were $2.0 billion, a 6% increase over total assets of $1.9 billion at December 31, 2000. Shareholders' equity was $1.1 billion at March 31, 2001, and net asset value was $12.26 per share.

The Company invested a total of $150.8 million for the three months ended March 31, 2001. At March 31, 2001, the overall weighted average yield on the Company's portfolio was 14.3%.

PRIVATE FINANCE

The private finance portfolio totaled $1.3 billion at March 31, 2001. The debt portion of this portfolio, which totaled $959.5 million at March 31, 2001, had a weighted average yield of 14.7%. The equity securities in the private finance portfolio totaled $343.8 million at March 31, 2001. Included in the equity portfolio is the Company's equity investment in Business Loan Express, Inc. ("BLX"), which was valued at $145 million.

During the first quarter of 2001, the Company committed a total of $31.5 million and invested a total of $20.6 million in its core private finance business. Buyout and private finance activity across the industry was slow during the first quarter of 2001 largely due to credit tightening among senior lenders. Equity-focused buyout firms need both senior and subordinated debt to leverage private equity investments, and during the first quarter of 2001, the senior bank market, and in particular the senior syndicated loan market, was effectively closed. The Company completed the financing for only one buyout transaction during the quarter. The Company provided $10 million of senior subordinated debt financing with warrants to finance the management buyout of Redox Brands, Inc., which is a marketer of leading consumer branded products in the cleaning and detergent market, including Biz and Oxydol. The Company also funded financing commitments for existing portfolio companies.

CMBS INVESTING

During the first quarter of 2001, the Company's commercial real estate finance group invested $104.4 million in non-investment grade commercial mortgage-backed securities (CMBS) in two transactions. In addition, the Company purchased $24.6 million in non-investment grade securities related to a collateralized debt offering secured by CMBS and investment grade REIT bonds. The effective yield on these new commercial real estate securities is estimated to be 15.9%, after assuming a 1% loss on the entire underlying collateral pool. The Company also sold $35.2 million in CMBS BB bonds during the quarter, and recognized short-term capital gains of $0.8 million.

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The Company's entire purchased CMBS portfolio of $406.6 million at March 31, 2001 had a weighted average yield to maturity of 15.6%, after assuming a 1% loss on the entire underlying collateral pool. The credit characteristics of the underlying loan portfolios remain strong with less than 0.5% in delinquencies. At March 31, 2001, the unamortized discount on the purchased CMBS portfolio was $431.7 million.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2001, the Company had a weighted average cost of debt of 7.8%. The Company has significant current availability on its unsecured short-term line of credit, and the Company has no significant maturities of long-term debt until 2003. At March 31, 2001, the Company had regulatory asset coverage ratio of 232%. The Company is required to maintain regulatory asset coverage of at least 200%.

PORTFOLIO QUALITY AND VALUATION

As a business development company, the Company is required quarterly to value its portfolio at fair value as determined by the Board of Directors. During the first quarter of 2001, the Company recognized $11.1 million in net unrealized gains.

The Company increased the value of its equity investment in BLX by $15.5 million at March 31, 2001. During the first quarter, BLX secured a 3-year $117 million revolving credit facility and completed a $65 million securitization of unguaranteed SBA 7(a) loans. As a result of the elimination of the refinancing risk that existed at the time of the merger, and BLX's progress in merger integration, the Company increased the value of its equity investment. The Company also increased the value of its investment in Wyo-Tech Acquisition Corporation by $8.8 million, due to its continued growth and positive performance. In addition to BLX and Wyo-Tech, the Company increased the value of other portfolio companies by $6.1 million in total. These companies increased in value because of continued positive performance, and valuation data that would indicate that a valuation increase was necessary.

The Company decreased the value of its common equity investment in Startec Global Communications Corporation by $3 million. The Company also decreased the value of its debt investment in NETtel Communications, Inc. by $5 million. In addition, the Company decreased the value of other private finance investments by a total of $11.3 million.

The Company employs a grading system to monitor the quality of its portfolio. Grade 1 is for those investments from which a capital gain is expected. Grade 2 is for investments performing in accordance with plan. Grade 3 is for investments that require closer monitoring, but no loss of interest or principal is expected. Grade 4 is for investments for which some loss of contractually due interest is expected, but no loss of principal is expected. Grade 5 is for investments for which full loss of interest and some loss of principal is expected, and the loan is marked down to net realizable value.

At March 31, 2001, the portfolio of Grade 1 investments totaled $430.2 million, or 23% of the total portfolio at value; Grade 2 investments totaled $1.3 billion, or 70% of the total portfolio; Grade 3 investments totaled $35.3 million, or 2% of the total portfolio; Grade 4 investments totaled $61.1 million, or 3% of the total portfolio; and Grade 5 investments totaled $36.6 million, or 2% of the total portfolio. Included in Grade 4 and 5 investments are assets totaling $14.4 million that are secured by commercial real estate.

For the total investment portfolio, loans greater than 120 days delinquent were $55.3 million at value at March 31, 2001, or 2.9% of the total portfolio. Included in this category are loans valued at $9.8 million that are fully secured by commercial real estate. Loans greater than 120 days delinquent generally do not accrue interest. At December 31, 2000, delinquencies in the CMBS portfolio related to the underlying collateral pool were negligible.

ALLIED CAPITAL TO LIST ON THE NYSE

The Company has been cleared to list its common stock on the New York Stock

Exchange, and will begin trading on June 6, 2001 under the symbol "ALD". Until that day, the Company will continue to trade

on the Nasdaq National Market under ticker symbol "ALLC." The Company's CUSIP number, 01903-Q10-8, and transfer agent, American Stock Transfer & Trust Company, will remain the same.

QUARTERLY DIVIDEND

The Company increased its regular quarterly dividend to $0.50 per share for the second quarter of 2001. The regular quarterly dividend had previously been $0.49 per share. The dividend will be payable on June 29, 2001 to shareholders of record on June 15, 2001.

The Company's dividend is paid from taxable income. The Board of Directors determines the dividend based on annual estimates of taxable income, which differs from book income because of both timing and absolute differences in income and expense recognition. Changes in unrealized appreciation and depreciation have no impact on the Company's taxable income.

SUMMARY FINANCIAL INFORMATION

(IN THOUSANDS, EXCEPT PER SHARE AMOUNT)	AT MARCH 31, 2001 (UNAUDITED)	AT DECEMBER 31, 2000
ASSETS		
Portfolio at Value:		
Private finance	$1,303,288	$1,282,467
Commercial real estate finance	583,465	505,534
Total Portfolio at Value	1,886,753	1,788,001
Cash and cash equivalents	9,392	2,449
Other assets	77,353	63,367
Total Assets	$1,973,498	$1,853,817
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Debt	883,776	786,648
Other liabilities	28,477	30,477
	912,253	817,125
Preferred stock issued to SBA	7,000	7,000
Common shareholders' equity	1,054,245	1,029,692
Total Liabilities and Shareholders' Equity	$1,973,498	$1,853,817
Net asset value per share	$12.26	$12.11
Actual shares outstanding at end of period	85,956	85,057

	FOR THE THREE MONTHS ENDED MARCH 31,	
	2001	2000
	(UNAUDITED)	
INTEREST AND RELATED PORTFOLIO INCOME:		
Interest and dividends	$ 54,875	$ 38,812
Net premiums from loan dispositions	821	3,289
Investment advisory fees and other income	9,375	1,796
Total interest and related portfolio income	65,071	43,897
EXPENSES:		
Interest	15,930	12,311
Employee	6,418	4,569
Administrative	2,967	2,753
Total operating expenses	25,315	19,633
Formula and cut-off awards	28	1,691
Net operating income before net realized and unrealized gains	39,728	22,573
Net realized and unrealized gains:		
Net realized gains	1,154	2,176
Net unrealized gains	11,146	4,832
Total net realized and unrealized gains	12,300	7,008
Net Income	$ 52,028	$ 29,581
Diluted earnings per common share	$0.60	$0.45
Weighted average common shares outstanding -- diluted	87,059	66,308

USE OF PROCEEDS

The net proceeds from the sale of the shares, after deducting estimated expenses of this offering, are estimated to be $86.2 million (and $99.2 million, if the overallotment is exercised). We intend to use the net proceeds from selling the shares to finance our Company's growth and for general corporate purposes, which may include investment in private companies and undervalued public companies, purchase of commercial-backed securities, and acquisitions. We may also repay a portion of our revolving line of credit. At May 2, 2001, the interest rate on our revolving line of credit was 6.4% and there was approximately $123.5 million outstanding.

We raise new equity from time to time using a universal shelf registration statement. We raise new equity when we have a clear use of proceeds for attractive investment opportunities. Historically, this process has enabled us to raise equity on an accretive basis for existing shareholders.

UNDERWRITING

Merrill Lynch, Pierce, Fenner & Smith Incorporated and U.S. Bancorp Piper

Jaffray Inc. are acting as the underwriters. Subject to the terms and conditions set forth in the underwriting agreement among the underwriters and us, we have agreed to sell to the underwriters, and the underwriters severally have agreed to purchase from us, the number of shares listed opposite their names below.

UNDERWRITER	NUMBER OF SHARES
Merrill Lynch, Pierce, Fenner & Smith Incorporated	2,800,000
U.S. Bancorp Piper Jaffray Inc.	1,200,000
Total	4,000,000

This offering will be underwritten on a firm commitment basis. In the underwriting agreement, the underwriters have agreed, subject to the terms and conditions set forth therein, to purchase the shares of common stock being sold pursuant thereto at a price per share equal to the public offering price less the underwriting discount specified on the cover page of this prospectus supplement. According to the terms of the underwriting agreement, the underwriters will either purchase all of the shares or none of them.

The underwriters have advised us that they will offer the shares of common stock to the public initially at the public offering price specified on the cover page of this prospectus supplement. The underwriters may also offer the shares to certain dealers at the public offering price less a concession not in excess of $.68 per share. The underwriters may allow, and these dealers may re-allow, a concession not in excess of $.10 per share to certain other brokers and dealers. The underwriters will offer the shares subject to prior sale and subject to receipt and acceptance of the shares by the underwriters. The underwriters may reject any order to purchase shares in whole or in part. The underwriters expect that we will deliver the shares to the underwriters through the facilities of The Depository Trust Company in New York, New York, on or about May 8, 2001. At that time, the underwriters will pay us for the shares in immediately available funds. After the commencement of the public offering, the public offering price, concession and discount may be changed.

The underwriters have the option to purchase up to an aggregate of 600,000 additional shares of common stock from us at the same price they are paying for the 4,000,000 shares offered hereby. The underwriters may purchase additional shares only to cover over-allotments made in connection with this offering and only within 30 days after the date of this prospectus supplement. The underwriters will offer any additional shares that they purchase on the terms described in the preceding paragraph.

The following table summarizes the compensation to be paid by us to the underwriters:

	PER SHARE	WITHOUT OPTION	WITH OPTION

Public offering price	$22.78	$91,120,000	$104,788,000
Underwriting discount	$1.14	$4,560,000	$5,244,000
Proceeds, before expenses, to us	$21.64	$86,560,000	$99,544,000

We estimate the expenses of this offering payable by us (excluding underwriting discount) to be $350,000.

We have agreed to indemnify the underwriters and their controlling persons against certain liabilities, including liabilities under the Securities Act.

We and certain of our executive officers have agreed not to sell or transfer any shares of common stock or to engage in certain hedging transactions with respect to the common stock for a period of 90 days after the date of this prospectus supplement without first obtaining the written consent of Merrill Lynch, Pierce, Fenner & Smith Incorporated, except in certain limited circumstances, including our ability to sell in privately negotiated transactions not in excess of an additional $45 million of equity securities.

Until the distribution of the common stock is completed, rules of the Commission may limit the ability of the underwriters to bid for and purchase shares of common stock. As an exception to these rules, the underwriters are permitted to engage in certain transactions that stabilize the price of the common stock. Such transactions consist of bids or purchases for the purpose of pegging, fixing or maintaining the price of the common stock.

If the underwriters create a short position in the common stock in connection with this offering, i.e., they sell more shares of common stock than are set forth on the cover page of this prospectus supplement, the underwriters may reduce that short position by purchasing shares of common stock in the open market. The underwriters may also elect to reduce any short position through the exercise of all or part of the over-allotment option described above.

In general, purchases of a security for the purpose of stabilization or to reduce a short position could cause the price of the security to be higher than it might be in the absence of these purchases.

Neither we nor the underwriters make any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of the common stock. In addition, neither we nor the underwriters make any representation that the underwriters will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

In connection with this offering, the underwriters may engage in passive market making transactions in the common stock on the Nasdaq National Market in accordance with Regulation M under the Securities Exchange Act of 1934, as amended during a period before the commencement of offers or sales of the shares of common stock.

The underwriters from time to time provide investment banking and other services to us.

LEGAL MATTERS

Certain legal matters with respect to the validity of the shares of common stock will be passed upon for the Company by Sutherland Asbill & Brennan LLP, Washington, D.C. Certain legal matters related to the offering will be passed upon for the underwriters by Hogan & Hartson L.L.P., Washington, D.C.

PROSPECTUS

FILED PURSUANT TO RULE 497
REGISTRATION STATEMENT NO. 333-43534

$310,500,000

[ALLIED CAPITAL LOGO]

COMMON STOCK
PREFERRED STOCK
DEBT SECURITIES

Please read this prospectus, and the accompanying prospectus supplement, if any, before investing, and keep it for future reference. It contains important information about the Company.

To learn more about the Company, you may want to look at the Statement of Additional Information dated March 30, 2001 (known as the "SAI"). For a free copy of the SAI, contact us at:

Allied Capital Corporation
1919 Pennsylvania Avenue, N.W.
Washington, DC 20006
1-888-818-5298

The Company has filed the SAI with the U.S. Securities and Exchange Commission and has incorporated it by reference into this prospectus. The SAI's table of contents appears on page 70 of this prospectus.

The Commission maintains an Internet website (http://www.sec.gov) that contains the SAI, material incorporated by reference and other information about the Company.

Our common stock is traded on the Nasdaq National Market under the symbol "ALLC." As of March 30, 2001, the last reported sales price for the common stock was $20.13.

We may offer, from time to time, up to $310,500,000 of our common stock, par value $0.0001 per share, preferred stock, or debt securities in one or more offerings. All shares of common stock, preferred stock, and debt securities that are offered under this prospectus are collectively referred to herein as the "Securities."

The Securities may be offered at prices and on terms to be described in one or more supplements to this prospectus. In the case of our common stock, the offering price per share less any underwriting commissions or discounts will not be less than the net asset value per share of our common stock at the time we make the offering.

We are an internally managed closed-end management investment company that has elected to be regulated as a business development company under the Investment Company Act of 1940, as amended.

Our investment objective is to achieve current income and capital gains. We seek to achieve our investment objective by investing primarily in private businesses in a variety of industries throughout the United States. No assurances can be given that we will continue to achieve our objective.

YOU SHOULD REVIEW THE INFORMATION INCLUDING THE RISK OF LEVERAGE, SET FORTH UNDER "RISK FACTORS" ON PAGE 8 OF THIS PROSPECTUS BEFORE INVESTING IN SECURITIES OF THE COMPANY.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ADEQUACY OR ACCURACY OF THIS PROSPECTUS. ANY REPRESENTATIONS TO THE CONTRARY IS A CRIMINAL OFFENSE.

THIS PROSPECTUS MAY NOT BE USED TO CONSUMMATE SALES OF SECURITIES UNLESS ACCOMPANIED BY A PROSPECTUS SUPPLEMENT.

March 30, 2001

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WE HAVE NOT AUTHORIZED ANY DEALER, SALESMAN OR OTHER PERSON TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATION OTHER THAN THOSE CONTAINED OR INCORPORATED BY REFERENCE IN THIS PROSPECTUS OR ANY ACCOMPANYING SUPPLEMENT TO THIS PROSPECTUS. YOU MUST NOT RELY UPON ANY INFORMATION OR REPRESENTATION NOT CONTAINED OR INCORPORATED BY REFERENCE IN THIS PROSPECTUS OR THE ACCOMPANYING PROSPECTUS SUPPLEMENT AS IF WE HAD AUTHORIZED IT. THIS PROSPECTUS AND ANY PROSPECTUS SUPPLEMENT DO NOT CONSTITUTE AN OFFER TO SELL OR A SOLICITATION OF ANY OFFER TO BUY ANY SECURITY OTHER THAN THE REGISTERED SECURITIES TO WHICH THEY RELATE, NOR DO THEY CONSTITUTE AN OFFER TO SELL OR A SOLICITATION OF AN OFFER TO BUY ANY SECURITIES IN ANY JURISDICTION TO ANY PERSON TO WHOM IT IS UNLAWFUL TO MAKE SUCH AN OFFER OR SOLICITATION IN SUCH JURISDICTION. THE INFORMATION CONTAINED IN THIS PROSPECTUS AND ANY PROSPECTUS SUPPLEMENT IS ACCURATE AS OF THE DATES ON THEIR COVERS.

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PROSPECTUS SUMMARY

The following summary contains basic information about this offering. It may not contain all the information that is important to an investor. For a more complete understanding of this offering, we encourage you to read this entire document and the documents to which we have referred.

Our current business and investment portfolio resulted from the merger of five affiliated companies on December 31, 1997. The companies that merged were Allied Capital Corporation (old), Allied Capital Corporation II, Allied Capital Advisers, Inc. ("Advisers"), Allied Capital Commercial Corporation and Allied Capital Lending Corporation. The five companies are referred to as the predecessor companies.

All information in this prospectus, unless otherwise indicated, has been presented as if the predecessor companies had merged as of the beginning of the earliest period presented. In this prospectus or any accompanying prospectus supplement, unless otherwise indicated, the "Company", "ACC", "we", "us" or "our" refer to the post-merger Allied Capital Corporation and its subsidiaries.

THE COMPANY (Page 13)

We are a business development company and provide private investment capital to private and undervalued public companies in a variety of different industries throughout the United States. We have been investing in growing businesses for over 40 years and have financed thousands of companies nationwide. As of January 2001, our investment activity is focused in two areas:

- private finance, and
- commercial real estate finance, primarily the purchase of commercial mortgage-backed securities ("CMBS").

Our investment portfolio includes:

- long-term unsecured loans with equity features,
- commercial mortgage-backed securities, and
- commercial mortgage loans.

We identify loans and investments through our numerous relationships with:

- mezzanine and private equity investors,
- investment banks, and
- other intermediaries, including professional services firms.

In order to increase our sourcing and origination activities, we have three regional offices in New York, Chicago and San Francisco. We centralize our credit approval function and service our loans through an experienced staff of professionals at our headquarters in Washington, DC.

We have an advantageous tax structure, as compared to operating companies, that allows for the "pass-through" of income to our shareholders through dividends without the imposition of a corporate level of taxation. See "Tax

Status."

We are an internally managed diversified closed-end management investment company that has elected to be regulated as a business development company ("BDC") under the Investment Company Act of 1940, as amended ("1940 Act"). Our investment objective is to achieve current income and capital gains. We seek to achieve our investment objective by investing in growing businesses in a variety of industries throughout the United States. As a BDC, we are required to meet regulatory tests, the most significant relating to its investments and borrowings.

A BDC is required to invest at least 70% of its assets in private or thinly traded public, U.S.-based companies. A BDC must maintain a coverage ratio of assets to senior securities of at least 200%. See "Business -- Certain Government Regulations."

We are quoted on the Nasdaq National Market and trade under the symbol "ALLC."

THE OFFERING (Page 68)

We may offer, from time to time, up to $310,500,000 of our Securities, on terms to be determined at the time of offering.

Securities may be offered at prices and on terms described in one or more supplements to this prospectus. In the case of the offering of our common stock, the offering price per share less any underwriting commission or discount will not be less than the net asset value per share of our common stock at the time we make the offering.

Our Securities may be offered directly to one or more purchasers, through agents designated from time to time by us, or to or through underwriters or dealers. The supplement to this prospectus relating to the offering will identify any agents or underwriters involved in the sale of our Securities, and will set forth any applicable purchase price, fee and commission or discount arrangement between our agents and us or among our underwriters or the basis upon which such amount may be calculated.

We may not sell Securities without delivering a prospectus supplement describing the method and terms of the offering of our Securities.

USE OF PROCEEDS (Page 13)

Unless otherwise specified in the prospectus supplement accompanying this prospectus, we intend to use the net proceeds from selling Securities for general corporate purposes, which may include investments in private and undervalued public companies, purchase of CMBS, repayment of indebtedness, acquisitions and other general corporate purposes.

DISTRIBUTIONS (Page 14)

We pay quarterly dividends to holders of our common stock. The amount of our quarterly dividends is determined by the board of directors. Other types of Securities will likely pay distributions in accordance with their terms.

DIVIDEND REINVESTMENT PLAN (Page 63)

We have adopted an "opt out" dividend reinvestment plan ("DRIP plan") for our common stockholders. Under the DRIP plan, if your shares of common stock are registered in your name, your dividends will be automatically reinvested in additional shares of our common stock unless you "opt out" of the DRIP plan.

PRINCIPAL RISK FACTORS (Page 8)

Investment in Securities involves certain risks relating to our structure and our investment objective that you should consider before purchasing Securities.

As a BDC, our consolidated portfolio includes securities primarily issued by privately held companies. These investments may involve a high degree of business and financial risk, and they are generally illiquid. A large number of entities and individuals compete for the same kind of investment opportunities as we do.

We borrow funds to make investments in private businesses. As a result, we are exposed to the risks of leverage, which may be considered a speculative investment technique. Borrowings, also known as leverage, magnify the potential for gain and loss on amounts invested and, therefore increase the risks associated with investing in our securities.

Also, we are subject to certain risks associated with investing in non-investment grade CMBS, valuing our portfolio, changing interest rates, accessing additional capital, fluctuating quarterly results, and operating in a regulated environment. In addition, the loss of pass-through tax treatment could have a material adverse effect on our total return, if any.

CERTAIN ANTI-TAKEOVER PROVISIONS (Page 65)

Our charter and bylaws, as well as certain statutory and regulatory requirements, contain certain provisions that may have the effect of discouraging a third party from making an acquisition proposal for the Company. These anti-takeover provisions may inhibit a change in control in circumstances that could give the holders of our common stock the opportunity to realize a premium over the market price for our common stock.

FEES AND EXPENSES

This table describes the various costs and expenses that an investor in our Securities will bear directly or indirectly.

SHAREHOLDER TRANSACTION EXPENSES	
Sales load (as a percentage of offering price)(1).......	--%
Dividend reinvestment plan fees(2)......................	None
ANNUAL EXPENSES (AS A PERCENTAGE OF CONSOLIDATED NET ASSETS ATTRIBUTABLE TO COMMON STOCK)(3)	
Operating expenses(4)..................................	3.4%
Interest payments on borrowed funds(5)..................	5.6%
Total annual expenses(6)..........................	9.0%

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(1) In the event that the Securities to which this prospectus relates are sold to or through underwriters, a corresponding prospectus supplement will disclose the applicable sales load.

(2) The expenses of the Company's DRIP plan are included in "Operating expenses." The Company has no cash purchase plan. The participants in the DRIP plan will bear a pro rata share of brokerage commissions incurred with respect to open market purchases, if any. See "Dividend Reinvestment Plan."

(3) "Consolidated net assets attributable to common stock" equals net assets (i.e., total assets less total liabilities and preferred stock) at December 31, 2000.

(4) "Operating expenses" represent all operating expenses of the Company for the year ending December 31, 2000 excluding interest on indebtedness. Operating expenses exclude the formula and cut-off awards. See "Management -- Compensation Plans."

(5) The "Interest payments on borrowed funds" percentage is based on interest payments for the year ending December 31, 2000 divided by consolidated net assets attributable to common stock at December 31, 2000. The Company had outstanding borrowings of $786.6 million at December 31, 2000. See "Risk Factors."

(6) "Total annual expenses" as a percentage of consolidated net assets attributable to common stock are higher than the total annual expenses percentage would be for a company that is not leveraged. The Company borrows money to leverage its net assets and increase its total assets. The Securities and Exchange Commission requires that "Total annual expenses" percentage be calculated as a percentage of net assets, rather than the total assets, including assets that have been funded with borrowed monies. If the "Total annual expenses" percentage were calculated instead as a percentage of consolidated total assets, "Total annual expenses" for the Company would be 5.0% of consolidated total assets.

EXAMPLE

The following example, required by the Commission, demonstrates the projected dollar amount of total cumulative expenses that would be incurred over various periods with respect to a hypothetical investment in the Company. In calculating the following expense amounts, we assumed we would have no additional leverage and that our operating expenses would remain at the levels set forth in the table above. In the event that shares to which this prospectus relates are sold to or through underwriters, a corresponding prospectus supplement will restate this example to reflect the applicable sales load.

	1 YEAR	3 YEARS	5 YEARS	10 YEARS
You would pay the following expenses on a $1,000 investment, assuming a 5.0% annual return........	$90	$271	$451	$902

Although the example assumes (as required by the Commission) a 5.0% annual return, our performance will vary and may result in a return of greater or less than 5.0%. In addition, while the example assumes reinvestment of all dividends and distributions at net asset value, participants in the DRIP plan may receive shares of common stock that we issue at or above net asset value or are purchased by the administrator of the DRIP plan, at the market price in effect at the time, which may be higher than, at, or below net asset value. See "Dividend Reinvestment Plan."

THE EXAMPLE SHOULD NOT BE CONSIDERED A REPRESENTATION OF FUTURE EXPENSES, AND THE ACTUAL EXPENSES MAY BE GREATER OR LESS THAN THOSE SHOWN.

SELECTED CONSOLIDATED FINANCIAL DATA

You should read the consolidated financial information below with the Consolidated Financial Statements and Notes thereto included in this prospectus. Financial information for the years ended December 31, 2000, 1999, 1998, 1997 and 1996 has been derived from audited financial statements. The selected financial data reflects the operations of the Company with all periods restated as if the predecessor companies had merged as of the beginning of the earliest period presented. SEE "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS" ON PAGE 15 FOR MORE INFORMATION.

	YEAR ENDED DECEMBER 31,				
(IN THOUSANDS, EXCEPT PER SHARE DATA)	2000	1999	1998	1997	1996
OPERATING DATA:					
Interest and related portfolio income:					
Interest and dividends	$182,307	$121,112	$ 80,281	$86,882	$77,54
Premiums from loan dispositions	16,138	14,284	5,949	7,277	4,24
Post-merger gain on securitization of commercial mortgage loans	--	--	14,812	--	-
Investment advisory fees and other income	13,144	5,744	5,696	3,246	3,15
Total interest and related portfolio income	211,589	141,140	106,738	97,405	84,93
Expenses:					
Interest	57,412	34,860	20,694	26,952	20,29
Employee	19,842	16,136	11,829	10,258	8,77
Administrative	15,435	12,350	11,921	8,970	8,28
Merger	--	--	--	5,159	-
Total operating expenses	92,689	63,346	44,444	51,339	37,36
Formula and cut-off awards(1)	6,183	6,753	7,049	--	-
Portfolio income before net realized and unrealized gains	112,717	71,041	55,245	46,066	47,57
Net realized and unrealized gains:					
Net realized gains	15,523	25,391	22,541	10,704	19,15
Net unrealized gains (losses)	14,861	2,138	1,079	7,209	(7,41
Total net realized and unrealized gains	30,384	27,529	23,620	17,913	11,74
Income before minority interests and income taxes	143,101	98,570	78,865	63,979	59,31
Minority interests	--	--	--	1,231	2,42
Income tax expense	--	--	787	1,444	1,94

Net increase in net assets resulting from operations	$143,101	$ 98,570	$ 78,078	$61,304	$54,94

	YEAR ENDED DECEMBER 31,				
	2000	1999	1998	1997	1996
PER SHARE:					
Basic earnings per common share	$ 1.95	$ 1.64	$ 1.50	$ 1.24	$ 1.19
Diluted earnings per common share	$ 1.94	$ 1.64	$ 1.50	$ 1.24	$ 1.17
Dividends per common share(2)	$ 1.82	$ 1.60	$ 1.43	$ 1.71	$ 1.23
Weighted average common shares outstanding - basic(3)	73,165	59,877	51,941	49,218	46,172
Weighted average common shares outstanding - diluted(3)	73,472	60,044	51,974	49,251	46,733

	AT DECEMBER 31,				
(IN THOUSANDS, EXCEPT PER SHARE DATA)	2000	1999	1998	1997	1996
BALANCE SHEET DATA:					
Portfolio at value	$1,788,001	$1,228,497	$807,119	$703,331	$612,411
Portfolio at cost	1,765,895	1,222,901	803,479	697,030	618,319
Total assets	1,853,817	1,290,038	856,079	807,775	713,360
Total debt outstanding(4)	786,648	592,850	334,350	347,663	274,997
Preferred stock issued to SBA(4)	7,000	7,000	7,000	7,000	7,000
Shareholders' equity	1,029,692	667,513	491,358	420,060	402,134
Shareholders' equity per common share (NAV)	$ 12.11	$ 10.20	$ 8.79	$ 8.07	$ 8.34
Common shares outstanding at period end(3)	85,057	65,414	55,919	52,047	48,238

	YEAR ENDED DECEMBER 31,				
	2000	1999	1998	1997	1996
OTHER DATA:					
New portfolio investments	$ 901,545	$ 751,871	$524,530	$364,942	$283,295
Loan repayments	154,112	145,706	138,081	233,005	179,292
Loan sales(5)	280,244	198,368	81,013	53,912	27,715
Realized gains	28,604	31,536	25,757	15,804	30,417
Realized losses	(13,081)	(6,145)	(3,216)	(5,100)	(11,262)

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(1) See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Results of Operations -- Comparison of the Years Ended December 31, 2000, 1999 and 1998."

(2) Distributions are based on taxable income, which differs from income for financial reporting purposes. In 1997, Allied Capital Corporation (old) distributed $0.34 per common share representing the 844,914 shares of Allied Capital Lending Corporation distributed in conjunction with the merger. The distribution resulted in a partial return of capital. Also in conjunction with the merger, the Company distributed $0.17 per common share representing the undistributed earnings of the predecessor companies at December 31, 1997.

(3) Excludes 234,977, 516,779 and 810,456 common shares held in the deferred compensation trust at or for the year ended December 31, 2000, 1999 and 1998, respectively.

(4) See "Senior Securities" on page 28 for more information regarding the Company's level of indebtedness.

(5) Excludes loans sold through securitization in January 1998. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Results of Operations -- Comparison of the Years Ended December 31, 2000, 1999 and 1998."

(IN THOUSANDS, EXCEPT PER SHARE DATA)	2000 QTR 4	QTR 3	QTR 2	QTR 1	199 QTR 4	QTR 3
QUARTERLY DATA:						
Total interest and related portfolio income	$61,735	$55,992	$49,965	$43,897	$42,278	$37,998
Portfolio income before net realized and unrealized gains	34,725	30,719	24,700	22,573	21,319	19,273
Net increase in net assets resulting from operations	42,281	36,449	34,790	29,581	30,925	26,944
Basic earnings per common share	$ 0.52	$ 0.48	$ 0.50	$ 0.45	$ 0.49	$ 0.44
Diluted earnings per common share	0.52	0.48	0.50	0.45	0.49	0.44
Net asset value per common share(1)	12.11	11.56	10.96	10.44	10.20	9.66
Dividends declared per common share	0.46	0.46	0.45	0.45	0.40	0.40

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(1) We determine net asset value per common share as of the last day of the quarter. The net asset values shown are based on outstanding shares at the end of each period, excluding common shares held in the Company's deferred compensation trust.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We have filed with the Commission a registration statement on Form N-2 together with all amendments and related exhibits under the Securities Act of 1933, as amended (the "Securities Act"). The registration statement contains additional information about us and the registered securities being offered by this prospectus. You may inspect the registration statement and the exhibits without charge at the Securities and Exchange Commission at 450 Fifth Street, NW, Washington, DC 20549. You may obtain copies from the Commission at prescribed rates.

We file annual, quarterly and special reports, proxy statements and other information with the Commission. You can inspect, without charge, at the public reference facilities of the Commission at 450 Fifth Street, NW, Washington, DC 20549. The Commission also maintains a web site at http://www.sec.gov that contains reports, proxy statements and other information regarding public companies, including our Company. You can also obtain copies of these materials from the public reference section of the Commission at 450 Fifth Street, NW, Washington, DC 20549, at prescribed rates. Please call the Commission at 202-942-8090 for further information on the public reference room. Copies may also be obtained, after paying a duplicating fee, by electronic request to publicinfo@sec.gov or by written request to Public Reference Section, Washington, DC 20549-0102. You can also inspect reports and other information we file at the offices of the Nasdaq Stock Market, 1735 K Street, NW, Washington, DC 20006.

RISK FACTORS

Investing in the Company involves a number of significant risks and other factors relating to the structure and investment objective of the Company. As a result, there can be no assurance that the Company will achieve its investment objective. In addition to the information contained in this prospectus, you should consider carefully the following information before making investments in the Securities.

INVESTING IN PRIVATE COMPANIES INVOLVES A HIGH DEGREE OF RISK. Our portfolio consists primarily of long-term loans to and investments in private companies. Investments in private businesses involve a high degree of business and financial risk, which can result in substantial losses and accordingly should be considered speculative. There is generally no publicly available information about the companies in which we invest, and we rely significantly on the diligence of our employees and agents to obtain information in connection with the Company's investment decisions. In addition, some smaller businesses have narrower product lines and market shares than their competition, and may be more vulnerable to customer preferences, market conditions or economic downturns, which may adversely affect the return on, or the recovery of, our investment in such businesses.

OUR FINANCIAL RESULTS COULD BE NEGATIVELY AFFECTED IF BLX FAILS TO PERFORM AS EXPECTED. Business Loan Express, Inc. ("BLX") is our largest portfolio investment. Our financial results could be negatively affected if BLX, as a portfolio company, fails to perform as expected.

OUR BORROWERS MAY DEFAULT ON THEIR PAYMENTS. We make unsecured, subordinated loans and invest in equity securities, which may involve a higher degree of repayment risk. We primarily invest in and lend to companies that may have limited financial resources and that may be unable to obtain financing from traditional sources. Numerous factors may affect a borrower's ability to repay its loan, including the failure to meet its business plan, a downturn in its industry or negative economic conditions. Deterioration in a borrower's financial condition and prospects may be accompanied by deterioration in any collateral for the loan.

OUR PORTFOLIO OF INVESTMENTS IS ILLIQUID. We acquire most of our investments directly from private companies. The majority of the investments in our portfolio will be subject to restrictions on resale or otherwise have no established trading market. The illiquidity of most of our portfolio may adversely affect our ability to dispose of loans and securities at times when it may be advantageous for us to liquidate such investments.

INVESTMENTS IN NON-INVESTMENT GRADE COMMERCIAL MORTGAGE-BACKED SECURITIES MAY BE ILLIQUID AND MAY HAVE A HIGHER RISK OF DEFAULT. The commercial mortgage-backed securities ("CMBS") in which we invest are non-investment grade, which means that nationally recognized statistical rating organizations rate them below the top four investment-grade rating categories (i.e., "AAA" through "BBB"), and are sometimes referred to as "junk bonds." The non-investment grade CMBS tend to be less liquid, may have a higher risk of default and may be more difficult to value. Non-investment grade securities usually provide a higher yield than do investment-grade bonds, but with the higher return comes greater risk. Non-investment grade securities are considered speculative, and their capacity to pay principal and interest in accordance with the terms of their issue is not ensured.

OUR PORTFOLIO INVESTMENTS ARE RECORDED AT FAIR VALUE AS DETERMINED BY THE BOARD OF DIRECTORS IN ABSENCE OF READILY ASCERTAINABLE PUBLIC MARKET VALUES. Pursuant to the requirements of the Investment Company Act of 1940 ("1940 Act"), the Board of Directors is required to value each asset quarterly, and we are required to carry our portfolio at fair value as determined by the Board of Directors. Since there is typically no public market for the loans and equity securities of the companies in which we make investments, our Board of Directors estimates the fair value of these loans and equity securities pursuant to a written valuation policy and a consistently applied valuation process. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses; we are instead required by the 1940 Act to specifically value each individual investment and record an unrealized loss for an asset that we believe has become impaired. Without a readily ascertainable market value, the estimated value of our portfolio of loans and equity securities may differ significantly from the values that would be placed on the portfolio if there existed a ready market for the loans and equity securities. We adjust quarterly the valuation of our portfolio to reflect the Board of Directors' estimate of the current realizable value of each investment in our portfolio. Any changes in estimated value are recorded in the Company's statement of operations as "Net unrealized gains (losses)."

WE BORROW MONEY WHICH MAGNIFIES THE POTENTIAL FOR GAIN OR LOSS ON AMOUNTS INVESTED AND MAY INCREASE THE RISK OF INVESTING IN OUR COMPANY. We borrow from, and issue senior debt securities to, banks, insurance companies and other lenders. Lenders of these senior securities have fixed dollar claims on our consolidated assets that are superior to the claims of our common shareholders. Borrowings, also known as leverage, magnify the potential for gain or loss on amounts invested and, therefore, increase the risks associated with investing in our securities. If the value of our consolidated assets increases, then leveraging would cause the net asset value attributable to the Company's common stock to increase more sharply than it would have had we not leveraged. Conversely, if the value of our consolidated assets decreases, leveraging would cause net asset value to decline more sharply than it otherwise would have had we not leveraged. Similarly, any increase in our consolidated income in excess of consolidated interest payable on the borrowed funds would cause our net income to increase more than it would without the leverage, while any decrease in our consolidated income would cause net income to decline more sharply than it would have had we not borrowed. Such a decline could negatively affect our ability to make common stock dividend payments. Leverage is generally considered a speculative investment technique.

At December 31, 2000, the Company had $786.6 million of outstanding indebtedness, bearing a weighted annual interest cost of 8.3%. In order for us to cover these annual interest payments on indebtedness, we must achieve annual returns on our December 31, 2000 portfolio of at least 3.4%.

Illustration. The following table illustrates the effect of leverage on returns from an investment in our common stock assuming various annual returns, net of expenses. The

calculations in the table below are hypothetical and actual returns may be higher or lower than those appearing below.

ASSUMED RETURN ON THE COMPANY'S PORTFOLIO
(NET OF EXPENSES)

	-20%	-10%	-5%	0%	5%	10%	20%
Corresponding return to shareholder(1).............	-42.4%	-24.4%	-15.4%	-6.4%	2.6%	11.6%	29.6%

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(1) The calculation assumes (i) $1,853.8 million in total assets, (ii) an average cost of funds of 8.3%, (iii) $786.6 million in debt outstanding and (iv) $1,029.7 million of shareholders' equity.

WE MAY NOT BORROW MONEY UNLESS WE MAINTAIN ASSET COVERAGE FOR INDEBTEDNESS OF AT LEAST 200% WHICH MAY AFFECT RETURNS TO SHAREHOLDERS. We must maintain asset coverage for a class of senior security representing indebtedness of at least 200%. Our ability to achieve our investment objective may depend in part on our continued ability to maintain a leveraged capital structure by borrowing from banks or other lenders on favorable terms. There can be no assurance that we will be able to maintain such leverage. If asset coverage declines to less than 200%, we may be required to sell a portion of our investments when it is disadvantageous to do so. As of December 31, 2000, our asset coverage for indebtedness was 245%.

CHANGES IN INTEREST RATES MAY AFFECT OUR COST OF CAPITAL AND NET OPERATING INCOME. Because we borrow money to make investments, our net operating income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest these funds. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our portfolio income. In periods of sharply rising interest rates, our cost of funds would increase, which would reduce our net operating income before net realized and unrealized gains. However, there would be no effect on the return, if any, that could be generated from our equity interests. We use a combination of long-term and short-term borrowings and equity capital to finance our investing activities. The Company utilizes its short-term credit facilities only as a means to bridge to long-term financing. Our long-term fixed-rate investments are financed primarily with long-term fixed-rate debt and equity. We may use interest rate risk management techniques in an effort to limit our exposure to interest rate fluctuations. Such techniques may include various interest rate hedging activities to the extent permitted by the 1940 Act.

BECAUSE WE MUST DISTRIBUTE INCOME, WE WILL CONTINUE TO NEED ADDITIONAL CAPITAL TO GROW. We will continue to need capital to fund incremental growth in our investments. Historically, we have borrowed from financial institutions and have issued equity securities. A reduction in the availability of new capital could limit our ability to grow. We must distribute at least 90% of our taxable net operating income excluding net realized long-term capital gains to our stockholders to maintain our regulated investment company ("RIC") status. As a result such earnings will not be available to fund investment originations. We expect to continue to borrow from financial institutions and sell additional equity securities. If we fail to obtain funds from such sources or from other sources to fund our investments, it could limit our ability to grow, which could have a material adverse

effect on the value of the Company's common stock. In addition, as a business development company ("BDC"), we are generally required to maintain a ratio of at least 200% of total assets to total borrowings, which may restrict our ability to borrow in certain circumstances.

OUR PRIVATE FINANCE INVESTMENTS MAY NOT PRODUCE CAPITAL GAINS. Private finance investments are typically structured as debt securities with a relatively high fixed rate of interest and with an equity feature such as conversion rights, warrants or options. As a result, private finance investments generate interest income from the time they are made, and may also produce a realized gain from an accompanying equity feature. We cannot be sure that our portfolio will generate a current return or capital gains.

LOSS OF PASS-THROUGH TAX TREATMENT WOULD SUBSTANTIALLY REDUCE NET ASSETS AND INCOME AVAILABLE FOR DIVIDENDS. We have operated the Company so as to qualify to be taxed as a RIC under Subchapter M of the Internal Revenue Code of 1986, as amended ("Code"). If we meet source of income, diversification and distribution requirements, the Company qualifies for pass-through tax treatment. If the Company fails to qualify as a RIC, the Company would become subject to federal income tax as if it were an ordinary corporation, which would substantially reduce our net assets and the amount of income available for distribution to our shareholders. The Company would cease to qualify for pass-through tax treatment if it were unable to comply with these requirements, or if it ceased to qualify as a BDC under the 1940 Act. We also could be subject to a 4% excise tax and/or corporate level income tax if we fail to make required distributions.

WE OPERATE IN A COMPETITIVE MARKET FOR INVESTMENT OPPORTUNITIES. We compete for investments with many other companies and individuals, some of whom have greater resources than we do. Increased competition would make it more difficult for us to purchase or originate investments at attractive prices. As a result of this competition, sometimes we may be precluded from making otherwise attractive investments.

CHANGES IN THE LAW OR REGULATIONS THAT GOVERN THE COMPANY COULD HAVE A MATERIAL IMPACT ON THE COMPANY OR OUR OPERATIONS. We are regulated by the Securities and Exchange Commission and the SBA. In addition, changes in the laws or regulations that govern BDCs, RICs, real estate investment trusts ("REITs") and SBICs may significantly affect our business. Any change in the law or regulations that govern our business could have a material impact on the Company or its operations. Laws and regulations may be changed from time to time, and the interpretations of the relevant laws and regulations also are subject to change.

QUARTERLY RESULTS MAY FLUCTUATE AND MAY NOT BE INDICATIVE OF FUTURE QUARTERLY PERFORMANCE. The Company's quarterly operating results could fluctuate and therefore, you should not rely on quarterly results to be indicative of the Company's performance in future quarters. Factors that could cause quarterly operating results to fluctuate include, among others, variations in the investment origination volume, variation in timing of prepayments, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our markets and general economic conditions.

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

INFORMATION CONTAINED OR INCORPORATED BY REFERENCE IN THIS PROSPECTUS, AND THE ACCOMPANYING PROSPECTUS SUPPLEMENT, IF ANY, 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 OR SIMILAR WORDS OR PHRASES. THE MATTERS DESCRIBED IN "RISK FACTORS" AND CERTAIN OTHER FACTORS NOTED THROUGHOUT THIS PROSPECTUS, AND THE ACCOMPANYING PROSPECTUS SUPPLEMENT, IF ANY, AND IN ANY EXHIBITS TO THE REGISTRATION STATEMENT OF WHICH THIS PROSPECTUS, AND THE ACCOMPANYING PROSPECTUS SUPPLEMENT, IF ANY, IS A PART, 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.

THE COMPANY

Our Company is principally engaged in lending to and investing in private and undervalued public companies. The Company is organized in the state of Maryland and is an internally managed closed-end management investment company that has elected to be regulated as a business development company (as defined above, a "BDC") under the 1940 Act.

Our executive offices are located at 1919 Pennsylvania Avenue, NW, Washington, DC 20006 and our telephone number is (202) 331-1112. In addition, we have three regional offices in New York, Chicago and San Francisco. We also have an office in Frankfurt, Germany.

USE OF PROCEEDS

Unless otherwise specified in the prospectus supplement accompanying this prospectus, we intend to use the net proceeds from selling Securities for general corporate purposes, which may include investment in private and undervalued public companies, purchase of commercial mortgage-backed securities, repayment of indebtedness, acquisitions and other general corporate purposes.

We raise equity from time to time using a shelf registration statement. We raise new equity when we have a clear use of proceeds for attractive investment opportunities. Historically, this process has enabled us to raise equity on an accretive basis for existing shareholders of our common stock.

We anticipate that substantially all of the net proceeds of any offering of Securities will be used, as described above, within six months, but in no event longer than two years. Pending investment, we intend to invest the net proceeds of any offering of Securities in time deposits, income-producing securities with maturities of three months or less that are issued or guaranteed by the federal government or an agency of the federal government, and high quality debt securities maturing in one year or less from the time of investment. Our ability to achieve our investment objective may be limited to the extent that the net proceeds of any offering, pending full investment, are held in time deposits and other short-term instruments.

PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS

Our common stock is traded on the Nasdaq National Market under the symbol "ALLC." The following table lists the high and low closing sales prices for the Company's common stock. The stock quotations are interdealer quotations and do not include markups, markdowns or commissions. On March 30, 2001, the last reported closing sale price of the common stock was $20.13 per share.

	CLOSING SALE PRICE	
	HIGH	LOW
YEAR ENDED DECEMBER 31, 1999		
First Quarter	$20.250	$16.500
Second Quarter	24.000	17.000
Third Quarter	23.813	20.250
Fourth Quarter	23.125	16.750
YEAR ENDED DECEMBER 31, 2000		
First Quarter	$19.688	$16.063
Second Quarter	18.688	16.563
Third Quarter	21.125	17.438
Fourth Quarter	21.375	18.500
YEAR ENDING DECEMBER 31, 2001		
First Quarter	$24.938	$20.125

Our common stock continues to trade in excess of net asset value. There can be no assurance, however, that we will maintain a premium to net asset value.

We pay quarterly dividends to stockholders of our common stock. The amount of our quarterly dividends is determined by the Board of Directors. The Company's board has established a dividend policy to review the dividend rate quarterly and to adjust the quarterly dividend rate as the Company's earnings momentum builds. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Equity Capital and Dividends" and "Tax Status." We cannot assure that we will achieve investment results or maintain a tax status that will permit any particular level of dividend payment.

Our credit facilities limit our ability to declare dividends if we default under certain provisions.

We have adopted an "opt out" dividend reinvestment plan ("DRIP plan") for our common stockholders. Under the DRIP plan, if your shares of our common stock are registered in your name, your dividends will be automatically reinvested in additional shares of common stock unless you "opt out" of the DRIP plan.

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

The information contained in this section should be read in conjunction with the Selected Consolidated Financial Data and the Company's 2000 Consolidated Financial Statements and Notes thereto.

OVERVIEW

The Company provides private investment capital to private and undervalued public companies in a variety of different industries and in diverse geographic locations. Our lending and investment activity is focused in private finance and commercial real estate finance, primarily the purchase of commercial mortgage-backed securities.

The Company's portfolio composition at December 31, 2000, 1999 and 1998 was as follows:

	2000	1999	1998
Private Finance	72%	53%	48%
Commercial Real Estate Finance	28%	42%	44%
Small Business Finance	--%	5%	8%

The Company's earnings depend primarily on the level of interest and related portfolio income and net realized and unrealized gains earned on the Company's investment portfolio after deducting interest paid on borrowed capital and operating expenses. Interest income results from the stated interest rate earned on a loan and the amortization of loan origination points and discounts. The level of interest income is directly related to the balance of the investment portfolio multiplied by the weighted average yield on the portfolio. The Company's ability to generate interest income is dependent on economic, regulatory and competitive factors that influence interest rates and loan originations, and the Company's ability to secure financing for its investment activities.

PORTFOLIO AND INVESTMENT ACTIVITY

Total portfolio investment activity and yields as of and for the years ended December 31, 2000, 1999 and 1998 were as follows:

($ IN MILLIONS)	2000	1999	1998
Portfolio at Value	$1,788.0	$1,228.5	$807.1
New Investments	$ 901.5	$ 751.9	$524.5
Repayments	$ 154.1	$ 145.7	$138.0
Sales	$ 280.2	$ 198.4	$304.4
Yield	14.1%	13.0%	12.5%

PRIVATE FINANCE

Private finance investment activity and yields as of and for the years ended December 31, 2000, 1999 and 1998 were as follows:

($ IN MILLIONS)	2000	1999	1998

Portfolio at Value..........................	$1,282.5	$647.0	$388.6
New Investments.............................	$ 600.9	$346.7	$236.0
Repayments..................................	$ 117.7	$ 87.5	$ 41.3
Yield.......................................	14.6%	14.2%	14.6%

The private finance portfolio increased 98% and 67% during the years ended December 31, 2000 and 1999, respectively. The Company's increasing capital base has enabled it to make larger private finance investments, supporting the increase in originations in 2000, 1999 and 1998. Key investment characteristics for new private finance mezzanine investments were as follows:

	2000	1999	1998
New investment characteristics:			
Number of investments........................	34	27	19
Average investment size (millions)............	$ 14.0	$12.4	$10.6
Average current yield........................	14.7%	13.6%	13.3%
Average portfolio company revenue (millions)...	$153.5	$86.9	$81.3
Average portfolio company years in business....	36	29	22

The average investment characteristics above are computed using simple averages based upon underwriting data for investment activity for that year. As a result, any one investment may have had individual investment characteristics that may vary significantly from the stated simple average. In addition, average investment characteristics may vary from year to year.

The current yield on the private finance portfolio will fluctuate over time depending on the equity "kicker" or warrants received with each debt financing. Private finance investments are generally structured such that equity kickers may provide an additional future investment return of up to 10%.

In addition to the Company's core private finance investment activity, the Company acquired 95% of BLC Financial Services, Inc. in a "going private" buyout transaction for $95.2 million on December 31, 2000. The Company issued approximately 4.1 million shares, or $86.1 million of new equity, and paid $9.1 million in cash to acquire BLC. The new portfolio company has changed its name to Business Loan Express, Inc. ("BLX").

As part of the transaction, the Company recapitalized its Allied Capital Express operations as an independently managed private portfolio company and merged it into BLX. As part of the recapitalization, the Company contributed certain assets, including the online rules-based underwriting technology and fixed assets, and transferred 37 employees into the private portfolio company. Upon completion of the transaction, the Company's investment in BLX totaled $204 million and consisted of $75 million of 25% subordinated debt, $25 million of preferred stock, and $104 million of common stock. In addition, the Company has entered into a management contract with BLX to provide management services, including certain technology and transition services. The Company's investment in BLX is included in the private finance portfolio.

BLX is a non-bank small business lender licensed as a participant in the SBA 7(a) Guaranteed Loan Program. BLX is headquartered in New York City, has 22 offices throughout the country and is an SBA-designated Preferred Lender in 64 markets.

During the second quarter of 2000, the Company began an initiative to invest in and strategically partner with select private equity funds focused on investments in technology and the new economy. The strategy for these fund investments is to provide solid investment returns and build strategic relationships with the fund managers and their portfolio companies. The Company believes that it will have opportunities to co-invest with the funds as well as finance their portfolio companies as they mature.

The Company believes that the fund investment strategy is an effective means of participating in technology investing through a diverse pooled investment portfolio. The

fund concept allows the Company to participate in a pooled investment return without exposure to the risk of any single technology investment. During 2000, the Company committed a total of $41.5 million to seven private equity funds. The committed amount is expected to be invested over the next three years. The Company funded $7.0 million of this commitment during 2000.

COMMERCIAL REAL ESTATE FINANCE

Commercial real estate finance investment activity and yields as of and for the years ended December 31, 2000, 1999 and 1998 were as follows:

($ IN MILLIONS)	2000	1999	1998
Portfolio at Value	$505.5	$520.0	$355.0
New Investments	$149.0	$288.7	$214.6
Repayments	$ 24.8	$ 51.5	$ 92.5
Sales	$151.7	$ 86.1	$256.9
Yield	13.1%	12.3%	10.4%

The commercial real estate finance portfolio decreased 3% and increased 46% for the years ended December 31, 2000 and 1999, respectively. During 1998, the Company reduced its commercial mortgage loan origination activity for its own portfolio due to declining interest rates and began to sell its loans to other lenders. Then, beginning in the fourth quarter of 1998, the Company began to take advantage of a unique market opportunity to acquire non-investment grade commercial mortgage-backed securities ("CMBS") at significant discounts from the face amount of the bonds. Turmoil in the capital markets created a lack of liquidity for the traditional buyers of non-investment grade bonds. As a result, yields on these collateralized bonds increased, thus providing an attractive investment opportunity. The Company believes that CMBS is an attractive asset class because of the yields that can be earned on a security that is fully secured by commercial mortgage loans. The Company opportunistically purchased CMBS throughout 1999 and 2000. The Company plans to continue its CMBS investment activity, however, in order to maintain a balanced portfolio the Company expects that purchased CMBS will continue to represent approximately 20% to 25% of total assets during 2001. The Company's CMBS investment activity level will be dependent upon its ability to purchase CMBS at attractive yields.

The Company purchases CMBS at an average discount of 50% from the face amount of the bonds. During 2000, the Company purchased $124.3 million in CMBS with a face amount of $244.6 million and a weighted average yield to maturity of

14.7% after assuming a 1% loss rate on the underlying collateral mortgage pool. In 1999, the Company purchased $245.9 million in CMBS with a face amount of $507.9 million and a weighted average yield to maturity of 14.6% after assuming a 1% loss rate on the underlying collateral mortgage pool.

As part of the Company's strategy to maximize its return on equity capital, during the fourth quarter of 2000 the Company sold $98.7 million of CMBS bonds rated BB+, BB and BB-. These bonds had an effective yield of 11.5%, and were sold for $102.5 million, resulting in a realized gain on the sale. The sale of these bonds increased the Company's overall liquidity and raised the yield on the Company's remaining purchased CMBS portfolio to 15.4%, after assuming a 1% loss on the entire underlying mortgage loan pool. At December 31, 2000, the value of the purchased CMBS portfolio was $311.3 million and the unamortized discount was $364.9 million.

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The original principal balance of the underlying pool of the approximately 2,600 loans that are collateral for the Company's CMBS had underwritten loan to value ("LTV") and underwritten debt service coverage ratios ("DSCR") as follows:

LOAN TO VALUE RANGES	$ ($ IN MILLIONS)	%
Less than 60%	$ 1,535.0	12%
60-65%	961.8	8%
65-70%	2,050.9	16%
70-75%	4,247.0	33%
75-80%	3,727.4	29%
Greater than 80%	212.4	2%
	$12,734.5	100%
Weighted average LTV	71.0%	

DEBT SERVICE COVERAGE RATIO RANGES	$ ($ IN MILLIONS)	%
Greater than 2.00	$ 465.5	4%
1.76-2.00	433.0	3%
1.51-1.75	1,487.6	12%
1.26-1.50	7,172.2	56%
1.00-1.25	3,176.2	25%
	$12,734.5	100%
Weighted average DSCR	1.31	

The Company has been liquidating much of its whole commercial mortgage loan portfolio so that it can redeploy the proceeds into higher yielding assets. For the year ended December 31, 2000, the Company sold $53.1 million of commercial mortgage loans.

At December 31, 2000, the Company's whole commercial loan portfolio had been reduced to $106.4 million from $154.1 million at December 31, 1999. During 1999, the Company sold $86.1 million of commercial mortgage loans.

During 1998, the Company sold through securitization approximately $295 million in lower yielding commercial mortgage loans and sold whole loans to third parties aggregating approximately $33.5 million.

SMALL BUSINESS FINANCE

As discussed above in the Private Finance section, the Company established its Allied Capital Express operations as an independently managed private portfolio company at the end of 2000 and these operations are now included in the private finance portfolio.

During the second quarter of 1999, the Company combined its whole commercial real estate loan origination activity with its SBA 7(a) lending activity in order to increase its loans originated for sale business under the Allied Capital Express brand name. Through Allied Capital Express, the Company provided small business and commercial real estate loans up to $3 million. The majority of the loans originated in this area were originated for sale, generally at premiums of up to 10% of the loan amount.

Allied Capital Express loan activity and yields as of and for the years ended December 31, 2000, 1999 and 1998 were as follows:

($ IN MILLIONS)	2000	1999	1998
Portfolio at Value	$ --	$ 61.4	$63.6
New Investments	$151.6	$116.5	$73.9
Repayments	$ 11.6	$ 6.7	$ 4.2
Sales	$128.5	$112.3	$47.5
Yield	--	11.5%	11.2%

Allied Capital Express loan origination activity for 2000 and 1999 increased due to the opening of new regional office locations and from opportunities created by the Company's Internet site launched in the fall of 1999. Loans in the Allied Capital Express program were originated for sale; therefore, the increase in loan sales was the result of the increase in originations. In addition, beginning in 1999, the Company began to sell 90% of the unguaranteed portion of SBA 7(a) loans through a structured finance agreement with a commercial paper conduit. Allied Capital Express targeted small commercial real estate loans that were, in many cases, originated in conjunction with SBA 7(a) loans. SBA 7(a) loans were originated with variable interest rates priced at spreads ranging from 1.75% to 2.75% over the prime lending rate.

RESULTS OF OPERATIONS

COMPARISON OF THE YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

The following table summarizes Allied Capital's operating results for the years ended December 31, 2000, 1999 and 1998:

	2000	1999	CHANGE	PERCENT CHANGE	1999	19
			(IN THOUSANDS, EXCEPT PER SHARE AMOUN			
INTEREST AND RELATED PORTFOLIO INCOME						
Interest and dividends............	$182,307	$121,112	$61,195	51%	$121,112	$80,
Premiums from loan dispositions....	16,138	14,284	1,854	13%	14,284	5,
Post-Merger gain on securitization of commercial mortgage loans.....	--	--	--	0%	--	14,
Investment advisory fees and other income..........................	13,144	5,744	7,400	129%	5,744	5,
Total interest and related portfolio income...........	211,589	141,140	70,449	50%	141,140	106,
EXPENSES						
Interest..........................	57,412	34,860	22,552	65%	34,860	20,
Employee..........................	19,842	16,136	3,706	23%	16,136	11,
Administrative....................	15,435	12,350	3,085	25%	12,350	11,
Total operating expenses.....	92,689	63,346	29,343	46%	63,346	44,
Formula and cut-off awards.........	6,183	6,753	(570)	(8%)	6,753	7,
Net operating income before net realized and unrealized gains.....................	112,717	71,041	41,676	59%	71,041	55,
NET REALIZED AND UNREALIZED GAINS						
Net realized gains................	15,523	25,391	(9,868)	(39%)	25,391	22,
Net unrealized gains..............	14,861	2,138	12,723	595%	2,138	1,
Total net realized and unrealized gains...........	30,384	27,529	2,855	10%	27,529	23,
Income before income taxes...........	143,101	98,570	44,531	45%	98,570	78,
Income tax expense...................	--	--	--	0%	--	
Net increase in net assets resulting from operations...................	$143,101	$ 98,570	$44,531	45%	$ 98,570	$78,
Diluted earnings per share...........	$ 1.94	$ 1.64	$ 0.30	18%	$ 1.64	$ 1
Weighted average shares outstanding - diluted..........................	73,472	60,044	13,428	22%	60,044	51,

Net increase in net assets resulting from operations (NIA) results from total interest and related portfolio income earned, less total expenses incurred in the operations of the Company, plus net realized and unrealized gains or losses.

Total interest and related portfolio income is primarily a function of the level of interest income earned and the balance of portfolio assets. In addition, total interest and related portfolio income includes premiums from loan dispositions, prepayment premiums, and investment advisory fees and other income.

	2000	1999	1998
	(IN MILLIONS, EXCEPT PER SHARE AMOUNTS)		
Total Interest and Related Portfolio Income....	$211.6	$141.1	$106.7
Per share....................................	$ 2.88	$ 2.35	$ 2.05

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The increase in interest income earned results primarily from continued growth of the Company's investment portfolio and the Company's focus on increasing its overall portfolio yield. The Company's investment portfolio, excluding non-interest bearing equity interests in portfolio companies, increased by 29% to $1,471.8 million at December 31, 2000 from $1,141.2 million at December 31, 1999, and increased by 51% during 1999 from $757.7 million at December 31, 1998. The weighted average yield on the interest bearing investments in the portfolio at December 31, 2000, 1999 and 1998 was as follows:

	2000	1999	1998
Private Finance................................	14.6%	14.2%	14.6%
Commercial Real Estate Finance.................	13.1%	12.3%	10.4%
Small Business Finance.........................	--	11.5%	11.2%
Total Portfolio................................	14.1%	13.0%	12.5%

Included in net premiums from loan dispositions are premiums from loan sales and premiums received on the early repayment of loans. Premiums from loan sales were $13.3 million, $10.5 million and $3.8 million for the years ended December 31, 2000, 1999 and 1998, respectively. This premium income results primarily from the premium paid by purchasers of loans originated through Allied Capital Express, less the origination commissions associated with the loans sold. In addition to selling the guaranteed portion of the SBA 7(a) loans, in 1999 the Company began to sell 90% of the unguaranteed portion of SBA 7(a) loans through a structured finance agreement with a commercial paper conduit. The 176% increase in premiums from loan sales in 1999 is primarily the result of a significant increase in the sale of the guaranteed SBA 7(a) loans and unguaranteed portions of SBA 7(a) loans. SBA 7(a) loan sales were $101.0 million, $93.7 million and $37.0 million for the years ended December 31, 2000, 1999 and 1998, respectively. Upon the merger of the Allied Capital Express operations into BLX, the premium from loan sales earned historically is intended to be replaced with interest income earned by the Company from its subordinated debt investment in BLX as well as fees earned from its management contract with BLX.

Prepayment premiums were $2.8 million, $3.8 million and $2.2 million for the years ended December 31, 2000, 1999 and 1998, respectively. While the scheduled maturities of private finance and commercial real estate loans range from five to ten years, it is not unusual for the Company's borrowers to refinance or pay off their debts to the Company ahead of schedule. Because the Company seeks to finance primarily seasoned, performing companies, such companies at times can secure lower cost financing as their balance sheets strengthen, or as more favorable interest rates become available. Therefore, the Company generally structures its loans to require a prepayment premium for the first three to five years of the loan.

Total interest and related portfolio income for 1998 includes a one-time gain on sale of $14.8 million resulting from a commercial mortgage loan securitization transaction that was completed in January 1998. Excluding the 1998 gain on sale, total interest and related portfolio income increased for the year ended December 31, 1999 by 53% as compared to the year ended December 31, 1998. The proceeds of $238.4 million from this transaction were used to repay outstanding debt.

Operating expenses include interest, employee and administrative expenses. The Company's single largest expense is interest on indebtedness. The fluctuations in interest expense during 2000, 1999 and 1998 are attributable to changes in the level of borrowings by the Company and its subsidiaries under various notes payable and debentures and

revolving credit facilities. The Company's borrowing activity and weighted average interest cost, including fees and closing costs, were as follows:

	2000	1999	1998
	($ IN MILLIONS)		
Total Outstanding Debt........................	$786.6	$592.9	$334.4
Average Outstanding Debt......................	$707.4	$461.5	$261.3
Weighted Average Cost.........................	8.3%	7.9%	7.5%
BDC Asset Coverage*...........................	245%	228%	273%

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* As a BDC, the Company is generally required to maintain a ratio of 200% of total assets to total borrowings.

Employee expenses include salaries and employee benefits. The increase in salaries and employee benefits for the periods presented reflects the increase in total employees, combined with wage increases and the experience level of employees hired. Total employees were 97, 129 and 106 at December 31, 2000, 1999 and 1998, respectively. As part of the recapitalization of Allied Capital Express discussed above, 37 employees of the Company were transferred to the portfolio company at the end of 2000. Expenses related to these employees are reflected in employee expense for the year.

Administrative expenses include the leases for the Company's headquarters in Washington, DC and its regional offices, travel costs, stock record expenses, directors' fees, legal and accounting fees and various other expenses. For the years ended December 31, 2000, 1999 and 1998, employee and administrative costs as a percentage of total interest and related portfolio income less interest expense plus net realized and unrealized gains was 19%, 21% and 22%, respectively.

The formula and cut-off awards totaled $6.2 million, $6.8 million and $7.0 million, or $0.08 per share, $0.11 per share and $0.14 per share, for the years ended December 31, 2000, 1999 and 1998, respectively.

The formula award expense totaled $5.7 million, $6.2 million and $6.2 million for the years ended December 31, 2000, 1999 and 1998, respectively. The formula award was designed as an incentive compensation program that would replace canceled stock options that were canceled as a result of the Company's 1997 Merger and would balance share ownership among key officers. The formula award vested over a three-year period, on the anniversary date of the Merger, beginning on December 31, 1998.

The cut-off award expense totaled $0.5 million, $0.6 million and $0.8 million for the years ended December 31, 2000, 1999 and 1998, respectively. The cut-off award was designed to cap the appreciated value in unvested options at the Merger announcement date in order to set the foundation to balance option awards upon the Merger. The cut-off award will only be payable if the award recipient is employed by the Company on a future vesting date.

Net realized gains resulted from the sale of equity securities associated with certain private finance investments, commercial mortgage loans and CMBS bonds, and the realization of unamortized discount resulting from the sale and early repayment of private finance and commercial mortgage loans, offset by losses on investments. Realized gains

and losses and net unrealized gains for the years ended December 31, 2000, 1999 and 1998 were as follows:

	2000	1999	1998
	(IN MILLIONS)		
Realized Gains	$28.6	$31.5	$25.8
Realized Losses	(13.1)	(6.1)	(3.3)
Net Realized Gains	$15.5	$25.4	$22.5
Net Unrealized Gains	$14.9	$ 2.1	$ 1.1

Realized gains during 2000 resulted primarily from transactions involving eight investments -- Southwest PCS, L.P. ($11.5 million), Grant Television, Inc. ($5.4 million), CMBS bonds sold ($3.9 million), Julius Koch USA, Inc. ($1.7 million), Wilmar Industries, Inc. ($1.2 million), Hotelevision ($1.0 million), FTI Consulting, Inc. ($0.7 million) and Panera Bread Co. ($0.7 million). The Company reversed previously recorded unrealized appreciation of $7.5 million when these gains were realized in 2000. Realized gains in 1999 and 1998 resulted primarily from transactions involving 6 and 10 portfolio companies, and the Company reversed previously recorded unrealized appreciation of $14.6 million and $8.1 million, respectively, when these gains were realized.

Realized losses in 2000, 1999 and 1998 represented 0.7%, 0.5% and 0.4% of the Company's total assets, respectively. Realized losses of $13.1 million during 2000 resulted primarily from two portfolio investments -- NETtel Communications, Inc. ($8.5 million) and Total Foam, Inc. ($1.3 million). The remaining losses consisted of several losses of less than $0.5 million each. Losses realized in 2000 had been recognized in NIA over time as unrealized depreciation when the Company determined that the respective portfolio security's value had become impaired. Thus, the Company reversed previously recorded unrealized depreciation totaling $12.0 million, $5.4 million and $3.6

million when the related losses were realized in 2000, 1999 and 1998, respectively.

Net unrealized gains for 2000, 1999 and 1998 consisted of valuation changes resulting from the Board of Directors' valuation of the Company's assets and the effect of reversals of unrealized appreciation or depreciation resulting from realized gains or losses. At December 31, 2000, net unrealized appreciation in the portfolio totaled $19.4 million and was composed of unrealized appreciation of $49.1 million, resulting primarily from appreciated equity interests in portfolio investments, and unrealized depreciation of $29.7 million resulting primarily from underperforming loan and equity interests in the portfolio. At December 31, 1999 and 1998, net unrealized appreciation in the portfolio totaled $4.5 million and $2.4 million, respectively, and was composed of unrealized appreciation of $32.1 million and $27.3 million, and unrealized depreciation of $27.6 million and $24.9 million, respectively.

The Company employs a standard grading system for the entire portfolio. Grade 1 is used for those investments from which a capital gain is expected. Grade 2 is used for investments performing in accordance with plan. Grade 3 is used for investments that require closer monitoring; however, no loss of interest or principal is expected. Grade 4 is used for investments for which some loss of contractually due interest is expected, but no loss of principal is expected. Grade 5 is used for investments for which some loss of principal is expected and the investment is written down to net realizable value.

At December 31, 2000, the Company's portfolio was graded as follows:

GRADE	PORTFOLIO AT VALUE	PERCENTAGE OF TOTAL PORTFOLIO
	($ IN MILLIONS)	
1	$ 208.3	11.7%
2	1,461.7	81.7%
3	15.4	0.9%
4	76.0	4.2%
5	26.6	1.5%
	$1,788.0	100.0%

Included in Grade 4 and 5 investments are assets totaling $20.5 million and $10.6 million that are secured by commercial real estate at December 31, 2000 and 1999, respectively. Grade 5 private finance investments at December 31, 2000 and 1999 totaled $18.7 million and $12.6 million at value, or 1.0% and 1.0% of the Company's total portfolio, respectively. The Company continues to follow its historical practices of working with a troubled portfolio company in order to recover the maximum amount of the Company's investment, but records unrealized depreciation for the expected full amount of the potential loss when such exposure is identified.

At December 31, 2000, delinquencies in the underlying collateral pool for the Company's CMBS portfolio were negligible at 0.38%. The yield used to accrue interest on this portfolio assumes a 1% loss rate on the entire underlying collateral mortgage pool.

For the total investment portfolio, loans greater than 120 days delinquent were $56.4 million at value at December 31, 2000, or 3.2% of the total portfolio. Included in this category are loans valued at $13.3 million that are fully secured by commercial real estate. Loans greater than 120 days delinquent at December 31, 1999 were $18.6 million at value, or 1.5% of the total portfolio, which included $11.7 million that were fully secured by real estate. As a provider of long-term privately negotiated investment capital, it is not atypical to defer payment of principal or interest from time to time. As a result, the amount of the portfolio that is greater than 120 days delinquent may vary from quarter to quarter. The terms of the private finance agreements frequently provide an opportunity for portfolio companies to restructure their debt and equity capital. During such restructuring, the Company may not receive or accrue interest or dividend payments. The investment portfolio is priced to provide current returns for our shareholders assuming that a portion of the portfolio at any time may not be accruing interest currently. The Company also prices its investments for a total return including current interest or dividends plus capital gains from the sale of equity securities. Therefore, the amount of loans greater than 120 days delinquent is not necessarily an indication of future principal loss or loss of anticipated investment return. The Company's portfolio grading system is used as a means to assess loss of investment return (Grade 4 assets) or loss of investment principal (Grade 5 assets).

The Company has elected to be taxed as a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code of 1986, as amended ("Code"). As long as the Company qualifies as a RIC, the Company is not taxed on its investment company taxable income or realized capital gains, to the extent that such income or gains are distributed, or deemed to be distributed, to shareholders on a timely basis. Annual tax distributions may differ from NIA for the fiscal year due to timing differences in the recognition of income and expenses, returns of capital and net unrealized appreciation or depreciation, which are not included in taxable income.

In order to maintain its RIC status, the Company must, in general, (1) derive at least 90% of its gross income from dividends, interest, gains from the sale of securities and other specified types of income; (2) meet investment diversification requirements as defined in the Code; and (3) distribute annually to shareholders at least 90% of its investment company taxable ordinary income. The Company intends to take all steps necessary to continue to meet the RIC qualifications. However, there can be no assurance that the Company will continue to elect or qualify for such treatment in future years.

The weighted average common shares outstanding used to compute basic earnings per share were 73.2 million, 59.9 million and 51.9 million for the years ended December 31, 2000, 1999 and 1998, respectively. The increases in the weighted average shares reflect the issuance of new shares and the issuance of shares pursuant to a dividend reinvestment plan.

All per share amounts included in management's discussion and analysis have been computed using the weighted average shares used to compute diluted earnings per share, which were 73.5 million, 60.0 million and 52.0 million for the years ended December 31, 2000, 1999 and 1998, respectively.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

CASH AND CASH EQUIVALENTS

At December 31, 2000, the Company had $2.4 million in cash and cash equivalents. The Company invests otherwise uninvested cash in U.S. government-or agency-issued or guaranteed securities that are backed by the full faith and credit of the United States, or in high quality, short-term repurchase agreements fully collateralized by such securities. The Company's objective is to manage to a low cash balance and fund new originations with its credit facilities.

DEBT

The Company had outstanding debt at December 31, 2000 as follows:

	FACILITY AMOUNT	AMOUNT OUTSTANDING	ANNUAL INTEREST COST(1)	ANNUAL PORTFOLIO RETURN TO COVER INTEREST PAYMENTS(2)
	($ IN MILLIONS)			
Notes payable and debentures:				
Unsecured long-term notes payable........................	$ 544.0	$544.0	8.1%	2.3%
SBA debentures...................	87.3	78.3	8.3%	0.4%
Auction rate reset note..........	76.6	76.6	8.6%	0.4%
OPIC loan........................	5.7	5.7	6.6%	0.0%
Total notes payable and debentures..............	$ 713.6	$704.6	8.2%	3.1%
Revolving credit facilities:				
Revolving line of credit.......	$ 417.5	$ 82.0	8.4%	0.4%
Total debt................	$1,131.1	$786.6	8.3%	3.4%

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(1) The annual interest cost includes the cost of commitment fees and other facility fees.

(2) The annual portfolio return to cover interest payments is calculated as the December 31, 2000 annualized cost of debt per class of financing divided by total assets at December 31, 2000.

UNSECURED LONG-TERM NOTES PAYABLE. The Company has issued long-term debt to institutional lenders, primarily insurance companies. The notes have five- or seven-year maturities. The notes require payment of interest only semi-annually, and all principal is due upon maturity.

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SBA DEBENTURES. The Company, through its SBIC subsidiary, has debentures payable to the SBA with terms of ten years. The notes require payment of interest only semi-annually, and all principal is due upon maturity. The Company may borrow up to $108.8 million from the SBA under the SBIC program. At December 31, 2000, the Company has a commitment to borrow up to an additional $9 million from the SBA. The commitment expires on September 30, 2004.

AUCTION RATE RESET NOTE. The Company has a $75 million Auction Rate Reset Senior Note Series A that matures on December 2, 2002 and bears interest at the three-month London Inter-Bank Offer Rate ("LIBOR") plus 1.75% which adjusts quarterly. Interest is due quarterly and the Company, at its option, may pay or defer and capitalize such interest payments. The amount outstanding on the note will increase as interest due is deferred and capitalized.

REVOLVING LINE OF CREDIT. The Company has a two-year, $417.5 million unsecured revolving line of credit that expires in May 2002. This facility may be expanded up to $500 million. At the Company's option, the credit facility bears interest at a rate equal to (i) the one-month LIBOR plus 1.25% or (ii) the higher of (a) the Bank of America, N.A. prime rate or (b) the Federal Funds rate plus 0.50%. The credit facility requires monthly payments of interest, and all principal is due upon maturity.

EQUITY CAPITAL AND DIVIDENDS

The Company raises debt and equity capital for continued investment in its portfolio. Because the Company is a RIC, it distributes its income and requires external capital for growth. Because the Company is a BDC, it is limited in the amount of debt capital it may use to fund its growth, since it is generally required to maintain a ratio of 200% of total assets to total borrowings, or approximately 1 to 1 debt to equity capital ratio.

To support its growth during 2000, the Company raised $250.9 million in new equity capital primarily through the sale of shares from its shelf registration statement. The Company issues equity from time to time using a shelf registration statement when it has a clear use of proceeds for attractive investment opportunities. Historically, this process has enabled the Company to raise equity on an accretive basis for existing shareholders. In addition, the Company issued $86.1 million of equity capital to purchase BLC Financial Services, Inc. on December 31, 2000. At December 31, 2000, total shareholders' equity had increased to $1.03 billion.

The Company's Board reviews the dividend rate quarterly, and adjusts the quarterly dividend rate throughout the year as the Company's earnings momentum builds. For the first and second quarter of 2000, the Board declared a $0.45 per common share dividend. For the third and fourth quarters of 2000, the Board declared a dividend of $0.46 per common share. The Board declared a dividend of $0.49 per common share for the first quarter of 2001.

As a result of growth in ordinary taxable income combined with the increased size and diversity of the Company's portfolio and its projected future capital gains, the Company's Board of Directors will continue to evaluate whether to retain or distribute capital gains as they occur. The Company's dividend policy allows the Company to continue to distribute some capital gains, but will also allow the Company to retain gains that exceed a normal capital gains distribution level, and therefore avoid any unusual spike in dividends in any one year. The dividend policy also enables the Board to selectively retain gains to support future growth.

The Company plans to maintain a strategy of financing its operations, dividend requirements and future investments with cash from operations, through borrowings under short- or long-term credit facilities or other debt securities, through asset sales, or through the sale or issuance of new equity capital. The Company will utilize its short-term credit facilities only as a means to bridge to long-term financing. The Company evaluates its interest rate exposure on an ongoing basis. The Company maintains a matched-funding philosophy that focuses on matching the estimated maturities of its loan and investment portfolio to the estimated maturities of its borrowings. To the extent deemed necessary, the Company may hedge variable and short-term interest rate exposure through interest rate swaps or other techniques. At December 31, 2000, the Company's debt to equity ratio was less than 1 to 1 and weighted average cost of funds was 8.3%. There are no significant maturities of long-term debt until 2003. The Company believes that it has access to capital sufficient to fund its ongoing investment and operating activities, and from which to pay dividends.

SENIOR SECURITIES

Information about our senior securities is shown in the following tables as of the fiscal year ended December 31, unless otherwise noted. The "--" indicates information which the Commission expressly does not require to be disclosed for certain types of senior securities.

CLASS AND YEAR	TOTAL AMOUNT OUTSTANDING EXCLUSIVE OF TREASURY SECURITIES(1)	ASSET COVERAGE PER UNIT(2)	INVOLUNTARY LIQUIDATING PREFERENCE PER UNIT(3)	AVERAGE MARKET VALUE PER UNIT(4)
UNSECURED LONG-TERM NOTES PAYABLE				
1991	$ 0	$ 0	$--	N/A
1992	0	0	--	N/A
1993	0	0	--	N/A
1994	0	0	--	N/A
1995	0	0	--	N/A
1996	0	0	--	N/A
1997	0	0	--	N/A
1998	180,000,000	2,734	--	N/A
1999	419,000,000	2,283	--	N/A
2000	544,000,000	2,445	--	N/A
SBA DEBENTURES(5)				
1991	$ 49,800,000	$3,834	$--	N/A
1992	49,800,000	5,789	--	N/A
1993	49,800,000	6,013	--	N/A
1994	54,800,000	3,695	--	N/A
1995	61,300,000	2,868	--	N/A
1996	61,300,000	2,485	--	N/A
1997	54,300,000	2,215	--	N/A
1998	47,650,000	2,734	--	N/A
1999	62,650,000	2,283	--	N/A
2000	78,350,000	2,445	--	N/A
AUCTION RATE RESET NOTE				
1991	$ 0	$ 0	$--	N/A
1992	0	0	--	N/A
1993	0	0	--	N/A
1994	0	0	--	N/A
1995	0	0	--	N/A
1996	0	0	--	N/A
1997	0	0	--	N/A
1998	0	0	--	N/A
1999	0	0	--	N/A
2000	76,598,000	2,445	--	N/A

CLASS AND YEAR	TOTAL AMOUNT OUTSTANDING EXCLUSIVE OF TREASURY SECURITIES(1)	ASSET COVERAGE PER UNIT(2)	INVOLUNTARY LIQUIDATING PREFERENCE PER UNIT(3)	AVERAGE MARKET VALUE PER UNIT(4)
OVERSEAS PRIVATE INVESTMENT CORPORATION LOAN				
1991.......................	$ 0	$ 0	$--	N/A
1992.......................	0	0	--	N/A
1993.......................	0	0	--	N/A
1994.......................	0	0	--	N/A
1995.......................	0	0	--	N/A
1996.......................	8,700,000	2,485	--	N/A
1997.......................	8,700,000	2,215	--	N/A
1998.......................	5,700,000	2,734	--	N/A
1999.......................	5,700,000	2,283	--	N/A
2000.......................	5,700,000	2,445	--	N/A
REVOLVING LINES OF CREDIT				
1991.......................	$ 0	$ 0	$--	N/A
1992.......................	0	0	--	N/A
1993.......................	0	0	--	N/A
1994.......................	32,226,000	3,695	--	N/A
1995.......................	20,414,000	2,868	--	N/A
1996.......................	45,099,000	2,485	--	N/A
1997.......................	38,842,000	2,215	--	N/A
1998.......................	95,000,000	2,734	--	N/A
1999.......................	82,000,000	2,283	--	N/A
2000.......................	82,000,000	2,445	--	N/A
MASTER REPURCHASE AGREEMENT AND MASTER LOAN AND SECURITY AGREEMENT				
1991.......................	$ 0	$ 0	$--	N/A
1992.......................	0	0	--	N/A
1993.......................	0	0	--	N/A
1994.......................	23,210,000	3,695	--	N/A
1995.......................	0	0	--	N/A
1996.......................	85,775,000	2,485	--	N/A
1997.......................	225,821,000	2,215	--	N/A
1998.......................	6,000,000	2,734	--	N/A
1999.......................	23,500,000	2,283	--	N/A
2000.......................	0	0	--	N/A
SENIOR NOTE PAYABLE(6)				
1991.......................	$ 0	$ 0	$--	N/A
1992.......................	20,000,000	5,789	--	N/A
1993.......................	20,000,000	6,013	--	N/A
1994.......................	20,000,000	3,695	--	N/A
1995.......................	20,000,000	2,868	--	N/A
1996.......................	20,000,000	2,485	--	N/A
1997.......................	20,000,000	2,215	--	N/A
1998.......................	0	0	--	N/A
1999.......................	0	0	--	N/A
2000.......................	0	0	--	N/A

CLASS AND YEAR	TOTAL AMOUNT OUTSTANDING EXCLUSIVE OF TREASURY SECURITIES(1)	ASSET COVERAGE PER UNIT(2)	INVOLUNTARY LIQUIDATING PREFERENCE PER UNIT(3)	AVERAGE MARKET VALUE PER UNIT(4)
BONDS PAYABLE				
1991	$ 0	$ 0	$--	N/A
1992	0	0	--	N/A
1993	0	0	--	N/A
1994	0	0	--	N/A
1995	98,625,000	2,868	--	N/A
1996	54,123,000	2,485	--	N/A
1997	0	0	--	N/A
1998	0	0	--	N/A
1999	0	0	--	N/A
2000	0	0	--	N/A
REVERSE REPURCHASE AGREEMENTS(7)				
1991	$ 2,761,000	$3,834	$--	N/A
1992	0	0	--	N/A
1993	0	0	--	N/A
1994	0	0	--	N/A
1995	0	0	--	N/A
1996	0	0	--	N/A
1997	0	0	--	N/A
1998	0	0	--	N/A
1999	0	0	--	N/A
2000	0	0	--	N/A
REDEEMABLE CUMULATIVE PREFERRED STOCK(5)				
1991	$ 1,000,000	$ 338	$100	N/A
1992	1,000,000	526	100	N/A
1993	1,000,000	546	100	N/A
1994	1,000,000	351	100	N/A
1995	1,000,000	277	100	N/A
1996	1,000,000	242	100	N/A
1997	1,000,000	217	100	N/A
1998	1,000,000	267	100	N/A
1999	1,000,000	225	100	N/A
2000	1,000,000	242	100	N/A
NON-REDEEMABLE CUMULATIVE PREFERRED STOCK(5)				
1991	$ 6,000,000	$ 338	$100	N/A
1992	6,000,000	526	100	N/A
1993	6,000,000	546	100	N/A
1994	6,000,000	351	100	N/A
1995	6,000,000	277	100	N/A
1996	6,000,000	242	100	N/A
1997	6,000,000	217	100	N/A
1998	6,000,000	267	100	N/A
1999	6,000,000	225	100	N/A
2000	6,000,000	242	100	N/A

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(1) Total amount of each class of senior securities outstanding at the end of

the period presented.

(2) The asset coverage ratio for a class of senior securities representing indebtedness is calculated as the Company's consolidated total assets, less all liabilities and indebtedness not represented by senior securities, divided by senior securities representing indebtedness. This asset coverage ratio is multiplied by $1,000 to determine the Asset Coverage Per Unit. The asset coverage ratio for a class of senior securities that is preferred stock is calculated as the Company's consolidated total assets, less all liabilities and indebtedness not represented by senior securities, divided by senior securities representing indebtedness, plus the involuntary liquidation preference of the preferred stock (see footnote 3). The Asset Coverage Per Unit for preferred stock is expressed in terms of dollar amounts per share.

(3) The amount to which such class of senior security would be entitled upon the involuntary liquidation of the issuer in preference to any security junior to it.

(4) Not applicable, as senior securities are not registered for public trading.

(5) Issued by the Company's SBIC subsidiary to the SBA. These categories of senior securities are not subject to the asset coverage requirements of the 1940 Act. See "Certain Government Regulations -- SBA Regulations."

(6) The Company was the obligor on $15 million of the senior notes. The Company's SBIC subsidiary was the obligor on the remaining $5 million, which is not subject to the asset coverage requirements of the 1940 Act.

(7) U.S. government agency guaranteed loans sold under agreements to repurchase. The Company was advised by the Staff of the Commission that these reverse repurchase agreements were not considered a class of senior security representing indebtedness and thus were not subject to the asset coverage requirements of the 1940 Act.

BUSINESS

As a business development company, we provide private investment capital to private companies and undervalued public companies in a variety of different industries and in diverse geographic locations throughout the United States. We have been investing in growing businesses for over 40 years and have financed thousands of private companies nationwide. Today, our investment activity is focused in two areas:

- Private finance and

- Commercial real estate finance, primarily the purchase of CMBS.

Our investment portfolio consists primarily of long-term unsecured loans with equity features, commercial mortgage-backed securities, and commercial mortgage loans. At December 31, 2000, our investment portfolio totaled $1.8 billion. The Company's investment objective is to achieve current income and capital gains.

PRIVATE FINANCE

We provide long-term debt and equity financing to private companies nationwide. Our private finance activities target a market niche between the senior debt financing provided by traditional lenders, such as banks, commercial finance companies and insurance companies, and the equity capital provided by private equity investors.

Our private financing is generally used to fund growth, buyouts, note purchases, acquisitions, recapitalizations, and bridge financings. We generally invest in private companies though, from time to time, we may invest in undervalued public companies that lack access to public capital and whose securities may not be marginable. We target two types of companies when seeking new investments. The first type of company we seek is a market leader in a stable industry that has demonstrated over many years of operations that it can successfully achieve its business plan and thereby achieve our investment objective. The second type of company we seek is an emerging company in a growing industry that is positioned for significant growth. We have spent over 40 years refining our highly selective investment discipline, which is founded on seeking portfolio companies having key characteristics and targeting specific industries.

We originate investments generally ranging in size from $5 million to $30 million, and for the year ended December 31, 2000 our average investment size was $14.0 million. Our private finance investments are generally structured as an unsecured, subordinated loan that carries a relatively high fixed interest rate (generally 12% to 18%), with interest-only payments in the early years and payments of both principal and interest in the later years, with maturities of five to ten years. Approximately 98% of the investments in the private finance portfolio have fixed rates of interest. Our private finance investments typically include equity features, such as warrants or options to buy a minority interest in the portfolio company. We also make preferred and common equity investments, particularly when we see unique opportunities to profit from the growth of an emerging company. At December 31, 2000, 75% of the private finance portfolio consisted of debt securities, and 25% consisted of equity securities. Our nationwide private finance portfolio includes investments in a wide variety of industries, including business services, consumer products, education, light industrial products and broadcasting.

Capital providers for the finance of private companies can be generally categorized as shown in the diagram below:

CAPITAL PROVIDER	Banks	Commercial Finance Companies	Insurance Companies/ High Yield Market	Allied Capital	Private Mezzanine Funds	Priv Equi Fund
PRIMARY BUSINESS FOCUS	Senior, short- term debt	Asset-based lending	Large >$30 million credits	Unsecured long-term debt with equity upside Preferred and common equity	Unsecured long-term debt with equity upside Preferred and common equity	Equi
TYPICAL PRICING SPECTRUM*	LIBOR+	[graphic of arrow stretching between 'LIBOR+' and '30%+']				30%+

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* Based on market experience of our marketing and investment professionals.

Banks are primarily focused on providing senior secured and unsecured short-term debt. They typically do not provide meaningful long-term unsecured loans. Commercial finance companies are primarily focused on providing senior secured long-term debt. The private insurance company and high-yield debt markets are focused primarily on very large financing transactions, typically in excess of the financings we do. We generally do not compete with banks, commercial finance companies, or the insurance company/high yield market. Instead, we compete directly with the private mezzanine sector of the private equity market. Private mezzanine funds are also focused on providing unsecured long-term debt to private companies for the types of transactions discussed above. We believe that we have key structural and operational advantages when compared to private mezzanine funds.

Our scale of operations, equity capital base, and successful track record as a private finance investor has enabled us to borrow long-term capital to leverage our returns on our common equity. Therefore, our access to debt capital reduces our total cost of capital. In many cases, a private mezzanine fund is unable to access the debt capital markets, and therefore must achieve an unleveraged equity return for their investors. Our lower cost of capital gives us a pricing advantage when competing for new investments. In addition, the perpetual nature of our corporate structure enables us to be a better long-term partner for our portfolio companies than a traditional mezzanine fund, which typically has a finite life.

We estimate that we fund approximately 2% of all the private finance investments that we review. When assessing a prospective investment, we look for a company that has achieved, or has the potential to achieve, market leadership in a niche, critical mass, and a sustainable cash flow. We also look for companies that, because of their industry and business plan, can demonstrate minimal vulnerability to changes in economic cycles. Since our debt securities are primarily unsecured in nature, we look for companies in industries that are non-cyclical, cash flow intensive, and can demonstrate a high return on their invested capital. We generally do not target companies in industries where businesses tend to be vulnerable to changes in economic cycles, are capital intensive, and have low returns on their invested capital. We generally target and do not target the following industries,

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though we will consider investments in any industry if the prospective company demonstrates unique characteristics that make it an attractive investment opportunity:

INDUSTRIES TARGETED NON-CYCLICAL/CASH FLOW INTENSIVE/ HIGH RETURN ON CAPITAL
Business services
Education
Consumer products
Light industrial products
Broadcasting

INDUSTRIES NOT TARGETED CYCLICAL/CAPITAL INTENSIVE/ LOW RETURN ON CAPITAL
Heavy manufacturing
Natural resources
Most retail

Low value-add distribution
Agriculture
Transportation
Construction

Another critical element of our investment discipline is to invest in companies with a significant equity capital base, and a strong private equity sponsor. For example, in 2000, 75% of our private financings were completed in conjunction with private equity firms, which provided capital that is junior to ours. We believe strong equity sponsorship significantly strengthens our position as a long-term lender. A strong equity sponsor provides not only strong equity capital beneath our investment, but also provides a reliable source of additional equity capital if the portfolio company requires additional financing. Private equity sponsors also help us confirm our own due diligence findings when assessing a new investment opportunity, and they provide assistance and leadership to the portfolio company's management team throughout our investment period.

We target a total return of 18% to 25% for our private finance investments. The typical private finance structure focuses, first and foremost, on the protection of our investment principal. Our debt instruments generally provide for a contractual interest rate ranging from 12% to 18%, which provides current interest income. The debt instruments also have restrictive covenants that protect our interests in the transaction. The warrants we receive with our debt securities generally require only a minimal cost to exercise, and thus as the portfolio company appreciates in value, we achieve additional investment return from this equity interest. We seek to achieve additional investment returns of up to 10% from the appreciation and sale of our warrants.

Generally, our warrants expire five years after the related debt is repaid. The warrants typically include registration rights, which allow us to sell the securities if the portfolio company completes a public offering. In most cases, the warrants also have a put option that requires that the borrower repurchase our equity position after a specified period of time at a formula price or at its fair market value. Most of the gains we realize from our warrant portfolio arise as a result of the sale of the portfolio company to another business, or through a recapitalization. Historically, we have not been dependent on the public equity markets for the sale of our warrant positions. With respect to preferred or common equity investments, we target an investment return of 25% to 40%.

We hold a portion of our private finance investments in a wholly owned subsidiary, Allied Investment Corporation. Allied Investment is a BDC and is licensed and regulated by the Small Business Administration to operate as a small business investment company ("SBIC"). See "Certain Government Regulations" below for further information about SBIC regulation.

In addition to funding private finance investments as described above, during the second quarter of 2000 we made commitments to invest in select technology-oriented private equity funds. In addition to the return we expect to achieve from these

investments, we believe we can achieve strategic benefits from these funds, including technology expertise from private finance portfolio companies, co-investment opportunities and increased dealflow. We may make additional commitments to other such funds, but expect our total investment in this area to remain a small percentage of our total portfolio.

COMMERCIAL REAL ESTATE FINANCE

COMMERCIAL MORTGAGE LOANS. We have been a commercial real estate lender for many years, and maintain a small whole commercial mortgage loan portfolio. During 1998, we significantly reduced our middle-market commercial real estate lending activities, because we believed that the market was under-pricing commercial real estate loans, and that the returns on senior commercial real estate loans were below a level that would result in a fair return on equity for our shareholders.

Since 1999, we have been liquidating a significant portion of our whole commercial mortgage loan portfolio. We believe that we can redeploy the proceeds into higher yielding investments. We continue to derive income from the interest charged on the whole commercial mortgage loan portfolio through contractual interest and amortization of discounts.

COMMERCIAL MORTGAGE-BACKED SECURITIES. The same pricing pressures that caused us to reduce our origination of commercial mortgage loans in 1998 created significant liquidity problems for many other real estate lenders who had remained active lenders as pricing declined throughout 1998. In the fourth quarter of 1998, many of these lenders experienced severe liquidity constraints that caused them to exit the commercial mortgage-backed securities market. This liquidity turmoil in the real estate capital markets created a unique opportunity for us to acquire newly issued, non-investment grade commercial mortgage-backed securities ("Purchased CMBS") at significant discounts from the face amount of the bonds and at attractive yields.

As an investor, we believe that Purchased CMBS has attractive risk/return characteristics. The Purchased CMBS in which we invest are non-investment grade, which means that nationally recognized statistical rating organizations rate them below the top four investment-grade rating categories (i.e., "AAA" through "BBB"), and are sometimes referred to as "junk bonds." Unlike most "junk bonds," which are typically unsecured debt instruments, the non-investment grade Purchased CMBS in which we invest are secured by mortgage loans with real estate collateral. Our Purchased CMBS are fully collateralized by senior mortgage loans on commercial real estate properties where the loans are, on average, supported by a 30% equity investment. We acquire our Purchased CMBS on the initial issuance of the CMBS bond offering, and are able to underwrite and negotiate to purchase the securities at a significant discount from their face amount, generally resulting in an estimated yield to maturity ranging from 13% to 16%. Our negotiated discount and estimated yield to maturity assumes a 1% loss rate on the entire underlying commercial mortgage loan collateral pool, which takes into consideration certain business and economic uncertainties and contingencies. We find the yields for Purchased CMBS very attractive given their collateral protection.

We believe this risk/return dynamic exists in this market today because there are significant barriers to entry for a non-investment grade CMBS investor. First, non-investment grade CMBS are long-term investments and require long-term investment capital. Our capital structure, which is in excess of 50% equity capital, is well suited for this asset class. Second, when we purchase CMBS in an initial issuance, we re-underwrite every mortgage loan in the underlying collateral pool, and we meet with the issuer to discuss the nature and type of loans we will accept into the pool. We have significant

commercial mortgage loan underwriting expertise, both in terms of the number of professionals we employ and the depth of their commercial real estate experience. Access to this type of expertise is another barrier to entry into this market.

As a non-investment grade CMBS investor, we recognize that non-investment grade securities have a higher degree of risk than do investment grade bonds. Non-investment grade securities are considered speculative, and their capacity to pay principal and interest in accordance with the terms of their issue is not ensured. They tend to be less liquid, may have a higher risk of default, and may be more difficult to value. We invest in non-investment grade CMBS represented by the "BB" to non-rated tranches of a CMBS issuance. Due to the underlying structure of the CMBS issuances, our CMBS tranches receive principal payments only after the securities that are senior to our securities are repaid. Thus, if losses are incurred in the underlying mortgage loan collateral pool, we would experience these losses.

To mitigate this risk, we perform extensive due diligence prior to an investment in Purchased CMBS. When we evaluate a CMBS investment, we use the same underwriting procedures and criteria for the mortgage loans in the collateral pool as we do for all of the loans we originate. These underwriting procedures and criteria are described in detail below. We will only invest in CMBS when we believe, as a result of our underwriting procedures, that the underlying mortgage pool adequately secures our position. Our portfolio of CMBS is secured by approximately 2,600 commercial real estate properties located in diverse geographic locations across the United States in a wide variety of property types, including retail, multi-family housing, office, and hospitality. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a summary of the loan to value ratios and debt service coverage ratios of the mortgage loans securing our Purchased CMBS investments.

Our Purchased CMBS activity complements our private finance activity because it provides a steady stream of recurring interest income. In order to maintain a balanced investment portfolio, we expect to limit our Purchased CMBS activity to approximately 20% to 25% of total assets.

SMALL BUSINESS FINANCE -- ALLIED CAPITAL EXPRESS

On December 31, 2000, Allied Capital and BLC Financial Services, Inc. ("BLC") completed a merger whereby Allied Capital acquired BLC. The effect of the merger was to create an independently managed, private portfolio company of Allied Capital to focus exclusively on small business lending, including the origination of SBA 7(a) loans. BLC has changed its name to Business Loan Express, Inc. ("BLX").

As part of this transaction, on December 28, 2000, we recapitalized our wholly owned small business lending subsidiary, Allied Capital SBLC Corporation, as an independently managed private portfolio company. Allied SBLC established a separate board of directors, and the employees and operations attributed to Allied Capital Express, including the online loan origination technology, were transferred to Allied SBLC. We restructured previous intercompany debt owed to us by Allied SBLC as $74.8 million in subordinated debt now owed by the new portfolio company. Allied SBLC was subsequently merged into BLX and we received approximately $25 million in BLX preferred stock in exchange for our equity in Allied SBLC.

BLX is currently financed with a combination of senior and subordinated debt, and preferred and common equity. Allied Capital, directly and indirectly, owns 94.9% of BLX. Allied Capital's investment in BLX is expected to generate interest income, dividends and fee income. In addition, we believe there is opportunity to add value to the new portfolio

company and to position the investment for a future capital gain. The Company has entered into a management contract with BLX to provide management services, including certain technology and transition services. Our investment in BLX is included in our private finance portfolio.

BLX is a non-bank small business lender licensed as a participant in the SBA 7(a) Guaranteed Loan Program. BLX has a total of 22 offices nationwide, and SBA Preferred Lender status in 64 markets. BLX believes it will be a technology leader in online small business loan origination, and will have significant online loan origination relationships as well as solid core broker relationships in the small business community. BLX is licensed by the SBA as a Small Business Lending Company ("SBLC"), and therefore, changes in the laws or regulations that govern SBLCs could have a material impact on BLX or its operations.

INVESTMENT ADVISORY SERVICES

We are a registered investment adviser, pursuant to the Investment Advisers Act of 1940, and have certain investment advisory agreements to manage private investment funds. The revenue generated from these agreements is not material to the Company's operations.

LOAN SOURCING

Over the last two years, we have significantly increased the scope of our sales and marketing activity by opening new regional offices and increasing our sales and marketing staff. To source new investment opportunities, we work with thousands of intermediaries including:

- private mezzanine and equity investors;

- investment banks;

- business and mortgage brokers;

- national retail financial services companies; and

- banks, law firms and accountants.

We believe that our experience and reputation provide a competitive advantage in originating new investments. We have established an extensive network of investment referral relationships over our history. We are recognized as a pioneer in the private finance industry, and have developed a reputation in the commercial real estate finance market for our ability to finance complex transactions.

INVESTMENT APPROVAL AND UNDERWRITING PROCEDURES

In assessing new investment opportunities, we maintain conservative credit standards based on our underwriting guidelines, a thorough due diligence process, and a centralized credit approval process requiring committee review, all of which are described below. The combination of conservative underwriting standards and our credit-oriented culture has resulted in a record of minimal realized losses.

PRIVATE FINANCE. We generally require that the companies in which we invest demonstrate strong market position, sales growth, positive cash flow, and profitability, as discussed above. We emphasize the quality of management, and seek experienced entrepreneurs with a management track record, relevant industry experience and a significant equity stake in the business. In a typical private financing, we thoroughly review, analyze and substantiate, through due diligence, the business plan and operations of the potential portfolio company. We perform financial due diligence, often with assistance of an accounting firm; perform operational due diligence, often with the assistance of an industry consultant; study the industry and competitive landscape; and conduct numerous reference checks with current and former employees, customers, suppliers and competitors. The typical private finance transaction requires two to three months of diligence and structuring before funding occurs.

Private finance transactions are approved by an investment committee consisting of our most senior private finance professionals and chaired by our Chairman and Chief Executive Officer. The private finance approval process benefits from the experience of the investment committee members and from the experience of our other investment professionals who together with the committee members, on average, have over eleven years of professional experience. For every transaction of $10 million or greater, we also require approval from the Executive Committee of the Board of Directors in addition to the investment committee approval. Even after all such approvals are received, due diligence must be successfully completed with final investment committee approval before funds are disbursed to a new portfolio company.

PURCHASED CMBS. We receive extensive packages of information regarding the mortgage loans comprising a CMBS pool. We work with the issuer, the investment bank, and the rating agencies in performing our diligence on a CMBS purchase. The typical CMBS purchase takes between two to three months to complete because of the breadth and depth of our diligence procedures. We re-underwrite all of the underlying commercial mortgage loans securing the CMBS. We challenge the estimate of underwriteable cash flow and challenge necessary carve-outs, such as replacement reserves. We study the trends of the industry and geographic location of each property, and independently assess our own estimate of the anticipated cash flow over the period of the loan. Our loan officers physically inspect most of the collateral properties, and assess appraised values based on our own opinion of comparable market values.

Based on the findings of our diligence procedures, we may reject certain mortgage loans from inclusion in the pool. We then formulate our negotiated purchase price and discount to achieve an effective yield on our investment over a ten-year period to approximate 13% to 16%. In computing this estimated yield, we assume a 1% loss rate on the entire underlying mortgage pool.

CMBS transactions are approved by an investment committee and, because of their size, every CMBS transaction is reviewed and approved by the Executive Committee of the Board of Directors. The investment committee for CMBS transactions consists of our most senior commercial real estate professionals and is chaired by our Chairman and Chief Executive Officer.

PORTFOLIO MANAGEMENT

PORTFOLIO DIVERSITY. We monitor the portfolio to maintain both industry and geographic diversity. We currently do not have a policy with respect to "concentrating" (i.e., investing 25% or more of our total assets) in any industry or group of industries and currently our portfolio is not concentrated. We may or may not concentrate in any industry or group of industries in the future.

LOAN SERVICING. Our loan servicing staff is responsible for routine loan servicing, which includes:

- delinquency monitoring;

- payment processing;

- borrower inquiries;

- escrow analysis and processing;

- third-party reporting; and

- insurance and tax administration.

In addition, our staff is responsible for special servicing activities including delinquency monitoring and collection, workout administration and management of foreclosed assets.

PORTFOLIO MONITORING AND VALUATION

We use a grading system in order to help us monitor the credit quality of our portfolio and the potential for capital gains. The grading system assigns grades to investments from 1 to 5, and the portfolio was graded at December 31, 2000 as follows:

GRADE	DESCRIPTION	PORTFOLIO AT VALUE	PERCENTAGE OF TOTAL PORTFOLIO
		(IN MILLIONS)	
1	Probable capital gain	$ 208.3	11.7%
2	Performing security	1,461.7	81.7%
3	Close monitoring -- no loss of principal or interest expected	15.4	0.9%
4	Workout -- Some loss of interest expected	76.0	4.2%
5	Workout -- Some loss of principal expected	26.6	1.5%
		$1,788.0	100.0%

The 1940 Act requires that the Board of Directors value each asset in the portfolio on a quarterly basis. We are not permitted to have a general loan loss reserve, but instead must value each specific investment. We have a written valuation policy that governs the valuation of our assets, and we follow a consistent valuation process quarterly. In valuing each individual investment, we consider the financial performance of each portfolio company, loan payment histories, indications of potential equity realization events, current collateral values and determine whether the value of the asset should be increased through unrealized appreciation or decreased through unrealized depreciation. After each investment professional has made his or her determination of value, members of senior management review the valuations. These valuations are then presented to the board of directors for review and approval.

As a general rule, we do not value our loans above principal balance, but loans are subject to depreciation events when the asset is considered impaired. Also as a general rule, equity securities may be assigned appreciation if circumstances warrant. With respect to private equity securities, each investment is valued using industry valuation benchmarks, and then the value is assigned a discount reflecting the illiquid nature of the investments as well as our minority, non-control position. When an external event such as a purchase transaction, public offering, or subsequent equity sale occurs, the pricing indicated by the external event is used to corroborate our private equity valuation. Equity securities in public companies that carry certain restrictions on sale are generally valued at a discount from the public market value of the securities. Restricted and unrestricted publicly traded stocks may also be valued at discounts due to the size of our investment, restrictions on trading or market liquidity concerns.

We monitor loan delinquencies in order to assess the appropriate course of action and overall portfolio quality. With respect to our private finance portfolio, investment

professionals closely monitor the status and performance of each individual investment throughout each quarter. Through the process, investments that may require closer monitoring are generally detected early, and for each such investment, an appropriate course of action is determined. For the private finance portfolio, loan delinquencies or payment default is not necessarily an indication of credit quality or the need to pursue active workout of a portfolio investment. Because we are a provider of long-term privately negotiated investment capital, it is not atypical for us to defer payment of principal or interest from time to time. As a result, the amount of our private finance portfolio that is delinquent may vary. The terms of our private finance agreements frequently provide an opportunity for our portfolio companies to restructure their debt and equity capital. During such restructuring, we may not receive or accrue interest or dividend payments. Our senior investment professionals actively work with the portfolio company in these instances to negotiate an appropriate course of action.

We price our private finance investment portfolio to provide adequate current returns for our shareholders assuming that a portion of the portfolio at any time may not be accruing interest currently. We also price our investments for a total return including current interest or dividends plus capital gains from sale of equity securities. Therefore, the amount of loans that are delinquent is not necessarily an indication of future principal loss or loss of anticipated investment return. The Company's portfolio grading system is used as a means to assess loss of investment return (Grade 4 assets) or loss of investment principal (Grade 5 assets).

With respect to our commercial real estate portfolio, the following outlines the treatment of each delinquency category:

30 Days Past Due	Our loan servicing staff monitors loans and contacts borrowers for collection.
60 Days Past Due	We generally transfer loans to professionals responsible for special servicing activity for monitoring, collection and development of a workout plan, if necessary.
90 Days Past Due	Our accounting department reviews loans in conjunction with the professional responsible for special servicing to determine whether the loans should be placed on a non-accrual status or whether a valuation adjustment is required.
120 Days Past Due	Generally, we place such loans on non-accrual status and the loan is an active workout.

INVESTMENT GAINS AND LOSSES

As an investor focused primarily on debt investments, our investment decisions are based on credit dynamics. Our underwriting focuses on the preservation of principal, and we will pursue our available means to recover our capital investment. As a result of this investment discipline and credit culture, we have a history of low levels of loan losses, and have a demonstrated track record of successfully resolving troubled credit situations with

minimal losses. Our realized gains from the sale of our equity interests have historically exceeded losses, as is reflected in the chart below.

	YEAR ENDED DECEMBER 31,				
	2000	1999	1998	1997	1996
Realized gains......................	$ 28,604	$ 31,536	$ 25,757	$ 15,804	$ 30,417
Realized losses.....................	$ (13,081)	$ (6,145)	$ (3,216)	$ (5,100)	$(11,262)
Net realized gains..................	$ 15,523	$ 25,391	$ 22,541	$ 10,704	$ 19,155
Total assets........................	$1,853,817	$1,290,038	$856,079	$807,775	$713,360
Realized losses/ Total assets........	0.7%	0.5%	0.4%	0.6%	1.6%

EMPLOYEES

At December 31, 2000, we employed 97 individuals including investment and portfolio management professionals, operations professionals and administrative staff. The majority of these individuals are located in the Washington, DC office. As part of the BLC merger, 37 Allied Capital employees were transferred to BLX as full-time employees of the new portfolio company. We believe that our relations with our employees are excellent.

LEGAL PROCEEDINGS

We are a party to certain lawsuits in the normal course of our business. While the outcome of these legal proceedings cannot at this time be predicted with certainty, we do not expect that these proceedings will have a material effect upon our financial condition or results of operations.

PORTFOLIO COMPANIES

The following is a listing of our portfolio companies in which we had an equity investment at December 31, 2000. We make available significant managerial assistance to our portfolio companies. Other than loans to the portfolio company, our only relationship with each portfolio company is our investment. For information relating to the amount and general terms of our loans to portfolio companies, see the Consolidated Statement of Investments at December 31, 2000 at pages F-5 to F-12.

NAME AND ADDRESS OF PORTFOLIO COMPANY	NATURE OF ITS PRINCIPAL BUSINESS	TITLE OF SECURITIES HELD BY THE COMPANY	PERCENT OF CLA HELD(

Acme Paging, L.P. .... 1336 Basswood, Suite F Schaumburg, IL 60173	Paging Services	Limited Partnership Interests	1.8
Allied Office Products, Inc. ... 75 Route 17 South Hasbrouck Heights, NJ 07604	Office Products Retailer	Warrants to Purchase Common Stock	4.9
American Barbecue & Grill, Inc. .... 7300 W. 110th Street, Suite 570 Overland Park, KS 66210	Restaurant Chain	Warrants to Purchase Common Stock	17.3
American Homecare Supply, LLC... One First Avenue Suite 100 Conshohocken, PA 19428	Home Medical Equipment Provider	Warrants to Purchase Class A Common Units	2.1
Aspen Pet Products, Inc. .... 11701 East 53rd Ave. Denver, CO 80239	Pet Product Provider	Series A Preferred Stock	40.8
		Common Stock	4.7
ASW Holding Corporation......... 2825 W. 31st Street Chicago, IL 60623	Steel Wool Manufacturer	Warrants to Purchase Common Stock	5.0
Aurora Communications, LLC...... 3 Stamford Landing, Suite 210 46 Southfield Avenue Stamford, CT 06902	Radio Stations	Redeemable Preferred Equity Interest	3.2
Avborne, Inc. .... c/o Trivest, Inc. 2665 S. Bayshore Dr., Suite 800 Miami, FL 33133-5462	Aviation Services Company	Warrants to Purchase Common Stock	3.5
Border Foods, Inc. .... J Street Deming Industrial Park Deming, NM 88030	Mexican Ingredient & Food Product Manufacturer	Series A Convertible Preferred Stock	9.4
		Warrants to Purchase Common Stock	6.2
Business Loan Express, Inc. .... 645 Madison Ave. 19th Floor New York, NY 10022	Small Business Lender	Preferred Stock	100.0
		Common Stock	94.9
Camden Partners Strategic Fund II, L.P. (formerly Cahill-Warnock Strategic Partners Fund II, L.P.)....... One South Street Suite 2150 Baltimore, MD 21202	Private Equity Fund	Limited Partnership Interest	4.2
CampGroup, LLC.................. 4 New King Street White Plains, NY 10604	Recreational Camp Operator	Warrants to Purchase Common Stock	2.6
Candlewood Hotel Company........ 9342 East Central Wichita, KS 67206	Extended Stay Facilities	Series A Convertible Preferred Stock	5.0
Celebrities, Inc. .... 408-412 W. Oakland Park Boulevard Ft. Lauderdale, FL 33311-1712	Radio Stations	Warrants to Purchase Common Stock	25.0

NAME AND ADDRESS OF PORTFOLIO COMPANY	NATURE OF ITS PRINCIPAL BUSINESS	TITLE OF SECURITIES HELD BY THE COMPANY	PERCENT OF CLA HELD(
Colibri Holding Corporation..... 2201 S. Walbash Street Denver, CO 80231	Outdoor Living Product Retailer	Common Stock	3.4
		Warrants to Purchase Common Stock	2.0
Component Hardware Group, Inc. .... 1890 Swarthmore Ave. P.O. Box 2020 Lakewood, NJ 08701	Designer & Developer of Hardware Components	Preferred Stock	9.1
		Common Stock	8.2
Convenience Corporation of America...................... 711 N. 108th Court Omaha, NE 68154	Convenience Store Chain	Series A Preferred Stock	10.0
		Warrants to Purchase Senior Preferred Stock	4.0
Cooper Natural Resources, Inc. .... P.O. Box 1477 Seagraves, TX 79360	Sodium Sulfate Producer	Warrants to Purchase Common Stock	25.2
CorrFlex Graphics, LLC.......... P.O. Box 1337 Monroe, NC 28110	Packaging Manufacturer	Warrants to Purchase Common Stock	4.8
		Options to Purchase Common Stock	1.0
Cosmetic Manufacturing.......... Resources, LLC 11312 Penrose Street Sun Valley, CA 91352	Cosmetic Manufacturer	Options to Purchase Shares	22.5
Coverall North America, Inc..... 500 West Cypress Creek Rd. Ste. 580 Ft. Lauderdale, FL 33309	Commercial Cleaning Service	Warrants to Purchase Common Stock	15.0
Csabai Canning Factory Rt. ..... 5600 Bekescasba Bekis: vt 52-54 Hungary	Food Processing	Hungarian Quotas	9.2
CyberRep.coM.................... 8300 Greensboro Drive, 6th Floor McLean, VA 22102	Operator of Call Service Centers	Warrants to Purchase Common Stock	22.5
Directory Investment Corporation.................. 1919 Pennsylvania Avenue, N.W. Washington, DC 20006	Telephone Directories	Common Stock	50.0
Directory Lending Corporation... 1919 Pennsylvania Avenue, N.W. Washington, DC 20006	Telephone Directories	Common Stock	50.0
Drilltec Patents & Technologies Company, Inc.................. 10875 Kempwood Drive, Suite 2 Houston, TX 77043	Drill Pipe Packager	Warrants to Purchase Common Stock	15.0
eCentury Capital Partners, L.P.......................... 1101 Connecticut Ave, NW 7th Floor Washington, DC 20036	Private Equity Fund	Limited Partnership Interest	44.8
EDM Consulting, LLC............ 14 Macopin Avenue Montclair, NJ 07043	Environmental Consulting	Common Stock	25.0
Elexis Beta GmbH................	Distance Measurement	Options to Purchase	9.8

Ulmenstrabe 22	Device	Shares	
60325 Frankfurt am Main	Manufacturer		
Germany			
Esquire Communications Ltd.	Court Reporting	Warrants to Purchase	3.0
216 E. 45th Street, 8th floor	Services	Common Stock	
New York, NY 10017			
E-Talk Corporation.............	Telecommunications	Warrants to Purchase	5.5
4425 Cambridge Road	Software Provider	Common Stock	
Fort Worth, TX 76155-2692			
ExTerra Credit Recovery,			
Inc.	Consumer Finance	Preferred Stock	0.9
35 Lennon Lane, Suite 200		Common Stock	0.7
Walnut Creek, CA 94598		Warrants to Purchase	0.7
		Common Stock	

NAME AND ADDRESS OF PORTFOLIO COMPANY	NATURE OF ITS PRINCIPAL BUSINESS	TITLE OF SECURITIES HELD BY THE COMPANY	PERCENT OF CLA HELD(
Executive Greetings, Inc.	Personalized Business	Warrants to Purchase	1.5
120 Industrial Park Access			
Road	Products	Common Stock	
New Hartford, CT 06057			
Fairchild Industrial Products			
Company......................	Industrial Controls	Warrants to Purchase	20.0
3920 Westpoint Boulevard	Manufacturer	Common Stock	
Winston-Salem, NC 27013			
FTI Consulting, Inc.	Litigation Support	Warrants to Purchase	4.4
2021 Research Drive	Services	Common Stock	
Annapolis, MD 21401			
Galaxy American Communications,			
LLC..........................	Cable Television	Warrants to Purchase	6.0
1220 N. Main Street	Operator	Common Stock	
Sikeston, MO 63801			
Garden Ridge Corporation........	Home Decor Retailer	Series A Preferred Stock	2.6
650 Madison Avenue		Common Stock	4.7
New York, NY 10022			
Gibson Guitar Corporation	Guitar Manufacturer	Warrants to Purchase	3.0
1818 Elm Hill Pike		Common Stock	
Nashville, TN 37210			
Ginsey Industries, Inc.	Bathroom Accessories	Convertible Debentures	7.0
281 Benigno Boulevard	Manufacturer	Warrants to Purchase	16.0
Bellmawr, NJ 08031		Common Stock	
Global Communications I, LLC....	Communications and	Preferred Equity	59.3
201 East 69th Street	Media Businesses	Interest	
New York, NY 10021		Options for Common	59.3
		Membership Interest	
Grant Broadcasting Systems II...	Television Stations	Warrants to Purchase	25.0
919 Middle River Drive,		Common Stock	
Suite 409		Warrants to Purchase	25.0
Ft. Lauderdale, FL 33304		Common Stock in	
		Affiliate Company	
Grant Television, Inc.	Television Stations	Equity Interest	20.0
(See Grant Broadcasting System			
II)			

Grotech Partners VI, LP......... c/o Gntech Capital Group 9690 Deereco Road Suite 800 Timonium, MD 21093	Private Equity Fund	Limited Partnership Interest	3.1
Hartz Mountain Corporation...... 400 Plaza Drive Secaucus, NJ 07094	Pet Supply Manufacturer	Common Stock Warrants to Purchase Common Stock	2.0 3.5
HealthASPex, Inc................ 2812 Trinity Square Drive Carrollton, TX 75006	Third Party Administrator	Common Stock Class A Preferred Stock	24.0 70.0
HMT, Inc. .... 1422 FM 1960 W. Suite 350 Houston, TX 77068	Storage Tank Maintenance & Repair	Common Stock Warrants to Purchase Common Stock	27.3 10.0
Hotelevision, Inc. .... 599 Lexington Avenue Suite 2300 New York, NY 10022	Hotel Cable-TV Network	Series 3 Preferred Stock	16.2
Icon International, Inc. .... 281 Tressor Boulevard 8th Floor Stamford, CT 06901	Corporate Barter Services	Series A Preferred Stock Series B Preferred Stock	3.5 3.5
Impact Innovations Group........ 5825 Glenridge Drive Building II, Suite 107 Atlanta, GA 30328	Information Technology Services Provider	Warrants to Purchase Common Stock	4.0

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NAME AND ADDRESS OF PORTFOLIO COMPANY	NATURE OF ITS PRINCIPAL BUSINESS	TITLE OF SECURITIES HELD BY THE COMPANY	PERCENT OF CLA HELD(
International Fiber Corporation.................. 50 Bridge Street North Tonawanda, NY 14120	Cellulose and Fiber Producer	Common Stock Warrants to Purchase Common Stock	11.0 2.9
iSolve Incorporated............ 281 Tresser Boulevard Two Stamford Plaza Stamford, CT 06901	Corporate Barter Services	Series A Preferred Stock Common Stock	2.9 1.1
JRI Industries, Inc. .... 2958 East Division Springfield, MO 65803	Machinery Manufacturer	Warrants to Purchase Common Stock	7.5
Julius Koch USA, Inc. .... 387 Church Street New Bedford, MA 02745	Cord Manufacturer	Warrants to Purchase Common Stock	45.0
Kirker Enterprises, Inc. .... 55 East 6th Street Paterson, NJ 07524	Nail Enamel Manufacturer	Warrants to Purchase Common Stock Equity Interest in Affiliate Company	22.5 5.0
Kirkland's, Inc. .... P.O. Box 7222 Jackson, TN 38308-7222	Home Furnishing Retailer	Series D Preferred Stock Warrants to Purchase Common Stock	3.3 4.2
Kyrus Corporation............... 25 Westridge Market Place	Value-Added Reseller, Computer Systems	Warrants to Purchase Common Stock	8.0

Chandler, NC 28715			
Liberty-Pittsburgh Systems, Inc. .... 265 Executive Drive Plainview, NY 11803	Business Forms Printing	Common Stock	21.2
Logic Bay Corporation........... 7900 International Drive Suite 750 Minneapolis, MN 55425	Computer-Based Training Developer	Series C Redeemable Preferred Stock	29.4
Love Funding Corporation........ 1220 19th Street, NW, Suite 801 Washington, DC 20036	Mortgage Services	Series D Preferred Stock	26.0
Master Plan, Inc. .... 21540 Plummer Street Chatsworth, CA 91311	Healthcare Outsourcing	Common Stock	13.6
MedAssets.com, Inc. .... 21540 Plummer Street Chatsworth, CA 91311	Healthcare Outsourcing	Series B Convertible Preferred Stock	8.5
		Warrants to Purchase Preferred Stock	5.3
Mid-Atlantic Venture Fund IV, L.P.......................... 128 Goodman Drive Bethlehem, PA 18015	Private Equity Fund	Limited Partnership Interest	9.7
Midview Associates, L.P. .... 2 Eaton Street, Suite 1101 Hampton, VA 23669	Residential Land Development	Warrants to purchase partnership interests	35.0
Monitoring Solutions, Inc. ..... 4303 South High School Road Indianapolis, IN 46241	Air Emissions Monitoring	Common Stock	25.0
		Warrants to Purchase Common Stock	50.0
MortgageRamp.com, Inc. .... 116 Welsh Road Horsham, PA 19044	Internet Based Loan Originator	Class A Common Stock	8.0
Morton Grove Pharmaceuticals, Inc.......................... 6451 West Main Street Morton Grove, IL 60053	Generic Drug Manufacturer	Redeemable Convertible Preferred Stock	27.8
MVL Group, Inc.................. 1061 E. Indiantown Road Suite 300 Jupiter, FL 33477	Market Research Service	Warrants to Purchase Common Stock	8.0

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NAME AND ADDRESS OF PORTFOLIO COMPANY	NATURE OF ITS PRINCIPAL BUSINESS	TITLE OF SECURITIES HELD BY THE COMPANY	PERCENT OF CLA HELD(
Nobel Learning Communities, Inc. .... 1400 N. Providence Road, Suite 3055 Media, PA 19063	Educational Services	Series D Convertible Preferred Stock	100.0
		Warrants to Purchase Common Stock	13.1
North American Archery, LLC..... 1733 Gunn Highway Odessa, FL 33556	Sporting Equipment Manufacturer	Convertible Debentures	26.9
Nursefinders, Inc.	Home Healthcare	Warrants to Purchase	3.4

1200 Copeland Road, Suite 200 Arlington, TX 76011	Providers	Common Stock	
Onyx Television Gmbh............ Immedia Park 6b 50670 Koln Germany	Cable Television	Preferred Units	12.0
Opinion Research Corporation.... P.O. Box 183 Princeton, NJ 08542	Corporate Marketing Research Firm	Warrants to Purchase Common Stock	5.5
Oriental Trading Company, Inc........................... 108th Street, 4206 South Omaha, Nebraska 68137	Direct Marketer of Toys	Redeemable Preferred Stock	1.7
		Class A Common Stock	1.7
		Warrants to Purchase Common Stock	1.4
Outsource Partners, Inc. .... 200 Mansell Court East Suite 500 Roswell, GA 30076	Outsourced Facility Services Provider	Warrants to Purchase Common Stock	4.0
		Warrants to Purchase Preferred Stock	4.0
Packaging Advantage Corporation................... 4633 Downey Road Los Angeles, CA 90058	Personal Care, Household and Disinfectant Product Packager	Common Stock	9.9
		Warrants to Purchase Common Stock	5.5
PF.Net Communications, Inc. .... 677 Washington Blvd. Stamford, CT 06912	Fiber Optic Network	Warrants to Purchase Common Stock	0.6
Physicians Specialty Corporation................... 1150 Lake Hearn Drive Atlanta, GA 30342	Physician Management Services Provider	Redeemable Preferred Stock	3.1
		Convertible Preferred Stock	3.0
		Warrants to Purchase Common Stock	1.9
Pico Products, Inc. .... 12500 Foothill Boulevard Lakeview Terr., CA 91342	Satellite/Television Component Manufacturer	Common Stock	5.0
		Warrants to Purchase Common Stock	15.0
Polaris Pool Systems, Inc. ..... P.O. Box 1149 San Marcos, CA 92079-1149	Pool Cleaner Manufacturer	Warrants to Purchase Common Stock	2.1
Professional Paint, Inc......... 3900 Joliet Street Denver, CO 80239	Paint Manufacturer	Common Stock	11.0
		Series A-1 Senior Exchangeable Preferred Stock	100.0
Progressive International Corporation .... 6111 S. 228th Street P.O. Box 97045 Kent, WA 98064	Retail Kitchenware	Common Stock	0.0
		Redeemable Preferred Stock	12.5
		Warrants to Purchase Common Stock	6.2
Schwinn Holdings Corporation.... 1690 38th Street Boulder, CO 80301	Bicycle Manufacturer/ Distributor	Warrants to Purchase Common Stock	0.7
Seasonal Expressions, Inc....... 230 5th Avenue, Suite 1007 New York, NY 10001	Decorative Ribbon Manufacturer	Series A Preferred Stock	50.0

NAME AND ADDRESS OF PORTFOLIO COMPANY	NATURE OF ITS PRINCIPAL BUSINESS	TITLE OF SECURITIES HELD BY THE COMPANY	PERCENT OF CLA HELD(
Soff-Cut Holdings, Inc.......... 1112 Olympic Drive Corona, CA 91719	Concrete Sawing Equipment Manufacturer	Common Stock	2.7
		Series A Preferred Stock	4.0
		Warrants to Purchase Common Stock	6.7
Southern Communications, LLC.... 1919 Pennsylvania Ave., NW Washington, D.C. 20006	Communications Towers	Equity Interest	85.0
Spa Lending Corporation......... 1919 Pennsylvania Avenue, N.W. Washington, DC 20006	Health Spas	Series A Preferred Stock	100.0
		Series B Preferred Stock	68.4
		Series C Preferred Stock	46.3
		Common Stock	62.1
Staffing Partners Holding Company, Inc. .... 104 Church Lane #100 Baltimore, MD 21208	Temporary Employee Services	Redeemable Preferred Stock	48.3
		Class A-1 Common Stock	50.0
		Class A-2 Common Stock	24.4
		Class B Common Stock	24.0
Startec Global Communications Corporation.................. 10411 Motor City Drive Bethesda, MD 20852	Integrated Communications Service Provider	Common Stock	1.3
		Warrants to Purchase Common Stock	0.9
Sunsource Inc. .... One Logan Square Philadelphia, PA 19013	Wholesale Machinery and Supplies	Warrants to Purchase Common Stock	4.0
Sure-Tel, Inc. .... 5 North McCormick Oklahoma City, OK 73127	Telephone Services Company	Series A Convertible Redeemable Preferred Stock	41.7
		Warrants to Purchase Common Stock	9.6
Total Foam, Inc. .... P.O. Box 688 Ridgefield, CT 06877	Packaging Systems	Common Stock	49.0
Tubbs Snowshoe Company, LLC. ... 52 River Road Stowe, VT 05672	Snowshoe Manufacturer	Warrants to Purchase Common Units	7.7
		Common Units of Affiliate Company	10.9
United Pet Group, Inc. .... 125 High Street Boston, MA 02110	Manufacturer of Pet Products	Warrants to Purchase Common Stock	0.8
Venturehouse Group, LLC......... 1780 Tysons Blvd., Suite 400 McLean, VA 22102	Private Equity Fund	Common Equity Interest	1.5
Walker Investment Fund II, LLLP......................... 3060 Washington Road Suite 200 Glenwood, MD 21738	Private Equity Fund	Limited Partnership Interest	5.1
Warn Industries, Inc. .... 12900 S.E. Capps Rd. Clackamas, OR 97015	Sport Utility Accessories Manufacturer	Warrants to Purchase Common Stock	4.3
Williams Brothers Lumber Company...................... 3165 Pleasant Hill Road	Builders' Supplies	Warrants to Purchase Common Stock	14.1

Duluth, GA 30136			
Wilmar Industries, Inc. .... 303 Harper Drive Moorestown, NJ 08057	Repair and Maintenance Product Distributor	Warrants to Purchase Common Stock	3.0

NAME AND ADDRESS OF PORTFOLIO COMPANY	NATURE OF ITS PRINCIPAL BUSINESS	TITLE OF SECURITIES HELD BY THE COMPANY	PERCENT OF CLA HELD(
Wilshire Restaurant Group, Inc. .... 1100 Town & Country Road Suite 1300 Orange, CA 92868-4654	Restaurant Chain	Warrants to Purchase Common Stock	3.0
Woodstream Corporation.......... 69 North Locust Street Lititz, PA 17543	Pest Control Manufacturer	Equity Interest	13.8
		Warrants to Purchase Common Stock	7.2
Wyo-Tech Acquisition Corporation.................. 4373 N. 3rd Street Laramie, WY 82072	Vocational School	Common Stock	99.0
		Preferred Stock	100.0

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(1) Percentages shown for warrants and options held represent the percentage of class of security we may own, on a fully diluted basis, assuming we exercise our warrants or options.

DETERMINATION OF NET ASSET VALUE

We determine the net asset value per share of our common stock quarterly. The net asset value per share is equal to the value of our total assets minus liabilities and preferred stock divided by the total number of common shares outstanding.

Portfolio assets are carried at fair value as determined by the board of directors under our valuation policy. As a general rule, we do not value the Company's loans above cost, but loans are subject to depreciation events when the asset is considered impaired. Also as a general rule, equity securities may be assigned appreciation if circumstances warrant. With respect to private equity securities, each investment is valued using industry valuation benchmarks, and then the value is assigned a discount reflecting the illiquid nature of the investment as well as our minority, non-control position. When an external event such as a purchase transaction, public offering, or subsequent equity sale occurs, the pricing indicated by the external event is used to corroborate our private equity valuation. Equity securities in public companies that carry certain restrictions on sale are generally valued at a discount from the public market value of the securities. Restricted and unrestricted publicly traded stocks may also be valued at discounts, due to the size of our investment or market liquidity concerns.

Determination of fair value involves subjective judgments that cannot be substantiated by auditing procedures. Accordingly, under current standards, the accountants' opinion on the Company's financial statements in our annual report refers to the uncertainty with respect to the possible effect on the financial statements of such valuation.

MANAGEMENT

The Board of Directors supervises the management of our Company. The responsibilities of each director include, among other things, the oversight of the loan approval process, the quarterly valuation of our assets, and oversight of our financing arrangements. The board of directors maintains an Executive Committee, Audit Committee, Compensation Committee, and Nominating Committee, and may establish additional committees in the future. All of the Company's directors also serve as directors of its subsidiaries.

Our investment decisions in each business area are made by investment committees comprised of the Company's most senior investment professionals. No one person is primarily responsible for making recommendations to a committee.

The Company is internally managed and our investment professionals manage our portfolio and the portfolios of companies for which we serve as investment adviser. These investment professionals have extensive experience in managing investments in private growing businesses in a variety of industries and in diverse geographic locations, and are familiar with our approach of lending and investing. Because the Company is internally managed, we pay no investment advisory fees, but instead we pay the operating costs associated with employing investment management professionals.

STRUCTURE OF BOARD OF DIRECTORS

The Company's Board of Directors is classified into three approximately equal classes with three-year terms, with only one of the three classes expiring each year. Directors serve until their successors are elected and qualified.

DIRECTORS

Information regarding the board of directors is as follows:

NAME	AGE	POSITION	DIRECTOR SINCE(1)	EXPIRATION OF TERM
William L. Walton*...........	51	Chairman, Chief Executive Officer and President	1986	2001
George C. Williams, Jr.*.....	74	Chairman Emeritus	1964	2001
Brooks H. Browne.............	51	Director	1990	2001
John D. Firestone............	57	Director	1993	2002
Anthony T. Garcia............	44	Director	1991	2002
Lawrence I. Hebert...........	54	Director	1989	2002
John I. Leahy................	70	Director	1994	2003
Robert E. Long...............	69	Director	1972	2001
Warren K. Montouri...........	71	Director	1986	2003
Guy T. Steuart II............	69	Director	1984	2003
T. Murray Toomey, Esq........	77	Director	1959	2003
Laura W. van Roijen..........	48	Director	1992	2002

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* Interested persons of the Company, as defined in the 1940 Act.

(1) Includes service as a director of any of the predecessor companies.

EXECUTIVE OFFICERS

Information regarding the Company's executive officers is as follows:

NAME	AGE	POSITION
William L. Walton............	51	Chairman, Chief Executive Officer and President
Joan M. Sweeney..............	41	Managing Director and Chief Operating Officer
Scott S. Binder..............	46	Managing Director
Samuel B. Guren..............	54	Managing Director
Philip A. McNeill............	41	Managing Director
John M. Scheurer.............	48	Managing Director
Thomas H. Westbrook..........	37	Managing Director
G. Cabell Williams, III	46	Managing Director
Penni F. Roll................	35	Executive Vice President and Chief Financial Officer

BIOGRAPHICAL INFORMATION

DIRECTORS

William L. Walton has been the Chairman, Chief Executive Officer and President of the Company since 1997. He has served on Allied Capital's board of directors since 1986, and was named Chairman and CEO in February 1997. Mr. Walton has an extensive background in general management, marketing, strategic planning, mergers and acquisitions and financial analysis. Mr. Walton previously served as Managing Director of New York-based Butler Capital Corporation (1987-1991) and was the personal venture capital advisor for William S. Paley, founder and Chairman of CBS. In addition, he was a Senior Vice President in Lehman Brother Kuhn Loeb's Investment Banking Group. Mr. Walton also founded and managed two start-up businesses in the emerging education industry (1992-1996). Mr. Walton is a director of Nobel Learning Communities, Inc. and Riggs National Corporation. He received both a B.A. and a M.B.A. from Indiana University.

George C. Williams, Jr. is Chairman Emeritus of the Company. Mr. Williams was an officer of the predecessor companies from the later of 1959 or the inception of the relevant entity and President or Chairman and Chief Executive Officer of the predecessor companies from the later of 1964 or each entity's inception until 1991. Mr. Williams is the father of G. Cabell Williams III, an executive officer of the Company.

Brooks H. Browne has been the President of Environmental Enterprises Assistance Fund since 1993. Mr. Browne is a director of SEAF, Corporation Financiera Ambiental (Panama), Empresas Ambientales de Centro America (Costa Rica) Renewable Energy and Energy Efficiency Fund, Terra Capital Investors Limited, the Solar Development Foundation, and Yayasan Bina Usaha Lingkungan (Indonesia) (environmental nonprofit or investment funds).

John D. Firestone has been a Partner of Secor Group (venture capital) since 1978. Mr. Firestone is a director of Security Storage Company of Washington, DC, Bryn Mawr Bank Corporation and the National Organization on Disability. Mr. Firestone is Senior Advisor to GeoPortals.com, and a Trustee of The Washington Ballet.

Anthony T. Garcia is currently a private investor. Mr. Garcia was General Manager of Breen Capital Group (investor in tax liens) from 1997 to 2000 and a Senior Vice President of Lehman Brothers Inc. from 1985 to 1996.

Lawrence I. Hebert is a director and President and Chief Executive Officer of Riggs Bank N.A. (a subsidiary of Riggs National Corporation); Director of Riggs National Corporation since 1988. He also serves as director of Riggs Investment Management Corporation and Riggs Bank Europe Limited (both indirect subsidiaries of Riggs National Corporation). Mr. Herbert is the President and a director Perpetual Corporation (owner of Allbritton Communications Company and ALLSNEWSCO, Inc.) Mr. Hebert is a director of ALLSNEWSCO, Inc. (news programming service), the President of Westfield News Advertiser, Inc. (owner of a television station and newspapers), Trustee of The Allbritton Foundation and Vice Chairman of Allbritton Communications Company. Mr. Hebert previously served as Vice Chairman (1983 to 1998), President (1984 to 1998) and Chairman and Chief Executive Officer (1998 to 2001) of Allbritton Communications Company.

John I. Leahy has been the President of Management and Marketing Associates (a management consulting firm) since 1986. Mr. Leahy was the President and Group Executive Officer, Western Hemisphere of Black & Decker Corporation from 1982 to 1985. Mr. Leahy is a director of Kar Kraft Systems, Inc., Cavanaugh Capital, Inc., Acorn Products, Inc., The Wills Group, Thulman-Eastern Company and Gallagher Fluid Seals, Inc.

Robert E. Long is the CEO and Director of Goodwyn, Long & Black Investment Management, Inc. and has been the Chairman and Chief Executive Officer of Emerald City Radio Partners, LLC since 1997. Mr. Long was the President of Business News Network, Inc. from 1995 to 1998, was the Chairman and Chief Executive Officer of Southern Starr Broadcasting Group, Inc. from 1991 to 1995, and a director and the President of Potomac Asset Management, Inc. from 1983 to 1991. Mr. Long is a director of AmBase Corporation, CSC Scientific, Inc., and Advanced Solutions International, Inc.

Warren K. Montouri has been a Partner of Montouri & Roberson (real estate investment firm) since 1980. Mr. Montouri was a director of C&S/Sovran Bank from 1970 to 1990, a director of Sovran Financial Corporation from 1989 to 1990, a director of NationsBank, N.A. from 1990 to 1996, a director of BB&T Bank (formerly Franklin National Bank) from 1996 to 2000, a Trustee of Suburban Hospital from 1991 to 1994, and a Trustee of The Audubon Naturalist Society from 1979 to 1985.

Guy T. Steuart II has been a director and President of Steuart Investment Company (manages, operates, and leases real and personal property and holds stock in operating subsidiaries engaged in various businesses) since 1960. Mr. Steuart is Trustee Emeritus of Washington and Lee University.

T. Murray Toomey, Esq. has been an attorney at law since 1949. Mr. Toomey is a director of The National Capital Bank of Washington and Federal Center Plaza Corporation. He is also a Trustee of The Catholic University of America.

Laura W. van Roijen has been a private real estate investor since 1992. Ms. van Roijen was the Chairman of CWV & Associates (RTC qualified contracting firm) from 1991 to 1994, a director and the Treasurer of Black Possum Inc. (retail concern) from 1994 to 1996, the President of Volta Place, Inc. (real estate advisory firm) from 1991 to

1994, and Vice President (from 1986 to 1991) and Market Director (from 1989 to 1991) of Citicorp Real Estate, Inc.

EXECUTIVE OFFICERS WHO ARE NOT DIRECTORS

Joan M. Sweeney, Managing Director and Chief Operating Officer, has been employed by the Company since 1993. Ms. Sweeney oversees all company operations and is responsible for strategic planning, financial management, information technology, marketing, investor relations, and all regulatory compliance. Prior to joining the Company, Ms. Sweeney spent ten years of her career consulting with private and small public companies at both Ernst & Young and Coopers & Lybrand. Ms. Sweeney was a member of the SEC Division of Enforcement in the late 1980s.

Scott S. Binder, Managing Director, has worked with the Company since 1991 and is responsible for the Company's telecommunications and broadcasting/cable investments within the private finance group. Prior to joining the Company, Mr. Binder formed and was President of Overland Communications Group, which owned and operated cable television systems and radio stations. He also has worked in the specialty finance and leasing industry.

Samuel B. Guren, Managing Director, joined the Company in 1999. He joined the Company to develop the Company's private equity investment business. Mr. Guren has more than 26 years of venture capital investing experience. Prior to joining the Company, Mr. Guren was the Senior Managing Partner at Baird Capital. He also served as a Senior Managing Partner at William Blair Venture Partners for 15 years.

Philip A. McNeill, Managing Director, has been employed by the Company since 1993 in the Company's private finance group. Before joining the Company, he served as a vice president of M&T Capital Corporation. Prior to entering the private finance industry, he was founding director of Western Oklahoma National Bank, and structured and managed numerous privately negotiated investments.

John M. Scheurer, Managing Director, has been employed by the Company since 1991 and manages the Company's real estate finance group. He has more than 22 years of experience in commercial finance and real estate lending and management. Prior to joining the Company, Mr. Scheurer worked in various capacities with Capital Recovery Advisors, Inc. and First American Bank. He also started his own company, The Scheurer Company, and co-founded Hunter & Associates, a major leasing and consulting real estate firm in the Washington, DC area.

Thomas H. Westbrook, Managing Director, has been with the Company since 1991 and is responsible for the Company's business services investments within the private finance group. Prior to joining the Company, Mr. Westbrook worked with North Carolina Enterprise Fund and was a lending officer in NationsBank's corporate lending unit. He is the former president of the southern RASBIC and has served on the NASBIC Board of Governors.

G. Cabell Williams, III, Managing Director, has been employed by the Company since 1981 in the Company's private finance group. He has over 19 years of private finance experience, and has structured numerous types of private debt and equity finance transactions. Mr. Williams has served in many capacities during his tenure with the Company.

Penni F. Roll, Executive Vice President and Chief Financial Officer, has been employed by the Company since 1995. Ms. Roll is responsible for the

Company's financial management and reporting, accounting, loan servicing, special servicing, portfolio monitoring and regulatory compliance activities. Prior to joining the Company, she spent seven years in the financial services practice at KPMG Peat Marwick, including serving as a Manager from 1993 to 1995.

EMPLOYMENT AGREEMENTS

The Company has entered into employment agreements with eight senior executives of the Company, including William L. Walton, the Company's Chairman and CEO, Joan M. Sweeney, Managing Director and Chief Operating Officer, and John M. Scheurer, Managing Director. Each of the agreements provides for a three-year term, with annual renewals thereafter, and specifies each executive's compensation during the term of the agreement, in accordance with the achievement of certain performance standards.

The annual base salary on the effective date of the employment agreements of Mr. Walton, Ms. Sweeney, and Mr. Scheurer was $405,000, $256,500, and $256,500, respectively. The Board of Directors has the right to increase the base salary during the term of the employment agreement. In addition, each employment agreement states that the Board of Directors may provide, at their sole discretion, an annual cash bonus. This bonus is to be determined with reference to each executive's performance in accordance with performance criteria to be determined by the Board in its sole discretion. Under each agreement, each executive also is entitled to participate in the Company's Amended Stock Option Plan, and to receive all other awards and benefits previously granted to each executive including life insurance premiums.

In addition, each employment agreement provides for a long-term cash retention award for the performance period from 2001 through 2003. The long-term cash retention award will vest and be payable in six equal installments on June 30th and December 31st of each year from 2001 through 2003. Mr. Walton will be eligible for a long-term cash retention award of $3,375,000, or $1,125,000 per year, over the performance period; Ms. Sweeney will be eligible for $2,550,000, or $850,000 per year; and Mr. Scheurer will be eligible for $2,115,000, or $705,000 per year.

Employment will terminate if the term of the agreement expires without written agreement of both parties. The executive has the right to voluntarily terminate employment at any time with 30 days' notice, and in such case, the employee will not receive any severance pay. Among other things, the employment agreements prohibit the solicitation of employees from the Company in the event of an executive's departure for a period of two years.

If employment is terminated with cause, the employee will not receive any severance pay. If employment is terminated without cause during the term of the agreement, the executive shall be entitled to severance pay for a period not to exceed 36 months for Mr. Walton; 30 months for Ms. Sweeney; and 24 months for Mr. Scheurer. Severance pay shall include the continuation of the employee's base salary, and the greater of (a) the average of the annual bonuses paid during the preceding three years, or (b) the amount of the last annual bonus paid to the employee. In addition, the executive shall be entitled to receive any payments under the long-term cash retention award that would have vested and been payable during the severance period. However, stock options would cease to vest during the severance period.

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If, within 12 months after a change of control (as defined in the employment agreements) termination of employment occurs either by the executive officer or the Company, the executive officer shall not be entitled to severance pay, but will instead be entitled to lump sum compensation as well as certain other benefits. For Mr. Walton, this lump sum is equal to three years of base salary and bonus (as calculated for severance pay), plus an amount equal to $5,565,000. For Ms. Sweeney, this lump sum is equal to two and a half years of base salary and bonus, plus an amount equal to $2,600,000. For Mr. Scheurer, this lump sum is equal to two years of base salary and bonus, plus an amount equal to $2,350,000. Under the terms of the agreement, the Company would also provide compensation to offset any applicable excise tax penalties imposed on the executive under section 4999 of the Internal Revenue Code.

The other six employment agreements carry terms substantially similar to those of Mr. Scheurer's agreement, as described herein.

COMPENSATION PLANS

STOCK OPTION PLAN

The Company's stock option plan (the "Stock Option Plan") is intended to encourage stock ownership in the Company by officers and directors, thus giving them a proprietary interest in the Company's performance. The Stock Option Plan was approved by shareholders at the Special Meeting of Shareholders on November 26, 1997. On May 9, 2000, the Company's stockholders amended the Stock Option Plan to increase the authorized shares under the plan to 12,350,000 shares as well as make certain other administrative changes.

The Committee's principal objective in awarding stock options to the eligible officers of the Company is to align each optionee's interests with the success of the Company and the financial interests of its stockholders by linking a portion of such optionee's compensation with the performance of the Company's stock and the value delivered to stockholders.

Stock options are granted under the Stock Option Plan at a price not less than the prevailing market value and will have value only if the Company's stock price increases. The Committee determines the amount and features of the stock options, if any, to be awarded to optionees. The Committee evaluates a number of criteria, including the past service of each such optionee to the Company, the present and potential contributions of such optionee to the success of the Company and such other factors as the Committee shall deem relevant in connection with accomplishing the purposes of the Stock Option Plan, including the recipient's current stock holdings, years of service, position with the Company and other factors. The Committee does not apply a formula assigning specific weights to any of these factors when making its determination. The Committee awards stock options on a subjective basis and such awards depend in each case on the performance of the officer under consideration.

For the year ended, December 31, 2000, a total of 4,162,112 options were granted, including grants made by the Company's compensation committee to certain officers and automatic grants to non-officer directors of the Company. These options generally vest over a three-year period except that grants to non-officer directors vest immediately. See "Control Persons and Principal Holders of Securities" in the SAI for currently exercisable options granted to certain executive officers and non-officer directors.

On September 8, 1999, the Company received approval from the Commission to grant options under the Stock Option Plan to non-officer directors. On that date, each incumbent non-officer director received options to purchase 10,000 shares, and pursuant to the Commission order, each will receive options to purchase 5,000 shares each year thereafter on the date of the annual meeting of stockholders. New directors will receive options to purchase 10,000 shares upon election to the board, and options to purchase 5,000 shares each year thereafter on the date of the annual meeting.

The Stock Option Plan is designed to satisfy the conditions of Section 422 of the Code so that options granted under the Stock Option Plan may qualify as "incentive stock options." To qualify as "incentive stock options," options may not become exercisable for the first time in any year if the number of incentive options first exercisable in that year multiplied by the exercise price exceeds $100,000.

FORMULA AWARD AND CUT-OFF AWARD

Formula Award. The Formula Award was designed as an incentive compensation program that would replace stock options of the predecessor companies that were cancelled as a result of the Company's 1997 merger, and would balance share ownership among key officers. The Company accrued the Formula Award over the three-year period on the anniversary of the merger date (December 31) in 1998, 1999 and 2000. The Formula Award expense for 1998, 1999 and 2000 totaled $6.2 million, $6.2 million and $5.7 million, respectively. The terms of the Formula Award required that the award be contributed to the Company's deferred compensation plan, and used to purchase shares of the Company in the open market. See "Deferred Compensation Plan." The amount of the Formula Awards received by certain executive officers in 2000 is provided in the SAI.

On January 2, 2001, the trust that holds the deferred compensation plan distributed shares of the Company's common stock with a value of $4,383,165 representing the final portion of the Formula Award that vested on December 31, 2000. These shares are held in restricted accounts at a brokerage firm.

Cut-Off Award. The Cut-Off Award was designed to cap the appreciated value in unvested options at the merger announcement date in order to set the foundation to balance option awards upon the merger on December 31, 1997. The Cut-Off Award is payable for each canceled option as the canceled options would have vested and vests automatically in the event of a change of control. The Cut-Off Award is payable if the award recipient is employed by the Company on the future vesting date. The Cut-Off Award expense for the years ended December 31, 2000, 1999 and 1998 totaled $0.5 million, $0.6 million and $0.8 million, respectively. The amount of the Cut-Off Award received by certain executive officers in 2000 is provided in the SAI.

401(K) PLAN

The Company maintains a 401(k) plan (the "401(k) Plan"). All employees who are at least 21 years of age have the opportunity to contribute pre-tax salary deferrals into the 401(k) Plan of up to $10,500, and to direct the investment of these contributions. The 401(k) Plan allows eligible participants to invest in shares of the Company's common stock, among other investment options. In addition, beginning in 2000, the Company contributed to each eligible participant (i.e., employees with one (1) year of service), 5% of each participant's total cash compensation for the year, up to $170,000, to each participant's plan account on the participant's behalf, which fully vests at the time of contribution. The contribution with respect to compensation in excess of $170,000 is made

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to the Deferred Compensation Plan. On March 16, 2001, the 401(k) Plan held less than 1% of the outstanding shares of the Company.

DEFERRED COMPENSATION PLAN

The Company maintains a deferred compensation plan (the "Deferred

Compensation Plan"). The Deferred Compensation Plan is a funded plan that provides for the deferral of compensation by employees and consultants of the Company. Any employee or consultant of the Company is eligible to participate in the plan at such time and for such period as designated by the board of directors. The Deferred Compensation Plan is administered through a trust, and the Company funds this plan through cash contributions.

TAX STATUS

The following discussion is a general summary of the material United States federal income tax considerations applicable to the Company and to an investment in the common stock. 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 Code, Treasury Regulations, and administrative and judicial interpretations, each as of the date of this prospectus and all of which are subject to change. You should consult your own tax advisor with respect to tax considerations that pertain to your purchase of the common stock.

This summary is intended to apply to investments in common stock and assumes that investors hold the common stock as capital assets. This summary does not discuss all aspects of federal income taxation relevant to holders of the common stock in light of particular circumstances, or to certain types of holders subject to special treatment under federal income tax laws, including dealers in securities, pension plans and trusts and financial institutions. This summary does not discuss any aspects of U.S. estate and gift tax or foreign, state or local tax. It does not discuss the special treatment under federal income tax laws that could result if the Company invested in tax-exempt securities or certain other investment assets.

This summary does not discuss the consequences of investments in preferred stock or debt securities of the Company. The tax consequences of an offering of preferred stock or debt securities of the Company will be discussed in a prospectus supplement relating to or for such offering.

Except as specifically indicated herein, this summary is intended to apply to U.S. Stockholders (as defined below) and does not purport to discuss all U.S. federal income tax consequences to persons who are not U.S. Stockholders ("Non-U.S. Stockholders") from an investment in the common stock. (A "U.S. Stockholder" generally is a stockholder who is (i) a citizen or resident of the United States, (ii) a corporation, partnership or other entity created in or organized under the laws of the United States or any political subdivision thereof, (iii) an estate, the income of which is subject to United States federal income taxation regardless of its source, or (iv) a trust subject to the supervision of a court within the United States and the control of a United States person.) Non-U.S. Stockholders should consult their own tax advisors to discuss the consequences of an investment in the common stock.

TAXATION AS A RIC

The Company intends to be treated for tax purposes as a "regulated investment company" or "RIC" under Subchapter M of the Code. If the Company (i) qualifies as a RIC and (ii) distributes to stockholders in a timely manner at least 90% of its "investment company taxable income," as defined in the Code (i.e., net investment income, including accrued original issue discount, and net short-term capital gain) (the "90% Distribution Requirement") each year, it will not be subject to federal income tax on the portion of its investment company taxable income and net capital gain (i.e., net long-term capital gain in excess of net short-term capital loss) it distributes (or treats as "deemed distributed") to stockholders. In addition, if the Company distributes in a timely manner the sum of (i) 98% of its ordinary income for each calendar year, (ii) 98% of its capital gain net income for the one-year period ending December 31 in that calendar year, and (iii) any income not distributed in prior years, the Company will not be subject to the 4% nondeductible federal excise tax on certain undistributed income of RICs (the "Excise Tax Avoidance Requirements"). The Company generally will endeavor to distribute (or treat as deemed distributed) to stockholders all of its investment company taxable income and its net capital gain, if any, for each taxable year so that it will not incur federal income or excise taxes on its earnings. The Company will be subject to federal income tax at the regular corporate rate for any amounts of investment company taxable income or net capital gain not distributed (or deemed distributed) to the stockholders.

In order to qualify as a RIC for federal income tax purposes, the Company must, among other things: (a) continue to qualify as a BDC under the 1940 Act, (b) derive in each taxable year at least 90% of its gross income from dividends, interest, payments with respect to securities loans, gains from the sale of stock or other securities, or other income derived with respect to its business of investing in such stock or securities (the "90% Income Test"); and (c) diversify its holdings so that at the end of each quarter of the taxable year (i) at least 50% of the value of the Company's assets consists of cash, cash items, U.S. government securities, securities of other RICs, and other securities if such other securities of any one issuer do not represent more than 5% of the Company's assets or more than 10% of the outstanding voting securities of the issuer, and (ii) no more than 25% of the value of the Company's assets is invested in the securities (other than U.S. government securities or securities of other RICs) of one issuer or of two or more issuers that are controlled (as determined under applicable Code rules) by the Company and are engaged in the same or similar or related trades or businesses (the "Diversification Tests"). The failure of one or more of the Company's subsidiaries to continue to qualify as RICs could adversely affect the Company's ability to satisfy the Diversification Tests.

If the Company acquires or is deemed to have acquired debt obligations that were issued originally at a discount or that otherwise are treated under applicable tax rules as having original issue discount, it must include in income each year a portion of the original issue discount that accrues over the life of the obligation regardless of whether cash representing such income is received by it in the same taxable year. Any amount accrued as original issue discount will be included in the Company's investment company taxable income for the year of accrual and may have to be distributed to the stockholders in order to satisfy the 90% Distribution Requirement or the Excise Tax Avoidance Requirements even though the Company has not received any cash representing such income.

Although it does not currently intend to do so, if the Company were to invest in certain options, futures, or forward contracts, it may be required to report income from such investments on a mark-to-market basis, which could result in the Company

recognizing unrealized gains and losses for federal income tax purposes even though it may not realize such gains and losses when it ultimately disposes of such investments. The Company could also be required to treat such gains and losses as 60% long-term capital gain or loss and 40% short-term capital gain or loss regardless of its holding period for the investments. In addition, if the Company were to engage in certain hedging transactions, including hedging transactions in options, future contracts, and straddles, or other similar transactions, it will be subject to special tax rules (including constructive sale, mark-to-market, straddle, wash sale, and short sale rules), the effect of which may be to accelerate income to the Company, defer losses to the Company, cause adjustments in the holding periods of the Company's securities, convert long-term capital gains into short-term capital gains or convert short-term capital losses into long-term capital losses. These rules could affect the Company's investment company taxable income or net capital gain for a taxable year and thus affect the amounts that the Company would be required to distribute to its stockholders pursuant to the 90% Distribution Requirement and the Excise Tax Avoidance Requirements for such year.

Although it does not presently expect to do so, the Company is authorized to borrow funds and to sell assets in order to satisfy distribution requirements. However, under the 1940 Act, the Company is not permitted to make distributions to stockholders while the Company's debt obligations and other senior securities are outstanding unless certain "asset coverage" tests are met. Moreover, the Company's ability to dispose of assets to meet its distribution requirements may be limited by other requirements relating to its status as a RIC, including the Diversification Test. If the Company disposes of assets in order to meet the 90% Distribution Requirement or the Excise Tax Avoidance Requirements, the Company may make such dispositions at times that, from an investment standpoint, are not advantageous.

If the Company fails to satisfy the 90% Distribution Requirement or otherwise fails to qualify as a RIC in any taxable year, it will be subject to tax in that year on all of its taxable income, regardless of whether it makes any distributions to its stockholders. In that case, all of the Company's distributions to its stockholders will be characterized as ordinary income (to the extent of the Company's current and accumulated earnings and profits). In contrast, as is explained below, if the Company qualifies as a RIC, a portion of its distributions or deemed distributions may be characterized as long-term capital gain in the hands of stockholders.

The remainder of this Summary assumes that the Company qualifies as a RIC and satisfies the 90% Distribution Requirement.

TAXATION OF STOCKHOLDERS

Distributions of the Company generally are taxable to stockholders as ordinary income or capital gains. Distributions of the Company's investment company taxable income will be taxable as ordinary income to stockholders to the extent of the Company's current or accumulated earnings and profits, whether paid in cash or reinvested in additional common stock. Distributions of the Company's net capital gains properly designated by the Company as "capital gain dividends" will be taxable to a stockholder as long-term capital gains regardless of the stockholder's holding period for his or her common stock and regardless of whether paid in cash or reinvested in additional common stock. Distributions in excess of the Company's earnings and profits first will reduce a stockholder's adjusted tax basis in such stockholder's common stock and, after the adjusted basis is reduced to

zero, will constitute capital gains to such stockholder. For a summary of the tax rates applicable to capital gains, including capital gain dividends, see the discussion below.

At the Company's option, the Company may elect to retain some or all of its net capital gains for a tax year, but designate the retained amount as a "deemed distribution." In that case, among other consequences, the Company will pay tax on the retained amount for the benefit of its stockholders, the stockholders will be required to report their share of the deemed distribution on their tax returns as if it had been distributed to them, and the stockholders will report a credit for the tax paid thereon by the Company. The amount of the deemed distribution net of such tax will be added to the stockholder's cost basis for his or her common stock. Since the Company expects to pay tax on any retained net capital gains at its regular corporate capital gain tax rate, and since that rate is in excess of the maximum rate currently payable by individuals on long-term capital gains, the amount of tax that individual stockholders will be treated as having paid will exceed the amount of tax that such stockholders would be required to pay on the retained net capital gains. A stockholder that is not subject to U.S. federal income tax or tax on long-term capital gains should be able to file a return on the appropriate form or a claim for refund that allows such stockholder to recover the taxes paid on his or her behalf. In the event the Company chooses this option, it must provide written notice to the stockholders prior to the expiration of 60 days after the close of the relevant tax year.

Any dividend declared by the Company in October, November, or December of any calendar year, payable to stockholders of record on a specified date in such a month and actually paid during January of the following year, will be treated as if it had been received by the stockholders on December 31 of the year in which the dividend was declared.

You should consider the tax implications of buying common stock just prior to a distribution. Even if the price of the common stock includes the amount of the forthcoming distribution, you may be taxed upon receipt of the distribution and will not be entitled to offset the distribution against the tax basis in your common stock.

You may recognize taxable gain or loss if you sell or exchange your common stock. The amount of the gain or loss will be measured by the difference between your adjusted tax basis in your common stock and the amount of the proceeds you receive in exchange for such stock. Any gain or loss arising from (or, in the case of distributions in excess of earnings and profits, treated as arising from) the sale or exchange of common stock generally will be a capital gain or loss. This capital gain or loss normally will be treated as a long-term capital gain or loss if you have held your common stock for more than one year; otherwise, it will be classified as short-term capital gain or loss. However,any capital loss arising from the sale or exchange of common stock held for six months or less generally will be treated as a long-term capital loss to the extent of the amount of capital gain dividends received (or treated as deemed distributed) with respect to such stock and, for this purpose, the special rules of Section 852(b)(4)(C) of the Code generally apply in determining the holding period of such stock. In addition, all or a portion of any loss realized upon a taxable disposition of common stock may be disallowed if other shares of the Company's common stock are purchased (under the Company's DRIP or otherwise) within 30 days before or after the disposition.

In general, non-corporate stockholders currently are subject to a maximum federal income tax rate of 20% (subject to reduction in certain situations) on their net long-term capital gain (the excess of net long-term capital gain over net short-term capital loss) for a taxable year (including a long-term capital gain derived from an investment in the

common stock), while other income may be taxed at rates as high as 39.6%. Corporate taxpayers currently are subject to federal income tax on net capital gain at the maximum 35% rate also applied to ordinary income. Tax rates imposed by states and local jurisdictions on capital gain and ordinary income may differ. Non-corporate stockholders with net capital losses for a year (i.e., capital losses in excess of capital gains) generally may deduct up to $3,000 of such losses against their ordinary income each year; any net capital losses of a non-corporate stockholder in excess of $3,000 generally may be carried forward and used in subsequent years as provided in Section 1212(b) of the Code. Corporate stockholders generally may not deduct any net capital losses for a year, but may carryback such losses for three years or carry forward such losses for five years.

The Company will send to each of its stockholders, as promptly as possible after the end of each calendar year, a notice detailing, on a per share and per distribution basis, the amounts includible in such stockholder's taxable income for such year as ordinary income and as long-term capital gain. In addition, the federal tax status of each year's distributions generally will be reported to the IRS. Distributions may also be subject to additional state, local, and foreign taxes depending on a stockholder's particular situation. The Company's ordinary income dividends to corporate stockholders may, if certain conditions are met, qualify for the dividends received deduction to the extent that the Company has received qualifying dividend income during the taxable year; capital gain dividends distributed by the Company are not eligible for the dividends received deduction.

A Non-U.S. Stockholder may be subject to withholding of U.S. federal tax at a 30% rate (or lower applicable treaty rate) on distributions (including certain redemptions of common stock) from the Company. Accordingly, investment in the Company is likely to be appropriate for a Non-U.S. Stockholder only if such person can utilize a foreign tax credit or corresponding tax benefit in respect of such withholding tax. Non-U.S. Stockholders should consult their own tax advisors with respect to the U.S. federal income and withholding tax, and state, local, and foreign tax, consequences of an investment in the common stock.

The Company may be required to withhold U.S. federal income tax at a rate of 31% ("backup withholding") from all taxable distributions payable to (i) any stockholder who fails to furnish the Company with its correct taxpayer identification number or a certificate that the stockholder is exempt from backup withholding, and (ii) any stockholder with respect to whom the IRS notifies the Company that the stockholder has failed to properly report certain interest and dividend income to the IRS and to respond to notices to that effect. The Company may be required to report annually to the IRS and to each Non-U.S. Stockholder the amount of dividends paid to such stockholder and the amount, if any, of tax withheld pursuant to the backup withholding rules with respect to such dividends. This information may also be made available to the tax authorities in the Non-U.S. Stockholder's country of residence. Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules from payments made to a stockholder may be refunded or credited against such stockholder's United States federal income tax liability, if any, provided that 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 THE COMPANY, INCLUDING THE POSSIBLE EFFECT OF ANY PENDING LEGISLATION OR PROPOSED REGULATION.

CERTAIN GOVERNMENT REGULATIONS

We operate in a highly regulated environment. The following discussion generally summarizes certain regulations.

BUSINESS DEVELOPMENT COMPANY ("BDC"). A business development company is defined and regulated by the Investment Company Act of 1940. It is a unique kind of investment company that primarily focuses on investing in or lending to small private companies and making managerial assistance available to them. A BDC may use capital provided by public shareholders and from other sources to invest in long-term, private investments in growing businesses. A BDC provides shareholders the ability to retain the liquidity of a publicly traded stock, while sharing in the possible benefits, if any, of investing in privately owned growth companies.

As a BDC, we may not acquire any asset other than "Qualifying Assets" unless, at the time we make the acquisition, our Qualifying Assets represent at least 70% of the value of our total assets (the "70% test"). The principal categories of Qualifying Assets relevant to our business are:

(1) Securities purchased in transactions not involving any public offering, the issuer of which is an eligible portfolio company. An eligible portfolio company is defined to include any issuer that (a) is organized and has its principal place of business in the United States, (b) is not an investment company other than an SBIC wholly owned by a BDC (our investments in Allied Investment and certain other subsidiaries generally are Qualifying Assets), and (c) does not have any class of publicly traded securities with respect to which a broker may extend margin credit;

(2) Securities received in exchange for or distributed with respect to securities described in (1) above or pursuant to the exercise of options, warrants, or rights relating to such securities; and

(3) Cash, cash items, government securities, or high quality debt securities (within the meaning of the 1940 Act), maturing in one year or less from the time of investment.

To include certain securities described above as Qualifying Assets for the purpose of the 70% test, a BDC must make available to the issuer of those securities significant managerial assistance such as providing significant guidance and counsel concerning the management, operations, or business objectives and policies of a portfolio company, or making loans to a portfolio company. We will provide managerial assistance on a continuing basis to any portfolio company that requests it, whether or not difficulties are perceived.

As a BDC, the Company is entitled to issue senior securities in the form of stock or senior securities representing indebtedness, including debt securities and preferred stock, as long as each class of senior security has an asset coverage of at least 200% immediately after each such issuance. This limitation is not applicable to borrowings by our SBIC subsidiary, and therefore any borrowings by these subsidiaries are not included in this asset coverage test. See "Risk Factors."

We have adopted a Code of Ethics that establishes procedures for personal investments and restricts certain transactions by the Company's personnel. See "Where You Can Find More Information."

We may not change the nature of our business so as to cease to be, or withdraw our election as, a BDC unless authorized by vote of a "majority of the outstanding voting

securities," as defined in the 1940 Act, of our shares. Since we made our BDC election, we have not made any substantial change in the nature of our business.

REGULATED INVESTMENT COMPANY ("RIC"). Our status as a RIC enables us to avoid the cost of federal and state taxation, and as a result achieve pre-tax investment returns. We believe that this tax advantage enables us to achieve strong equity returns without having to aggressively leverage our balance sheet.

In order to qualify as a RIC, the Company must, among other things:

(1) Derive at least 90% of its gross income from dividends, interest, payments with respect to securities loans, gains from the sale of stock or other securities or other income derived with respect to its business of investing in such stock or securities.

(2) Diversify its holdings so that

(a) at least 50% of the value of the Company's assets consists of cash, cash items, U.S. government securities, securities of other RICs and other securities if such other securities of any one issuer do not represent more than 5% of the Company's assets and 10% of the outstanding voting securities of the issuer, and

(b) no more than 25% of the value of the Company's assets are invested in securities (other than U.S. government securities) of one issuer, or of two or more issuers that are controlled by the Company.

(3) Distribute at least 90% of its "investment company taxable income" each tax year to its shareholders. In addition, if a RIC distributes in a timely manner (or treats as "deemed distributed") 98% of its capital gain net income for each one year period ending on December 31 and distributes 98% of its ordinary income for each calendar year, it will not be subject to the 4% nondeductible federal excise tax on certain undistributed income of RICs.

SBA REGULATIONS. Allied Investment, a wholly owned subsidiary of the Company, is licensed by the SBA as an SBIC under Section 301(c) of the Small Business Investment Act of 1958, as amended (the "1958 Act"), and has elected to be regulated as a BDC.

SBICs are authorized to stimulate the flow of private equity capital to eligible small businesses. Under present SBA regulations, eligible small businesses include businesses that have a net worth not exceeding $18 million and have average annual fully taxed net income not exceeding $6 million for the most recent two fiscal years. In addition, an SBIC must devote 20% of its investment activity to "smaller" concerns as defined by the SBA. A smaller concern is one that has a net worth not exceeding $6 million and has average annual fully taxed net income not exceeding $2 million for the most recent two fiscal years. SBA regulations also provide alternative size standard criteria to determine eligibility, which depend on the industry in which the business is engaged and are based on such factors as the number of employees and gross sales. According to SBA regulations, SBICs may make long-term loans to small businesses, invest in the equity securities of such businesses, and provide them with consulting and advisory services. Allied Investment provides long-term loans to qualifying small businesses; equity investments and consulting and advisory services are typically provided only in connection with such loans.

Allied Investment is periodically examined and audited by the SBA staff to determine its compliance with SBIC regulations.

Allied Investment has the opportunity to sell to the SBA subordinated debentures with a maturity of up to ten years, up to an aggregate principal amount of $108.8 million.

This limit generally applies to all financial assistance provided by the SBA to any licensee and its "associates," as that term is defined in SBA regulations.

Historically, an SBIC was also eligible to sell preferred stock to the SBA. Allied Investment had received $78.3 million of subordinated debentures and $7.0 million of preferred stock from the SBA at December 31, 2000; as a result of the $108.8 million limit, the Company is limited on its ability to apply for additional financing from the SBA. Interest rates on the SBA debentures currently outstanding have a weighted average interest cost of 8.3%.

DIVIDEND REINVESTMENT PLAN

We have adopted an "opt out" dividend reinvestment plan ("DRIP plan"). Under the DRIP plan, if you own shares of common stock registered in your own name, our transfer agent, acting as reinvestment plan agent, will automatically reinvest any dividend in additional shares of common stock. Shareholders may change enrollment status in the DRIP plan at any time by contacting either the plan agent or the Company.

A shareholder's ability to participate in a DRIP plan may be limited according to how the shares of common stock are registered. A nominee may preclude beneficial owners holding shares in street name from participating in the DRIP plan. Shareholders who wish to participate in a DRIP plan may need to register their shares of common stock in their own name. Shareholders will be informed of their right to opt out of the DRIP plan in the Company's annual and quarterly reports to shareholders. Shareholders who hold shares in the name of a nominee should contact the nominee for details.

All distributions to investors who do not participate (or whose nominee elects not to participate) in the DRIP plan will be paid by check mailed directly, or through the nominee, to the record holder by or under the discretion of the plan agent. The plan agent is American Stock Transfer and Trust Company, 59 Maiden Lane, New York, New York 10038. Their telephone number is 800-937-5449.

Under the DRIP plan, we may issue new shares unless the market price of the outstanding shares of common stock is less than 110% of the last reported net asset value. Alternatively, the plan agent may buy shares of common stock in the market. We value newly issued shares of common stock for the DRIP plan at the average of the reported last sale prices of the outstanding shares of common stock on the last five trading days prior to the payment date of the distribution, but not less than 95% of the opening bid price on such date. The price in the case of shares bought in the market will be the average actual cost of such shares of common stock, including any brokerage commissions. There are no other fees charged to shareholders in connection with the DRIP plan. Any distributions reinvested under the plan will nevertheless remain taxable to the shareholders.

DESCRIPTION OF SECURITIES

The following summary of the Company's capital stock and other securities does not purport to be complete and is subject to, and qualified in its entirety by, the Company's Amended and Restated Articles of Incorporation, as amended (the "Charter"). Reference is made to the Charter for a detailed description of the provisions summarized below.

On September 18, 2000, the Board of Directors voted unanimously to amend the Company's Charter to increase its authorized capital stock (the "Capital Stock") from 100,000,000 shares, $0.0001 par value, to 200,000,000 shares, and authorized management to hold a special meeting of shareholders on November 15, 2000 to seek shareholder approval for such amendment. The Charter amendment was approved by shareholders and the Charter amendment was filed with the state of

Maryland on November 17, 2000.

The Board of Directors may classify and reclassify any unissued shares of Capital Stock of the Company by setting or changing in one or more respects the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends, qualifications, terms or conditions or redemption or other rights of such shares of Capital Stock.

COMMON STOCK

At March 30, 2001, there were 85,877,875 shares of common stock outstanding and 11,674,084 shares of common stock reserved for issuance under the Amended Stock Option Plan. The following are the outstanding classes of securities of the Company as of March 30, 2001:

	(1) TITLE OF CLASS	(2) AMOUNT AUTHORIZED	(3) AMOUNT HELD BY COMPANY OR FOR ITS ACCOUNT	(4) AMOUNT OUTSTANDING EXCLUSIVE OF AMOUNTS SHOWN UNDER(3)
Allied Capital Corporation........	Common Stock	200,000,000	0	85,877,875

All shares of common stock have equal rights as to earnings, assets, dividends and voting privileges and all outstanding shares of common stock are fully paid and non-assessable. Distributions may be paid to the holders of common stock if and when declared by the Board of Directors of the Company out of funds legally available therefore. Our common stock has no preemptive, conversion, or redemption rights and is freely transferable. In the event of liquidation, each share of common stock is entitled to share ratably in all assets of the Company that are legally available for distributions after payment of all debts and liabilities and subject to any prior rights of holders of Preferred Stock, if any, then outstanding. Each share of common stock is entitled to one vote and does not have cumulative voting rights, which means that holders of a majority of the shares, if they so choose, could elect all of the directors, and holders of less than a majority of the shares would, in that case, be unable to elect any director. All shares of common stock offered hereby will be, when issued and paid for, fully paid and non-assessable.

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PREFERRED STOCK

In addition to shares of common stock, the articles of incorporation authorizes the issuance of preferred stock ("Preferred Stock"). The Board of Directors is authorized to provide for the issuance of Preferred Stock with such preferences, powers, rights and privileges as the Board deems appropriate; except that, such an issuance must adhere to the requirements for the 1940 Act. The 1940 Act requires, among other things, that (i) immediately after issuance and before any distribution is made with respect to common stock, the Preferred Stock, together with all other senior securities, must not exceed an amount equal to 50% of the Company's total assets and (ii) the holders of shares of Preferred Stock, if any are issued, must be entitled as a class to elect two directors at all times and to elect a majority of the directors if dividends on the Preferred Stock are in arrears by two years or more. The Company believes the availability of such stock will provide the Company with increased flexibility in structuring future financings and acquisitions. If we offer Preferred Stock under this prospectus, we will issue an appropriate prospectus supplement. You should read that prospectus supplement for a description of the Preferred Stock, including, but not limited to, whether there will be an arrearage in the payment of dividends or sinking fund installments, if any, restrictions with respect to the declaration of dividends, requirements in connection with the maintenance of any ratio or assets, or creation or maintenance of reserves, or provisions for permitting or restricting the issuance of additional securities.

DEBT SECURITIES

The Company may issue debt securities that may be senior or subordinated in priority of payment. The Company will provide a prospectus supplement that describes the ranking, whether senior or subordinated, the specific designation, the aggregate principal amount, the purchase price, the maturity, the redemption terms, the interest rate or manner of calculating the interest rate, the time of payment of interest, if any, the terms for any conversion or exchange, including the terms relating to the adjustment of any conversion or exchange mechanism, the listing, if any, on a securities exchange, the name and address of the trustee and any other specific terms of the debt securities.

LIMITATION ON LIABILITY OF DIRECTORS

The Company has adopted provisions in its charter and bylaws limiting the liability of directors and officers of the Company for monetary damages. The effect of these provisions in the charter and bylaws is to eliminate the rights of the Company and its shareholders (through shareholders' derivative suits on behalf of the Company) to recover monetary damages against a director or officers for breach of the fiduciary duty of care as a director or officer (including breaches resulting from negligent or grossly negligent behavior) except in certain limited situations. These provisions do not limit or eliminate the rights of the Company or any shareholder to seek non-monetary relief such as an injunction or rescission in the event of a breach of a director's or officer's duty of care. These provisions will not alter the liability of directors or officers under federal securities laws.

CERTAIN ANTI-TAKEOVER PROVISIONS

The charter and bylaws of the Company and certain statutory and regulatory requirements contain certain provisions that could make more difficult the acquisition of the Company by means of a tender offer, a proxy contest or otherwise. These provisions are expected to discourage certain types of coercive takeover practices and inadequate takeover bids and to encourage persons seeking to acquire control of the Company to negotiate first with the board of directors. We believe that the benefits of these provisions

outweigh the potential disadvantages of discouraging such proposals because, among other things, negotiation of such proposals might result in an improvement of their terms. The description set forth below is intended as a summary only and is qualified in its entirety by reference to the charter and the bylaws.

CLASSIFIED BOARD OF DIRECTORS

The charter provides for the Board of Directors to be divided into three classes of directors serving staggered three-year terms, with each class to consist as nearly as possible of one-third of the directors then elected to the board. A classified board may render more difficult a change in control of the

Company or removal of incumbent management. We believe, however, that the longer time required to elect a majority of a classified board of directors helps to ensure continuity and stability of the Company's management and policies.

ISSUANCE OF PREFERRED STOCK

The Board of Directors of the Company, without shareholder approval, has the authority to reclassify authorized but unissued common stock as preferred stock and to issue preferred stock. Such stock could be issued with voting, conversion or other rights designed to have an anti-takeover effect.

MARYLAND CORPORATE LAW

The Company is subject to the Maryland Business Combination Statute and the Control Share Acquisition Statute, as defined below. The partial summary of the foregoing statutes contained in this prospectus is not intended to be complete and reference is made to the full text of such states for their entire terms.

BUSINESS COMBINATION STATUTE. Certain provisions of the Maryland Law establish special requirements with respect to "business combinations" between Maryland corporations and "interested shareholders" unless exemptions are applicable (the "Business Combination Statute"). Among other things, the Business Combination Statute prohibits for a period of five years a merger or other specified transactions between a company and an interested shareholder and requires a super majority vote for such transactions after the end of such five-year period.

"Interested shareholders" are all persons owning beneficially, directly or indirectly, 10% or more of the outstanding voting stock of a Maryland corporation. "Business combinations" include certain mergers or similar transactions subject to a statutory vote and additional transactions involving transfer of assets or securities in specified amounts to interested shareholders or their affiliates.

Unless an exemption is available, a "business combination" may not be consummated between a Maryland corporation and an interested shareholder or its affiliates for a period of five years after the date on which the shareholder first became an interested shareholder and thereafter may not be consummated unless recommended by the board of directors of the Maryland corporation and approved by the affirmative vote of at least 80% of the votes entitled to be cast by all holders of outstanding shares of voting stock and 66 2/3% of the votes entitled to be cast by all holders of outstanding shares of voting stock other than the interested shareholder or its affiliates or associates, unless, among other things, the corporation's shareholders receive a minimum price (as defined in the Business Combination Statute) for their shares and the consideration is received in cash or in the same form as previously paid by the interested shareholder for its shares.

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A business combination with an interested shareholder which is approved by the board of directors of a Maryland corporation at any time before an interested shareholder first becomes an interested shareholder is not subject to the five-year moratorium or special voting requirements. An amendment to a Maryland corporation charter electing not to be subject to the foregoing requirements must be approved by the affirmative vote of at least 80% of the votes entitled to be cast by all holders of outstanding shares of voting stock and 66 2/3% of the votes entitled to be cast by holders of outstanding shares of voting stock who are not interested shareholders. Any such amendment is not effective until 18 months after the vote of shareholders and does not apply to any business combination of a corporation with a shareholder who became an interested shareholder on or prior to the date of such vote.

CONTROL SHARE ACQUISITION STATUTE. The Maryland Law imposes limitations on the voting rights of shares acquired in a "control share acquisition." The control share statute defines a "control share acquisition" to mean the acquisition, directly or indirectly, of "control shares" subject to certain exceptions. "Control shares" of a Maryland corporation are defined to be voting shares of stock which, if aggregated with all other shares of stock previously acquired by the acquiror, would entitle the acquiror to exercise voting power in electing directors with one of the following ranges of voting power:

(1) one-fifth or more but not less than one-third;

(2) one-third or more but less than a majority; or

(3) a majority of all voting power.

Control shares do not include shares which the acquiring person is entitled to vote as a result of having previously obtained shareholder approval. Control shares of a Maryland corporation acquired in a control share acquisition have no voting rights except to the extent approved by a vote of two-thirds of the votes entitled to be cast by shareholders in the election of directors, excluding shares of stock as to which the acquiring person, officers of the corporation and directors of the corporation who are employees of the corporation are entitled to exercise or direct the exercise of the voting power of the shares in the election of the directors.

The control share statute also requires Maryland corporations to hold a special meeting at the request of an actual or proposed control share acquiror generally within 50 days after a request is made with the submission of an "acquiring person statement," but only if the acquiring person:

(1) gives a written undertaking and, if required by the directors of the issuing corporation, posts a bond for the cost of the meeting; and

(2) submits definitive financing agreements for the acquisition of the control shares to the extent that financing is not provided by the acquiring person.

In addition, unless the issuing corporation's charter or bylaws provide otherwise, the control share statute provides that the issuing corporation, within certain time limitations, shall have the right to redeem control shares (except those for which voting rights have previously been approved) for "fair value" as determined pursuant to the control share statue in the event:

(1) there is a shareholder vote and the grant of voting rights is not approved; or

(2) an "acquiring person statement" is not delivered to the target within 10 days following a control share acquisition.

Moreover, unless the issuing corporation's charter or bylaws provide otherwise, the control share statute provides that if, before a control share acquisition occurs, voting rights are accorded to control shares which result in the acquiring person having majority voting power, then all shareholders other than the acquiring person have appraisal rights as provided under the Maryland Law. An acquisition of shares may be exempted from the control share statute provided that a charter or bylaw provision is adopted for such purpose prior to the control share acquisition by any person with respect to the Company. The control share acquisition statute does not apply to shares acquired in a merger, consolidation or share exchange to which the corporation is a party.

REGULATORY RESTRICTIONS

Allied Investment, a wholly owned subsidiary, is an SBIC. The SBA prohibits, without prior SBA approval, a "change of control" or transfers which would result in any person (or group of persons acting in concert) owning 10% or more of any class of capital stock of an SBIC. A "change of control" is any event which would result in a transfer of the power, direct or indirect, to direct the management and policies of an SBIC, whether through ownership, contractual arrangements or otherwise.

PLAN OF DISTRIBUTION

We may offer, from time to time, up to $310,500,000 of our Securities. We may sell the Securities through underwriters or dealers, directly to one or more purchasers, through agents or through a combination of any such methods of sale. Any underwriter or agent involved in the offer and sale of the Securities will be named in the applicable prospectus supplement.

The distribution of the Securities may be effected from time to time in one or more transactions at a fixed price or prices, which may be changed, at prevailing market prices at the time of sale, at prices related to such prevailing market prices, or at negotiated prices, provided, however, that in the case of common stock, the offering price per share, less any underwriting commissions or discounts, must equal or exceed the net asset value ("NAV") per share of our common stock at the time of the offering.

In connection with the sale of the Securities, underwriters or agents may receive compensation from the Company or from purchasers of the Securities, for whom they may act as agents, in the form of discounts, concessions or commissions. Underwriters may sell the Securities to or through dealers and such dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters and/or commissions from the purchasers for whom they may act as agents. Underwriters, dealers and agents that participate in the distribution of the Securities may be deemed to be underwriters under the Securities Act, and any discounts and commissions they receive from the Company and any profit realized by them on the resale of the Securities may be deemed to be underwriting discounts and commissions under the Securities Act. Any such underwriter or agent will be identified and any such compensation received from the Company will be described in the applicable prospectus supplement.

Any common stock sold pursuant to a prospectus supplement will be quoted on the Nasdaq National Market, or another exchange on which the common stock is traded.

Under agreements into which the Company may enter, underwriters, dealers and agents who participate in the distribution of the Securities may be entitled to indemnification by the Company against certain liabilities, including liabilities under the Securities Act. Underwriters, dealers and agents may engage in transactions with, or perform services for, the Company in the ordinary course of business.

If so indicated in the applicable prospectus supplement, the Company will authorize underwriters or other persons acting as the Company's agents to solicit offers by certain institutions to purchase the Securities from the Company pursuant to contracts providing for payment and delivery on a future date. Institutions with which such contracts may be made include commercial and savings banks, insurance companies, pension funds, investment companies, educational and charitable institutions and others, but in all cases such institutions must be approved by the Company. The obligations of any purchaser under any such contract will be subject to the condition that the purchase of the Securities shall not at the time of delivery be prohibited under the laws of the jurisdiction to which such purchaser is subject. The underwriters and such other agents will not have any responsibility in respect of the validity or performance of such contracts. Such contracts will be subject only to those conditions set forth in the prospectus supplement, and the prospectus supplement will set forth the commission payable for solicitation of such contracts.

In order to comply with the securities laws of certain states, if applicable, the Securities offered hereby will be sold in such jurisdictions only through registered or licensed brokers or dealers. In addition, in certain states, the Securities may not be sold unless they have been registered or qualified for sale in the applicable state or an exemption from the registration or qualification requirement is available and is complied with.

LEGAL MATTERS

The legality of the Securities offered hereby will be passed upon for the Company by Sutherland Asbill & Brennan LLP, Washington, D.C. Certain legal matters will be passed upon for underwriters, if any, by the counsel named in the prospectus supplement.

SAFEKEEPING, TRANSFER AND DIVIDEND PAYING AGENT AND REGISTRAR

The Company's and its subsidiaries' investments are held in safekeeping by Riggs Bank, N.A. at 808 17th Street, N.W., Washington, D.C. 20006. LaSalle National Bank, located at 25 Northwest Point Boulevard, Suite 800, Elk Grove Village, Illinois 60007, serves as trustee with respect to assets of the Company held for securitization purposes. American Stock Transfer and Trust Company, 59 Maiden Lane, New York, New York 10038 acts as the Company's transfer, dividend paying and reinvestment plan agent and registrar.

INDEPENDENT PUBLIC ACCOUNTANTS

The financial statements included in this prospectus and elsewhere in the registration statement to the extent and for the periods indicated in their report have been audited by Arthur Andersen LLP, independent public accountants, and is included herein in reliance upon the authority of said firm as experts in giving said report.

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

(IN THOUSANDS, EXCEPT NUMBER OF SHARE AMOUNTS)	DECEMBER 31, 2000	1999
ASSETS		
Portfolio at value:		
Private finance (cost: 2000-$1,262,529; 1999-$639,171)	$1,282,467	$ 647,040
Commercial real estate finance (cost: 2000-$503,366; 1999-$522,022)	505,534	520,029
Small business finance (cost: 2000-$0; 1999-$61,708)	--	61,428
Total portfolio at value	1,788,001	1,228,497
Cash and cash equivalents	2,449	18,155
Other assets	63,367	43,386
Total assets	$1,853,817	$1,290,038

LIABILITIES AND SHAREHOLDERS' EQUITY

Liabilities:		
Notes payable and debentures	$ 704,648	$ 487,350
Revolving credit facilities	82,000	105,500
Accounts payable and other liabilities	30,477	22,675
Total liabilities	817,125	615,525
Commitments and Contingencies		
Preferred stock	7,000	7,000
Shareholders' equity:		
Common stock, $0.0001 par value, 200,000,000 shares authorized; 85,291,696 and 65,930,360 issued and outstanding at December 31, 2000 and 1999, respectively	9	7
Additional paid-in capital	1,043,653	699,148
Common stock held in deferred compensation trust (234,977 shares and 516,779 shares at December 31, 2000 and 1999, respectively)	--	(6,218)
Notes receivable from sale of common stock	(25,083)	(29,461)
Net unrealized appreciation on portfolio	19,378	4,517
Distributions in excess of earnings	(8,265)	(480)
Total shareholders' equity	1,029,692	667,513
Total liabilities and shareholders' equity	$1,853,817	$1,290,038

The accompanying notes are an integral part of these consolidated financial statements.

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS

	FOR THE YEARS ENDED DECEMBER 31,		
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	2000	1999	1998
Interest and related portfolio income:			
Interest and dividends	$182,307	$121,112	$ 80,281
Premiums from loan dispositions	16,138	14,284	5,949
Post-Merger gain on securitization of commercial mortgage loans	--	--	14,812
Investment advisory fees and other income	13,144	5,744	5,696
Total interest and related portfolio income	211,589	141,140	106,738
Expenses:			
Interest	57,412	34,860	20,694
Employee	19,842	16,136	11,829
Administrative	15,435	12,350	11,921
Total operating expenses	92,689	63,346	44,444
Formula and cut-off awards	6,183	6,753	7,049

Net operating income before net realized and unrealized gains	112,717	71,041	55,245
Net realized and unrealized gains:			
Net realized gains	15,523	25,391	22,541
Net unrealized gains	14,861	2,138	1,079
Total net realized and unrealized gains	30,384	27,529	23,620
Net income before income taxes	143,101	98,570	78,865
Income tax expense	--	--	787
Net increase in net assets resulting from operations	$143,101	$ 98,570	$ 78,078
Basic earnings per common share	$ 1.95	$ 1.64	$ 1.50
Diluted earnings per common share	$ 1.94	$ 1.64	$ 1.50
Weighted average common shares outstanding -- basic	73,165	59,877	51,941
Weighted average common shares outstanding -- diluted	73,472	60,044	51,974

The accompanying notes are an integral part of these consolidated financial statements.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	FOR THE YEARS ENDED DECEMBER 31, 2000	1999	1998
Operations:			
Net operating income before realized and unrealized gains	$ 112,717	$ 71,041	$ 55,245
Net realized gains	15,523	25,391	22,541
Net unrealized gains	14,861	2,138	1,079
Income tax expense	--	--	(787)
Net increase in net assets resulting from operations	143,101	98,570	78,078
Shareholder distributions:			
Common stock dividends	(135,795)	(97,941)	(75,087)
Preferred stock dividends	(230)	(230)	(230)
Net decrease in net assets resulting from shareholder distributions	(136,025)	(98,171)	(75,317)
Capital share transactions:			
Sale of common stock	250,912	164,269	69,675

Issuance of common stock for portfolio investments...	86,076	--	--
Issuance of common stock upon the exercise of stock options...	3,309	5,920	221
Issuance of common stock in lieu of cash distributions....................................	4,773	4,610	6,184
Net decrease (increase) in notes receivable from sale of common stock..................................	4,378	(5,725)	5,576
Net decrease (increase) in common stock held in deferred compensation trust.......................	6,218	6,972	(13,190)
Other...	(563)	(290)	71
Net increase in net assets resulting from capital share transactions..................	355,103	175,756	68,537
Total increase in net assets...................	$ 362,179	$176,155	$ 71,298
Net assets at beginning of year..........................	$ 667,513	$491,358	$420,060
Net assets at end of year................................	$1,029,692	$667,513	$491,358
Net asset value per common share.........................	$ 12.11	$ 10.20	$ 8.79
Common shares outstanding at end of year.................	85,057	65,414	55,919

The accompanying notes are an integral part of these consolidated financial statements.

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS

	FOR THE YEARS ENDED DECEMBER 31,		
(IN THOUSANDS)	2000	1999	1998
Cash flows from operating activities:			
Net increase in net assets resulting from operations.......................................	$ 143,101	$ 98,570	$ 78,078
Adjustments			
Net unrealized gains.............................	(14,861)	(2,138)	(1,079)
Post-Merger gain on securitization of commercial mortgages......................................	--	--	(14,812)
Depreciation and amortization....................	925	788	702
Amortization of loan discounts and fees...........	(10,101)	(10,674)	(6,032)
Changes in other assets and liabilities............	2,036	(8,712)	11,998
Net cash provided by operating activities..................................	121,100	77,834	68,855
Cash flows from investing activities:			
Portfolio investments................................	(889,251)	(751,871)	(524,530)
Repayments of investment principal...................	154,112	145,706	138,081
Proceeds from loan sales.............................	280,244	198,368	81,013
Proceeds from securitization of commercial mortgages..	--	--	223,401
Net redemption of U.S. government securities..........	--	--	11,091

Other investing activities	1,417	(1,754)	(2,539)
Net cash used in investing activities	(453,478)	(409,551)	(73,483)
Cash flows from financing activities:			
Sale of common stock	250,912	164,269	69,896
Purchase of common stock by deferred compensation trust	--	--	(19,431)
Collections of notes receivable from sale of common stock	6,363	195	5,591
Common dividends and distributions paid	(131,022)	(95,031)	(69,536)
Special undistributed earnings distribution paid	--	--	(8,848)
Preferred stock dividends paid	(230)	(230)	(450)
Net borrowings under (payments on) notes payable and debentures	217,298	254,000	(69,471)
Net borrowings under (payments on) revolving lines of credit	(23,500)	4,500	56,158
Other financing activities	(3,149)	(2,906)	(4,643)
Net cash provided by (used in) financing activities	316,672	324,797	(40,734)
Net decrease in cash and cash equivalents	$ (15,706)	$ (6,920)	$ (45,362)
Cash and cash equivalents at beginning of year	$ 18,155	$ 25,075	$ 70,437
Cash and cash equivalents at end of year	$ 2,449	$ 18,155	$ 25,075

The accompanying notes are an integral part of these consolidated financial statements.

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ALLIED CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF INVESTMENTS

PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	DECEMB COST
Ability One Corporation	Loans	$ 9,97
ACE Products, Inc.	Loans	14,27
Acme Paging, L.P.	Debt Securities	6,98
	Limited Partnership Interest	1,45
Allied Office Products, Inc.	Debt Securities	9,36
	Warrants	62
American Barbecue & Grill, Inc.	Warrants	12
American Home Care Supply, LLC	Debt Securities	6,85
	Warrants	57
Aspen Pet Products, Inc.	Loans	13,86

	Series A Preferred Stock (1,860 shares)	1,86
	Series A Common Stock (1,400 shares)	14
ASW Holding Corporation	Warrants	2
Aurora Communications, LLC	Loans	14,41
	Equity Interest	1,50
Avborne, Inc.	Debt Securities	12,25
	Warrants	1,18
Bakery Chef, Inc.	Loans	15,89
Border Foods, Inc.	Debt Securities	9,90
	Series A Convertible Preferred Stock (50,919 shares)	2,00
	Warrants	-
Business Loan Express, Inc.	Debt Securities	74,46
	Preferred Stock (25,111 shares)	25,11
	Common Stock (25,503,043 shares)	104,50
Camden Partners Strategic Fund II, L.P.	Limited Partnership Interest	61
CampGroup, LLC	Debt Securities	2,57
	Warrants	22
Candlewood Hotel Company (1)	Preferred Stock (3,250 shares)	3,25
Celebrities, Inc.	Loan	27
	Warrants	1
Colibri Holding Corporation	Loans	3,43
	Common Stock (3,362 shares)	1,25
	Warrants	29
Component Hardware Group	Debt Securities	10,30
	Class A Preferred Stock (18,000 shares)	1,80
	Common Stock (2,000 shares)	20
Convenience Corporation of America	Debt Securities	8,35
	Series A Preferred Stock (31,521 shares)	33
	Warrants	-

(1) Public company.
(2) Common stock, preferred stock, warrants, options and equity interests are generally non-incom producing and restricted.

The accompanying notes are an integral part of these consolidated financial statements.

PRIVATE FINANCE DECEMB

PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	COST
Cooper Natural Resources, Inc.	Debt Securities	$ 3,42
	Warrants	-
CorrFlex Graphics, LLC	Loan	6,95
	Debt Securities	4,95
	Warrants	-
	Options	-
Cosmetic Manufacturing Resources, LLC	Loan	12
	Debt Securities	5,84
	Options	8
Coverall North America, Inc.	Loan	9,69
	Debt Securities	4,96
	Warrants	-
Csabai Canning Factory Rt.	Hungarian Quotas (9.2%)	70
CTT Holdings	Loan	1,22
CyberRep.coM	Loan	94
	Debt Securities	10,29
	Warrants	66
Directory Investment Corporation	Common Stock (470 shares)	10
Directory Lending Corporation	Series A Common Stock (34 shares)	-
	Series B Common Stock (6 shares)	
	Series C Common Stock (10 shares)	2
Drilltec Patents & Technologies Company, Inc.	Loan	10,91
	Debt Securities	1,50
	Warrants	-
eCentury Capital Partners, L.P.	Limited Partnership Interest	1,87
EDM Consulting, LLC	Debt Securities	1,87
	Common Stock (100 shares)	25
El Dorado Communications, Inc.	Loans	30
Elexis Beta GmbH	Options	42
Eparfin S.A.	Loan	2
Esquire Communications Ltd. (1)	Warrants	
E-Talk Corporation	Debt Securities	8,80
	Warrants	1,15
Ex Terra Credit Recovery, Inc.	Series A Preferred Stock (500 shares)	59
	Common Stock (2,500 shares)	-
	Warrants	-
Executive Greetings, Inc.	Debt Securities	15,88
	Warrants	36
Fairchild Industrial Products	Debt Securities	5,81

Company	Warrants	28
FTI Consulting, Inc. (1)	Warrants	97
Galaxy American Communications, LLC	Debt Securities	33,39
	Warrants	50

(1) Public company.
(2) Common stock, preferred stock, warrants, options and equity interests are generally non-incom producing and restricted.

The accompanying notes are an integral part of these consolidated financial statements.

PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	DECEMB COST
Garden Ridge Corporation	Debt Securities	$ 26,53
	Preferred Stock (1,130 shares)	1,13
	Common Stock (471 shares)	61
Genesis Worldwide, Inc. (1)	Loan	1,06
Gibson Guitar Corporation	Debt Securities	16,44
	Warrants	52
Ginsey Industries, Inc.	Loans	5,00
	Convertible Debentures	50
	Warrants	-
Global Communications, LLC	Debt Securities	12,73
	Equity Interest	10,46
	Options	1,63
Global Vacation Group, Inc.	Debt Securities	5,68
Grant Broadcasting Systems II	Warrants	8
Grant Television, Inc.	Equity Interest	66
Grotech Partners, VI, L.P.	Limited Partnership Interest	86
The Hartz Mountain Corporation	Debt Securities	27,16
	Common Stock (200,000 shares)	2,00
	Warrants	2,61
HealthASPex, Inc.	Series A Convertible Preferred Stock (396,908 shares)	1,34
	Series A Preferred Stock (225,112 shares)	76

	Common Stock (1,036,700 shares)	-
HMT, Inc.	Debt Securities	9,95
	Common Stock (300,000 shares)	3,00
	Warrants	-
Hotelevision, Inc.	Preferred Stock (315,100 shares)	31
Icon International, Inc.	Class A Common Stock (12,114 shares)	1,14
	Class C Common Stock (25,707 shares)	7
Impact Innovations Group	Debt Securities	6,36
	Warrants	1,67
Intellirisk Management Corporation	Loans	21,44
International Fiber Corporation	Debt Securities	21,62
	Common Stock (1,029,068 shares)	5,48
	Warrants	55
iSolve Incorporated	Series A Preferred Stock (14,853 shares)	87
	Common Stock (13,306 shares)	1
Jakel, Inc.	Loan	19,23
JRI Industries, Inc.	Debt Securities	1,95
	Warrants	7

(1) Public company.
(2) Common stock, preferred stock, warrants, options and equity interests are generally non-incom producing and restricted.

The accompanying notes are an integral part of these consolidated financial statements.

PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	DECEMB COST
Julius Koch USA, Inc.	Debt Securities	$ 2,29
	Warrants	25
Kirker Enterprises, Inc.	Warrants	34
	Equity Interest	
Kirkland's, Inc.	Debt Securities	6,34
	Preferred Stock (917 shares)	41
	Warrants	9
Kyrus Corporation	Debt Securities	7,73
	Warrants	34

Liberty-Pittsburgh Systems, Inc.	Debt Securities	3,47
	Common Stock (64,535 shares)	14
The Loewen Group, Inc. (1)	High-Yield Senior Secured Debt	15,15
Logic Bay Corporation	Preferred Stock (1,131,222 shares)	5,00
Love Funding Corporation	Series D Preferred Stock (26,000 shares)	35
Master Plan, Inc.	Loan	2,00
	Common Stock (156 shares)	4
MedAssets.com, Inc.	Series B Convertible Preferred Stock (227,665 shares)	2,04
	Warrants	13
Mid-Atlantic Venture Fund IV, L.P.	Limited Partnership Interest	2,47
Midview Associates, L.P.	Warrants	-
Monitoring Solutions, Inc.	Debt Securities	1,82
	Common Stock (33,333 shares)	-
	Warrants	-
MortgageRamp.com, Inc.	Class A Common Stock (800,000 shares)	4,00
Morton Grove Pharmaceuticals, Inc.	Loan	15,35
	Redeemable Convertible Preferred Stock (106,947 shares)	5,00
MVL Group	Debt Securities	14,12
	Warrants	64
NETtel Communications, Inc.	Debt Securities	13,47
Nobel Learning Communities, Inc. (1)	Debt Securities	9,57
	Series D Convertible Preferred Stock (265,957 shares)	2,00
	Warrants	57
North American Archery, LLC	Loans	1,39
	Convertible Debentures	2,24
Northeast Broadcasting Group, L.P.	Debt Securities	34
Nursefinders, Inc.	Debt Securities	11,00
	Warrants	90

(1) Public company.
(2) Common stock, preferred stock, warrants, options and equity interests are generally non-incom producing and restricted.

The accompanying notes are an integral part of these consolidated financial statements.

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PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	DECEMB COST
Old Mill Holdings, Inc.	Debt Securities	$ 14
Onyx Television GmbH	Common Stock (600,000 shares)	20
Opinion Research Corporation (1)	Debt Securities	14,03
	Warrants	99
Oriental Trading Company, Inc.	Debt Securities	12,45
	Loan	12
	Preferred Equity Interest	1,48
	Common Equity Interest	1
	Warrants	-
Outsource Partners, Inc.	Debt Securities	23,85
	Warrants	82
Packaging Advantage Corporation	Debt Securities	11,49
	Common Stock (200,000 shares)	2,00
	Warrants	96
PF.Net Communications, Inc.	Debt Securities	11,53
	Warrants	3,54
Physicians Specialty Corporation	Debt Securities	14,80
	Redeemable Preferred Stock (850 shares)	85
	Convertible Preferred Stock (97,411 shares)	15
	Warrants	47
Pico Products, Inc. (1)	Loan	1,30
	Debt Securities	4,59
	Common Stock (208,000 shares)	5
	Warrants	-
Polaris Pool Systems, Inc.	Debt Securities	6,48
	Warrants	1,05
Powell Plant Farms, Inc.	Loan	15,70
Proeducation GmbH	Loan	4
Professional Paint, Inc.	Debt Securities	20,00
	Preferred Stock (15,000 shares)	15,00
	Common Stock (110,000 shares)	6
Progressive International Corporation	Debt Securities	3,94
	Preferred Stock (500 shares)	50
	Common Stock (197 shares)	1
	Warrants	-
Schwinn Holdings Corporation	Debt Securities	10,36

	Warrants	39
Seasonal Expressions, Inc.	Series A Preferred Stock (1,000 shares)	50
Soff-Cut Holdings, Inc.	Debt Securities	8,45
	Preferred Stock (300 shares)	30
	Common Stock (2,000 shares)	20
	Warrants	44

(1) Public company.
(2) Common stock, preferred stock, warrants, options and equity interests are generally non-incom producing and restricted.

The accompanying notes are an integral part of these consolidated financial statements.

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PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	DECEMB COST
Southern Communications, LLC	Equity Interest	$ 9,77
Southwest PCS, LLC	Loan	7,50
Southwest PCS, L.P.	Debt Securities	6,51
Spa Lending Corporation	Preferred Stock (28,625 shares)	54
	Common Stock (6,208 shares)	2
Staffing Partners Holding Company, Inc.	Debt Securities	4,99
	Series A Redeemable Preferred Stock (414,600 shares)	2,07
	Class A1 Common Stock (1,000 shares)	
	Class A2 Common Stock (40,000 shares)	4
	Class B Common Stock (9,200 shares)	
	Warrants	1
Startec Global Communications, Corporation (1)	Debt Securities	20,20
	Common Stock (258,064 shares)	3,00
	Warrants	-
Sunsource Inc. (1)	Debt Securities	29,85
	Warrants	-
SunStates Refrigerated Services, Inc.	Loans	6,06
	Debt Securities	2,44
Sure-Tel, Inc.	Loan	20
	Preferred Stock (1,116,902 shares)	4,55
	Warrants	66

	Options	-
Sydran Food Services II, L.P.	Debt Securities	12,97
Total Foam, Inc.	Debt Securities	26
	Common Stock (910 shares)	1
Tubbs Snowshoe Company, LLC	Debt Securities	3,89
	Warrants	5
	Equity Interests	50
United Pet Group	Debt Securities	4,95
	Warrants	1
Venturehouse Group, LLC	Common Equity Interest	33
Walker Investment Fund II, LLLP	Limited Partnership Interest	80
Warn Industries, Inc.	Debt Securities	19,33
	Warrants	1,42
Williams Brothers Lumber Company	Warrants	2
Wilmar Industries, Inc.	Debt Securities	31,72
	Warrants	3,16
Wilshire Restaurant Group, Inc.	Debt Securities	15,19
	Warrants	-
Wilton Industries, Inc.	Loan	12,83

(1) Public company.
(2) Common stock, preferred stock, warrants, options and equity interests are generally non-incom producing and restricted.

The accompanying notes are an integral part of these consolidated financial statements.

PRIVATE FINANCE PORTFOLIO COMPANY (IN THOUSANDS, EXCEPT NUMBER OF SHARES)	INVESTMENT(2)	DECEMB COST
Woodstream Corporation	Debt Securities	$ 7,59
	Equity Interests	1,70
	Warrants	45
Wyo-Tech Acquisition Corporation	Debt Securities	15,67
	Preferred Stock (100 shares)	3,70
	Common Stock (99 shares)	10
Total private finance (122 investments)		$1,262,52

(1) Public company.
(2) Common stock, preferred stock, warrants, options and equity interests are generally non-incom
producing and restricted.

The accompanying notes are an integral part of these consolidated financial statements.

(IN THOUSANDS, EXCEPT NUMBER OF LOANS)	INTEREST RATE RANGES	NUMBER OF LOANS	DECEMBER 31, 2000 COST	DECEMBER 31, 2000 VALUE
COMMERCIAL REAL ESTATE FINANCE				
Commercial Mortgage Loans	Up to 6.99%	3	$ 882	$ 2,582
	7.00%- 8.99%	13	30,032	32,132
	9.00%-10.99%	17	22,302	22,190
	11.00%-12.99%	38	35,250	35,042
	13.00%-14.99%	12	14,391	14,391
	15.00% and above	2	100	76
Total commercial mortgage loans		85	$102,957	$106,413

	STATED INTEREST	FACE		
Purchased CMBS				
Mortgage Capital Funding, Series 1998-MC3	5.5%	$ 54,491	$ 25,681	$ 25,68
Morgan Stanley Capital I, Series 1999-RM1	6.4%	59,640	27,429	27,42
COMM 1999-1	5.6%	74,879	34,352	34,35
Morgan Stanley Capital I, Series 1999-FNV1	6.1%	45,536	21,972	21,97
DLJ Commercial Mortgage Trust 1999-CG2	6.1%	96,432	44,332	44,33
Commercial Mortgage Acceptance Corp., Series 1999-C1	6.8%	34,856	16,397	16,39
LB Commercial Mortgage Trust, Series 1999-C2	6.7%	29,005	10,910	10,91
Chase Commercial Mortgage Securities Corp., Series 1999-2	6.5%	43,046	20,552	20,55
FUNB CMT, Series 1999-C4	6.5%	49,287	22,515	22,76
Heller Financial, HFCMC Series 2000 PH-1	6.6%	45,456	19,039	19,03
SBMS VII, Inc., Series 2000-NL1	7.2%	30,079	17,820	18,00
DLJ Commercial Mortgage Trust, Series 2000-CF1	7.0%	40,502	19,166	19,16
Deutsche Bank Alex. Brown, Series Comm 2000-C1	6.9%	41,084	19,170	19,17
LB-UBS Commercial Mortgage Trust, Series 2000-C4	6.9%	31,471	11,552	11,55
Total purchased CMBS		$675,764	$ 310,887	$ 311,32

Residual CMBS	$ 78,723	$ 78,72
Residual Interest Spread	3,297	2,99
Real Estate Owned	7,502	6,08
Total commercial real estate finance	$ 503,366	$ 505,53
Total portfolio	$1,765,895	$1,788,00

The accompanying notes are an integral part of these consolidated financial statements.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION

Allied Capital Corporation, a Maryland corporation, is a closed-end management investment company that has elected to be regulated as a business development company ("BDC") under the Investment Company Act of 1940 ("1940 Act"). Allied Capital Corporation ("ACC") has a wholly owned subsidiary that has also elected to be regulated as a BDC. Allied Investment Corporation ("Allied Investment") is licensed under the Small Business Investment Act of 1958 as a Small Business Investment Company ("SBIC"). In addition, the Company has a real estate investment trust subsidiary, Allied Capital REIT, Inc. ("Allied REIT") and several single- member limited liability companies established primarily to hold real estate properties.

ACC also owned Allied Capital SBLC Corporation ("Allied SBLC"), a BDC licensed by the Small Business Administration ("SBA") as a Small Business Lending Company and a participant in the SBA Section 7(a) Guaranteed Loan Program. On December 31, 2000, ACC acquired BLC Financial Services, Inc. as a private portfolio company, which then changed its name to Business Loan Express, Inc. ("BLX"). As a part of the transaction, Allied SBLC was recapitalized as an independently managed, private portfolio company on December 28, 2000 and ceased to be a consolidated subsidiary of the Company at that time. Allied SBLC was then subsequently merged into BLX. The results of the operations of Allied SBLC are included in the consolidated financial results of ACC and its subsidiaries for 1998, 1999 and for 2000 through December 27, 2000.

Allied Capital Corporation and its subsidiaries, collectively, are hereinafter referred to as the "Company."

The investment objective of the Company is to achieve current income and capital gains. In order to achieve this objective, the Company invests in private and undervalued public companies in a variety of different industries and in diverse geographic locations.

On December 31, 1997, Allied Capital Corporation, Allied Capital Corporation II, Allied Capital Commercial Corporation, and Allied Capital Advisers ("Advisers") merged with and into Allied Capital Lending Corporation ("Allied Lending") (each a "Predecessor Company" and collectively the "Predecessor Companies") in a stock-for-stock exchange (the "Merger"). Immediately following the Merger, Allied Lending changed its name to Allied Capital Corporation.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications have been made to the 1999 and 1998 balances to conform with the 2000 financial statement presentation.

VALUATION OF PORTFOLIO INVESTMENTS

Portfolio assets are carried at fair value as determined by the Board of Directors under the Company's valuation policy.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

LOANS AND DEBT SECURITIES

The values of loans and debt securities are considered to be amounts that could be realized in the normal course of business, which generally anticipates the Company holding the loan to maturity and realizing the face value of the loan. For loans and debt securities, value normally corresponds to cost unless the borrower's condition or external factors lead to a determination of value at a lower amount.

When the Company receives nominal cost warrants or free equity securities ("nominal cost equity"), the Company allocates its cost basis in its investment between its debt securities and its nominal cost equity at the time of origination. At that time, the value of the nominal cost equity is recorded as original issue discount by increasing the cost basis in the equity and decreasing the cost basis in the related debt securities.

Interest income is recorded on the accrual basis to the extent that such amounts are expected to be collected. Loan origination fees, original issue discount and market discount are amortized into interest income using the effective interest method. The weighted average yield on loans and debt securities is computed as the (a) annual stated interest rate earned plus the annual amortization of loan origination fees, original issue discount and market discount earned on accruing loans and debt securities, divided by (b) total loans and debt securities at value. The weighted average yield is computed as of the balance sheet date.

EQUITY SECURITIES

Equity interests in portfolio companies for which there is no liquid public market are valued based on various factors including a history of positive cash flow from operations, the market value of comparable publicly traded companies, and other pertinent factors such as recent offers to purchase a portfolio company's securities or other liquidation events. The determined values are generally discounted to account for liquidity issues and minority control positions.

The Company's equity interests in public companies that carry certain restrictions on sale are typically valued at a discount from the public market value of the security at the balance sheet date. Restricted and unrestricted publicly traded stocks may also be valued at a discount due to the investment size or market liquidity concerns. Dividend income on equity securities is recorded when dividends are declared by the portfolio company.

COMMERCIAL MORTGAGE-BACKED SECURITIES ("CMBS")

CMBS consists of purchased commercial mortgage-backed securities ("Purchased CMBS"), residual interest in a mortgage securitization ("Residual CMBS") and residual interest spread.

PURCHASED CMBS

Purchased CMBS is carried at fair value. The Company recognizes income from the amortization of original issue discount using the effective interest method, using the anticipated yield over the projected life of the investment. Yields are revised when there are changes in estimates of future credit losses, actual losses incurred, and actual and estimated prepayment speeds. Changes in

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

estimated yield are currently recognized as an adjustment to the estimated yield over the remaining life of the Purchased CMBS. The Company recognizes unrealized depreciation on its Purchased CMBS whenever it determines that the value of its Purchased CMBS is less than the cost basis. The Company generally purchases CMBS bonds with the intention of holding the bonds to their maturity. However, the Company will classify CMBS bonds as held for sale at the time that the Company determines that the bonds will be sold. The Company then recognizes unrealized appreciation or depreciation on its Purchased CMBS classified as held for sale based upon the price at which the CMBS bonds could be sold.

RESIDUAL CMBS

The Company values its residual interest in securitization and recognizes income using the same accounting policies used for the Purchased CMBS.

RESIDUAL INTEREST SPREAD

Residual interest spread is carried at fair value based on discounted estimated future cash flows. The Company recognizes income from the residual interest spread using the effective interest method. At each reporting date, the effective yield is recalculated and used to recognize income until the next reporting date.

NET REALIZED AND UNREALIZED GAINS

Realized gains or losses are measured by the difference between the net proceeds from the sale and the cost basis of the investment without regard to unrealized gains or losses previously recognized, and include investments charged off during the year, net of recoveries. Unrealized gains or losses reflect the change in portfolio investment values during the reporting period.

DEFERRED FINANCING COSTS

Financing costs are based on actual costs incurred in obtaining financing and are deferred and amortized as part of interest expense over the term of the related debt instrument.

DERIVATIVE FINANCIAL INSTRUMENTS

The Company may or may not use derivative financial instruments to reduce interest rate risk. The Company has established policies and procedures for risk assessment and the approval, reporting and monitoring of derivative financial instrument activities. The Company does not hold or issue derivative financial instruments for trading purposes. All derivative financial instruments are recorded at fair value with changes in value reflected in net unrealized gains during the reporting period. The Company held no derivative financial instruments at December 31, 2000 and 1999.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash in banks and all highly liquid investments with original maturities of three months or less.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

DIVIDENDS TO SHAREHOLDERS

Dividends to shareholders are recorded on the record date.

FEDERAL AND STATE INCOME TAXES

The Company and its wholly owned subsidiaries intend to comply with the requirements of the Internal Revenue Code ("Code") that are applicable to regulated investment companies ("RIC") and real estate investment trusts ("REIT"). The Company and its wholly owned subsidiaries intend to annually distribute or retain through a deemed distribution all of their taxable income to shareholders; therefore, the Company has made no provision for income taxes.

With the exception of Advisers, the Predecessor Companies qualified as a RIC or a REIT; however, Advisers was a corporation subject to federal and state income taxes. Income tax expense reported on the consolidated statement of operations relates to the operations of Advisers for all periods presented.

PER SHARE INFORMATION

Basic earnings per share is calculated using the weighted average number of shares outstanding for the period presented. Diluted earnings per share reflects the potential dilution that could occur if options to issue common stock were exercised into common stock. Earnings per share is computed after subtracting dividends on preferred shares.

USE OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS

The preparation of financial statements in conformity with generally accepted accounting principles 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 financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

NOTE 3. PORTFOLIO

PRIVATE FINANCE

At December 31, 2000 and 1999, the private finance portfolio consisted of the following:

($ IN THOUSANDS)	2000 COST	2000 VALUE	2000 YIELD	1999 COST	1999 VALUE	1999 YIELD
Loans and debt securities.........	$ 983,887	$ 966,257	14.6%	$578,570	$559,746	14.2%
Equity interests.................	278,642	316,210		60,601	87,294	
Total...................	$1,262,529	$1,282,467		$639,171	$647,040	

Private finance investments are generally structured as loans and debt securities that carry a relatively high fixed rate of interest, which may be combined with equity features, such as conversion

privileges, or warrants or options to purchase a portion of the portfolio company's equity at a nominal price.

Debt securities typically have a maturity of five to ten years, with interest-only payments in the early years and payments of both principal and interest in the later years, although debt maturities and principal amortization schedules vary.

Equity interests consist primarily of securities issued by privately owned companies and may be subject to restrictions on their resale or may be otherwise illiquid. Equity securities generally do not produce a current return, but are held for investment appreciation and ultimate gain on sale. At December 31, 2000, equity securities include the Company's common stock and preferred stock investment in Business Loan Express, Inc. of $104,504,000 and $25,111,000, respectively.

At December 31, 2000 and 1999, approximately 98% of the Company's private finance loan portfolio was composed of fixed interest rate loans. At December 31, 2000 and 1999, loans and debt securities with a value of $72,966,000 and $34,560,000, respectively, were not accruing interest. Loans greater than 120 days delinquent generally do not accrue interest.

The geographic and industry compositions of the private finance portfolio at value at December 31, 2000 and 1999 were as follows:

	2000	1999
GEOGRAPHIC REGION		
Mid-Atlantic...	43%	23%

Midwest	18	26
West	17	11
Southeast	12	27
Northeast	8	9
International	2	4
Total	100%	100%
INDUSTRY		
Consumer Products	26%	19%
Business Services	24	32
Financial Services	16	--
Industrial Products	9	12
Telecommunications	6	5
Retail	5	8
Broadcasting & Cable	5	11
Education	3	5
Other	6	8
Total	100%	100%

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

NOTE 3. PORTFOLIO, CONTINUED

COMMERCIAL REAL ESTATE FINANCE

At December 31, 2000 and 1999, the commercial real estate finance portfolio consisted of the following:

	2000			1999		
($ IN THOUSANDS)	COST	VALUE	YIELD	COST	VALUE	YIELD
Loans	$102,957	$106,413	9.1%	$153,767	$154,109	9.4%
CMBS	392,907	393,040	14.2%	360,950	359,450	13.5%
REO	7,502	6,081		7,305	6,470	
Total	$503,366	$505,534		$522,022	$520,029	

LOANS

The commercial mortgage loan portfolio contains loans that were originated by the Company or were purchased from third-party sellers.

At December 31, 2000 and 1999, approximately 69% and 31%, and 81% and 19% of the Company's commercial mortgage loan portfolio was composed of fixed and adjustable interest rate loans, respectively. As of December 31, 2000 and 1999, loans with a value of $14,433,000 and $8,334,000, respectively, were not accruing interest. Loans greater than 120 days delinquent generally do not accrue interest.

In December 2000, the Company purchased commercial mortgage loans with a face amount of $6.5 million for $5.5 million from Business Mortgage Investors, Inc., a company managed by ACC.

The geographic composition and the property types securing the commercial mortgage loan portfolio at value at December 31, 2000 and 1999 were as follows:

	2000	1999
GEOGRAPHIC REGION		
Southeast	39%	31%
Mid-Atlantic	22	32
West	20	25
Midwest	14	9
Northeast	5	3
Total	100%	100%
PROPERTY TYPE		
Office	30%	24%
Hospitality	28	42
Retail	19	11
Recreation	9	8
Other	14	15
Total	100%	100%

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

NOTE 3. PORTFOLIO, CONTINUED

CMBS

At December 31, 2000 and 1999, the CMBS portfolio consisted of the following:

	2000		1999	
(IN THOUSANDS)	COST	VALUE	COST	VALUE
Purchased CMBS	$310,887	$311,320	$277,694	$277,694
Residual CMBS	78,723	78,723	76,374	76,374
Residual interest spread	3,297	2,997	6,882	5,382
Total	$392,907	$393,040	$360,950	$359,450

PURCHASED CMBS The Company has Purchased CMBS bonds with a face amount of $675,764,000 and a cost of $310,887,000, with the difference representing original issue discount. As of December 31, 2000 and 1999, the estimated yield to maturity on the Purchased CMBS was approximately 15.4% and 14.6%, respectively. The Company's yield on its Purchased CMBS is based upon a number of assumptions that are subject to certain business and economic uncertainties and contingencies. Examples include the timing and magnitude of credit losses on the mortgage loans underlying the Purchased CMBS that are a result of the general condition of the real estate market (including competition for tenants and their related credit quality) and changes in market rental rates. At December 31, 2000 and 1999, the yield on the Purchased CMBS portfolio was computed assuming a 1% loss estimate for its entire underlying collateral mortgage pool. As these uncertainties and contingencies are difficult to predict and are subject to future events which may alter these assumptions, no assurance can be given that the anticipated yields to maturity will be achieved.

The non-investment grade and unrated tranches of the Purchased CMBS bonds are junior in priority for payment of principal to the more senior tranches of the related commercial securitization. Cash flow from the underlying mortgages generally is allocated first to the senior tranches, with the most senior tranches having a priority right to the cash flow. Then, any remaining cash flow is allocated, generally, among the other tranches in order of their relative seniority. To the extent there are defaults and unrecoverable losses on the underlying mortgages resulting in reduced cash flows, the subordinate tranche will bear this loss first.

The underlying rating classes of the Purchased CMBS are as follows:

($ IN THOUSANDS)	2000 VALUE	2000 PERCENTAGE OF TOTAL	1999 VALUE	1999 PERCENTA OF TOTA
BB	$ 8,472	2.7%	$ 41,091	14.8%
BB-	37,061	11.9	46,692	16.8
B+	59,827	19.3	41,765	15.0
B	89,999	28.9	64,830	23.4
B-	56,665	18.2	40,995	14.8
CCC	7,857	2.5	6,506	2.3
Unrated	51,439	16.5	35,815	12.9
Total	$311,320	100.0%	$277,694	100.0%

NOTE 3. PORTFOLIO, CONTINUED

RESIDUAL CMBS AND RESIDUAL INTEREST SPREAD. The Residual CMBS primarily consists of a retained interest from a post-Merger asset securitization whereby bonds were sold in three classes rated "AAA," "AA" and "A."

The Company sold $295 million of loans, and received cash proceeds, net of costs, of approximately $223 million. The Company retained a trust certificate for its residual interest in the loan pool sold, and will receive interest income from this Residual CMBS as well as the Residual Interest Spread from the interest earned on the loans sold less the interest paid on the bonds over the life of the bonds.

As a result of this securitization, the Company recorded a gain of $14.8 million, which represents the difference between the cost basis of the assets sold and the fair value of the assets received, net of the costs of the securitization and the cost of settlement of interest rate swaps. As of December 31, 2000 and 1999, the mortgage loan pool had an approximate weighted average stated interest rate of 9.3%. The three bond classes sold had an aggregate weighted average interest rate of 6.5% as of December 31, 2000 and 1999.

The Company uses a discounted cash flow methodology for determining the value of its retained Residual CMBS and Residual Interest Spread ("Residual"). The discounted cash flow methodology includes the use of a cash flow model to project the gross cash flows from the underlying commercial mortgage pool that serve as collateral for the Company's Residual. The gross cash flows are based on the respective loan attributes of each commercial mortgage, such as the interest rate, original loan amount, prepayment lockout period and term to maturity, contained within a commercial mortgage pool.

The underlying gross mortgage cash flows from the commercial mortgage pool may be affected by numerous assumptions and variables including:

(i) the receipt of mortgage payments earlier than projected ("prepayment risk");

(ii) delays in the receipt of monthly cash flow distributions to CMBS as a result of mortgage loan defaults;

(iii) increases in the timing and/or amount of credit losses on the underlying commercial mortgage loans which are a function of:

- the percentage of mortgage loans that experience a default either during their mortgage term or at maturity;
- the recovery periods represented by the time that elapses between the default of a commercial mortgage and the subsequent correction, foreclosure or liquidation of the corresponding real estate by the Company; and,
- an increase in the percentage of principal loss resulting from the length of time and/or increased expenses incurred in foreclosing on the commercial real estate and liquidating the assets in order to satisfy the Company's lien;

(iv) the discount rate used to derive the value of the Company's Residual.

NOTE 3. PORTFOLIO, CONTINUED

In determining the cash flow of the Residual, the Company assumes a prepayment speed of 15% after the applicable prepayment lockout period and credit losses of 1% or approximately $1.3 million of the total principal balance of the underlying collateral throughout the life of the collateral. These assumptions result in an expected weighted average life of the bonds of 1.3 years. The value of the resulting Residual cash flows is then determined by applying a discount rate of 9% which, in the Company's view, is commensurate with the market's perception of risk of comparable assets.

UNDERLYING COLLATERAL. As of December 31, 2000 the underlying collateral balance of the Residual CMBS was $147.8 million, of which $78.7 million has been retained by the Company. At December 31, 2000, the underlying collateral loans include $7.0 million at value that is greater than 120 days delinquent. For the year ended December 31, 2000, the Company had experienced $0.1 million in credit losses, which represents 0.1% of the Residual.

ADVERSE CHANGES IN PREPAYMENT SPEED. The Company increased the prepayment speed of the underlying collateral used in its discounted cash flow methodology while keeping all other original assumptions constant to demonstrate the impact of prepayments exceeding those currently anticipated by the Company's management on the value of its Residual. The Company increased the level of future anticipated prepayments by 10% and 20%, which resulted in a corresponding decline in the value of the Residual by approximately $0.02 million (or 0.03%) and $0.05 million (or 0.06%), respectively.

ADVERSE CHANGES IN CREDIT LOSSES. The Company increased the amount of credit losses of the underlying collateral used in its discounted cash flow methodology while keeping all other original assumptions constant to demonstrate the impact of credit losses exceeding those currently anticipated by the Company's management on the value of its Residual. The Company increased the level of future anticipated credit losses by 10% and 20%, which resulted in a corresponding decline in the value of the Residual by approximately $0.05 million (or 0.06%) and $0.1 million (or 0.13%), respectively.

ADVERSE CHANGES IN THE DISCOUNT RATES. The determination of the discount rate is dependent on many quantitative and qualitative factors, such as the market's perception of the issuers and the credit fundamentals of the commercial real estate underlying each pool of commercial mortgage loans. The Company assumed that the discount rate used to value its Residual increased by 0.5% and 1.0%. The increase in the discount rate by 0.5% and 1.0%, respectively, resulted in a corresponding decline in the value of the Company's Residual by approximately $0.9 million (or 1.1%) and $1.7 million (or 2.2%), respectively.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

NOTE 3. PORTFOLIO, CONTINUED

The geographic composition and the property types of the underlying mortgage loan pools securing the CMBS calculated using the underwritten principal balance at December 31, 2000 and 1999 were as follows:

	2000	1999
GEOGRAPHIC REGION		
West	31%	32%
Mid-Atlantic	23	23
Midwest	22	21
Southeast	19	20
Northeast	5	4
Total	100%	100%

PROPERTY TYPE		
Retail	32%	33%
Housing	30	29
Office	21	20
Hospitality	8	9
Other	9	9
Total	100%	100%

SMALL BUSINESS FINANCE

The Company, through its wholly owned subsidiary, Allied SBLC, participated in the SBA's Section 7(a) Guaranteed Loan Program ("7(a) loans"). As discussed in Note 1, Allied SBLC is no longer a consolidated subsidiary of the Company at December 31, 2000. As a result, the Company's small business portfolio had no balance at December 31, 2000.

At December 31, 1999, the small business finance portfolio consisted of the following:

	1999	
(IN THOUSANDS)	COST	VALUE
7(a) loans	$43,246	$43,000
Residual interest in loans sold	4,036	4,036
Residual interest spread	14,046	14,046
REO	380	346
Total	$61,708	$61,428

Pursuant to Section 7(a) of the Small Business Act of 1958, the 7(a) loans were guaranteed by the SBA for 80% of any qualified loan up to $100,000 regardless of maturity, and 75% of any such loan over $100,000 regardless of maturity, to a maximum guarantee of $750,000 for any one borrower.

The Company charged interest on the 7(a) loans at a variable rate, typically 1.75% to 2.75% above the prime rate, as published in The Wall Street Journal or other financial newspaper, adjusted monthly.

NOTE 3. PORTFOLIO, CONTINUED

As permitted by SBA regulations, the Company sold to investors, without recourse, 100% of the guaranteed portion of its 7(a) loans while retaining the right to service 100% of such loans. Additionally, the Company sold up to a 90% interest in the unguaranteed portion of its 7(a) loans through a structured finance agreement with a commercial paper conduit.

In 1999, the Company sold $36,387,000 of the unguaranteed portion of 7(a) loans into the facility. The Company received $35,500,000 in proceeds and retained a subordinated interest valued at $4,036,000. The Company recognized a premium from the loan sale of $4,106,000, which includes the value of the retained residual interest spread.

As of December 31, 1999, 7(a) loans with a value of $5,562,000 were not accruing interest. Loans greater than 120 days delinquent generally do not accrue interest.

NOTE 4. DEBT

At December 31, 2000 and 1999, the Company had the following debt:

	2000		1999	
(IN THOUSANDS)	FACILITY AMOUNT	AMOUNT DRAWN	FACILITY AMOUNT	AMOUNT DRAWN
Notes payable and debentures:				
Unsecured long-term notes payable	$ 544,000	$544,000	$419,000	$419,000
SBA debentures	87,350	78,350	74,650	62,650
Auction rate reset note	76,598	76,598	--	--
OPIC loan	5,700	5,700	5,700	5,700
Total notes payable and debentures	713,648	704,648	499,350	487,350
Revolving credit facilities:				
Revolving line of credit	417,500	82,000	340,000	82,000
Master loan and security agreement	--	--	100,000	23,500
Total revolving credit facilities	417,500	82,000	440,000	105,500
Total	$1,131,148	$786,648	$939,350	$592,850

NOTES PAYABLE AND DEBENTURES

UNSECURED LONG-TERM NOTES PAYABLE. In June 1998, May 1999, November 1999 and October 2000, the Company issued unsecured long-term notes to private institutional investors. The notes require semi-annual interest payments until maturity and have terms of five or seven years. The weighted average interest rate on the notes was 7.8% and 7.6% at December 31, 2000 and 1999, respectively. The notes may be prepaid in whole or in part together with an interest premium, as stipulated in the note agreement.

SBA DEBENTURES. At December 31, 2000 and 1999, the Company had debentures payable to the SBA with terms of ten years and at fixed interest rates ranging from 6.6% to 9.6%. The weighted average interest rate was 7.6% and 7.8% at December 31, 2000 and 1999, respectively. The

NOTE 4. DEBT, CONTINUED

debentures require semi-annual interest-only payments with all principal due upon maturity. The SBA debentures are subject to prepayment penalties if paid prior to maturity.

AUCTION RATE RESET NOTE. The Company has a $75 million Auction Rate Reset Senior Note Series A that matures on December 2, 2002 and bears interest at the three-month London Interbank Offer Rate ("LIBOR") plus 1.75%, which adjusts quarterly. Interest is due quarterly and the Company, at its option, may pay or defer and capitalize such interest payments. The amount outstanding on the note will increase as interest due is deferred and capitalized.

As a means to repay the note, the Company has entered into an agreement to issue $75 million of debt, equity or other securities in one or more public or private transactions, or prepay the Auction Rate Reset Note, on or before August 31, 2002. If the note is prepaid, the Company will pay a fee equal to 0.5% of the aggregate amount of the note outstanding.

Scheduled future maturities of notes payable and debentures at December 31, 2000 are as follows:

YEAR	AMOUNT MATURING (IN THOUSANDS)
2001	$ 9,350
2002	76,598
2003	140,000
2004	221,000
2005	179,000
Thereafter	78,700
Total	$704,648

REVOLVING CREDIT FACILITIES

REVOLVING LINE OF CREDIT. The Company has an unsecured revolving line of credit for $417,500,000. The facility may be expanded up to $500,000,000. At the Company's option, the facility bears interest at a rate equal to (i) the one-month LIBOR plus 1.25% or (ii) the higher of (a) the Bank of America, N.A. prime rate or (b) the Federal Funds rate plus 0.50%. The interest rate adjusts at the beginning of each new interest period, usually every thirty days. The interest rates were 7.9% and 7.7% at December 31, 2000 and December 31, 1999, respectively, and the facility requires an annual commitment fee equal to 0.25% of the committed amount. The line expires in March 2002. The line of credit requires monthly interest payments and all principal is due upon its expiration.

MASTER LOAN AND SECURITY AGREEMENT. The Company had a facility to borrow up to $100,000,000, using certain commercial mortgage loans as collateral. The agreement charged interest at the one-month LIBOR plus 1.0%, adjusted daily, or 6.8% at December 31, 1999. The agreement matured on October 27, 2000 and was not renewed.

The average debt outstanding on the revolving credit facilities was $154,853,000 and $123,860,000 for the years ended December 31, 2000 and 1999, respectively. The maximum amount

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

NOTE 4. DEBT, CONTINUED

borrowed under these facilities and the weighted average interest rate for the years ended December 31, 2000 and 1999, were $257,000,000 and $199,392,000, and 7.6% and 6.5%, respectively.

NOTE 5. INCOME TAXES

For the year ended December 31, 1998, the Company incurred income tax expense of $787,000, which resulted from the realization of a taxable net built-in gain associated with property owned by Advisers prior to the Merger. Therefore, the Company's effective tax rate was 1.0% for the year ended December 31, 1998.

NOTE 6. PREFERRED STOCK

Allied Investment has outstanding a total of 60,000 shares of $100 par value, 3% cumulative preferred stock and 10,000 shares of $100 par value, 4% redeemable cumulative preferred stock issued to the SBA pursuant to Section 303(c) of the Small Business Investment Act of 1958, as amended. The 3% cumulative preferred stock does not have a required redemption date. Allied Investment has the option to redeem in whole or in part the preferred stock by paying the SBA the par value of such securities and any dividends accumulated and unpaid to the date of redemption. The 4% redeemable cumulative preferred stock has a required redemption date in June 2005.

NOTE 7. SHAREHOLDERS' EQUITY

Sales of common stock in 2000 and 1999 were as follows:

(IN THOUSANDS)	2000	1999
Number of common shares	14,812	8,659
Gross proceeds	$263,460	$172,539
Less costs including underwriting fees	(12,548)	(8,270)
Net proceeds	$250,912	$164,269

In addition, the Company issued 4,123,407 shares of common stock to acquire BLC Financial Services, Inc. in a stock-for-stock exchange on December 31, 2000 for proceeds of $86,076,000.

The Company has a dividend reinvestment plan, whereby the Company may buy shares of its common stock in the open market or issue new shares in order to satisfy dividend reinvestment requests. If the Company issues new shares, the issue price is equal to the average of the closing sale prices reported for the Company's common stock for the five consecutive days immediately prior to the dividend payment date.

Dividend reinvestment plan activity for 2000, 1999 and 1998 was as follows:

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	2000	1999	1998
Shares issued	254	233	241
Average price per share	$18.79	$19.43	$20.35

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

NOTE 8. EARNINGS PER COMMON SHARE

(IN THOUSANDS EXCEPT PER SHARE AMOUNTS)	2000	1999	1998
Net increase in net assets resulting from operations	$143,101	$98,570	$78,078
Less preferred stock dividends	(230)	(230)	(230)
Income available to common shareholders	$142,871	$98,340	$77,848
Basic shares outstanding	73,165	59,877	51,941
Dilutive options outstanding to officers	307	167	33
Diluted shares outstanding	73,472	60,044	51,974
BASIC EARNINGS PER COMMON SHARE	$ 1.95	$ 1.64	$ 1.50
DILUTED EARNINGS PER COMMON SHARE	$ 1.94	$ 1.64	$ 1.50

NOTE 9. EMPLOYEE STOCK OWNERSHIP PLAN, 401(k) PLAN AND DEFERRED COMPENSATION PLAN

The Company had an employee stock ownership plan ("ESOP") through 1999. Pursuant to the ESOP, the Company was obligated to contribute 5% of each eligible participant's total cash compensation for the year to a plan account on the participant's behalf, which vested over a two-year period. ESOP contributions were used to purchase shares of the Company's common stock.

As of December 31, 1999 and 1998, the ESOP held 303,210 shares and 282,500 shares, respectively, of the Company's common stock, all of which had been allocated to participants' accounts. The plan was funded annually and the total ESOP contribution expense for the years ended December 31, 1999 and 1998 was $641,000 and $489,000, respectively, net of forfeitures of $4,100 and $4,000, respectively. In 1999, the Company established a 401(k) plan (see below) and elected to terminate the ESOP Plan in 2000. During 2000, the ESOP assets were transferred into the 401(k) plan.

The Company's 401(k) retirement investment plan is open to all of its employees. The employees may elect voluntary wage deferrals ranging from 0% to 20% of eligible compensation for the year. In 2000, the Company began making contributions to the 401(k) plan equal to 5% of each eligible participant's total cash compensation for the year. Total 401(k) contribution expense for the year ended December 31, 2000 was $590,000.

The Company also has a deferred compensation plan (the "DC Plan"). Eligible participants in the DC Plan may elect to defer some of their compensation and have such compensation credited to a participant account. All amounts credited to a participant's account shall be credited solely for purposes of accounting and computation and remain assets of the Company and subject to the claims of the Company's general creditors. Amounts credited to participants under the DC Plan are at all times 100% vested and non-forfeitable except for amounts credited to participants' accounts related to the Formula Award (see Note 11). A participant's account shall become distributable upon his or her separation from service, retirement, disability, death or at a future determined date. All DC Plan accounts will be distributed in the event of a change of control of the Company or in the event of the Company's insolvency. Amounts deferred by participants under the DC Plan are funded to a trust, the trustee of which administers the DC Plan on behalf of the Company.

NOTE 10. STOCK OPTION PLAN

THE OPTION PLAN

The purpose of the stock option plan ("Option Plan") is to provide officers and non-officer directors of the Company with additional incentives.

On May 9, 2000, the Company's stockholders amended the Option Plan to increase the number of shares that may be granted from 6,250,000 to 12,350,000.

Options are exercisable at a price equal to the fair market value of the shares on the day the option is granted. Each option states the period or periods of time within which the option may be exercised by the optionee, which may not exceed ten years from the date the option is granted.

All rights to exercise options terminate 60 days after an optionee ceases to be (i) a non-officer director, (ii) both an officer and a director, if such optionee serves in both capacities, or (iii) an officer (if such officer is not also a director) of the Company for any cause other than death or total and permanent disability. In the event of a change of control of the Company, all outstanding options will become fully vested and exercisable as of the change of control.

Information with respect to options granted, exercised and forfeited under the Option Plan for the years ended December 31, 2000, 1999 and 1998 is as follows:

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	SHARES	WEIGHTED AVERAGE OPTION PRICE PER SHARE
Options outstanding at January 1, 1998	--	$ --
Granted	5,190	20.16
Exercised	(10)	21.38
Forfeited	(66)	21.38
Options outstanding at December 31, 1998	5,114	$20.14

Granted..	1,288	19.75
Exercised..	(318)	19.07
Forfeited..	(195)	20.00
Options outstanding at December 31, 1999....................	5,889	$20.12
Granted..	4,162	17.02
Exercised..	(195)	17.68
Forfeited..	(950)	19.81
Options outstanding at December 31, 2000....................	8,906	$18.76

NOTES RECEIVABLE FROM THE SALE OF COMMON STOCK

The Company provides loans to officers for the exercise of options. The loans have varying terms not exceeding ten years, bear interest at the applicable federal interest rate in effect at the date of issue and have been recorded as a reduction to shareholders' equity. At December 31, 2000, 1999 and 1998, the Company had outstanding loans to officers of $25,083,000, $29,461,000, and $23,735,000, respectively. Officers with outstanding loans repaid principal of $6,363,000, $195,000, and $5,591,000, for the years ended December 31, 2000, 1999 and 1998, respectively. The Company recognized

NOTE 10. STOCK OPTION PLAN, CONTINUED

interest income from these loans of $1,712,000, $1,539,000, and $1,600,000, respectively, during these same periods.

The following table summarizes information about stock options outstanding at December 31, 2000:

RANGE OF EXERCISE PRICES	TOTAL NUMBER OUTSTANDING	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)	WEIGHTED AVERAGE EXERCISE PRICE	TOTAL NUMBER EXERCISABLE	WEIG AVER EXER PRI
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS AND YEARS)					
$15.19..................	100	7.73	$15.19	25	$15
$16.81..................	3,733	9.40	$16.81	--	
$17.50-$19.88...........	1,824	8.59	$18.18	558	$17
$19.94..................	105	8.84	$19.34	35	$19
$21.38-$22.13...........	3,144	7.25	$21.47	1,609	$21
$15.19-$22.13...........	8,906	8.45	$18.76	2,227	$20

The Company accounts for its stock options as required by the Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees," and accordingly no compensation cost has been recognized as the exercise price equals the market price on the date of grant. Had compensation cost for the plan been determined consistent with SFAS No. 123 "Accounting for Stock Based

Compensation," which records options at fair value on the date of issuance and amortizes that amount over the vesting period of the option, the Company's net increase in net assets resulting from operations and basic and diluted earnings per common share would have been reduced to the following pro forma amounts:

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	2000	1999	1998
Net increase in net assets resulting from operations:			
As reported	$143,101	$98,570	$78,078
Pro forma	$137,716	$94,510	$72,684
Basic earnings per common share:			
As reported	$1.95	$1.64	$1.50
Pro forma	$1.88	$1.58	$1.39
Diluted earnings per common share:			
As reported	$1.94	$1.64	$1.50
Pro forma	$1.87	$1.57	$1.39

Pro forma expenses are based on the underlying value of the options granted by the Company. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model, with the following weighted average assumptions for grants: risk-free interest rate of 6.5%, 5.9% and 5.0% for 2000, 1999 and 1998, respectively; expected life of approximately five years for all options granted; expected volatility of 34%, 37% and 35% for 2000, 1999 and 1998, respectively; and dividend yield of 8.7%, 9.0% and 8.0% for 2000, 1999 and 1998, respectively.

NOTE 11. CUT-OFF AWARD AND FORMULA AWARD

The Predecessor Companies' existing stock option plans were canceled and the Company established a cut-off dollar amount for all existing, but unvested options as of the date of the Merger (the "Cut-off Award"). The Cut-off Award was computed for each unvested option as of the Merger date. The Cut-off Award was equal to the difference between the market price on August 14, 1997 (the Merger announcement date) of the shares of stock underlying the option less the exercise price of the option. The Cut-off Award was payable for each unvested option upon the future vesting date of that option. The Cut-off Award was designed to cap the appreciated value in unvested options at the Merger announcement date, in order to set the foundation to balance option awards upon the Merger. The Cut-off Award approximated $2.9 million in the aggregate and has been expensed as the Cut-off Award vests. For the years ended December 31, 2000, 1999 and 1998, $535,000, $532,000, and $807,000, respectively, of the Cut-off Award vested.

The Formula Award was established to compensate employees from the point when their unvested options would cease to appreciate in value (the Merger announcement date), up until the time at which they would be able to receive option awards in ACC post-merger. In the aggregate, the Formula Award equaled 6% of the difference between an amount equal to the combined aggregated market capitalizations of the Predecessor Companies as of the close of the market on the day before the Merger date (December 30, 1997), less an amount equal to the combined aggregate market capitalizations of Allied Lending and the Predecessor Companies as of the close of the market on the Merger announcement date.

Advisers' compensation committee allocated the Formula Award to individual officers on December 30, 1997. The amount of the Formula Award as computed at December 30, 1997 was $18,994,000. This amount was contributed to the Company's deferred compensation trust under the DC Plan (see Note 9) and was used to purchase shares of the Company's stock (included in common stock held in deferred compensation trust). The Formula Award vested equally in three installments on December 31, 1998, 1999 and 2000. The Formula Award has been expensed in each year in which it vested. For the years ended December 31, 2000, 1999 and 1998, $5,648,000, $6,221,000 and $6,241,000, respectively, was expensed as a result of the Formula Award. At December 31, 2000 and 1999, the liability related to the Formula Award was $5,648,000 and $6,221,000, respectively, and has been included in common stock held in deferred compensation trust. Vested Formula Awards have been distributed to recipients by the Company, however, sale of the Company's stock by the recipients is restricted. Unvested Formula Awards were forfeited upon a recipient's separation from service and the related Company stock was retired. During 2000, 1999 and 1998, $563,000, $61,000 and $270,000, respectively, of the Formula Award was forfeited.

NOTE 12. DIVIDENDS AND DISTRIBUTIONS

For the years ended December 31, 2000, 1999 and 1998, the Company declared the following distributions:

	2000		1999		1998	
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	TOTAL AMOUNT	TOTAL PER SHARE	TOTAL AMOUNT	TOTAL PER SHARE	TOTAL AMOUNT	TOTAL SHA
First quarter	$ 30,715	$0.45	$23,286	$0.40	$18,025	$0.
Second quarter	33,150	0.45	23,746	0.40	17,966	0.
Third quarter	34,751	0.46	24,768	0.40	17,976	0.
Fourth quarter	37,179	0.46	26,141	0.40	19,444	0.
Annual extra distribution	--	--	--	--	1,676	0.
Total distributions to common shareholders	$135,795	$1.82	$97,941	$1.60	$75,087	$1.

For income tax purposes, distributions for 2000, 1999 and 1998 were composed of the following:

	2000		1999		1998
	TOTAL AMOUNT	TOTAL PER SHARE	TOTAL AMOUNT	TOTAL PER SHARE	TOTAL AMOUNT

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)					
Ordinary income	$116,321	$1.56	$76,948	$1.26	$49,397
Long-term capital gains	19,474	0.26	20,993	0.34	25,690
Total distributions to common shareholders	$135,795	$1.82	$97,941	$1.60	$75,087

The following table summarizes the differences between financial statement net income and taxable income for the years ended December 31, 2000, 1999 and 1998:

(IN THOUSANDS)	2000	1999	1998
Financial statement net income	$143,101	$98,570	$ 78,0
Adjustments:			
Net unrealized gains	(14,861)	(2,138)	(1,0
Amortization of discount	233	129	2,2
Post-Merger gain on securitization of commercial mortgage loans	--	--	(14,8
Interest income from securitized commercial mortgage loans	3,149	4,640	4,9
Gains from disposition of portfolio assets	5,202	(4,547)	1,1
Expenses not deductible for tax:			
Formula award	1,374	2,158	6,2
Other	1,197	1,053	1,3
Other	(1,012)	(1,492)	(3,8
Income tax expense	--	--	7
Taxable income	$138,383	$98,373	$ 75,0

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

NOTE 12. DIVIDENDS AND DISTRIBUTIONS, CONTINUED

The Company must distribute at least 90% of its ordinary taxable income to qualify for pass through tax treatment and maintain its RIC status.

NOTE 13. CONCENTRATIONS OF CREDIT RISK

The Company places its cash with financial institutions and, at times, cash held in checking accounts in financial institutions may be in excess of the Federal Deposit Insurance Corporation insured limit. At December 31, 2000 and 1999, cash and cash equivalents consisted of the following:

(IN THOUSANDS)	2000	1999
Cash and cash equivalents	$11,337	$24,419
Less escrows held	(8,888)	(6,264)
Total cash and cash equivalents	$ 2,449	$18,155

NOTE 14. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

During 2000, 1999 and 1998, the Company paid $54,112,000, $21,092,000, and $21,708,000, respectively, for interest and income taxes. During 2000, 1999, and 1998, the Company's non-cash investing activities totaled $88,062,000, $19,320,000, and $1,265,000, respectively. During 2000, 1999, and 1998, the Company's non-cash financing activities totaled $92,835,000, $10,241,000, and $6,237,000, respectively, and includes common stock issuance resulting from stock option exercises and dividend reinvestment shares issued. The Company's non-cash investing and financing activities for the year ended December 31, 2000 includes the issuance of $86.1 million of the Company's common stock to acquire BLC Financial Services, Inc. as discussed in Note 1.

NOTE 15. SELECTED QUARTERLY DATA (UNAUDITED)

	2000			
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	QTR 1	QTR 2	QTR 3	QTR 4
Total interest and related portfolio income	$43,897	$49,965	$55,992	$61,735
Net operating income before net realized and unrealized gains	$22,573	$24,700	$30,719	$34,725
Net increase in net assets resulting from operations	$29,581	$34,790	$36,449	$42,281
Basic earnings per common share	$ 0.45	$ 0.50	$ 0.48	$ 0.52
Diluted earnings per common share	$ 0.45	$ 0.50	$ 0.48	$ 0.52

	1999			
	QTR 1	QTR 2	QTR 3	QTR 4
Total interest and related portfolio income	$27,678	$33,186	$37,998	$42,278
Net operating income before net realized and unrealized gains	$13,830	$16,619	$19,273	$21,319
Net increase in net assets resulting from operations	$18,580	$22,121	$26,944	$30,925
Basic earnings per common share	$ 0.33	$ 0.38	$ 0.44	$ 0.49
Diluted earnings per common share	$ 0.33	$ 0.38	$ 0.44	$ 0.49

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEET

(IN THOUSANDS)	DECEMBER 31, 2000 ALLIED CAPITAL	ALLIED INVESTMENT	OTHERS	ELIMINATIONS	CON
ASSETS					
Portfolio at value:					
Private finance	$1,134,409	$148,058	$ --	$ --	$1
Commercial real estate finance	408,113	4,605	92,816	--	
Small business finance	--	--	--	--	
Investments in subsidiaries	142,169	--	--	(142,169)	
Total portfolio at value	1,684,691	152,663	92,816	(142,169)	1
Cash and cash equivalents	41	802	1,606	--	
Intercompany notes and receivables	29,444	225	798	(30,467)	
Other assets	57,891	5,285	191	--	
Total assets	$1,772,067	$158,975	$95,411	$(172,636)	$1
LIABILITIES AND SHAREHOLDERS' EQUITY					
Liabilities:					
Notes payable and debentures	$ 626,298	$ 78,350	$ --	$ --	$
Revolving credit facilities	82,000	--	--	--	
Accounts payable and other liabilities	28,502	1,800	175	--	
Dividends and distributions payable	--	2,795	3,700	(6,495)	
Intercompany notes and payables	5,575	1,651	16,746	(23,972)	
Total liabilities	742,375	84,596	20,621	(30,467)	
Commitments and Contingencies					
Preferred stock	--	7,000	--	--	
Shareholders' Equity:					
Common stock	9	--	1	(1)	
Additional paid-in capital	1,043,653	43,873	72,254	(116,127)	1
Notes receivable from sale of common stock	(25,083)	--	--	--	
Net unrealized appreciation (depreciation) on portfolio	19,378	7,233	(1,720)	(5,513)	
Undistributed (distributions in excess of) earnings	(8,265)	16,273	4,255	(20,528)	
Total shareholders' equity	1,029,692	67,379	74,790	(142,169)	1
Total liabilities and shareholders' equity	$1,772,067	$158,975	$95,411	$(172,636)	$1

The accompanying notes are an integral part of these consolidating financial statements.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATING STATEMENT OF OPERATIONS

	FOR THE YEAR ENDED DECEMBER 31, 20				
(IN THOUSANDS)	ALLIED CAPITAL	ALLIED INVESTMENT	ALLIED SBLC	OTHERS	ELIMINA
Interest and Related Portfolio Income					
Interest and dividends..................	$155,790	$15,248	$ 4,958	$ 6,311	$
Intercompany interest...................	5,533	--	--	--	(5,
Premiums from loan dispositions.........	6,583	117	9,438	--	
Income from investments in wholly owned subsidiaries.........................	26,147	--	--	--	(26,
Investment advisory fees and other income...............................	10,166	103	1,915	960	
Total interest and related portfolio income.................	204,219	15,468	16,311	7,271	(31,
Expenses					
Interest................................	51,043	6,369	--	--	
Intercompany interest...................	--	170	4,861	502	(5,
Employee................................	19,375	--	--	467	
Administrative..........................	14,001	72	1,035	327	
Total operating expenses...........	84,419	6,611	5,896	1,296	(5,
Formula and cut-off awards.............	6,183	--	--	--	
Net operating income before net realized and unrealized gains.........................	113,617	8,857	10,415	5,975	(26,
Net Realized and Unrealized Gains					
Net realized gains (losses)............	14,623	1,585	(558)	(127)	
Net unrealized gains (losses)...........	14,861	5,178	(940)	615	(4,
Total net realized and unrealized gains (losses)...................	29,484	6,763	(1,498)	488	(4,
Net increase in net assets resulting from operations...............................	$143,101	$15,620	$ 8,917	$ 6,463	$(31,

The accompanying notes are an integral part of these consolidating financial statements.

ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

CONSOLIDATING STATEMENT OF CASH FLOWS

(IN THOUSANDS)	FOR THE YEAR ENDED DECEMBER 31, 2000				
	ALLIED CAPITAL	ALLIED INVESTMENT	ALLIED SBLC	OTHERS	ELIMINATIONS
Cash Flows from Operating Activities					
Net increase in net assets resulting from operations....	$ 143,101	$ 15,620	$ 8,917	$ 6,463	$(31,000)
Adjustments					
Net unrealized (gains) losses....................	(14,861)	(5,178)	940	(615)	4,853
Depreciation and amortization..............	925	--	--	--	--
Amortization of loan discounts and fees........	(8,995)	(737)	(369)	--	--
Changes in other assets and liabilities..............	442	(1,487)	2,097	984	--
Net cash provided by operating activities....	120,612	8,218	11,585	6,832	(26,147)
Cash Flows from Investing Activities					
Portfolio investments..........	(723,825)	(32,384)	(133,042)	--	--
Repayments of investment principal...................	125,840	21,156	7,116	--	--
Proceeds from loan sales.......	179,293	--	100,951	--	--
Net change in intercompany investments.................	(10,791)	(17,223)	10,207	(8,340)	26,147
Other investing activities.....	(2,488)	2,194	927	784	--
Net cash used in investing activities.............	(431,971)	(26,257)	(13,841)	(7,556)	26,147
Cash Flows from Financing Activities					
Sale of common stock...........	250,912	--	--	--	--
Collections of notes receivable from sale of common stock....	6,363	--	--	--	--
Common dividends and distributions paid...........	(131,022)	--	--	--	--
Preferred stock dividends paid.........................	--	(220)	--	(10)	--
Net borrowings under notes payable and debentures.......	201,598	15,700	--	--	--
Net repayments under revolving lines of credit.............	(23,500)	--	--	--	--
Other financing activities.....	(3,149)	--	--	--	--
Net cash provided by (used in) financing activities.............	301,202	15,480	--	(10)	--
Net decrease in cash and cash equivalents.....................	$ (10,157)	$ (2,559)	$ (2,256)	$ (734)	$ --
Cash and cash equivalents at beginning of year................	$ 10,198	$ 3,361	$ 2,256	$ 2,340	$ --

Cash and cash equivalents at end of year	$ 41	$ 802	$ --	$ 1,606	$ --

The accompanying notes are an integral part of these consolidating financial statements.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

TO THE SHAREHOLDERS AND BOARD OF DIRECTORS OF ALLIED CAPITAL CORPORATION AND SUBSIDIARIES:

We have audited the accompanying consolidated balance sheets of Allied Capital Corporation and subsidiaries as of December 31, 2000 and 1999, including the consolidated statement of investments as of December 31, 2000, and the related consolidated statements of operations, changes in net assets and cash flows for each of the three years in the period then ended. These consolidated financial statements and supplementary consolidating financial information referred to below are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and supplementary consolidating financial information referred to below based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. These procedures included physical counts of investments. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2, the consolidated financial statements include investments valued at $1,788,001,000 as of December 31, 2000 and $1,228,497,000 as of December 31, 1999 (96 percent and 95 percent, respectively, of total assets) whose values have been estimated by the board of directors in the absence of readily ascertainable market values. We have reviewed the procedures used by the board of directors in arriving at its estimate of value of such investments and have inspected the underlying documentation, and in the circumstances we believe the procedures are reasonable and the documentation appropriate. However, because of the inherent uncertainty of valuation, the board of directors' estimate of values may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Allied Capital Corporation and subsidiaries as of December 31, 2000 and 1999, and the consolidated results of their operations, changes in net assets and cash flows for each of the three years in the period then ended in conformity with accounting principles generally accepted in the United States.

Our audit was made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplementary consolidating balance sheet and related consolidating statements of operations and cash flows are presented for purposes of additional analysis and are not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in our audit of the basic consolidated financial statements and in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

/s/ Arthur Anderson

Vienna, Virginia
February 13, 2001

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ALLIED CAPITAL CORPORATION

STATEMENT OF ADDITIONAL INFORMATION
MARCH 30, 2001

This Statement of Additional Information ("SAI") is not a prospectus, and should be read in conjunction with the prospectus dated March 30, 2001 relating to this offering and the accompanying prospectus supplement, if any. You can obtain a copy of the prospectus by calling Allied Capital Corporation at 1-888-818-5298 and asking for Investor Relations. Terms not defined herein have the same meaning as given to them in the prospectus.

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GENERAL INFORMATION AND HISTORY

This SAI contains information with respect to Allied Capital Corporation (the "Company"). The Company changed its name from "Allied Capital Lending Corporation" to "Allied Capital Corporation," effective upon the merger, which was consummated on December 31, 1997. The Company is a registered investment adviser. The Company was initially organized as a corporation in the District of Columbia in 1976 and was reincorporated in the state of Maryland in 1990.

INVESTMENT OBJECTIVE AND POLICIES

The investment objective of the Company is to achieve current income and capital gains. The Company seeks to achieve its investment objective by providing investment capital to private companies and undervalued public companies in a variety of different industries and diverse geographic locations throughout the United States. We focus on investments in two areas: private finance and commercial real estate finance, primarily the purchase of commercial mortgage-backed securities ("CMBS"). Our investment portfolio consists primarily of long-term unsecured loans with equity features, commercial mortgage-backed securities, and commercial mortgage loans. At December 31, 2000, our investment portfolio totaled $1.8 billion. A discussion of the selected financial data, supplementary financial information and management's discussion and analysis of financial condition and results of operations is included in the prospectus. In addition to its core lending business, the Company also provides advisory services to private investment funds.

MANAGEMENT

COMPENSATION OF EXECUTIVE OFFICERS AND DIRECTORS

Under Commission rules applicable to BDCs, we are required to set forth certain information regarding the compensation of certain executive officers and directors. The following table sets forth compensation paid by the Company in all capacities during the year ended December 31, 2000 to the directors and the three highest paid executive officers of the Company, collectively, the "Compensated Persons".

COMPENSATION TABLE

NAME AND POSITION	AGGREGATE COMPENSATION FROM THE COMPANY(1)	SECURITIES UNDERLYING OPTIONS/ SARS(4)	PENSION OR RETIREMENT BENEFITS	DIRECTOR FEES PAI BY THE COMPANY(
William L. Walton, Chairman and CEO(2)	$2,582,916	755,500	--	$ 0
Joan M. Sweeney, Managing Director(2)	1,438,699	285,000	--	0
John M. Scheurer, Managing Director(2)	1,002,463	125,000	--	0
Brooks H. Browne, Director	14,000	5,000	--	14,000
John D. Firestone, Director	19,500	5,000	--	19,500
Anthony T. Garcia, Director	12,000	5,000	--	12,000
Lawrence I. Hebert, Director	7,000	5,000	--	7,000
John I. Leahy, Director	23,000	5,000	--	23,000
Robert E. Long, Director	22,000	5,000	--	22,000
Warren K. Montouri, Director	16,000	5,000	--	16,000
Guy T. Steuart II, Director	14,000	5,000	--	14,000
T. Murray Toomey, Director	8,000	5,000	--	8,000

NAME AND POSITION	AGGREGATE COMPENSATION FROM THE COMPANY(1)	SECURITIES UNDERLYING OPTIONS/ SARS(4)	PENSION OR RETIREMENT BENEFITS	DIRECTOR FEES PAI BY THE COMPANY(
Laura W. van Roijen, Director...............	8,000	5,000	--	8,000
George C. Williams, Jr., Director and Chairman Emeritus(3)......................	735,352	--	--	17,000

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(1) There were no perquisites paid by the Company in excess of the lesser of $50,000 or 10% of the Compensated Person's total salary and bonus for the year.
(2) The following table provides detail as to aggregate compensation paid during 2000 as to the three highest paid executive officers of the Company:

	SALARY	BONUS	VESTED FORMULA AWARD	CUT-OFF AWARD
Mr. Walton..................................	$430,979	$650,000	$1,278,740	$170,156
Ms. Sweeney.................................	271,612	350,000	749,246	36,603
Mr. Scheurer................................	262,727	335,000	347,590	29,248

Included for each executive officer in "Other Benefits" is a contribution to the 401(k) Plan, life insurance premiums and a contribution to the Deferred Compensation Plan. See also "--Employment Agreements" and "--Formula Award and Cut-Off Award".
(3) In addition to director's fees, Mr. Williams received $144,000 in consulting fees, $52,373 in Cut-Off Award and $521,979 in vested Formula Award.
(4) See "Stock Option Awards" for terms of options granted in 2000. The Company does not maintain a restricted stock plan or a long-term incentive plan.
(5) Consists only of directors' fees paid by the Company during 2000. Such fees are also included in the column titled "Aggregate Compensation from the Company."

COMPENSATION OF DIRECTORS

During 2000, each director received $1,000 for each Board of Directors or committee meeting attended, except with respect to the members of the Executive Committee, who each received an annual retainer of $10,000 in lieu of fees paid for each Executive Committee meeting attended.

Non-officer directors are eligible for stock option awards under the Company's Stock Option Plan pursuant to an exemptive order from the Commission. The terms of the order, which was granted in September 1999, provided for a one-time grant of 10,000 options to each non-officer director on the date that the order was issued, or on the date that any new director is elected to the Board. Thereafter, each non-officer director will receive 5,000 options each year on the date of the annual meeting of stockholders at the fair market value on the date of grant. See "Stock Option Plan."

STOCK OPTION AWARDS

The following table sets forth the details relating to option grants in

2000 to Compensated Persons under the Company's Stock Option Plan, and the potential realizable value of each grant, as prescribed to be calculated by the Commission. See "Stock Option Plan" in the Prospectus.

OPTIONS GRANTS DURING 2000

NAME	NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED(1)	PERCENT OF TOTAL OPTIONS GRANTED IN 2000(2)	EXERCISE PRICE PER SHARE	EXPIRATION DATE	POTENTIAL VALUE AT ANNUAL OF STOCK AP OVER 10-YE 5%
William L. Walton............	755,500	18.15%	$16.81	05/26/10	$7,988,359
Joan M. Sweeney..............	285,000	6.85%	16.81	05/26/10	3,013,477
John M. Scheurer.............	125,000	3.00%	16.81	05/26/10	1,321,701
Brooks H. Browne.............	5,000	0.12%	17.50	05/09/10	55,028
John D. Firestone............	5,000	0.12%	17.50	05/09/10	55,028
Anthony T. Garcia............	5,000	0.12%	17.50	05/09/10	55,028
Lawrence I. Hebert...........	5,000	0.12%	17.50	05/09/10	55,028
John I. Leahy................	5,000	0.12%	17.50	05/09/10	55,028
Robert E. Long...............	5,000	0.12%	17.50	05/09/10	55,028
Warren K. Montouri...........	5,000	0.12%	17.50	05/09/10	55,028
Guy T. Steuart II............	5,000	0.12%	17.50	05/09/10	55,028
T. Murray Toomey.............	5,000	0.12%	17.50	05/09/10	55,028
Laura W. van Roijen..........	5,000	0.12%	17.50	05/09/10	55,028

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(1) Options granted to officers in 2000 generally vest in three equal installments beginning on the first anniversary date of the grant, with full vesting occurring on the third anniversary of the grant date or change of control of the Company. Options granted to non-officer directors vest immediately.

(2) In 2000, the Company granted options to purchase a total of 4,162,112 shares.

(3) Potential realizable value is calculated on 2000 options granted, and is net of the option exercise price but before any tax liabilities that may be incurred. These amounts represent certain assumed rates of appreciation, as mandated by the Commission. Actual gains, if any, or stock option exercises are dependent on the future performance of the shares, overall market conditions, and the continued employment by the Company of the option holder. The potential realizable value will not necessarily be realized.

The following table sets forth the details of option exercises by Compensated Persons during 2000 and the values of those unexercised options at December 31, 2000.

OPTION EXERCISES AND YEAR-END OPTION VALUES

	NUMBER OF SECURITIES	VALUE OF U

NAME	SHARES ACQUIRED ON EXERCISE	VALUE REALIZED(1)	UNDERLYING UNEXERCISED OPTIONS AS OF 12/31/00		THE-MO AS OF
			EXERCISABLE	UNEXERCISABLE	EXERCISABLE
William L. Walton.........	0	0	393,448	1,196,961	$195,582
Joan M. Sweeney...........	0	0	212,310	522,476	161,162
John M. Scheurer..........	0	0	204,669	348,270	140,641
George C. Williams, Jr....	0	0	146,396	4,999	15,003
Brooks H. Browne..........	0	0	15,000	0	16,875
John D. Firestone.........	0	0	15,000	0	16,875
Anthony D. Garcia.........	0	0	15,000	0	16,875
Lawrence I. Hebert........	0	0	15,000	0	16,875
John I. Leahy.............	0	0	15,000	0	16,875
Robert E. Long............	0	0	15,000	0	16,875
Warren K. Montouri........	0	0	15,000	0	16,875
Guy T. Steuart II.........	0	0	15,000	0	16,875
T. Murray Toomey..........	0	0	15,000	0	16,875
Laura W. van Roijen.......	0	0	15,000	0	16,875

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(1) Value realized is calculated as the closing market price on the date of exercise, net of option exercise price, but before any tax liabilities or transaction costs. This is the deemed market value, which may actually be realized only if the shares are sold at that price.

(2) Value of unexercised options is calculated as the closing market price on December 31, 2000 ($20.88), net of the option exercise price, but before any tax liabilities or transaction costs. "In-the-

Money Options" are options with an exercise price that is less than the market price as of December 31, 2000.

FORMULA AWARD AND CUT-OFF AWARD

Formula Award. The Formula Award was designed as an incentive compensation program that would replace stock options of the predecessor companies that were cancelled as a result of the Company's 1997 merger, and would balance share ownership among key officers. The Company accrued the Formula Award over the three-year period on the anniversary of the merger date (December 31) in 1998, 1999 and 2000. The Formula Award expense for 2000 totaled $5.7 million. The terms of the Formula Award required that the award be contributed to the Company's deferred compensation plan, and used to purchase shares of the Company in the open market. See "Deferred Compensation Plan."

Cut-Off Award. The Cut-Off Award was designed to cap the appreciated value in unvested options at the merger announcement date in order to set the foundation to balance option awards upon the merger on December 31, 1997. The Cut-Off Award is payable for each canceled option as the canceled options would have vested and vests automatically in the event of a change of control. The Cut-Off Award is payable if the award recipient is employed by the Company on the future vesting date. The Cut-Off Award expense for 2000 totaled $0.5 million.

COMMITTEES OF THE BOARD OF DIRECTORS

The Board of Directors of the Company has established an Executive Committee, an Audit Committee, a Compensation Committee and a Nominating

Committee.

The Executive Committee has and may exercise those rights, powers and authority that the Board of Directors from time to time grants to it, except where action by the full Board is required by statute, an order of the Securities and Exchange Commission (the "Commission") or the Company's charter or bylaws. The Executive Committee also reviews and approves all investments of $10 million or more. The Executive Committee consists of Messrs. Walton, Leahy, Long, Montouri, and Williams. The Executive Committee met 34 times during 2000.

The Audit Committee operates pursuant to a charter approved by the Board of Directors, a copy of which is incorporated by reference to this registration statement. The charter sets forth the responsibilities of the Audit Committee. Generally, the Audit Committee recommends the selection of independent public accountants for the Company, reviews with such independent public accountants the planning, scope and results of their audit of the Company's financial statements and the fees for services performed, reviews with the independent public accountants the adequacy of internal control systems, reviews the Company's annual financial statements and receives the Company's audit reports and financial statements. The Audit Committee consists of Messrs. Browne, Leahy and Steuart, all of whom are considered independent under the rules promulgated by the Nasdaq Stock Market. The Audit Committee met six times during 2000.

The Compensation Committee determines the compensation for the Company's executive officers and the amount of salary and bonus to be included in the compensation package for each of the Company's officers and employees. In addition, the Compensation Committee approves stock option grants for the Company's officers under the Company's Stock Option Plan. The Compensation Committee consists of Messrs. Browne, Long, Firestone, and Garcia. The Compensation Committee met five times during 2000.

The Nominating Committee recommends candidates for election as directors to the Board of Directors. The Nominating Committee consists of Messrs. Walton, Hebert,

Toomey and Steuart, and Ms. van Roijen. The Nominating Committee met once during 2000.

CONTROL PERSONS AND PRINCIPAL HOLDERS OF SECURITIES

As of March 16, 2001, there were no persons that owned 25% or more of the Company's outstanding voting securities, and no person would be deemed to control the Company, as such term is defined in the 1940 Act.

The following table sets forth, as of March 16, 2001, each current director, the Chief Executive Officer, the Company's executive officers, and the executive officers and directors as a group. The address for each director and executive officer is 1919 Pennsylvania Avenue, NW, Washington, DC 20006. Unless otherwise indicated, the Company believes that each beneficial owner set forth in the table has sole voting and investment power. The Company is not aware of any shareholder that beneficially owns more than 5% of the Company's outstanding shares of common stock.

NAME OF BENEFICIAL OWNER	NUMBER OF SHARES OWNED BENEFICIALLY	PERCENTAGE OF CLASS(1)

DIRECTORS:		
William L. Walton	1,196,158(2,4,9)	1.4%
Brooks H. Browne	58,412(3)	*
John D. Firestone	45,203(3,11)	*
Anthony T. Garcia	73,112(3)	*
Lawrence I. Hebert	31,800(3)	*
John I. Leahy	31,818(3)	*
Robert E. Long	24,796(3)	*
Warren K. Montouri	241,182(3)	*
Guy T. Steuart II	333,180(3,5)	*
T. Murray Toomey, Esq	47,666(3,6)	*
Laura W. van Roijen	47,122(3,12)	*
George C. Williams, Jr	432,583(2)	*
EXECUTIVE OFFICERS:		
Scott S. Binder	189,564(2,10)	*
Samuel B. Guren	102,500(2)	*
Philip A. McNeill	341,683(2)	*
Penni F. Roll	111,461(2)	*
John M. Scheurer	550,857(2)	*
Joan M. Sweeney	548,458(2)	*
Thomas H. Westbrook	237,410(2,8)	*
G. Cabell Williams III	862,619(2,4)	1.0%
All directors and executive officers as a group (20 in number)	5,176,553(7)	5.9%

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* Less than 1%

(1) Based on a total of 85,877,875 shares of the Company's common stock issued and outstanding on March 16, 2001 and shares of the Company's common stock issuable upon the exercise of immediately exercisable stock options held by each individual executive officer and non-officer director.

(2) Share ownership for the following directors and executive officers includes:

	OWNED DIRECTLY	OPTIONS EXERCISABLE WITHIN 60 DAYS OF MARCH 16, 2001	ALLOCATED TO 401(K) PLAN ACCOUNT
William L. Walton	413,106	503,313	1,441
Scott S. Binder	52,148	136,087	1,329
Samuel B. Guren	2,500	100,000	0
Philip A. McNeill	191,706	139,915	10,062
Penni F. Roll	53,269	53,916	4,276
John M. Scheurer	268,568	257,524	24,765
Joan M. Sweeney	272,075	265,523	10,860
Thomas H. Westbrook	190,041	47,369	0
George C. Williams, Jr.	286,187	146,396	0
G. Cabell Williams, III	399,335	183,545	76,864

(3) Beneficial ownership includes exercisable options to purchase 15,000 shares, except Mr. Toomey who has 11,000 shares.
(4) Includes 279,739 shares held by the 401(k) Plan, of which Messrs. Walton and Williams III are co-trustees. Messrs. Walton and Williams III disclaim beneficial ownership of such shares.
(5) Includes 276,691 shares held by a corporation for which Mr. Steuart II serves as an executive officer.
(6) Shares are held by a trust for the benefit of Mr. Toomey and his wife.
(7) Includes a total of 1,979,588 shares underlying stock options exercisable within 60 days of March 16, 2001, which are assumed to be outstanding for the purpose of calculating the group's percentage ownership, and 279,739 shares held by the 401(k) Plan.
(8) Includes certain shares held in IRA or Keogh accounts: Walton -- 9,799 shares; Firestone -- 1,742 shares; van Roijen -- 3,820 shares; Binder -- 273 shares; Westbrook -- 15,865 shares.

INVESTMENT ADVISORY SERVICES

The Company is internally managed and therefore has not entered into any advisory agreement with, nor pays advisory fees to, an outside investment adviser. The Company is a registered investment adviser under the Advisers Act and provides advisory services to one other entity. The Company's officers provide investment and portfolio management services for the Company, as well as the investments of the other managed entities. See "Management" in the prospectus for additional information about the Company's executive officers. Our investment decisions in each business area are made by investment committees, composed of the Company's most senior investment professionals. In addition, in certain instances where risk/return characteristics warrant and for every transaction larger than $10 million, the Executive Committee of the Board of Directors must also approve the transaction. See "Management" in the prospectus.

SAFEKEEPING, TRANSFER AND DIVIDEND PAYING AGENT AND REGISTRAR

The investments of the Company and its subsidiaries are held in safekeeping by Riggs Bank N.A. ("Riggs") at 808 17th Street, N.W., Washington, D.C. 20006. LaSalle National Bank, located at 25 Northwest Point Boulevard, Suite 800, Elk Grove Village, Illinois 60007, serves as the trustee and custodian with respect to assets of the Company held for securitization purposes. American Stock Transfer & Trust Company, 59 Maiden Lane, New York, New York 10038 acts as the Company's transfer, dividend paying and reinvestment plan agent and registrar.

BROKERAGE ALLOCATION AND OTHER PRACTICES

Since the Company generally acquires and disposes of its investments in privately negotiated transactions, it infrequently uses brokers in the normal course of business.

4,000,000 SHARES

[ALLIED CAPITAL LOGO]

COMMON STOCK

PROSPECTUS SUPPLEMENT

MERRILL LYNCH & CO.

U.S. BANCORP PIPER JAFFRAY

MAY 2, 2001
