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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: SEPTEMBER 30, 2000

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM __________ TO __________ .

COMMISSION FILE NUMBER: 1-13759

REDWOOD TRUST, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

MARYLAND (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	68-0329422 (I.R.S. EMPLOYER IDENTIFICATION NO.)
591 REDWOOD HIGHWAY, SUITE 3100 MILL VALLEY, CALIFORNIA (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	94941 (ZIP CODE)

(415) 389-7373
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of stock, as of the last practicable date.

Class B Preferred Stock ($.01 par value)....	902,068 as of November 10, 2000
Common Stock ($.01 par value)...............	8,809,501 as of November 10, 2000

REDWOOD TRUST, INC.

FORM 10-Q

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

REDWOOD TRUST, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

ASSETS

<TABLE>
<CAPTION>

	SEPTEMBER 30, 2000 (UNAUDITED)	DECEMBER 31, 1999
<S>	<C>	<C>
Mortgage loans		
Residential: held-for-investment, net	$1,178,180	$ 968,709
Residential: held-for-sale	7,619	415,880
Commercial: held-for-sale	32,308	8,437
	1,218,107	1,393,026
Mortgage securities		
Residential: trading	871,396	941,781
Residential: available-for-sale, net	69,065	27,999
	940,461	969,780
Cash and cash equivalents	7,056	19,881
Restricted cash	3,591	5,384
Interest rate agreements	274	2,037
Accrued interest receivable	16,401	13,244
Principal receivable	5,845	4,599
Investment in RWT Holdings, Inc.	2,019	3,391
Loans to RWT Holdings, Inc.	--	6,500
Receivable from RWT Holdings, Inc.	--	472
Other assets	1,655	1,614
Total Assets	$2,195,409	$2,419,928
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Short-term debt	$ 822,389	$1,253,565
Long-term debt, net	1,148,519	945,270
Accrued interest payable	5,355	5,462
Accrued expenses and other liabilities	4,102	2,819
Dividends payable	4,381	2,877
Total Liabilities	1,984,746	2,209,993
Commitments and contingencies (See Note 13)		
STOCKHOLDERS' EQUITY		
Preferred stock, par value $0.01 per share; Class B 9.74%		

Cumulative Convertible 902,068 shares authorized, issued and outstanding ($28,645 aggregate liquidation preference)	26,517	26,517
Common stock, par value $0.01 per share; 49,097,932 shares authorized; 8,809,356 and 8,783,341 issued and outstanding	88	88
Additional paid-in capital	242,520	242,094
Accumulated other comprehensive income	(4,001)	(3,348)
Cumulative earnings	21,430	8,140
Cumulative distributions to stockholders	(75,891)	(63,556)
Total Stockholders' Equity	210,663	209,935
Total Liabilities and Stockholders' Equity	$2,195,409	$2,419,928

</TABLE>

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

REDWOOD TRUST, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

<TABLE>
<CAPTION>

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2000	1999	2000	1999
<S>	<C>	<C>	<C>	<C>
INTEREST INCOME				
Mortgage loans				
Residential: held-for-investment	$ 22,131	$ 16,816	$ 62,262	$ 49,646
Residential: held-for-sale	158	1,001	6,897	6,715
Commercial: held-for-sale	372	452	976	821
	22,661	18,269	70,135	57,182
Mortgage securities				
Residential: trading	16,662	14,507	50,921	49,571
Residential: available-for-sale	2,328	1,061	6,079	2,723
	18,990	15,568	57,000	52,294
U.S. Treasury securities: trading	--	--	--	913
Cash and cash equivalents	268	718	858	1,988
Total interest income	41,919	34,555	127,993	112,377
INTEREST EXPENSE				
Short-term debt	(14,053)	(11,887)	(47,203)	(38,517)
Long-term debt	(20,449)	(15,503)	(56,735)	(50,901)
Total interest expense	(34,502)	(27,390)	(103,938)	(89,418)
Net interest rate agreements expense	(192)	(457)	(819)	(1,527)
Net Interest Income	7,225	6,708	23,236	21,432
Net unrealized and realized market value gains (losses)				
Loans and securities	2,343	(2,532)	411	(550)
Interest rate agreements	(1,416)	464	(2,067)	2,063
	927	(2,068)	(1,656)	1,513
Provision for credit losses	(240)	(416)	(487)	(1,132)
Net Revenues	7,912	4,224	21,093	21,813
Operating expenses	(2,066)	(964)	(6,450)	(2,617)
Other income	34	39	69	80
Equity in earnings (losses) of RWT Holdings, Inc	(321)	(6,350)	(1,420)	(12,591)
Net income before preferred dividend	5,559	(3,051)	13,292	6,685
Less cash dividends on Class B preferred stock	(681)	(687)	(2,043)	(2,060)
Net Income Available to Common Stockholders	$ 4,878	$ (3,738)	$ 11,249	$ 4,625
EARNINGS PER SHARE:				
Basic	$ 0.55	$ (0.39)	$ 1.28	$ 0.46
Diluted	$ 0.55	$ (0.39)	$ 1.27	$ 0.45
WEIGHTED AVERAGE SHARES OF COMMON STOCK				

AND COMMON STOCK EQUIVALENTS:				
Basic..............................	8,789,966	9,481,418	8,788,127	10,090,305
Diluted............................	8,908,399	9,570,931	8,878,379	10,189,625

</TABLE>

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

REDWOOD TRUST, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

<TABLE>
<CAPTION>

	CLASS B PREFERRED STOCK		COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	ACCUMULATED OTHER COMPREHENSIVE INCOME	CUMULATIVE EARNINGS	CUMULATIVE DISTRIBUTIONS TO STOCKHOLDERS
	SHARES	AMOUNT	SHARES	AMOUNT				
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
BALANCE, DECEMBER 31, 1999...	902,068	$26,517	8,783,341	$88	$242,094	$(3,348)	$ 8,140	$(63,556)
Comprehensive income:								
Net income before preferred dividend................	--	--	--	--	--	--	3,964	--
Net unrealized loss on assets available-for-sale.......	--	--	--	--	--	(487)	--	--
Total comprehensive income............	--	--	--	--	--	--	--	--
Issuance of common stock.....	--	--	6,035	--	45	--	--	--
Dividends declared:								
Preferred.................	--	--	--	--	--	--	--	(681)
Common....................	--	--	--	--	--	--	--	(3,076)
BALANCE, MARCH 31, 2000......	902,068	$26,517	8,789,376	$88	$242,139	$(3,835)	$12,104	$(67,313)
Comprehensive income:								
Net income before preferred dividend................	--	--	--	--	--	--	3,767	--
Net unrealized loss on assets available-for-sale.......	--	--	--	--	--	(886)	--	--
Total comprehensive income............	--	--	--	--	--	--	--	--
Dividends declared:								
Preferred.................	--	--	--	--	--	--	--	(681)
Common....................	--	--	--	--	--	--	--	(3,516)
BALANCE, JUNE 30, 2000.......	902,068	$26,517	8,789,376	$88	$242,139	$(4,721)	$15,871	$(71,510)
Comprehensive income:								
Net income before preferred dividend................	--	--	--	--	--	--	5,559	--
Net unrealized loss on assets available-for-sale.......	--	--	--	--	--	720	--	

								--
Total comprehensive income............	--	--	--	--	--	--	--	--
Issuance of common stock.....			19,980		381			
Dividends declared:								
Preferred.................	--	--	--	--	--	--	--	(681)
Common....................	--	--	--	--	--	--	--	(3,700)
	-------	-------	---------	---	--------	-------	-------	--------
BALANCE, SEPTEMBER 30, 2000......................	902,068	$26,517	8,809,356	$88	$242,520	$(4,001)	$21,430	$(75,891)
	=======	=======	=========	===	========	=======	=======	========

<CAPTION>

<S>	TOTAL <C>
BALANCE, DECEMBER 31, 1999...	$209,935
Comprehensive income:	
Net income before preferred dividend................	3,964
Net unrealized loss on assets available-for-sale.......	(487)
Total comprehensive income............	3,477
Issuance of common stock.....	45
Dividends declared:	
Preferred.................	(681)
Common....................	(3,076)
BALANCE, MARCH 31, 2000......	$209,700
Comprehensive income:	
Net income before preferred dividend................	3,767
Net unrealized loss on assets available-for-sale.......	(886)
Total comprehensive income............	2,881
Dividends declared:	
Preferred.................	(681)
Common....................	(3,516)
BALANCE, JUNE 30, 2000.......	$208,384
Comprehensive income:	
Net income before preferred dividend................	5,559
Net unrealized loss on assets available-for-sale.......	720
Total comprehensive income............	6,279
Issuance of common stock.....	381
Dividends declared:	
Preferred.................	(681)
Common....................	(3,700)
BALANCE, SEPTEMBER 30, 2000......................	$210,663
	========

</TABLE>

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

REDWOOD TRUST, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

<TABLE>
<CAPTION>

<S>	THREE MONTHS ENDED SEPTEMBER 30, 2000 <C>	THREE MONTHS ENDED SEPTEMBER 30, 1999 <C>	NINE MONTHS ENDED SEPTEMBER 30, 2000 <C>	NINE MONTHS ENDED SEPTEMBER 30, 1999 <C>
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net income (loss) before preferred dividend	$ 5,559	$ (3,051)	$ 13,292	$ 6,685
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	1,445	1,212	3,033	5,601
Provision for credit losses	240	416	487	1,132
Equity in (earnings) losses of RWT Holdings, Inc.	321	6,350	1,420	12,591
Net unrealized and realized market value (gains) losses	(927)	2,068	1,656	(1,513)
Purchases of mortgage loans: held-for-sale	(32,363)	(27,194)	(67,897)	(98,949)
Proceeds from sales of mortgage loans: held-for-sale	9,800	71,481	432,714	121,619
Principal payments on mortgage loans: held-for-sale	542	3,089	19,735	58,327
Purchases of mortgage securities: trading	(45,229)	(72,867)	(224,779)	(76,592)
Proceeds from sales of mortgage securities: trading	--	--	77,309	7,668
Principal payments on mortgage securities: trading	58,575	90,909	217,093	398,310
Purchases of U.S. Treasury securities: trading	--	--	--	(45,844)
Proceeds from sales of U.S. Treasury securities: trading	--	--	--	90,519
Net (purchases) sales of interest rate agreements	(697)	(29)	(1,582)	459
(Increase) decrease in accrued interest receivable	(362)	273	(3,157)	5,803
(Increase) decrease in principal receivable	(509)	(1,208)	(1,246)	6,392
(Increase) decrease in other assets	(395)	155	(240)	74
Increase (decrease) in accrued interest payable	(627)	(319)	(107)	(5,853)
Increase (decrease) in accrued expenses and other liabilities	(452)	1,264	1,310	1,075
Net cash (used in) provided by operating activities	(5,079)	72,549	469,041	487,504
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of mortgage loans: held-for-investment	--	--	(384,328)	--
Principal payments on mortgage loans: held-for-investment	79,461	69,638	172,164	261,487
Purchases of mortgage securities: available-for-sale	(9,617)	(6,997)	(41,243)	(7,931)
Principal payments on mortgage securities: available-for-sale	522	83	1,171	213
Net (increase) decrease in restricted cash	30	3,620	1,793	7,930
Investment in RWT Holdings, Inc., net of dividends received	--	--	--	(9,900)
(Loans) to RWT Holdings, Inc., net of repayments	--	(17,375)	6,500	(12,875)
(Increase) decrease in receivable from RWT Holdings, Inc	--	(121)	472	115
Net cash provided by (used in) investing activities	70,397	48,848	(243,470)	239,039
CASH FLOWS FROM FINANCING ACTIVITIES:				
Net borrowings (repayments) on short-term debt	15,746	(68,280)	(431,176)	(403,105)
Proceeds (costs) from issuance of long-term debt	--	--	375,844	(337)
Repayments on long-term debt	(79,101)	(72,501)	(172,658)	(310,207)
Net proceeds from issuance of common stock	381	--	426	1
Repurchases of common stock	--	(15,004)	--	(35,036)
Dividends paid	(4,197)	(687)	(10,831)	(2,059)
Net cash used in financing activities	(67,171)	(156,472)	(238,395)	(750,743)
Net increase (decrease) in cash and cash equivalents	(1,854)	(35,075)	(12,825)	(24,200)
Cash and cash equivalents at beginning of period	8,910	66,502	19,881	55,627
Cash and cash equivalents at end of period	$ 7,056	$ 31,427	$ 7,056	$ 31,427
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash paid for interest	$ 35,129	$ 27,709	$ 104,045	$ 95,271

</TABLE>

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

REDWOOD TRUST, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2000
(UNAUDITED)

NOTE 1. THE COMPANY

Redwood Trust, Inc. ("Redwood Trust") was incorporated in Maryland on April 11, 1994 and commenced operations on August 19, 1994. During 1997, Redwood Trust formed Sequoia Mortgage Funding Corporation ("Sequoia"), a special-purpose finance subsidiary. Redwood Trust acquired an equity interest in RWT Holdings, Inc. ("Holdings"), a taxable affiliate of Redwood Trust, during the first quarter of 1998. For financial reporting purposes, references to the "Company" mean Redwood Trust, Sequoia, and Redwood Trust's equity interest in Holdings. Redwood Trust, together with its affiliates, is a real estate finance company specializing in the mortgage portfolio spread lending business. The Company's primary activity is the acquisition, financing, structuring, and management of high-quality residential mortgage loans with funds raised through long-term debt issuance. The Company also acquires, finances, and manages residential mortgage securities and originates, sells, finances and manages commercial mortgage loans.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The accompanying interim consolidated financial statements are unaudited. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the quarter ended September 30, 2000 are not necessarily indicative of the results that may be expected for the year ending December 31, 2000. The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 1999.

The consolidated financial statements include the accounts of Redwood Trust and Sequoia. Substantially all of the assets of Sequoia are pledged or subordinated to support long-term debt in the form of collateralized mortgage bonds ("Long-Term Debt") and are not available for the satisfaction of general claims of the Company. The Company's exposure to loss on the assets pledged as collateral for Long-Term Debt is limited to its net equity investment in Sequoia, as the Long-Term Debt is non-recourse to the Company. All significant inter-company balances and transactions with Sequoia have been eliminated in the consolidation of the Company. Certain amounts for prior periods have been reclassified to conform to the 2000 presentation.

During March 1998, the Company acquired an equity interest in Holdings, which originates and sells commercial mortgage loans. The Company owns all of the preferred stock and has a non-voting, 99% economic interest in Holdings. As the Company does not own the voting common stock of Holdings or control Holdings, its investment in Holdings is accounted for under the equity method. Under this method, original equity investments in Holdings are recorded at cost and adjusted by the Company's share of earnings or losses and decreased by dividends received.

USE OF ESTIMATES

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 certain assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of certain revenues and expenses during the reported period. Actual results could differ from those estimates. The primary estimates inherent in the accompanying consolidated financial statements are discussed below.

Fair Value. Management estimates the fair value of its financial instruments using available market information and other appropriate valuation methodologies. The fair value of a financial instrument, as defined by Statement of Financial Accounting Standards ("SFAS") No. 107, Disclosures about Fair Value of

Financial Instruments, is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced liquidation sale. Management's estimates are inherently subjective in nature and involve matters of uncertainty and judgement to interpret relevant market and other data. Accordingly, amounts realized in actual sales may differ from the fair values presented in Notes 3, 7 and 10.

Reserve for Credit Losses. A reserve for credit losses is maintained at a level deemed appropriate by management to provide for known losses, as well as potential losses inherent in its mortgage loan portfolio. The reserve is based upon management's assessment of various factors affecting its mortgage loans, including current and projected economic conditions, delinquency status, and credit protection. In determining the reserve for credit losses, the Company's credit exposure is considered based on its credit risk position in the mortgage pool. These estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the periods in which they become known. The reserve is increased by provisions, which are charged to income from operations. When a loan or portions of a loan are determined to be uncollectible, the portion deemed uncollectible is charged against the reserve and subsequent recoveries, if any, are credited to the reserve. The Company's actual credit losses may differ from those estimates used to establish the reserve. Summary information regarding the Reserve for Credit Losses is presented in Note 4.

MORTGAGE ASSETS

The Company's mortgage assets consist of mortgage loans and mortgage securities ("Mortgage Assets"). Interest is recognized as revenue when earned according to the terms of the loans and securities and when, in the opinion of management, it is collectible. Discounts and premiums relating to Mortgage Assets are amortized into interest income over the lives of the Mortgage Assets using methods that approximate the effective yield method. Gains or losses on the sale of Mortgage Assets are based on the specific identification method.

Mortgage Loans: Held-for-Investment

All of the assets of Sequoia that are pledged or subordinated to support the Long-Term Debt are classified as held-for-investment. Mortgage loans classified as held-for-investment are carried at their unpaid principal balance adjusted for net unamortized premiums or discounts, and net of the related allowance for credit losses.

Mortgage Loans: Held-for-Sale

The Company classifies certain short-funded mortgage loans as held-for-sale. These mortgage loans are carried at the lower of original cost or market value ("LOCOM"). Realized and unrealized gains and losses on these loans are recognized in "Net unrealized and realized market value gains (losses)" on the Consolidated Statements of Operations.

Some of the mortgage loans purchased by the Company for which securitization or sale is contemplated are committed for sale by the Company to Holdings, or a subsidiary of Holdings, under a Master Forward Commitment Agreement. As the forward commitment is entered into on the same date that the Company commits to purchase the loans, the price which Holdings will pay to purchase the loans under the forward commitment is the same as the price that the Company paid for the mortgage loans, as established by the external market. Fair value is therefore equal to the commitment price, which is the carrying value of the mortgage loans. Accordingly, no gain or loss is recognized on the subsequent sales of these mortgage loans to Holdings or subsidiaries of Holdings.

Mortgage Securities: Trading

The Company classifies all of its mortgage securities with a rating of AA or higher as trading. Mortgage securities classified as trading are accounted for in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. Accordingly, such securities are recorded at their estimated fair market value. Unrealized and realized gains and losses on these securities are recognized as a component of "Net unrealized and realized market value gains (losses)" on the Consolidated Statements of Operations.

Mortgage Securities: Available-for-Sale

The Company classifies all mortgage securities rated A or lower as available-for-sale. All mortgage securities classified as available-for-sale are carried at their estimated fair value. Current period unrealized gains and losses are excluded from net income and reported as a component of Other Comprehensive Income in Stockholders' Equity with cumulative unrealized gains and losses classified as Accumulated Other Comprehensive Income in Stockholders' Equity.

Unrealized losses on mortgage securities classified as available-for-sale that are considered other-than-temporary, are recognized in income and the carrying value of the mortgage security is adjusted. Other-than-temporary unrealized losses are based on management's assessment of various factors affecting the expected cash flow from the mortgage securities, including an other-than-temporary deterioration of the credit quality of the underlying mortgages and/or the credit protection available to the related mortgage pool and a significant change in the prepayment characteristics of the underlying collateral.

U.S. TREASURY SECURITIES

U.S. Treasury securities include notes issued by the U.S. Government. Interest is recognized as revenue when earned according to the terms of the Treasury securities. Discounts and premiums are amortized into interest income over the life of the security using the effective yield method. U.S. Treasury securities are classified as trading and, accordingly, are recorded at their estimated fair market value with unrealized gains and losses recognized as a component of "Net unrealized and realized market value gains (losses)" on the Consolidated Statements of Operations.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less.

RESTRICTED CASH

Restricted cash of the Company includes principal and interest payments on mortgage loans held as collateral for the Company's Long-Term Debt, and cash pledged as collateral on certain interest rate agreements.

INTEREST RATE AGREEMENTS

The Company maintains an overall interest-rate risk-management strategy that incorporates the use of derivative interest rate agreements to minimize significant unplanned fluctuations in earnings that are caused by interest-rate volatility. Interest rate agreements that are used as part of the Company's interest-rate risk management strategy include interest rate options, swaps, options on swaps, futures contracts, options on futures contracts, forward sales of fixed-rate Agency mortgage securities ("MBS"), and options on forward purchases or sales of MBS' (collectively "Interest Rate Agreements"). On the date an Interest Rate

Agreement is entered into, the Company designates the Interest Rate Agreement as (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value" hedge), (2) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow" hedge), or (3) held for trading ("trading" instruments). Since the adoption of SFAS No. 133, the Company has elected to designate all of its Interest Rate Agreements as trading instruments. Accordingly, such instruments are recorded at their estimated fair market value with changes in their fair value reported in current-period earnings in "Net unrealized and realized market value gains (losses)" on the Consolidated Statements of Operations.

Net premiums on interest rate options are amortized as a component of net interest income over the effective period of the interest rate option using the effective interest method. The income and/or expense related to interest rate options and swaps are recognized on an accrual basis.

DEBT

Short-Term and Long-Term Debt are carried at their unpaid principal balances, net of any unamortized discount or premium and any unamortized deferred bond issuance costs. The amortization of any discount or premium is recognized as an adjustment to interest expense using the effective interest method based on the maturity schedule of the related borrowings. Bond issuance costs incurred in connection with the issuance of Long-Term Debt are deferred and amortized over the estimated lives of the Long-Term Debt using the interest method adjusted for the effects of prepayments.

INCOME TAXES

The Company has elected to be taxed as a Real Estate Investment Trust ("REIT") under the Internal Revenue Code (the "Code") and the corresponding provisions of State law. In order to qualify as a REIT, the Company must annually distribute at least 95% of its taxable income to stockholders and meet certain other requirements. If these requirements are met, the Company generally will not be subject to Federal or state income taxation at the corporate level with respect to the taxable income it distributes to its stockholders. Because the Company believes it meets the REIT requirements and also intends to distribute all of its taxable income, no provision has been made for income taxes in the accompanying consolidated financial statements.

Under the Code, a dividend declared by a REIT in October, November or

December of a calendar year and payable to shareholders of record as of a specified date in such month, will be deemed to have been paid by the Company and received by the shareholders on the last day of that calendar year, provided the dividend is actually paid before February 1st of the following calendar year, and provided that the REIT has any remaining undistributed taxable income on the record date. Therefore, the dividends declared in December 1999 which were paid in January 2000 are considered taxable income to shareholders in 1999, the year declared.

NET INCOME PER SHARE

Net income per share for the three and nine months ended September 30, 2000 and 1999 is shown in accordance with SFAS No. 128, Earnings Per Share. Basic net income per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income available to common stockholders by the weighted average number of common shares and common equivalent shares outstanding during the period. The common equivalent shares are calculated using the treasury stock method, which assumes that all dilutive common stock equivalents are exercised and the funds generated by the exercise are used to buy back outstanding common stock at the average market price during the reporting period.

The following tables provide reconciliations of the numerators and denominators of the basic and diluted net income per share computations.

<TABLE>
<CAPTION>

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2000	1999	2000	1999
	(IN THOUSANDS, EXCEPT SHARE DATA)			
<S>	<C>	<C>	<C>	<C>
NUMERATOR:				
Numerator for basic and diluted earnings per share --				
Net income (loss) before preferred dividend.............................	$ 5,559	$ (3,051)	$ 13,292	$ 6,685
Cash dividends on Class B preferred stock................................	(681)	(687)	(2,043)	(2,060)
Basic and Diluted EPS -- Net income (loss) available to common stockholders.......	$ 4,878	$ (3,738)	$ 11,249	$ 4,625
DENOMINATOR:				
Denominator for basic earnings per share --				
Weighted average number of common shares outstanding during the period..........	8,789,996	9,481,418	8,788,127	10,090,305
Net effect of dilutive stock options......	118,403	89,513	90,252	99,320
Denominator for diluted earnings per share --................................	8,908,399	9,570,931	8,878,379	10,189,625
Net income per share -- basic..............	$ 0.55	$ (0.39)	$ 1.28	$ 0.46
Net income per share -- diluted............	$ 0.55	$ (0.39)	$ 1.27	$ 0.45

</TABLE>

COMPREHENSIVE INCOME

SFAS No. 130, Reporting Comprehensive Income, requires the Company to classify items of "other comprehensive income" by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet. In accordance with SFAS No. 130, current period unrealized gains and losses on assets available-for-sale are reported as a component of Comprehensive Income on the Consolidated Statements of Stockholders' Equity with cumulative unrealized gains and losses classified as Accumulated Other Comprehensive Income in Stockholders' Equity. At September 30, 2000 and December 31, 1999, the only component of Accumulated Other Comprehensive Income was net unrealized gains and losses on assets available-for-sale.

RECENT ACCOUNTING PRONOUNCEMENT

During March 2000, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 44, Accounting for Certain Transactions involving Stock Compensation -- an interpretation of APB Opinion No. 25 ("FIN 44"). FIN 44 clarifies the application of APB Opinion No. 25 by expanding upon a number of issues not specifically addressed in the Opinion such as the definition of an employee for purposes of applying APB Opinion No. 25 and the accounting for modifications to a previously fixed stock option award. FIN 44 was effective July 1, 2000. The impact on the Company of adopting FIN 44 does not have a material effect on the operations of the Company.

NOTE 3. MORTGAGE ASSETS

At September 30, 2000 and December 31, 1999, investments in Mortgage Assets consisted of interests in adjustable-rate, hybrid, or fixed-rate mortgage loans on residential and commercial properties. The hybrid

mortgages have an initial fixed coupon rate for three to ten years followed by annual adjustments. Agency mortgage securities ("Agency Securities") represent securitized interests in pools of adjustable-rate mortgages from the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association. The Agency Securities are guaranteed as to principal and interest by these United States government-sponsored entities. The original maturity of the majority of the Mortgage Assets is thirty years; the actual maturity is subject to change based on the prepayments of the underlying mortgage loans.

At September 30, 2000 and December 31, 1999, the annualized effective yield after taking into account the amortization expense due to prepayments on the Mortgage Assets was 7.76% and 7.00%, respectively, based on the reported cost of the assets. At September 30, 2000, 81% of the Mortgage Assets owned by the Company were adjustable-rate mortgages, 15% were hybrid mortgages, and 4% were fixed-rate mortgages. At December 31, 1999, 81% of the Mortgage Assets owned by the Company were adjustable-rate mortgages, 17% were hybrid mortgages, and 2% were fixed-rate mortgages. The coupons on 62% and 61% of the adjustable-rate Mortgage Assets were limited by periodic caps (generally interest rate adjustments are limited to no more than 1% every six months or 2% every year) at September 30, 2000 and December 31, 1999, respectively. The majority of the coupons on the adjustable-rate and hybrid Mortgage Assets owned by the Company are limited by lifetime caps. At September 30, 2000 and December 31, 1999, the weighted average lifetime cap on the adjustable-rate Mortgage Assets was 11.89% and 11.64%, respectively.

At September 30, 2000 and December 31, 1999, Mortgage Assets consisted of the following:

Mortgage Loans: Residential

<TABLE>
<CAPTION>

	SEPTEMBER 30, 2000			DECEMBER 31, 1999		
	HELD-FOR-INVESTMENT	HELD-FOR-SALE	TOTAL	HELD-FOR-INVESTMENT	HELD-FOR-SALE	TOTAL
			(IN THOUSANDS)			
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Current Face.................	$1,169,363	$7,748	$1,177,111	$960,928	$412,456	$1,373,384
Unamortized Discount.........	--	(129)	(129)	--	(305)	(305)
Unamortized Premium..........	14,390	--	14,390	12,906	3,729	16,635
Amortized Cost...............	1,183,753	7,619	1,191,372	973,834	415,880	1,389,714
Reserve for Credit Losses....	(5,573)	--	(5,573)	(5,125)	--	(5,125)
Carrying Value...............	$1,178,180	$7,619	$1,185,799	$968,709	$415,880	$1,384,589

</TABLE>

The Company recognized gains of $0.1 million and $0.0 million during the three and nine months ended September 30, 2000, respectively, as a result of LOCOM adjustments on residential mortgage loans held-for-sale. During both the three and nine months ended September 30, 1999, the Company recognized losses of $0.3 million and $0.2 million, respectively as a result of LOCOM adjustments on residential mortgage loans held-for-sale. The LOCOM adjustments are reflected as a component of "Net unrealized and realized market value gains (losses)" on the Consolidated Statements of Operations. During the nine months ended September 30, 2000, the Company sold to Holdings a $380.5 million participation agreement on residential mortgage loans for proceeds of $380.5 million (see Note 12). Additionally, during the nine months ended September 30, 2000, the Company sold residential mortgage loans to Redwood Residential Funding ("RRF"), a subsidiary of Holdings, for proceeds of $17.1 million. Pursuant to the terms of the Master Forward Commitment Agreement, the mortgage loans were sold to RRF at the same price for which the Company acquired the mortgage loans (see Note 12). Accordingly, there were no LOCOM adjustments or gains on sales related to the RRF sales transactions. During the three and nine months ended September 30, 1999, the Company sold residential mortgage loans held-for-sale for proceeds of $71.5 million and $121.6 million, respectively.

There were no sales of residential mortgage loans held-for-investment during the three and nine months ended September 30, 2000 and 1999.

Mortgage Loans: Commercial

<TABLE>
<CAPTION>

	SEPTEMBER 30, 2000 HELD-FOR-SALE	DECEMBER 31, 1999 HELD-FOR-SALE
	(IN THOUSANDS)	
<S>	<C>	<C>
Current Face..............................	$32,746	$8,450
Unamortized Discount......................	(438)	(13)
Carrying Value............................	$32,308	$8,437

</TABLE>

During the three and nine months ended September 30, 2000, the Company sold commercial mortgage loans to Redwood Commercial Funding ("RCF"), a subsidiary of Holdings, for proceeds of $9.8 million and $35.1 million, respectively. To date, pursuant to the Master Forward Commitment Agreement, all commercial mortgage loans purchased or originated by the Company are sold to RCF at the same price for which the Company acquires or originates the commercial mortgage loans (see Note 12). Accordingly, there are no LOCOM adjustments or gains on sales related to commercial mortgage loans.

During the three and nine months ended September 30, 2000, the Company purchased commercial mortgage loans from RCF aggregating $9.6 million which were not subject to the terms of the Master Forward Commitment Agreement. The Company intends to hold these commercial loans through maturity. All such commercial mortgage loans purchased by the Company from RCF are purchased at the market price at the time of the sale. Any inter-company gains or losses recorded on the sale of the commercial mortgage loans from RCF to the Company are eliminated against the basis of the commercial mortgage loan purchased by the Company. During both the three and nine months ended September 30, 2000, Redwood's 99% interest of such gains recognized by Holdings was $0.1 million. The Company made no such purchases from RCF during the three and nine months ended September 30, 1999.

Mortgage Securities: Residential

<TABLE>
<CAPTION>

	SEPTEMBER 30, 2000			DECEMBER 31, 1999		
	TRADING	AVAILABLE-FOR-SALE	TOTAL	TRADING	AVAILABLE-FOR-SALE	TOTAL
			(IN THOUSANDS)			
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Current Face............	$861,438	$109,172	$970,610	$934,360	$48,620	$982,980
Unamortized Discount.....	(1,498)	(35,662)	(37,160)	(3,548)	(16,444)	(19,992)
Unamortized Premium......	11,456	--	11,456	10,969	--	10,969
Amortized Cost..........	871,396	73,510	944,906	941,781	32,176	973,957
Reserve for Credit Losses................	--	(444)	(444)	--	(829)	(829)
Gross Unrealized Gains...	--	1,226	1,226	--	166	166
Gross Unrealized Losses................	--	(5,227)	(5,227)	--	(3,514)	(3,514)
Carrying Value..........	$871,396	$ 69,065	$940,461	$941,781	$27,999	$969,780
Agency..................	$630,274	--	$630,274	$576,480	--	$576,480
Non-Agency..............	241,122	$ 69,065	310,187	365,301	$27,999	393,300
Carrying Value..........	$871,396	$ 69,065	$940,461	$941,781	$27,999	$969,780

</TABLE>

For the three and nine months ended September 30, 2000, the Company recognized market value gains $2.3 million and $0.4 million on mortgage securities classified as trading, respectively. During the three and

nine months ended September 30, 1999, the Company recognized a market value loss of $2.3 million and a market value gain of $2.9 million on mortgage securities classified as trading, respectively. The market value adjustments are reflected as a component of "Net unrealized and realized market value gains (losses)" on the Consolidated Statements of Operations. The Company did not sell any mortgage securities classified as trading during the three months ended September 30, 2000 and 1999. The Company sold mortgage securities classified as trading for proceeds of $77.3 million and $7.7 million during the nine months ended September 30, 2000 and 1999, respectively.

NOTE 4. RESERVE FOR CREDIT LOSSES

The Reserve for Credit Losses is reflected as a component of Mortgage Assets on the Consolidated Balance Sheets. The following table summarizes the Reserve for Credit Losses activity:

<TABLE>
<CAPTION>

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2000	1999	2000	1999
	(IN THOUSANDS)			
<S>	<C>	<C>	<C>	<C>
Balance at beginning of period..........................	$5,931	$5,494	$5,954	$4,973
Provision for credit losses............................	240	416	487	1,132
Charge-offs..	(154)	(132)	(424)	(327)
Balance at end of period...............................	$6,017	$5,778	$6,017	$5,778

</TABLE>

NOTE 5. U.S. TREASURY SECURITIES

The Company did not hold any U.S. Treasury securities at September 30, 2000 or December 31, 1999. During the nine months ended September 30, 1999, the Company recognized market value losses of $3.3 million on U.S. Treasury securities and sold U.S. Treasury securities for proceeds of $90.5 million. The market value adjustments are reflected as a component of "Net unrealized and realized market value gains (losses)" on the Consolidated Statements of Operations.

NOTE 6. COLLATERAL FOR LONG-TERM DEBT

The Company has pledged collateral ("Bond Collateral") in order to secure the Long-Term Debt issued in the form of collateralized mortgage bonds. This Bond Collateral consists primarily of adjustable-rate and hybrid, conventional, 30-year mortgage loans secured by first liens on one- to four-family residential properties. All Bond Collateral is pledged to secure repayment of the related Long-Term Debt obligation. All principal and interest (less servicing and related fees) on the Bond Collateral is remitted to a trustee and is available for payment on the Long-Term Debt obligation. The Company's exposure to loss on the Bond Collateral is limited to its net investment, as the Long-Term Debt is non-recourse to the Company.

The components of the Bond Collateral are summarized as follows:

<TABLE>
<CAPTION>

	SEPTEMBER 30, 2000	DECEMBER 31, 1999
	(IN THOUSANDS)	
<S>	<C>	<C>
Mortgage loans		
Residential: held-for-investment, net...........	$1,178,180	$968,709
Restricted cash..................................	3,050	4,791
Accrued interest receivable......................	7,339	5,633
	$1,188,569	$979,133

</TABLE>

For presentation purposes, the various components of the Bond Collateral summarized above are reflected in their corresponding line items on the Consolidated Balance Sheets.

NOTE 7. INTEREST RATE AGREEMENTS

At September 30, 2000 and December 31, 1999, all of the Company's Interest Rate Agreements were classified as trading, and therefore, reported at fair value.

For the three and nine months ended September 30, 2000, the Company recognized market value losses of $1.4 million and $2.1 million on Interest Rate Agreements classified as trading, respectively. During the three and nine months ended September 30, 1999, the Company recognized market value gains of $0.5 million and $2.1 million on Interest Rate Agreements classified as trading, respectively. The market value gains and losses are reflected as a component of "Net unrealized and realized market value gains (losses)" on the Consolidated Statements of Operations.

The following table summarizes the aggregate notional amounts of all of the Company's Interest Rate Agreements as well as the credit exposure related to these instruments.

<TABLE>
<CAPTION>

	NOTIONAL AMOUNTS		CREDIT EXPOSURE(A)	
	SEPTEMBER 30, 2000	DECEMBER 31, 1999	SEPTEMBER 30, 2000	DECEMBER 31, 1999
	(IN THOUSANDS)			
<S>	<C>	<C>	<C>	<C>
Interest Rate Options				
Purchased............................	$1,677,300	$2,960,900	--	--
Sold.................................	--	--	--	--
Interest Rate Swaps.....................	12,000	250,000	$2,194	$2,632
Interest Rate Futures and Forwards......	646,600	630,000	541	593
Total.........................	$2,335,900	$3,840,900	$2,735	$3,225

</TABLE>

- ---------------

(a) Reflects the fair market value of all cash and collateral of the Company held by counterparties.

Interest Rate Options purchased (sold), which may include caps, floors, call and put corridors, options on futures, options on MBS forwards, and swaption collars (collectively, "Options"), are agreements which transfer, modify or reduce interest rate risk in exchange for the payment (receipt) of a premium when the contract is initiated. Purchased interest rate cap agreements provide cash flows to the Company to the extent that a specific interest rate index exceeds a fixed rate. Conversely, purchased interest rate floor agreements produce cash flows to the Company to the extent that the referenced interest rate index falls below the agreed upon fixed rate. Purchased call (put) corridors will cause the Company to incur a gain to the extent that the yield of the specified index is below (above) the strike rate at the time of the option expiration. The maximum gain or loss on a purchased call (put) corridor is equal to the up-front premium. Call (put) corridors that are sold will cause the Company to incur a loss to the extent that the yield of the specified index is below (above) the strike rate at the time of the option expiration. Such loss, if any, will, in part, be offset by upfront premium received. The maximum gain or loss on a call (put) corridor sold is determined at the time of the transaction by establishing a minimum (maximum) index rate. The Company will receive cash on the purchased options on futures/forwards if the futures/forward price exceeds (is below) the call (put) option strike price at the expiration of the option. For the written options on futures/forwards, the Company receives an up-front premium for selling the option, however, the Company will incur a loss on the written option if the futures/ forward price exceeds (is below) the call (put) option strike price at the expiration of the option. Purchased receiver (payor) swaption collars will cause the Company to incur a gain (loss) should the index rate be below (above) the strike rate as of the expiration date. The maximum gain or loss on a receiver (payor) swaption is established at the time of the transaction by establishing a minimum (maximum) index rate. The Company's credit risk on the purchased Options is limited to the carrying value of the Options agreements. The credit risk on options on futures is limited due to the fact that the exchange and its members are required to satisfy the obligations of any member that fails to perform.

Interest Rate Swaps ("Swaps") are agreements in which a series of interest rate flows are exchanged over a prescribed period. The notional amount on which the interest payments are based is not exchanged. Most of the Company's Swaps involve the exchange of one floating interest payment for another floating interest payment based on a different index. Most of the Swaps require that the Company provide collateral, such as mortgage securities, to the counterparty. Should the counterparty fail to return the collateral, the Company would be at risk for the fair market value of that asset.

Interest Rate Futures and Forwards ("Futures and Forwards") are contracts for the purchase or sale of securities or cash in which the seller (buyer) agrees to deliver (purchase) on a specified future date, a specified instrument (or the cash equivalent), at a specified price or yield. Under these agreements, if the Company has sold (bought) the futures/forwards, the Company will generally receive additional cash flows if interest rates rise (fall). Conversely, the Company will generally pay additional cash flows if interest rates fall (rise). The credit risk inherent in futures and forwards arises from the potential inability of counterparties to meet the terms of their contracts, however, the credit risk on futures is limited by the requirement that the exchange and its members make good on obligations of any member that fails to perform.

In general, the Company has incurred credit risk to the extent that the counterparties to the Interest Rate Agreements do not perform their obligations under the Interest Rate Agreements. If one of the counterparties does not perform, the Company would not receive the cash to which it would otherwise be entitled under the Interest Rate Agreement. In order to mitigate this risk, the Company has only entered into Interest Rate Agreements that are either a) transacted on a national exchange or b) transacted with counterparties that are either i) designated by the U.S. Department of the Treasury as a "primary government dealer", ii) affiliates of "primary government dealers", or iii) rated BBB or higher. Furthermore, the Company has entered into Interest Rate Agreements with several different counterparties in order to diversify the credit risk exposure.

NOTE 8. SHORT-TERM DEBT

The Company has entered into repurchase agreements, bank borrowings, and other forms of collateralized short-term borrowings (collectively, "Short-Term Debt") to finance acquisitions of a portion of its Mortgage Assets. This Short-Term Debt is collateralized by a portion of the Company's Mortgage Assets.

At September 30, 2000, the Company had $0.8 billion of Short-Term Debt outstanding with a weighted-average borrowing rate of 6.66% and a weighted-average remaining maturity of 207 days. This debt was collateralized with $0.9 billion of Mortgage Assets. At December 31, 1999, the Company had $1.3 billion of Short-Term Debt outstanding with a weighted-average borrowing rate of 6.22% and a weighted-average remaining maturity of 96 days. This debt was collateralized with $1.3 billion of Mortgage Assets.

At September 30, 2000 and December 31, 1999, the Short-Term Debt had the following remaining maturities:

<TABLE>
<CAPTION>

	SEPTEMBER 30, 2000	DECEMBER 31, 1999
	(IN THOUSANDS)	
<S>	<C>	<C>
Within 30 days	$ 3,005	$ 163,394
30 to 90 days	--	385,729
Over 90 days	819,384	704,442
Total Short-Term Debt	$822,389	$1,253,565

</TABLE>

For the three and nine months ended September 30, 2000, the average balance of Short-Term Debt was $0.8 billion and $0.9 billion with a weighted-average interest cost of 6.80% and 6.47%, respectively. For the three and nine months ended September 30, 1999, the average balance of Short-Term Debt was $0.9 billion and $1.0 billion with a weighted-average interest cost of 5.50% and 5.22%, respectively. The maximum balance outstanding during both the nine months ended September 30, 2000 and 1999 was $1.3 billion.

In March 2000, the Company entered into a $50 million revolving mortgage warehousing credit facility. The facility is intended to finance newly originated commercial mortgage loans. Holdings may borrow under this facility as a co-borrower. In September 2000, this facility was extended through August 2001 and was increased to $70 million. In addition, a portion of this facility allows for loans to be financed to the maturity of the loan, which may exceed the expiration date of the facility. At September 30, 2000, the Company and Holdings had outstanding borrowings of $4.3 million and $30.9 million, respectively, under this facility. Borrowings under this facility bear interest based on a specified margin over the London Interbank Offered Rate ("LIBOR"). At September 30, 2000, the weighted average borrowing rate under this facility was 8.50%. The Company and Holdings were in compliance with all material representations, warranties and covenants under this credit facility at September 30, 2000.

In July 2000, the Company renewed for one year, a $30 million master loan and security agreement with a Wall Street Firm. The facility is intended to finance newly originated commercial mortgage loans. In September 2000, this facility was increased to $50 million. Holdings may borrow under this facility as a co-borrower. At September 30, 2000, the Company had outstanding borrowings of $7.3 million under this facility. Holdings had no outstanding borrowings under this facility at September 30, 2000. Borrowings under this facility bear interest based on a specified margin over LIBOR. At September 30, 2000, the weighted average borrowing rate under this facility was 8.12%. The Company and Holdings were in compliance with all material representations, warranties and covenants under this credit facility at September 30, 2000.

In September 2000, the Company entered into two separate $30 million master repurchase agreements with a bank and a Wall Street Firm. These facilities are intended to finance residential mortgage-backed securities with lower than investment grade ratings. At September 30, 2000, the Company had outstanding borrowings of $27.2 million under these facilities. Borrowings under these facilities bear interest based on a specified margin over LIBOR. At September 30, 2000, the weighted average borrowing rate under these facilities was 7.60%. The Company was in compliance with all material representations, warranties and covenants under these credit facilities at September 30, 2000. In October 2000, the Company entered into a similar $20 million master repurchase agreement with another Wall Street Firm.

NOTE 9. LONG-TERM DEBT

Long-Term Debt in the form of collateralized mortgage bonds is secured primarily by a pledge of residential mortgage loans (see Note 6). As required by the indentures relating to the Long-Term Debt, the

mortgage loans are held in the custody of trustees. The trustees collect principal and interest payments on the mortgage loans and make corresponding principal and interest payments on the Long-Term Debt. The obligations under the Long-Term Debt are payable solely from the mortgage loans and are otherwise non-recourse to the Company.

Each series of Long-Term Debt consists of various classes of bonds at variable rates of interest. The maturity of each class is directly affected by the rate of principal prepayments on the related mortgage loans. Each series is also subject to redemption according to the specific terms of the respective indentures. As a result, the actual maturity of any class of a Long-Term Debt series is likely to occur earlier than its stated maturity.

The components of the Long-Term Debt at September 30, 2000 and December 31, 1999 along with selected other information are summarized below:

<TABLE>
<CAPTION>

<S>	SEPTEMBER 30, 2000 <C>	DECEMBER 31, 1999 <C>
	(IN THOUSANDS)	
Long-Term Debt...............................	$1,148,685	$944,225
Unamortized premium on Long-Term Debt.........	3,191	3,881

Deferred bond issuance costs	(3,357)	(2,836)
Total Long-Term Debt	$1,148,519	$945,270
Range of weighted-average coupon rates, by series	6.37% to 7.03%	6.21% to 6.88%
Stated maturities	2017 - 2029	2017 - 2029
Number of series	4	3

</TABLE>

For the three and nine months ended September 30, 2000, the average balance of Long-Term Debt was $1.2 billion and $1.1 billion, respectively. For the three and nine months ended September 30, 1999, the average balance of Long-Term Debt was $1.0 billion and $1.1 billion, respectively. For the three and nine months ended September 30, 2000, the average effective interest cost for Long-Term Debt, as adjusted for the amortization of bond premium, deferred bond issuance costs, and other related expenses, was 6.86% and 6.63%, respectively. The average effective interest cost for the three and nine months ended September 30, 1999 was 6.01% and 6.00%, respectively. At September 30, 2000 and December 31, 1999, accrued interest payable on Long-Term Debt was $3.2 million and $3.0 million, respectively, and is reflected as a component of Accrued Interest Payable on the Consolidated Balance Sheets.

NOTE 10. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying values and estimated fair values of the Company's financial instruments.

<TABLE>
<CAPTION>

	SEPTEMBER 30, 2000		DECEMBER 31, 1999	
	CARRYING VALUE	FAIR VALUE	CARRYING VALUE	FAIR VALUE
	(IN THOUSANDS)			
<S>	<C>	<C>	<C>	<C>
Assets				
Mortgage Loans				
Residential: held-for-investment, net	$1,178,180	$1,165,875	$968,709	$955,653
Residential: held-for-sale	$ 7,619	$ 7,619	$415,880	$415,880
Commercial: held-for-sale	$ 32,308	$ 32,308	$ 8,437	$ 8,437
Mortgage Securities				
Residential: trading	$ 871,396	$ 871,396	$941,781	$941,781
Residential: available-for-sale, net	$ 69,065	$ 69,065	$ 27,999	$ 27,999
Interest Rate Agreements	$ 274	$ 274	$ 2,037	$ 2,037
Investment in RWT Holdings, Inc.	$ 2,019	$ 2,308	$ 3,391	$ 3,675
Liabilities				
Long-Term Debt	$1,148,519	$1,137,602	$945,270	$928,449

</TABLE>

The carrying values of all other balance sheet accounts as reflected in the financial statements approximate fair value because of the short-term nature of these accounts.

NOTE 11. STOCKHOLDERS' EQUITY

Class B 9.74% Cumulative Convertible Preferred Stock

On August 8, 1996, the Company issued 1,006,250 shares of Class B Preferred Stock ("Preferred Stock"). Each share of the Preferred Stock is convertible at the option of the holder at any time into one share of Common Stock. Effective October 1, 1999, the Company can either redeem or, under certain circumstances, cause a conversion of the Preferred Stock. The Preferred Stock pays a dividend equal to the greater of (i) $0.755 per share, per quarter or (ii) an amount equal to the quarterly dividend declared on the number of shares of the Common Stock into which the Preferred Stock is convertible. The Preferred Stock ranks senior to the Company's Common Stock as to the payment of dividends and liquidation rights. In the event of a liquidation or dissolution of the Company, the liquidation preference entitles the holders of the Preferred Stock to receive $31.00 per share plus any accrued dividends before any distribution is made on the Common Stock. As of September 30, 2000 and December 31, 1999, 96,732 shares of the Preferred Stock have been converted into 96,732 shares of the Company's Common Stock.

In March 1999, the Company's Board of Directors approved the repurchase of up to 150,000 shares of the Company's Preferred Stock. There were no preferred stock repurchases during the three and nine months ended September 30, 2000 and 1999. At September 30, 2000 and December 31, 1999, there were 142,550 shares available for repurchase. At September 30, 2000 and December 31, 1999 there were 902,068 preferred shares outstanding.

Stock Option Plan

The Company has adopted a Stock Option Plan for executive officers, employees, and non-employee directors (the "Plan"). The Plan authorizes the Board of Directors (or a committee appointed by the Board of

Directors) to grant "incentive stock options" as defined under Section 422 of the Code ("ISOs"), options not so qualified ("NQSOs"), deferred stock, restricted stock, performance shares, stock appreciation rights, limited stock appreciation rights ("Awards"), and dividend equivalent rights ("DERs") to such eligible recipients other than non-employee directors. Non-employee directors are automatically provided annual grants of NQSOs with DERs pursuant to a formula under the Plan.

The number of shares of Common Stock available under the Plan for options and Awards, subject to certain anti-dilution provisions, is 15% of the Company's total outstanding shares of Common Stock. The total outstanding shares are determined as the highest number of shares outstanding prior to any stock repurchases. At September 30, 2000 and December 31, 1999, 545,145 and 283,975 shares of Common Stock, respectively, were available for grant. Of the shares of Common Stock available for grant, no more than 500,000 shares of Common Stock shall be cumulatively available for grant as ISOs. At September 30, 2000 and December 31, 1999, 322,303 and 389,942 ISOs had been granted, respectively. The exercise price for ISOs granted under the Plan may not be less than the fair market value of shares of Common Stock at the time the ISO is granted. All stock options granted under the Plan vest no earlier than ratably over a four-year period from the date of grant and expire within ten years after the date of grant.

The Company's Plan permits certain stock options granted under the plan to accrue stock DERs. Stock DERs represent shares of stock which are issuable to holders of stock options when the holders exercise the underlying stock options. The number of stock DER shares accrued is based on the level of the Company's dividends and on the price of the stock on the related dividend payment date. For the three and nine months ended September 30, 2000, the stock DERs accrued on NQSOs that had a stock DER feature resulted in charges to operating expenses of approximately $0.1 million and $0.2 million, respectively. For both the three and nine months ended September 30, 1999, the stock DERs accrued on NQSOs resulted in a credit to operating expenses of $0.0 million and $0.1 million, respectively.

A summary of the status of the Company's Plan as of September 30, 2000 and changes during the periods ending on that date is presented below.

<TABLE>
<CAPTION>

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	SHARES	WEIGHTED AVERAGE EXERCISE PRICE	SHARES	WEIGHTED AVERAGE EXERCISE PRICE
	(IN THOUSANDS, EXCEPT SHARE DATA)			
<S>	<C>	<C>	<C>	<C>
Outstanding options at beginning of period.......	1,485,573	$22.60	1,713,836	$21.97
Options granted...............................	1,500	$15.15	29,500	$13.63
Options exercised.............................	(19,980)	$15.05	(26,014)	$12.26
Options canceled..............................	(44,783)	$28.98	(302,944)	$18.96
Stock dividend equivalent rights earned........	4,340	--	12,274	--
Outstanding options at end of period............	1,426,650	$22.43	1,426,652	$22.43

</TABLE>

Common Stock Repurchases

Since September 1997, the Company's Board of Directors has approved the repurchase of 7,455,000 shares of the Company's Common Stock. At September 30, 2000 and December 31, 1999, there were 1,000,000 shares authorized and remaining for repurchase. The repurchased shares have been returned to the Company's authorized but unissued shares of Common Stock.

NOTE 12. RELATED PARTY TRANSACTIONS

Purchases and Sales of Mortgage Loans

During the three and nine months ended September 30, 2000, the Company sold $9.8 million and $35.1 million of commercial mortgage loans to RCF, respectively. For the three and nine months ended September 30, 1999, the Company sold $24 million and $32 million of commercial mortgage loans to RCF, respectively. Pursuant to the Master Forward Commitment Agreement, the Company sold the mortgage loans to RCF at the same price for which the Company acquired the mortgage loans. At September 30, 2000, under the terms of the Master Forward Commitment Agreement, the Company had committed to sell $22.7 million of commercial mortgage loans to RCF for settlement during the fourth quarter of 2000.

During the three and nine months ended September 30, 2000, the Company purchased commercial mortgage loans from RCF aggregating $9.6 million which were not subject to the terms of the Master Forward Commitment Agreement. The Company intends to hold these commercial loans through maturity. All such commercial mortgage loans purchased by the Company from RCF are purchased at the market price at the time of the sale. Accordingly, any inter-company gains or losses recorded on the sale of the commercial mortgage loans from RCF to the Company are eliminated against the basis of the commercial mortgage loan purchased by the Company. During both the three and nine months ended September 30, 2000, Redwood's 99% interest of such gains recognized by Holdings was $0.1. The Company made no such purchases from RCF during the three and nine months ended September 30, 1999.

During the nine months ended September 30, 2000, the Company sold $17.1 million of residential mortgage loans to Redwood Residential Funding ("RRF"), a subsidiary of Holdings. The Company had no such sales during the three months ended September 30, 2000. Pursuant to the Master Forward Commitment Agreement, the Company sold the mortgage loans to RRF at the same price for which the Company acquired the mortgage loans. During the three and nine months ended September 30, 1999, the Company sold $47.0 million of residential mortgage loans to RRF. As RRF ceased operations in 1999, there were no remaining outstanding commitments at September 30, 2000.

During December 1999, Holdings purchased $390 million of residential mortgage loans and subsequently sold a participation agreement on the mortgage loans to the Company. Pursuant to the terms of the Mortgage Loan Participation Purchase Agreement, the Company purchased a 99% interest in the mortgage loans, and assumed all related risks of ownership. Holdings did not recognize any gain or loss on this transaction. During March 2000, the Company sold the participation agreement back to Holdings for proceeds of $380.5 million. Holdings simultaneously sold $384 million of residential mortgage loans to Sequoia for proceeds of $384 million. Sequoia pledged these loans as collateral for a new issue of Long-Term Debt.

Other

Under a revolving credit facility arrangement, the Company may loan funds to Holdings to finance Holdings' operations. These loans are unsecured, subordinated, and are repaid within six months. Such loans bear interest at a rate of 3.50% over the one-month LIBOR. There were no outstanding loans to Holdings at September 30, 2000. At December 31, 1999, the Company had loaned $6.5 million to Holdings in accordance with the provisions of this arrangement. During both the nine months ended September 30, 2000, the Company earned $0.1 million in interest on loans to Holdings. The Company earned $0.3 million and $0.7 million in interest on loans to Holdings during the three and nine months ended September 30, 1999, respectively.

The Company shares many of the operating expenses of Holdings, including personnel and related expenses, which are subject to reimbursement by Holdings. During the three and nine months ended

September 30, 2000, $0.1 million and $0.2 million of Holdings' operating expenses were paid by the Company, and were subject to reimbursement by Holdings. During the three and nine months ended September 30, 1999, the Company paid $1.2 million and $2.7 million of Holdings' operating expenses, respectively.

The Company may provide credit support to Holdings to facilitate Holdings' financings from third-party lenders. As part of this arrangement, Holdings is authorized as a co-borrower under some of the Company's Short-Term Debt agreements subject to the Company continuing to remain jointly and severally liable for repayment. Accordingly, Holdings pays the Company credit support fees on borrowings subject to this arrangement. At September 30, 2000 and December 31, 1999, the Company was providing credit support on $30.9 million and $22.4 million of Holdings' Short-Term Debt. During both the three and nine months ended September 30, 2000 and 1999, the Company recognized approximately $0.1 million in credit support fee income. Credit support fees are reflected as a component of "Other Income" on the Consolidated Statements of Operations.

NOTE 13. COMMITMENTS AND CONTINGENCIES

At September 30, 2000, the Company had entered into commitments to sell $22.7 million of commercial mortgage loans to RCF for settlement during the fourth quarter of 2000.

At September 30, 2000, the Company is obligated under non-cancelable operating leases with expiration dates through 2003. The total future minimum lease payments under these non-cancelable leases is $352,367 and is expected to be recognized as follows: 2000 -- $83,364; 2001 -- $171,856; 2002 -- $53,546; 2003 -- $43,601.

RWT HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

ASSETS

<TABLE>
<CAPTION>

	SEPTEMBER 30, 2000	DECEMBER 31, 1999
	(UNAUDITED)	
<S>	<C>	<C>
Mortgage loans: held-for sale		
Commercial	$32,333	$29,605
Residential	--	4,399
	32,333	34,004
Cash and cash equivalents	1,441	1,999
Restricted cash	1,387	50
Accrued interest receivable	287	1,520
Property, equipment and leasehold improvements, net	86	299
Other assets	255	1,081
Total Assets	$35,789	$38,953
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Short-term debt	$30,903	$22,427
Loans from Redwood Trust, Inc.	--	6,500
Payable to Redwood Trust, Inc.	--	472
Accrued interest payable	232	831
Accrued restructuring charges	876	4,039
Accrued expenses and other liabilities	1,739	1,259
Total Liabilities	33,750	35,528
Commitments and contingencies (See Note 10)		
STOCKHOLDERS' EQUITY		
Series A preferred stock, par value $0.01 per share; 10,000 shares authorized; 5,940 issued and outstanding ($5,940 aggregate liquidation preference)	29,700	29,700
Common stock, par value $0.01 per share; 10,000 shares authorized; 3,000 issued and outstanding	--	--
Additional paid-in capital	300	300
Accumulated deficit	(27,961)	(26,575)
Total Stockholders' Equity	2,039	3,425
Total Liabilities and Stockholders' Equity	$35,789	$38,953

</TABLE>

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

RWT HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS)
(UNAUDITED)

	THREE MONTHS ENDED SEPTEMBER 30, 2000	THREE MONTHS ENDED SEPTEMBER 30, 1999	NINE MONTHS ENDED SEPTEMBER 30, 2000	NINE MONTHS ENDED SEPTEMBER 30, 1999
REVENUES				
Interest income				
Mortgage loans: held-for-sale				
Commercial	$1,032	$ 451	$ 2,167	$ 774
Residential	--	350	69	657
	1,032	801	2,236	1,431
Mortgage securities: trading	--	367	--	1,021
Cash and cash equivalents	29	79	110	295
Total interest income	1,061	1,247	2,346	2,747
Interest expense				
Short-term debt	(828)	(507)	(1,624)	(1,111)
Credit support fees	(34)	(31)	(70)	(72)
Loans from Redwood Trust, Inc.	(3)	(336)	(108)	(691)
Total interest expense	(865)	(874)	(1,802)	(1,874)
Net interest income	196	373	544	873
Net unrealized and realized market value gains (losses)	64	(531)	57	84
Other income (expense)	--	--	--	48
Net revenues	260	(158)	601	1,005
EXPENSES				
Compensation and benefits	(297)	(2,534)	(1,276)	(7,346)
General and administrative	(239)	(1,512)	(711)	(4,167)
Restructuring charge	--	(2,210)	--	(2,210)
Total expenses	(536)	(6,256)	(1,987)	(13,723)
Net Loss	$ (276)	$(6,414)	$(1,386)	$(12,718)

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

RWT HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

	SERIES A PREFERRED STOCK SHARES	SERIES A PREFERRED STOCK AMOUNT	COMMON STOCK SHARES	COMMON STOCK AMOUNT	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED DEFICIT	TOTAL
Balance, December 31, 1999	5,940	$29,700	3,000	$--	$300	$(26,575)	$3,425
Comprehensive income:							
Net loss	--	--	--	--	--	(574)	(574)
Balance, March 31, 2000	5,940	29,700	3,000	--	300	(27,149)	2,851
Comprehensive income:							
Net loss	--	--	--	--	--	(536)	(536)
Balance, June 30, 2000	5,940	$29,700	3,000	$--	$300	$(27,685)	$2,315
Comprehensive income:							
Net loss	--	--	--	--	--	(276)	(276)

Balance, September 30, 2000...	5,940	$29,700	3,000	$--	$300	$(27,961)	$2,039
	=====	=======	=====	===	====	========	======

</TABLE>

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

RWT HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

<TABLE>
<CAPTION>

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2000	1999	2000	1999
<S>	<C>	<C>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net loss..	$ (276)	$ (6,414)	$ (1,386)	$ (12,718)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation and amortization....................	11	267	28	464
Net unrealized and realized market value (gains) losses..	(64)	531	(57)	(84)
Purchases of mortgage loans: held for sale........	(22,705)	(79,178)	(460,543)	(231,359)
Proceeds from sales of mortgage loans: held for sale..	32,881	49,993	462,026	94,009
Principal payments on mortgage loans: held for sale..	37	472	250	1,280
Purchases of mortgage securities: trading.........	--	(4,619)	--	(4,619)
Proceeds from sales of mortgage securities: trading.....................................	--	44,969	--	99,488
Principal payments on mortgage securities: trading.....................................	--	1,206	--	3,549
(Increase) decrease in accrued interest receivable.................................	(14)	(224)	1,233	(289)
(Increase) decrease in other assets..............	(143)	1,239	821	821
Increase (decrease) in amounts due to Redwood Trust.......................................	--	121	(472)	(115)
Increase (decrease) in accrued interest payable...	(54)	--	(599)	--
Increase (decrease) in accrued restructuring charges.....................................	(250)	1,362	(3,163)	1,362
Increase (decrease) in accrued expenses and other liabilities.................................	(328)	17	480	747
	--------	--------	---------	---------
Net cash provided by (used in) operating activities...............................	9,095	9,742	(1,382)	(47,464)
	--------	--------	---------	---------
CASH FLOWS FROM INVESTING ACTIVITIES:				
(Purchases) sales of property and equipment, net.....	(4)	(567)	185	(2,849)
Net increase in restricted cash......................	426	--	(1,337)	--
	--------	--------	---------	---------
Net cash used in investing activities........	422	(567)	(1,152)	(2,849)
	--------	--------	---------	---------
CASH FLOWS FROM FINANCING ACTIVITIES:				
Net proceeds from issuance of short-term debt (net of repayments)....................................	(10,731)	(33,896)	8,476	19,207
Loans from Redwood Trust, Inc. (net of repayments)...	--	17,375	(6,500)	12,875
Net proceeds from issuance of preferred stock........	--	--	--	9,900
Net proceeds from issuance of common stock...........	--	--	--	100
	--------	--------	---------	---------
Net cash provided by (used in) financing activities...............................	(10,731)	(16,521)	1,976	42,082
	--------	--------	---------	---------
Net increase (decrease) in cash and cash equivalents...	(1,214)	(7,346)	(558)	(8,231)
Cash and cash equivalents at beginning of period.......	2,655	8,826	1,999	9,711
	--------	--------	---------	---------
Cash and cash equivalents at end of period.............	$ 1,441	$ 1,480	$ 1,441	$ 1,480
	========	========	=========	=========
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash paid for interest expense......................	$ 919	$ 822	$ 2,401	$ 1,769
Non-cash transaction:				
Securitization of mortgage loans into mortgage securities....................................	$ --	$ --	$ --	$ 98,290
	========	========	=========	=========

</TABLE>

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2000
(UNAUDITED)

NOTE 1. THE COMPANY

RWT Holdings, Inc. ("Holdings") was incorporated in Delaware on February 13, 1998 and commenced operations on April 1, 1998. Holdings originates and sells commercial mortgage loans. Redwood Trust, Inc. ("Redwood Trust") owns all of the preferred stock and has a non-voting, 99% economic interest in Holdings. The consolidated financial statements include the three wholly-owned subsidiaries of Holdings. Redwood Commercial Funding, Inc. ("RCF") originates commercial mortgage loans for sale to institutional investors. Redwood Residential Funding, Inc. ("RRF") and Redwood Financial Services, Inc. ("RFS") were start-up ventures that ceased operations in 1999. Holdings and its subsidiaries currently utilize both debt and equity to finance acquisitions. References to Holdings in the following footnotes refer to Holdings and its subsidiaries.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The accompanying interim consolidated financial statements are unaudited. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the quarter ended September 30, 2000 are not necessarily indicative of the results that may be expected for the year ending December 31, 2000. The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Annual Report on Form 10-K filed by Redwood Trust for the year ended December 31, 1999.

The consolidated financial statements include the accounts of Holdings and its subsidiaries. All significant intercompany balances and transactions with Holdings' consolidated subsidiaries have been eliminated.

USE OF ESTIMATES

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 the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. Actual results could differ from those estimates. The primary estimates inherent in the accompanying consolidated financial statements are discussed below.

Fair Value. Management estimates the fair value of its financial instruments using available market information and other appropriate valuation methodologies. The fair value of a financial instrument, as defined by Statement of Financial Accounting Standards ("SFAS") No. 107, Disclosures about Fair Value of Financial Instruments, is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced liquidation sale. Management's estimates are inherently subjective in nature and involve matters of uncertainty and judgement to interpret relevant market and other data. Accordingly, amounts realized in actual sales may differ from the fair values presented in Note 7.

MORTGAGE ASSETS

Holdings' mortgage assets consist of mortgage loans and mortgage securities ("Mortgage Assets"). Interest is recognized as revenue when earned according to the terms of the loans and when, in the opinion of management, it is collectible.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 2000
(UNAUDITED)

Mortgage Loans: Held-for-Sale

Mortgage loans are recorded at the lower of cost or market value ("LOCOM"). Cost generally consists of the loan principal balance net of any unamortized premium or discount and net loan origination fees. Interest income is accrued based on the outstanding principal amount of the mortgage loans and their contractual terms. Realized and unrealized gains or losses on the loans are based on the specific identification method and are recognized in "Net unrealized and realized market value gains (losses)" on the Consolidated Statements of Operations.

Some of the mortgage loans purchased by Redwood Trust for which securitization or sale is contemplated are committed for sale by Redwood Trust to Holdings, or a subsidiary of Holdings, under a Master Forward Commitment Agreement. As the forward commitment is entered into on the same date that Redwood Trust commits to purchase the loans, the price which Holdings will pay to purchase the loans under the forward commitment is the same as the price Redwood Trust paid for the mortgage loans, as established by the external market.

Mortgage Securities: Trading

Prior to 2000, Holdings invested in residential mortgage securities. These mortgage securities were classified as trading and were accounted for in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. Accordingly, such securities were recorded at their estimated fair market value. Unrealized and realized gains and losses on these securities were recognized as a component of "Net unrealized and realized market value gains (losses)" on the Consolidated Statements of Operations. Holdings did not own any mortgage securities at September 30, 2000 or December 31, 1999.

LOAN ORIGINATION FEES

Loan fees, discount points, and certain direct origination costs are recorded as an adjustment to the cost of the loan and are recorded in earnings when the loan is sold.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less.

RESTRICTED CASH

Restricted cash includes cash held back from borrowers until certain loan agreement requirements have been met. The corresponding liability for this cash is reflected as a component of "Accrued expenses and other liabilities" on the Consolidated Balance Sheets.

INCOME TAXES

Taxable earnings of Holdings are subject to state and federal income taxes at the applicable statutory rates. Holdings provides for deferred income taxes if any, to reflect the estimated future tax effects under the provisions of SFAS No. 109, Accounting for Income Taxes. Under this pronouncement, deferred income taxes, if any, reflect the estimated future tax effects of temporary differences between the amount of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws and regulations.

COMPREHENSIVE INCOME

SFAS No. 130, Reporting Comprehensive Income, requires Holdings to classify items of "other comprehensive income" by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet. As of September 30, 2000, there was no other comprehensive income.

RECENT ACCOUNTING PRONOUNCEMENT

During March 2000, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 44, Accounting for Certain Transactions involving Stock Compensation -- an interpretation of APB Opinion No. 25 ("FIN 44"). FIN 44 clarifies the application of APB Opinion No. 25 by expanding upon a number of issues not specifically addressed in the Opinion such as the definition of an employee for purposes of applying APB Opinion No. 25 and the accounting for modifications to a previously fixed stock option award. FIN 44 was effective July 1, 2000. The impact on Holdings of adopting FIN 44 does not have a material impact on the operating results of Holdings.

NOTE 3. MORTGAGE ASSETS

At September 30, 2000 and December 31, 1999 Mortgage Assets consisted of the following:

Mortgage Loans: Held-for-Sale

	SEPTEMBER 30, 2000	DECEMBER 31, 1999		
	COMMERCIAL	RESIDENTIAL	COMMERCIAL	TOTAL
		(IN THOUSANDS)		
Current Face	$33,303	$4,995	$30,324	$35,319
Unamortized Discount	(971)	(596)	(719)	(1,315)
Carrying Value	$32,333	$4,399	$29,605	$34,004

Holdings recognized losses of $0.2 million during the nine months ended September 30, 2000, as a result of LOCOM adjustments on mortgage loans held-for-sale. No such losses were recognized by Holdings during the three months ended September 30, 2000. Additionally, during the three and nine months ended September 30, 2000, Holdings sold residential and commercial mortgage loans for proceeds of $32.9 million and $462.0 million, resulting in net gains of $0.1 million and $0.3 million, respectively. During the three and nine months ended September 30, 1999, Holdings recognized $0.9 million and $1.1 million in LOCOM loss adjustments on mortgage loans held-for-sale and sold mortgage loans held-for-sale for proceeds of $50 million and $94 million, respectively. The LOCOM adjustments and gains on sale are reflected as a component of "Net unrealized and realized market value gains (losses)" on the Consolidated Statements of Operations.

Mortgage Securities: Trading

Holdings did not own any mortgage securities at September 30, 2000 or December 31, 1999. For the three and nine months ended September 30, 1999, Holdings recognized a mark-to-market loss of $0.6 million and a mark-to-market gain of $0.1 million, respectively, on mortgage securities classified as trading. This gain is reflected as a component of "Net unrealized and realized market value gains (losses)" on the Consolidated Statements of Operations. Also during the three and nine months ended September 30, 1999, Holdings sold mortgage securities classified as trading for proceeds of $45 million and $99 million, respectively.

NOTE 4. SHORT-TERM DEBT

Holdings has entered into reverse repurchase agreements and other forms of collateralized short-term borrowings (collectively, "Short-Term Debt") to finance acquisitions of a portion of its Mortgage Assets. This Short-Term Debt is collateralized by a portion of Holdings' mortgage loans.

At September 30, 2000, and December 31, 1999, Holdings had $30.9 million and $22.4 million of Short-Term Debt outstanding with a weighted-average borrowing rate of 8.50% and 7.02%, respectively. The average balance of Short-Term Debt outstanding during the three and nine months ended September 30, 2000 was $38 million and $26 million with a weighted-average interest cost of 8.50% and 8.21%, respectively. The maximum balance outstanding during both the three and nine months ended September 30, 2000 was $44.1 million. During the three and nine months ended September 30, 1999, the average balance of Short-Term Debt outstanding was $35 million and $27 million with a weighted-average interest cost of 5.77% and 5.42%, respectively. The maximum balance outstanding during the three and nine months ended September 30, 1999 was $53 million and $89 million, respectively.

In March 2000, the Redwood Trust entered into a $50 million revolving mortgage warehousing credit facility. The facility is intended to finance newly originated commercial mortgage loans. Holdings may borrow under this facility as a co-borrower. In September 2000, this facility was extended through August 2001 and was increased to $70 million. In addition, a portion of this facility allows for loans to be financed to the maturity of the loan, which may exceed the expiration date of the facility. At September 30, 2000, the Redwood Trust and Holdings had outstanding borrowings of $4.3 million and $30.9 million, respectively, under this facility. Borrowings under this facility bear interest based on a specified margin over the London Interbank Offered Rate ("LIBOR"). At September 30, 2000, the weighted average borrowing rate under this facility was 8.50%. Redwood Trust and Holdings were in compliance with all material representations, warranties and covenants under this credit facility at September 30, 2000.

In July 2000, the Redwood Trust renewed for one year, a $30 million master loan and security agreement with a Wall Street Firm. The facility is intended to finance newly originated commercial mortgage loans. In September 2000, this facility was increased to $50 million. Holdings may borrow under this facility as a co-borrower. At September 30, 2000, the Company had outstanding borrowings of $7.3 million under this facility. Holdings had no outstanding borrowings under this facility at September 30, 2000. Borrowings under this facility bear interest based on a specified margin over LIBOR. At September 30, 2000, the weighted average borrowing rate under this facility was 8.12%. The Redwood Trust and Holdings were in compliance with all material representations, warranties and covenants under this credit facility at September 30, 2000.

NOTE 5. RESTRUCTURING CHARGE

During the year ended December 31, 1999, Holdings recognized $8.4 million in restructuring charges as a result of the closure of two of its subsidiaries, RRF and RFS. Restructuring charges were determined in accordance with the provisions of Staff Accounting Bulletin No. 100 "Restructuring and Impairment Charges", Emerging Issues Task Force No. 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity", and other relevant accounting guidance. The restructuring accrual includes costs associated with existing contractual and lease arrangements at both subsidiaries which have no future value. In addition, as a result of the closure of the two subsidiaries, certain assets utilized in these businesses were determined to have little or no realizable value, resulting in impairment losses. These

assets included software developed for use at RRF and certain fixed assets at both subsidiaries. The following table provides a summary of the primary components of the restructuring liability.

<TABLE>
<CAPTION>

	TOTAL REMAINING LIABILITY	
	SEPTEMBER 30, 2000	DECEMBER 31, 1999
	(IN THOUSANDS)	
<S>	<C>	<C>
Payroll, severance, and termination benefits.........	$311	$2,431
Lease and other commitments..........................	404	1,068
Other..	161	540
Total....................................	$876	$4,039

</TABLE>

Holdings expects to pay the majority of the remaining restructuring costs during the year 2000. The liability for restructuring costs is reflected as "Accrued restructuring charges" on the Consolidated Balance Sheets.

NOTE 6. INCOME TAXES

The provision for income taxes for the three and nine months ended September 30, 2000 and 1999 is $3,200 and represents minimum California franchise taxes. No additional tax provision has been recorded for the three and nine months ended September 30, 2000, as Holdings reported a loss in each of the periods. Due to the uncertainty of realization of net operating losses, no deferred tax benefit has been recorded. That is, a valuation allowance has been provided to offset the deferred tax assets related to net operating loss carryforwards and other future temporary deductions at September 30, 2000 and December 31, 1999. At September 30, 2000 and December 31, 1999, the deferred tax assets and associated valuation allowances were approximately $9.4 million and $8.9 million, respectively. At December 31, 1999 Holdings had net operating loss carryforwards of approximately $19.5 million for federal tax purposes, and $9 million for state tax purposes. The federal loss carryforwards and a portion of the state loss carryforwards expire between 2018 and 2019, while the largest portion of the state loss carryforwards expire between 2003 and 2004.

NOTE 7. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying values and estimated fair values of Holdings' financial instruments at September 30, 2000 and December 31, 1999.

<TABLE>
<CAPTION>

	SEPTEMBER 30, 2000	DECEMBER 31, 1999

	CARRYING VALUE	FAIR VALUE	CARRYING VALUE	FAIR VALUE
		(IN THOUSANDS)		
<S>	<C>	<C>	<C>	<C>
Assets				
Mortgage loans: held-for-sale				
Commercial..........................	$32,333	$32,623	$29,605	$29,876
Residential.........................	--	--	$ 4,399	$ 4,415

</TABLE>

The carrying amounts of all other balance sheet accounts as reflected in the financial statements approximate fair value because of the short-term nature of these accounts.

NOTE 8. STOCKHOLDERS' EQUITY

The authorized capital stock of Holdings consists of Series A Preferred Stock ("Preferred Stock") and Common Stock. Holdings is authorized to issue 10,000 shares of Common Stock, each having a par value of

$0.01, and 10,000 shares of Preferred Stock, each having a par value of $0.01. All voting power is vested in the common stock.

Holdings has issued a total of 5,940 shares of Preferred Stock to Redwood Trust. The Preferred Stock entitles Redwood Trust to receive 99% of the aggregate amount of any such dividends or distributions made by Holdings. The holders of the Common Stock are entitled to receive the remaining 1% of the aggregate amount of such dividends or distributions. The Preferred Stock ranks senior to the Common Stock as to the payment of dividends and liquidation rights. The liquidation preference entitles the holders of the Preferred Stock to receive $1,000 per share liquidation preference before any distribution is made on the Common Stock. After the liquidation preference, the holders of Preferred Stock are entitled to 99% of any remaining assets.

NOTE 9. RELATED PARTY TRANSACTIONS

Purchases and Sales of Mortgage Loans

During the three and nine months ended September 30, 2000, RCF purchased $9.8 million and $35.1 million of commercial mortgage loans from Redwood Trust, respectively. For the three and nine months ended September 30, 1999, RCF purchased $24 million and $32 million of commercial mortgage loans from Redwood Trust, respectively. Pursuant to the Master Forward Commitment Agreement, RCF purchased the mortgage loans from Redwood Trust at the same price for which Redwood Trust acquired the mortgage loans. At September 30, 2000, under the terms of the Master Forward Commitment Agreement, Redwood Trust had committed to sell $22.7 million of commercial mortgage loans to RCF for settlement during the fourth quarter of 2000.

During the three and nine months ended September 30, 2000, RCF sold commercial mortgage loans aggregating $9.6 million to Redwood Trust which were not subject to the terms of the Master Forward Commitment Agreement. All such commercial mortgage loans sold by RCF to Redwood Trust are sold at the market price at the time of the sale. Accordingly, any inter-company gains or losses recorded on the sale of the commercial mortgage loans by RCF to Redwood Trust are recorded on the Holdings' Statements of Operations under "net unrealized and realized market value gains (losses)." Such gains or losses are eliminated on the Redwood Trust Statements of Operations against the basis of the asset held by Redwood Trust. During both the three and nine months ended September 30, 2000, the gains recognized by Holdings on the sale of RCF assets were $0.1 million. No such sales were made by the RCF during the three and nine months ended September 30, 1999.

During the nine months ended September 30, 2000, RRF purchased $17.1 million of residential mortgage loans from Redwood Trust, respectively. No such purchases were made during the three months ended September 30, 2000. For both the three and nine months ended September 30, 1999, RRF purchased $47.0 million of residential mortgage loans from Redwood Trust. Pursuant to the Master Forward Commitment Agreement, RRF purchased the mortgage loans from Redwood Trust at the same price for which Redwood Trust acquired the mortgage loans. As RRF ceased operations in 1999, there were no remaining outstanding commitments at September 30, 2000.

During December 1999, Holdings purchased $390 million of residential mortgage loans and subsequently sold a participation agreement on the mortgage loans to Redwood Trust. Pursuant to the terms of the Mortgage Loan Participation Purchase Agreement, Redwood Trust purchased a 99% interest in the mortgage loans, and assumed all related risks of ownership. Holdings did not recognize any gain or loss on this transaction. During March 2000, Redwood Trust sold the participation agreement back to Holdings for proceeds of $380.5 million. Holdings simultaneously sold $384 million of residential mortgage loans to Sequoia for proceeds of $384 million.

Other

Under a revolving credit facility arrangement, Redwood Trust may loan funds to Holdings to finance Holdings' operations. These loans are unsecured, subordinated, and are repaid within six months. Such loans bear interest at a rate of 3.50% over the LIBOR interest rate. Holdings had no outstanding loans from Redwood Trust at September 30, 2000. At December 31, 1999, Holdings had borrowed $6.5 million from Redwood Trust in accordance with the provisions of this arrangement. During the three and nine months ended September 30, 2000, Holdings incurred $0.0 million and $0.1 million in interest expense on loans from Redwood Trust, respectively. Holdings incurred $0.3 million and $0.7 million in interest expense on loans from Redwood Trust during the three and nine months ended September 30, 1999.

Redwood Trust shares many of the operating expenses of Holdings, including personnel and related expenses, subject to reimbursement by Holdings. During the three and nine months ended September 30, 2000, $0.1 million and $0.2 million of Holdings' operating expenses were paid by Redwood Trust, and were subject to reimbursement by Holdings, respectively. During the three and nine months ended September 30, 1999, $1.2 million and $2.7 million, respectively, of Holdings' operating expenses were paid by Redwood Trust.

Redwood Trust may provide credit support to Holdings to facilitate Holdings' financings from third-party lenders. As part of this arrangement, Holdings is authorized as a co-borrower under some of Redwood Trust's Short-Term Debt agreements subject to Redwood Trust continuing to remain jointly and severally liable for repayment. Accordingly, Holdings pays Redwood Trust credit support fees on borrowings subject to this arrangement. At September 30, 2000 and December 31, 1999, Redwood Trust was providing credit support on $30.9 million and $22.4 million of Holdings' Short-Term Debt, respectively. During the three and nine months ended September 30, 2000 and 1999, Holdings recognized approximately $0.0 million and $0.1 million in credit support fee expense, respectively.

NOTE 10. COMMITMENTS AND CONTINGENCIES

At September 30, 2000, RCF is obligated under non-cancelable operating leases with expiration dates through 2004. The total future minimum lease payments under these non-cancelable leases is $327,338 and is expected to be recognized as follows: 2000 -- $26,536; 2001 -- $91,470; 2002 -- $76,672; 2003 -- $78,972; 2004 -- $53,688.

At September 30, 2000, RCF had entered into commitments to purchase $22.7 million of commercial mortgage loans from Redwood Trust for settlement during the fourth quarter of 2000.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the Consolidated Financial Statements and Notes.

SAFE HARBOR STATEMENT

"Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995: Statements in this discussion regarding Redwood Trust, Inc., or "Redwood Trust", and our business which are not historical facts are "forward-looking statements" that involve risks and uncertainties. For a discussion of such risks and uncertainties, which could cause actual results to differ from those contained in the forward-looking statements, we refer you to "Company Business and Strategy" beginning on Page 4 and "Risk Factors" commencing on Page 13 of our 1999 Form 10-K included in our 1999 Annual Report.

COMPANY OVERVIEW

Redwood Trust is a real estate finance company. We acquire, originate, finance, structure, and manage residential and commercial mortgages representing interests in real estate property nationwide.

To build our residential loan portfolio, we acquire loans from large high-quality origination companies. In addition, we also buy residential loan portfolios from banks. The commercial mortgage loans that we own have been originated by our commercial mortgage origination affiliate.

Our business strategy is to actively manage our portfolio by monitoring and working out any credit issues, by managing the effective terms of our assets and our liabilities, and by changing our portfolio mix as opportunities arise or risks develop.

As a key part of our strategy, we focus on high-quality mortgages. We do not plan to invest in loans (or below-investment grade securities backed by loans) that are made to lower-quality borrowers or that otherwise have significant credit risk characteristics. As a result of this emphasis on high-quality assets, our credit losses to date have been minor.

Our revenues consist primarily of interest income generated from our real estate mortgage assets. Our profit consists of these revenues less interest, credit, and operating expenses. Since we are a Real Estate Investment Trust (REIT), we generally do not pay corporate taxes on our profits. As a REIT, we distribute each year a high percentage of the profits that we generate to shareholders in the form of quarterly dividend payments.

Redwood's primary goal is to generate high-quality cash flows from high-quality assets in order to provide a steady and growing stream of dividends to our shareholders.

For more information, please visit Redwood's Web site at www.redwoodtrust.com.

SIGNIFICANT ASPECTS OF THE THIRD QUARTER AND YEAR-TO-DATE 2000

In 2000, we paid a common stock dividend of $0.35 per share in the first quarter, $0.40 per share in the second quarter, and $0.42 per share in the third quarter.

In the third quarter of 2000, our net income was $4.9 million, or $0.55 per share. In the second quarter of 2000, our net income was $3.1 million, or $0.35 per share. In the third quarter of 1999, our net income was negative $3.7 million, or negative $0.39 per share. For the first nine months of 2000, our net income was $11.2 million, or $1.27 per share. For the first nine months of 1999, our net income was $4.6 million, or $0.45 per share.

We believe that core earnings -- earnings from on-going operations before mark-to-market -- reflects Redwood's on-going earnings, cash flow generation, and dividend-paying ability. Core earnings for the third quarter were $4.0 million, or $0.45 per share. Core earnings per share increased by 32% from the $0.34 per share we earned in the third quarter of 1999. Core earnings for the first nine months of 2000 were

$13.0 million, or $1.46 per share. Year-to-date 2000 core earnings increased by 20% from the $1.22 per share we earned in the first nine months of 1999.

Core earnings for the third quarter of 2000 were somewhat lower than the $0.51 per share we earned in each of the first two quarters of 2000. An increase in mortgage prepayment rates (typical for the summer months) and the temporary effect of rapid increases in short-term interest rates reduced our net interest income earnings from quarter to quarter.

Our credit results remain excellent. In the third quarter of 2000, our loan delinquency rates dropped and we had no loan losses. Loan losses to date for the year 2000 total $37,000, and loan losses in the mortgage pools that back our mortgage securities remain well below our original expectations. The annualized credit loss rate on our loan portfolio in 2000 has been less than one basis point (0.004%). Our credit reserve at the end of the third quarter of $6.0 million represented 0.49% of our loan portfolio.

FINANCIAL CONDITION

At September 30, 2000, we owned $1.2 billion mortgage loans and $0.9 billion mortgage securities. Our total assets were $2.2 billion. We financed these assets with $0.8 billion of recourse short-term debt, $1.1 billion of non-recourse long-term debt, and $211 million of preferred and common equity.

As reported on our third quarter 2000 balance sheet, our equity-to-assets ratio was 9.6% and our debt-to-equity ratio was 9.4 to 1.0. Nearly $1.2 billion of the assets and liabilities consolidated on our reported balance sheet, however, are owned by our Sequoia subsidiary. Sequoia is a special purpose entity designed to allow Redwood to issue long-term debt that is non-recourse to Redwood itself. Redwood's net investment in Sequoia is $38 million. Since Sequoia's debts are payable only by Sequoia, Redwood's total risk related to Sequoia's assets and liabilities is limited to its $38 million investment. Adjusting for the non-recourse nature of the Sequoia assets and debt that are reported on Redwood's balance sheet, at September 30, 2000 Redwood owned total assets-at-risk of $1.0 billion funded with $0.8 billion of recourse debt and

$0.2 billion of equity. The ratio of equity-to-risk-assets was 20.0%. The ratio of recourse-debt-to-equity was 3.9 to 1.0.

At December 31, 1999, we owned $1.4 billion mortgage loans and $1.0 billion mortgage securities. Our total assets were $2.4 billion. We financed these assets with $1.3 billion of recourse short-term debt, $0.9 billion of non-recourse long-term debt, and $210 million of preferred and common equity. Our equity-to-assets ratio was 8.7% and our debt -to-equity ratio was 10.5 to 1.0. Adjusting for Sequoia, we owned total assets at risk of $1.5 billion funded with $1.3 billion of recourse debt and $0.2 billion of equity. The ratio of equity-to-risk-assets was 14.3%. The ratio of recourse-debt-to-equity was 6.0 to 1.0.

The increase in long-term debt and reduction in short-term debt from December 31, 1999 to September 30, 2000 was the result of our issuance of non-recourse long-term debt in the first quarter of 2000.

Mortgage Assets

Mortgage Loans

Aspects of our loan portfolio are detailed in the paragraphs below. To summarize, at September 30, 2000 we owned $1.2 billion mortgage loans representing 56% of our total mortgage asset portfolio. Residential mortgage loans were 97% of our mortgage loan portfolio and commercial mortgage loans were 3%. Within our residential mortgage loan portfolio, 72% were adjustable-rate mortgages with coupon rates that adjust to market conditions at least annually and 28% were hybrid-coupon mortgages that are fixed rate on average for two years and then become adjustable-rate.

At September 30, 2000, $852 million carrying value, or 39% of our total mortgage asset portfolio, were high-quality residential mortgage loans with adjustable-rate coupons with a principal value of $842 million. Our carrying value of these loans, after $3.2 million of credit reserves, was 101.17% of the face or principal value of the loans. At December 31, 1999, we owned $993 million carrying value of these loans, or 42% of our portfolio, at a carrying value of 101.21% of the $981 million principal value (net of a $2.8 million credit

reserve). Seriously delinquent loans (over 90 days delinquent, in foreclosure, or REO) in this portion of our portfolio were $3.5 million at September 30, 2000 and $3.4 million at December 31, 1999.

At September 30, 2000, $334 million carrying value and principal value, or 15% of our total mortgage asset portfolio, were high-quality residential mortgage loans with hybrid coupons. Our hybrid mortgage loans have an initial fixed coupon rate for three to ten years followed by annual coupon adjustments. On average, these loans become floating-rate in December 2002. This portion of our portfolio is matched to the $326 million of amortizing non-recourse long-term debt we have issued that is fixed-rate debt until December 2002. Our carrying value of these loans, after $2.4 million of credit reserves, was 99.76% of the $335 million face value. At December 31, 1999 we owned $391 million carrying value of these loans, or 17% of our total portfolio, at a carrying value of 99.84% of the $392 million principal value (net of a $2.3 million credit reserve). Seriously delinquent loans in this portion of our portfolio were $0.8 million at September 30, 2000 and $1.3 million at December 31, 1999.

We generally seek to acquire residential mortgage loans that are high-quality, that have loan balances significantly larger than national averages, and that are geographically diverse. At September 30, 2000, our total residential loan portfolio consisted of 3,804 loans, with an average loan size of $309,400. The geographic distribution was California 25%, Florida 9%, New York 8%, New Jersey 5%, Texas 5%, and Georgia 5%. The remaining 43% were in other states located throughout the country, with no one of these states representing greater than 5% of the total. At December 31, 1999, we owned 4,366 loans with an average loan size of $315,700. The geographic distribution was California 26%, Florida 9%, New York 8%, New Jersey 5%, Texas 5%, and Georgia 5%. The remaining 42% were in other states located throughout the country, with no one of these states representing greater than 5% of the total.

At September 30, 2000, $32.3 million carrying value, or 1.5% of our total mortgage asset portfolio, were commercial mortgage loans originated by our affiliated commercial mortgage origination unit. These loans had a principal value $32.7 million and were carried on our books at 98.66% of principal value. These loans had an average size of $4.1 million and all the underlying properties were located in California, New Jersey or Texas. At December 31, 1999, we owned $8.4 million carrying value of commercial mortgage loans, or 0.4% of our portfolio, at a carrying value of 99.85% of principal value. These loans had an average size of $2.8 million and all the underlying properties were located in California. Generally, these loans are shorter-term bridge or transition loans to high-quality borrowers on a variety of types on income-producing properties. We expect that most of these loans will pre-pay or mature within three years. Most of these loans have floating-rate coupons.

In addition to the commercial loans reported on our balance sheet, our 99%-owned unconsolidated affiliate (Holdings) also owned similar commercial mortgage loans originated by our commercial origination affiliate of $32.3 million at September 30, 2000 and $29.6 million at December 31, 1999.

We have sold some of our originated commercial mortgage loans to banks and other finance companies; we may make further sales in the future.

Mortgage Securities

Aspects of our mortgage securities portfolio are detailed in the paragraphs below. To summarize, at September 30, 2000 we owned $0.9 billion mortgage securities representing 44% of our total mortgage asset portfolio. All of these securities represented interests in pools of residential mortgage loans. Of these securities, 93% were rated BBB or higher by credit rating agencies. A substantial majority of these were rated AAA. Securities with coupon rates that adjust to market conditions at least once per year represented 89% of the securities portfolio. Securities that have fixed rate coupons for 1 to 5 years (and then either adjust or mature) represented 3% of the securities portfolio. The remainder, 8%, had fixed rate coupons for longer than 5 years.

At September 30, 2000, 29% of our total mortgage asset portfolio, or $624 million carrying value with a principal value of $615 million, consisted of residential mortgage securities issued and credit-enhanced by Fannie Mae or Freddie Mac and effectively rated "AAA". The majority of these securities, $613 million or 99%, were adjustable-rate securities with the remaining 1% fixed-rate securities. The carrying value of these

securities was 101.62% of principal value. At December 31, 1999, we owned $575 million carrying value of these securities, or 24% of our portfolio, at a carrying value of 101.73% of the $565 million principal value.

At September 30, 2000, 9% of our total mortgage asset portfolio, or $197 million carrying and $196 principal value, consisted of adjustable-rate residential mortgage securities issued by private-label security issuers. These securities were credit-enhanced through subordination or other means and were rated "AAA" or "AA". The carrying value of these securities was 100.44% of face value. At December 31, 1999, we owned $291 million carrying value and principal value of these securities, or 12% of our portfolio, at a carrying value of 99.86%.

At September 30, 2000, 3% of our mortgage asset portfolio, or $69 million carrying value with a principal value of $109 million, consisted of lower-rated, residential mortgage securities issued by private-label security issuers. Due to their subordinated status, these securities bore some degree of credit risk and were rated "A" or below. The loans underlying these securities are, with minor exceptions, high-quality loans. The carrying value of these securities, after $0.4 million of credit reserves, was 65.28% of face value. At December 31, 1999, we owned $28 million carrying value of these securities, or 1% of our portfolio, at a carrying value, after credit reserves, of 57.85% of the $49 million face value. We intend to continue to increase our investment in lower-rated, subordinated residential mortgage securities backed by high-quality loans in the future.

At September 30, 2000, 1% of our total mortgage asset portfolio, or $23 million carrying value and principal value, consisted of residential floating-rate mortgage securities rated "AAA" or "AA" which were backed by home equity loans, or "HELs". The carrying value of these securities was 99.94% of face value. At December 31, 1999, we owned $47 million carrying value of these securities, or 2% of our portfolio, at a carrying value of 98.79% of the $48 million principal value.

At September 30, 2000, 1% of our mortgage asset portfolio, or $14 million carrying value and principal value, consisted of fixed-rate, private-label mortgage securities. These are commonly called "CMOs". They were rated "AAA" or "AA" and had average lives of 1 to 2 years. The carrying value of these securities was 97.56% of principal value. At December 31, 1999, we owned $16 million carrying value and principal value of these securities, or 1% of our portfolio, at a carrying value of 97.28% of principal value.

At September 30, 2000, 1% of our mortgage asset portfolio, or $12 million carrying value with a principal value of $13 million, consisted of fixed-rate, credit-enhanced private-label mortgage securities rated "AA" and backed by residential mortgage loans with loan-to-value ratios in excess of 100%. The carrying value of these securities was 94.66% of face value. At December 31, 1999, we owned $12 million carrying value of these securities, or 0.5% of our portfolio, at a carrying value of 91.00% of the $13 million principal value. The average life of these assets was 7.5 years at September 30, 2000 and 8.2 years at December 31, 1999

At December 31, 1999, 0.3% of our total mortgage asset portfolio, or $6 million carrying and face value, consisted of floating-rate CMO mortgage securities issued by Fannie Mae or Freddie Mac and effectively rated "AAA". The carrying value of these securities was 99.88% of principal value. We owned none of these assets at September 30, 2000.

At September 30, 2000, 0.01% of our mortgage asset portfolio, or $0.2 million carrying value with no principal value, consisted of interest-only mortgage securities rated "AAA" or "AA". At December 31, 1999, we owned $0.1 million carrying value of these securities, or 0.005% of our portfolio.

Cash

We had $7 million of unrestricted cash at September 30, 2000 and $20 million at year-end 1999.

Sequoia held cash totaling $3 million at September 30, 2000 and $5 million at December 31, 1999. In consolidating Sequoia assets on our balance sheet, we reflect this cash as "Restricted Cash" since it will be used for the specific purpose of making payments to Sequoia bondholders and is not available for general corporate purposes.

The amount of liquidity we maintain on a daily basis may differ from the amount of cash we show on our balance sheet at the end of each reporting period. Please refer to the discussion regarding our liquidity beginning on page 42.

Interest Rate Agreements

We use interest rate agreements as part of our asset/liability management. Our interest rate agreements are carried on our balance sheet at estimated market value, which was $0.3 million at September 30, 2000 and $2.0 million at December 31, 1999. Please see "Note 2. Summary of Significant Accounting Policies", "Note 7. Interest Rate Agreements" and "Note 10. Fair Value of Financial Instruments" in the Notes to Consolidated Financial Statements for more information.

Investment in RWT Holdings, Inc.

We do not consolidate the assets and liabilities of Holdings on our balance sheet. We reflect the net book value of our investment in one line item on our balance sheet labeled "Investment in RWT Holdings, Inc." We refer you to Holdings' "Consolidated Financial Statements and Notes" and Holdings' "Management's Discussion and Analysis" below for more information on Holdings.

The carrying value of our equity investment in Holdings was $2.0 million at September 30, 2000 and $3.4 million at December 31, 1999.

From time to time, we may provide additional liquidity to Holdings. At September 30, 2000, no such additional liquidity was needed. At December 31, 1999, loans to Holdings totaled $6.5 million and receivables from Holdings were $0.5 million.

Other Assets

Our other assets include principal receivable, accrued interest receivables, other receivables, fixed assets, leasehold improvements and prepaid expenses. These totaled $24 million at September 30, 2000 and $19 million at December 31, 1999.

Short-Term Debt

Short-term borrowings totaled $0.8 billion at September 30, 2000, or 42% of our total debt. At December 31, 1999, short-term borrowings were $1.3 billion, or 57% of our total debt. The level of short-term borrowings was reduced in the first half of 2000 as we issued long-term debt and used the proceeds to reduce short-term debt. We pledge a portion of our mortgage securities portfolio, mortgage loan portfolio, and other assets to secure our short-term debt. Maturities on this debt typically range from one month to one year. The interest rate on most of this debt adjusts monthly to a spread over or under the one-month LIBOR interest rate, with some of it adjusting daily based on the Fed Funds interest rate.

Long-Term Debt

At September 30, 2000, we owned $1.18 billion of residential mortgage loans that were financed with long-term debt through trusts owned by our financing subsidiary, Sequoia. The amount of outstanding Sequoia long-term debt amortizes as the underlying mortgages pay down. As the equity owner of these trusts, we are entitled to distributions of the net earnings of the trusts, which principally consist of the interest income earned from mortgages in each trust less the interest expense of the debt of each trust. Sequoia debt is non-recourse to Redwood Trust. The debt is consolidated on our balance sheet and is reflected as long-term debt, which is carried at historical amortized cost. The original scheduled maturity of this debt was approximately thirty years. Since these debt balances are retired over time as principal payments are received on the underlying mortgages, the expected average life of this debt is two to six years.

At September 30, 2000, 58% of our total debt, or $1.15 billion, was long-term mortgage-backed debt. Of this long-term debt, $518 million had a floating-rate based on one-month LIBOR and $304 million had a floating-rate based on the twelve-month average of the one-year Treasury rate. An additional $326 million was

fixed-rate until December 2002 with a floating-rate coupon thereafter; this debt is matched to our portfolio of hybrid fixed/floating residential mortgage loans.

At December 31, 1999, 43% of our total debt, or $945 million, was long-term mortgage-backed debt. Of this long-term debt, $212 million had a floating-rate based on one-month LIBOR, $351 had a floating-rate based on the twelve-month average of the one-year Treasury rate, and $382 million had a fixed-rate until December 2002 with a floating-rate coupon thereafter.

Other Liabilities

Our other liabilities include accrued interest payable, accrued expenses, and dividends payable. The net balance of these accounts totaled $14 million at September 30, 2000 and $11 million at December 31, 1999.

Stockholders' Equity

At September 30, 2000, total equity capital was $211 million. Preferred stock equity was $27 million. Reported common equity totaled $184 million, or $20.90 per common share outstanding.

In reporting equity, we mark-to-market all earning assets and interest rate agreements except mortgage loans that were financed to maturity (Sequoia). In accordance with Generally Accepted Accounting Principles ("GAAP"), no liabilities were marked-to-market.

If we had marked-to-market all of our assets and liabilities, total equity capital would have been reported as $209 million at September 30, 2000. After subtracting out the preference value of the preferred stock, common equity on a full mark-to-market basis was $181 million and the net asset value, or "NAV", per common share was $20.59.

At December 31, 1999, reported equity capital was $210 million, preferred stock equity was $27 million, and reported common equity was $183 million, or $20.88 per common share outstanding. Mark-to-market common equity was $185 million, or a NAV of $21.07 per common share.

During the first nine months of 2000, our total equity, book value per share, and NAV per share declined slightly after accruing for our $1.17 per share common dividends. These dividends were below our core earnings during this period of $1.46 per share and below our reported GAAP earnings of $1.27 per share. The deduction in our book value was due to the negative net market value adjustments on the assets and liabilities whose adjustments do not flow through our income statement. However, given the rising interest rate environment, which saw short-term rates rise by nearly 1.00% during the past nine months, we had a relatively small net market valuation adjustment on all our assets and liabilities, with the average net decline being 0.22% of average principal value of all our assets.

RESULTS OF OPERATIONS

Our reported GAAP earnings of $0.55 per share in the third quarter of 2000 exceeded our GAAP earnings of $0.35 per share in the second quarter of 2000 and exceeded our GAAP earnings of negative $0.39 per share in the third quarter of 1999. For the first nine months of 2000, our GAAP earnings of $1.27 per share exceeded our GAAP earnings of $.045 per share for the first nine months of 1999.

Core earnings equal GAAP earnings less the earnings effect of the market value changes of our assets less the effect of closed business units' operations. While reported GAAP earnings are important, we believe core earnings provide an alternative measure of our on-going cash flow generation and dividend-paying ability.

Core earnings of $0.45 per share in the third quarter of 2000 exceeded by 32% the $0.34 per share of core earnings we generated in the third quarter of 1999. Third quarter 2000 core earnings were, however, somewhat lower than the $0.51 per share of core earnings we generated in the second quarter of 2000.

The table below reconciles core earnings to reported GAAP earnings.

<TABLE>
<CAPTION>

	THIRD QUARTER 2000	SECOND QUARTER 2000	THIRD QUARTER 1999	FIRST NINE MONTHS 2000	FIRST NINE MONTHS 1999
			(DOLLARS IN THOUSANDS)		
<S>	<C>	<C>	<C>	<C>	<C>
Core Earnings...........................	$3,951	$ 4,495	$ 3,181	$12,984	$12,368
Market Value Changes....................	927	(1,452)	(2,074)	(1,689)	1,507
Closed Business Units...................	0	43	(4,845)	(46)	(9,250)
Reported GAAP Earnings..................	$4,878	$ 3,086	$(3,738)	$11,249	$ 4,625
PER SHARE					
Core Earnings...........................	$ 0.45	$ 0.51	$ 0.34	$ 1.46	$ 1.22
Market Value Changes....................	$ 0.10	$ (0.16)	$ (0.22)	$ (0.19)	$ 0.14
Closed Business Units...................	$ 0.00	$ 0.00	$ (0.51)	$ (0.00)	$ (0.91)
Reported GAAP Earnings..................	$ 0.55	$ 0.35	$ (0.39)	$ 1.27	$ 0.45

</TABLE>

Net Interest Income

The net interest income we generated from our real estate assets was $7.2 million in the third quarter of 2000. For the same quarter in 1999, we earned $6.7 million. In second quarter of 2000, we earned $8.0 million. Net interest income is interest income less interest expense and interest rate agreement hedging expenses.

A key ratio we monitor is annualized net interest income as a percentage of total equity. This was 13.9% in the third quarter of 2000, 11.5% in the third quarter of 1999, and 15.4% in each of the first two quarters of 2000.

Net interest income earnings improved from the third quarter of 1999 compared to the third quarter of 2000 due to an increase in capital utilization and an increase in interest rates. With our capital more fully utilized, we were able to carry a greater amount of assets. Average earning assets increased from $2.0 billion to $2.2 billion during this period. Due to rising short-term interest rates, both the yield on our assets and our cost of borrowed funds increased by approximately 1% over the last year. This was positive for our net interest income earnings during the third quarter as the amount of our assets exceeds our liabilities by $0.2 billion.

Net interest income earnings decreased somewhat from the second to the third quarter of 2000 largely due to an increase in premium amortization expense associated with an increase in mortgage prepayment rates. Our average annual prepayment rate was 17% in the second quarter and 21% in the third quarter. Prepayment rates typically increase in the summer months. Additional factors effecting net interest income from quarter to quarter were an increase in our cost of borrowed funds due to increases in short-term interest rates and a slight decrease in average earning assets.

<TABLE>
<CAPTION>

	THIRD QUARTER 2000	SECOND QUARTER 2000	THIRD QUARTER 1999	FIRST NINE MONTHS 2000	FIRST NINE MONTHS 1999
			(DOLLARS IN THOUSANDS)		
<S>	<C>	<C>	<C>	<C>	<C>
Mortgage Coupon Interest.....	$ 42,967	$ 43,048	$ 35,337	$ 129,445	$ 117,064
Premium Amortization.........	$ (1,048)	$ 88	$ (782)	$ (1,452)	$ (4,687)
Interest Income..............	$ 41,919	$ 43,136	$ 34,555	$ 127,993	$ 112,377
Interest Expense.............	$ (34,502)	$ (34,914)	$ (27,390)	$ (103,938)	$ (84,418)
Interest Rate Agree Exp......	(192)	(219)	(457)	(819)	(1,527)
Net Interest Income..........	$ 7,225	$ 8,003	$ 6,708	$ 23,236	$ 21,432
Ave. Earning Assets..........	$2,182,990	$2,278,670	$2,049,750	$2,273,825	$2,241,853
Ave. Coupon Rate.............	7.83%	7.53%	6.88%	7.57%	6.91%
Prepayment Rate..............	21%	17%	25%	18%	29%
Ave. Asset Yield.............	7.65%	7.54%	6.66%	7.47%	6.58%
Ave. Borrowings..............	$2,018,844	$2,123,927	$2,197,900	$2,113,212	$2,111,279
Cost of Funds and Hedging....	6.88%	6.62%	5.90%	6.61%	5.74%
Interest Rate Spread.........	0.78%	0.93%	0.76%	0.86%	0.84%
Net Interest Margin..........	1.29%	1.36%	1.26%	1.33%	1.21%
Ave. Total Equity............	$ 213,341	$ 213,147	$ 234,579	$ 213,426	$ 243,068
Net Int. Inc. to Equity......	13.9%	15.4%	11.5%	14.8%	11.8%

</TABLE>

Provision for Credit Losses

Our provision for credit loss expense was $0.2 million in the third quarter of 2000. This was a lower expense than the $0.5 million provision we took in the third quarter of 1999 and slightly higher than the $0.1 million provision we took in the second quarter of 2000. Credit provision expenses were $0.5 million for the first nine months of 2000 and $1.1 million for the first nine months of 1999.

We have reduced our credit provision expenses because our actual losses have been quite low and delinquencies are declining. We had no actual loan losses in the third quarter of 2000. Actual loan losses were $37,000 in the second quarter of 2000 and $71,000 in the third quarter of 1999. Actual loan losses were $37,000 for the first nine months of 2000 and $56,000 for the first nine months of 1999. Our credit reserve at September 30, 2000 was $6.0 million.

We would expect our credit provision expenses to increase if we acquire or originate a significant volume of new mortgage loans or if our delinquencies and actual credit losses increased.

Net Unrealized and Realized Market Value Gains and Losses

We recognize in our reported earnings the quarterly changes in the estimated market value of some of our assets. For the most part, these are unrealized gains and losses. Earnings from market value changes were $0.9 million in the third quarter of 2000 and negative $2.1 million in the third quarter of 1999. For the first nine months of 2000, earnings from market value changes were negative $1.7 million and for the first nine months of 1999, earnings from market value changes were $1.5 million.

Operating Expenses

Total operating expenses recognized at Redwood were $2.1 million in the third quarter of 2000, $2.2 million in the second quarter of 2000, and $1.0 million in the third quarter of 1999. Due to changes in amounts of expense allocated and recognized between Redwood and Holdings, we believe a more useful number for understanding trends in operating expenses is the total operating expenses of Redwood and Holdings combined. Combined operating expenses were $2.6 million in the third quarter of 2000, $2.8 million in the second quarter of 2000, and $5.0 million in the third quarter of 1999.

<TABLE>
<CAPTION>

	THIRD QUARTER 2000	SECOND QUARTER 2000	THIRD QUARTER 1999	FIRST NINE MONTHS 2000	FIRST NINE MONTHS 1999
			(DOLLARS IN THOUSANDS)		
<S>	<C>	<C>	<C>	<C>	<C>
Redwood Operating Expenses.............	$(2,066)	$(2,239)	$ (964)	$(6,450)	$ (2,617)
Holdings Operating Expenses............	(531)	(584)	(4,005)	(1,967)	(11,397)
Combined Operating Expenses............	$(2,597)	$(2,823)	$(4,969)	$(8,417)	$(14,014)
On-going Operating Expenses............	$(2,597)	$(2,838)	$(2,727)	$(8,244)	$ (6,570)
Closed Business Units Operating Expenses............................	(0)	15	(2,242)	(173)	(7,444)
Combined Operating Expenses............	$(2,597)	$(2,823)	$(4,969)	$(8,417)	$(14,014)

</TABLE>

Some of these expenses were associated with business units that have been closed. Combined operating expenses for on-going operations were $2.6 million in the third quarter of 2000, $2.8 million in the second quarter of 2000, and $2.7 million in the third quarter of 1999. Expenses are slightly lower in the third quarter of 2000 as we have fewer employees. These savings were partially offset by increased dividend equivalent rights payments to employees as a result of our increasing dividend. Due to the increase in dividend rates and an increase in the bonuses accrued (which are performance-based), our operating expenses from on-going operations increased to $8.2 million in the first nine months of 2000 from the $6.6 million of expenses in the first nine months of 1999.

Equity in Earnings (Losses) of RWT Holdings, Inc.

In the third quarter of 2000, our share of the losses generated by Holdings was $0.3 million. This accounting loss at Holdings' subsidiary RCF is not representative of the profitability of our overall commercial operations because it does not include related income recorded at Redwood.

In the second quarter of 2000, our share of the losses generated by Holdings was $0.5 million. In the third quarter of 1999, we recognized losses from Holdings of $6.4 million, which included losses and restructuring charges from the operations of two subsidiaries that were shut down.

In the first nine months of 2000, our share of the losses generated by Holdings was $1.4 million. In the first nine months of 1999, our share of losses from Holdings was $12.6 million.

We refer you to Holdings' "Consolidated Financial Statements and Notes" and

Holdings' "Management's Discussion and Analysis" below for more information on Holdings.

Net Income

For the quarter ended September 30, 2000, net income from all of our operations was $5.6 million. After preferred dividends of $0.7 million, net income available to common shareholders was $4.9 million. For the quarter ended June 30, 2000, net income from all of our operations was $3.8 million. After preferred dividends of $0.7 million, net income available to common stockholders was $3.1 million. For the quarter ended September 30, 1999, net income from all of our operations was negative $3.0 million. After preferred dividends of $0.7 million, net income available to common stockholders was negative $3.7 million.

For the first nine months of 2000, net income from all of our operations was $13.2 million. After preferred dividends of $2.0 million, net income available to common stockholders was $11.2 million. For the first nine months of 1999, net income from all our operations was $6.7 million. After preferred dividends of $2.1 million, net income available to common shareholders was $4.6 million.

Earnings per Share

Average diluted common shares outstanding were 8.9 million for the quarter ended September 30, 2000, 8.9 million for the quarter ended June 30, 2000, and 9.6 million for the third quarter of 1999. Shares outstanding declined as a result of our common stock repurchase program. We repurchased 2.5 million shares during 1999. We did not acquire any of our own shares in the first nine months of 2000.

Reported earnings per share were $0.55 for the third quarter of 2000, $0.35 for second quarter of 2000, and negative $0.39 for third quarter of 1999.

Reported earnings per share for the first nine months of 2000 were $1.27, as compared to reported earnings per share of $0.45 per share for the first nine months of 1999. Average diluted common shares outstanding were 8.9 million in the first nine months of 2000 as compared to 10.2 million in the first nine months of 1999.

Core earnings equal reported earnings less the earnings effect of the market value changes of our assets less the effect of closed business units' operations. Core earnings per share were $0.45 in the third quarter of 2000, $0.51 in the second quarter of 2000, and $1.46 for the first nine months of 2000.

Core earnings per share were $0.34 in the third quarter of 1999 and $1.22 for the first nine months of 1999.

Dividends

We declared common stock dividends of $0.42 per share for the quarter ended September 30, 2000 and $0.40 per share for the quarter ended March 31, 2000. For the first nine months of 2000, common dividends declared totaled $1.17 per share. Common dividends of $0.15 per share were declared in the third quarter of 1999, and this represented the first dividend declared in 1999.

We continue to pay a quarterly dividend on our preferred stock of $0.755 per share.

RISK MANAGEMENT

We seek to manage the interest rate, market value, liquidity, prepayment, and credit risks inherent in all financial institutions in a prudent manner designed to insure our longevity. At the same time, we endeavor to provide our shareholders an opportunity to realize an attractive total rate of return through stock ownership in our company. We seek, to the best of our ability, to only assume risk that can be quantified from historical experience, to actively manage such risk, to earn sufficient compensation to justify the taking of such risks, and to maintain capital levels consistent with the risks we do undertake.

Market Value Risk

The market value of our assets can fluctuate due to changes in interest rates, prepayment rates, liquidity, financing, supply and demand, credit, and other factors. These fluctuations affect our reported earnings.

At September 30, 2000, we owned mortgage securities and loans totaling $1.0 billion that we account for on a mark-to-market basis (in the case of mortgage loans, on a lower-of-cost-or-market basis) for purposes of determining reported earnings. Of these assets, 98% had adjustable-rate coupons and 2% had fixed-rate coupons.

Our interest rate agreements hedging program may offset some asset market value fluctuations due to interest rate changes, or, in some cases, may exacerbate such fluctuations. All of our $2.3 billion in notional amounts of interest rate agreements are marked-to-market for income statement purposes.

Market value fluctuations of assets and interest rate agreements, especially to the extent assets are funded with short-term borrowings, can also affect our access to liquidity.

Interest Rate Risk

At September 30, 2000, we owned $2.2 billion of assets and had $2.0 billion of liabilities. The majority of the assets were adjustable-rate, as were a majority of the liabilities.

On average, our cost of funds has the ability to rise or fall more quickly as a result of changes in short-term interest rates than does the earning rate on our assets. In addition, in the case of a large increase in short-term interest rates, periodic and lifetime caps for a portion of our assets could limit increases in interest income. The risk of reduced earnings in a rising interest rate environment may be mitigated to some extent by our interest rate agreements hedging program and by any concurrent slowing of mortgage prepayment rates that may occur.

Hybrid mortgage assets (with fixed-rate coupons for 3 to 7 years and adjustable-rate coupons thereafter) totaled $0.3 billion. We had debt with interest rate reset characteristics matched to the hybrid mortgages totaling $0.3 billion.

Our net income may vary somewhat as the yield curve between one-month interest rates and six- and twelve-month interest rates vary.

At September 30, 2000, we owned $0.6 billion of adjustable-rate mortgage assets with interest rates that adjust every six months as a function of six-month LIBOR interest rates funded with equity and with debt that had an interest rate that adjusts monthly as a function of one-month LIBOR interest rates.

At September 30, 2000, we owned $0.5 billion of adjustable-rate mortgage assets that adjust monthly as a function of one-month LIBOR interest rates, funded with equity and with debt that also adjusts monthly as a function of one-month LIBOR interest rates.

Adjustable-rate assets with earnings rates dependent on one-year U.S. Treasury rates with annual adjustments totaled $0.7 billion at September 30, 2000. These Treasury-based assets were effectively funded with equity and with $0.3 billion of liabilities with a cost of funds dependent on one-year U.S. Treasury rates with annual adjustments. The remainder of associated liabilities had a cost of funds dependent on one-month LIBOR rates or the daily Fed Funds rate. To the extent our Treasury-based assets are not funded with Treasury-based liabilities, we incur basis risk. Such risk arises because changes in Treasury rates may differ significantly from changes in the Fed Funds or LIBOR interest rates.

Interest rates and related factors can affect our spread income and our mark to market results. Changes in interest rates also affect prepayment rates (see below) and influence other factors that may affect our results.

Liquidity Risk

Our primary liquidity risk arises from financing long-maturity mortgage assets with short-term debt. Even if the interest rate adjustments of these assets and liabilities are well matched, maturities may not be matched. In addition, trends in the liquidity of the U.S. capital markets in general may affect our ability to rollover short-term debt.

The assets that we pledge to secure short-term borrowings are generally high-quality, liquid assets. As a result, we have not had difficulty refinancing our short-term debt as it matures, even during the financial market liquidity crisis in late 1998. Still, changes in the market values of our assets, in our perceived credit worthiness, in lender over-collateralization requirements, and in the capital markets can impact our access to liquidity.

At September 30, 2000, we had $65 million of highly liquid assets which were unpledged and available to meet margin calls on short-term debt that could be caused by asset value declines or changes in lender over-collateralization requirements. These assets consisted of unrestricted cash and unpledged "AAA" rated mortgage securities. Total available liquidity, including unrestricted cash, equaled 8% of our short-term debt balances.

At September 30, 2000, we had four committed lines of short-term financing, two for residential and two for commercial mortgage loans, with an additional residential line to become committed in October 2000.

There are certain restrictions regarding the collateral for which these lines can be used, but they generally allow us to fund either our commercial mortgage originations or our lower-rated residential mortgage-backed securities. There is no assurance that we will be able to renew such lines upon expiration. We believe we have many alternative uncommitted financing sources available to us for our residential loan acquisitions. We continue to pursue additional sources of financing in order to enhance the liquidity of our portfolio.

Prepayment Risk

As we receive repayments of mortgage principal, we amortize into income our mortgage premium balances as an expense and our mortgage discount balances as income. Mortgage premium balances arise when we acquire mortgage assets at a price in excess of the principal value of the mortgages. Premium balances are also created when an asset appreciates and is marked-to-market at a price above par. Mortgage discount balances arise when we acquire mortgage assets at a price below the principal value of the mortgages, or when an asset depreciates in market value and is marked-to-market at a price below par. At September 30, 2000, mortgage premium balances were $25.8 million and mortgage discount balances were $37.7 million. Net mortgage discount was $11.9 million. Since the prepayment characteristics of our premium and discount mortgage assets may vary, gross premium levels, net premium levels, and other factors may influence our earnings.

Sequoia's long-term debt has associated deferred bond issuance costs. These capitalized costs are amortized as an expense as the bonds are paid off with mortgage principal receipts. These deferred costs totaled $3.4 million at September 30, 2000. In addition, premium received from the issuance of bonds at prices over principal value is amortized as income as the bond issues pay down. These balances totaled $3.2 million at September 30, 2000. The combined effect of these two items was to increase our effective mortgage-related premium by $0.2 million.

Our net discount at September 30, 2000 for assets and liabilities affected by the rate of mortgage principal receipts was $11.7 million. This net discount equaled 6.4% of common equity. Amortization expense and income will vary as prepayment rates on mortgage assets vary. In addition, changes in prepayment rates will affect the market value of our assets and our earnings.

Credit Risk

Our principal credit risk comes from residential mortgage loans owned by Sequoia, residential and commercial mortgage loans held in portfolio, commercial mortgage loans held prior to sale, and our lower-rated mortgage securities. We also have credit risk with counter-parties with whom we do business.

Not including mortgage loans owned by Sequoia, we owned $7.3 million in residential mortgage loans at September 30, 2000. Of these, $0.3 million were seriously delinquent (delinquent over 90 days, in foreclosure, in bankruptcy, or real estate owned). We also owned $32.3 million in commercial mortgage loans. These commercial mortgage loans were all current at September 30, 2000.

The four Sequoia trusts owned $1.2 billion in residential mortgage loans at September 30, 2000. Our total credit risk from these trusts is limited to our equity investment in these trusts. These equity investments had a reported value of $38 million, net of related credit reserves, at September 30, 2000. At that time, $4.1 million of the underlying loans, or 0.34%, were seriously delinquent.

At September 30, 2000, we had $5.6 million of credit reserves to provide for potential future credit losses from our mortgage loans held for investment by the Sequoia trusts. The reserve is based upon our assessment of various factors affecting our mortgage loans, including current and projected economic conditions, delinquency status, and credit protection. To date, our realized credit losses from defaulted residential mortgage loans have averaged 9% of the loan balance of the defaulted loans. Delinquencies, defaults, and loss severities may increase in the future, however, particularly if real estate values decline or the general U.S. economy weakens. We believe our current level of reserve and credit provision policy is reasonable.

At September 30, 2000, we also held $0.4 million credit reserves against our SMFC re-REMIC securities. Our total potential credit exposure from these securities (after this credit reserve) is our net cost basis of $6.1 million.

We have purchased, and intend to continue purchasing, mortgage-backed securities that have risk of credit loss. In acquiring such assets, we project cash flows and resulting yields in a variety of potential loss scenarios as well as other factors (e.g., interest rates, prepayment speeds.) We calculate and book as income an effective yield on such assets after factoring in anticipated losses. Once acquired, we continually monitor and review credit performance and may revise our projected losses on each asset. Should projected credit losses change, the effective yield earned over the remaining life of these assets will change accordingly.

It should be noted that the establishment of a credit reserve for GAAP purposes does not reduce our taxable income or our dividend payment obligations as a REIT. For taxable income, credit expenses are recognized as incurred, and may have the effect of reducing taxable income and our minimum dividend payment obligation at that point.

Capital Risk

Our capital levels, and thus our access to borrowings and liquidity, may be tested, particularly if the market value of our assets securing short-term borrowings declines.

Through our risk-adjusted capital policy, we assign a guideline capital adequacy amount, expressed as a guideline equity-to-assets ratio, to each of our mortgage assets. For short-term funded assets, this ratio will fluctuate over time, based on changes in that asset's credit quality, liquidity characteristics, potential for market value fluctuation, interest rate risk, prepayment risk, and the over-collateralization requirements for that asset set by our collateralized short-term lenders. Capital requirements for residential mortgage securities rated below AA and commercial mortgage whole loans are generally higher than for higher-rated residential securities and residential whole loans. Capital requirements for these less-liquid assets depend chiefly on our access to secure funding for these assets, the number of sources of such funding, the funding terms, and on the amount of extra capital we decide to hold on hand to protect against possible liquidity events with these assets. Capital requirements for equity interests in Sequoia generally equal our net investment. The sum of the capital adequacy amounts for all of our mortgage assets is our aggregate guideline capital adequacy amount.

Generally, our total guideline equity-to-assets ratio capital amount has declined over the last few years as we have eliminated some of the risks of short-term debt funding through issuing long-term debt. In the most recent quarters, however, the guideline ratio has increased as we have acquired new types of assets requiring more capital, such as commercial mortgage loans and lower-rated mortgage securities.

We do not expect that our actual capital levels will always exceed the guideline amount. If interest rates were to rise in a significant manner, our capital guideline amount may rise, as the potential interest rate risk of our mortgages would increase, at least on a temporary basis, due to periodic and life caps and slowing prepayment rates. We measure all of our mortgage assets funded with short-term debt at estimated market value for the purpose of making risk-adjusted capital calculations. Our actual capital levels, as determined for the risk-adjusted capital policy, would likely fall as rates increase as the market values of our mortgages, net of mark-to-market gains on hedges, decreased. (Such market value declines may be temporary as well, as future coupon adjustments on adjustable-rate mortgage loans may help to restore some of the lost market value.)

In this circumstance, or any other circumstance in which our actual capital levels decreased below our capital adequacy guideline amount, we would generally cease the acquisition of new mortgage assets until capital balance was restored through prepayments, interest rate changes, or other means. In certain cases prior to a planned equity offering or other circumstances, the Board of Directors has authorized management to acquire mortgage assets in a limited amount beyond the usual constraints of our risk-adjusted capital policy.

Growth in assets and earnings may be limited when our access to new equity capital is limited. Holdings can benefit over time from the re-investment of retained earnings at Holdings. Our real estate finance operation, however, is generally required to distribute at least 95% of taxable income as dividends due to its REIT status.

Inflation Risk

Virtually all of our assets and liabilities are financial in nature. As a result, interest rates, changes in interest rates and other factors drive our performance far more than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates.

Our financial statements are prepared in accordance with GAAP and our dividends must equal at least 95% of our net income as calculated for tax purposes. In each case, our activities and balance sheet are measured with reference to historical cost or fair market value without considering inflation.

RWT HOLDINGS, INC.

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

OVERVIEW

RWT Holdings, Inc. ("Holdings") was incorporated in Delaware in February 1998 and commenced operations on April 1, 1998. Holdings' start-up operations have been funded by Redwood Trust, which has a significant investment in Holdings through the ownership of all of Holdings' non-voting preferred stock, and by Redwood Trust's senior management, who own Holding's voting common stock. We refer you to "Note 1. The Company" in the Notes to the Consolidated Financial Statements of RWT Holdings, Inc. and Subsidiaries for additional information on Holdings' initial capitalization.

Holdings originates commercial mortgage loans for sale to institutional investors (including Redwood Trust) through its Redwood Commercial Funding, Inc. ("RCF") subsidiary. Holdings had two other operating businesses, Redwood Financial Services, Inc. ("RFS") and Redwood Residential Funding ("RRF"). Due to a variety of start-up difficulties with these units, operations were closed at RFS in the third quarter of 1999 and at RRF in the fourth quarter of 1999.

For reporting purposes, some of RCF's commercial operations take place at Redwood Trust. Therefore, the reported earnings of Holdings' subsidiary RCF are not representative of the profitability of our overall commercial operations because it does not include related income recorded at Redwood Trust.

With a change in REIT tax rules, Redwood Trust intends to seek to acquire the common stock of Holdings, representing a 1% economic interest, in January 2001. If accomplished, the preferred stock would be converted to common stock and Redwood Trust would own 100% of Holdings. This would allow us to consolidate our financial statements for GAAP. The two companies would continue to be operated separately for tax purposes.

FINANCIAL CONDITION

At September 30, 2000, Holdings owned $32.3 million of commercial mortgage loans. Holdings also had $1.4 million in unrestricted cash, $1.4 million in restricted cash, $0.3 million of accrued interest receivable, and $0.3 million in other assets, for total assets of $35.8 million. Holdings had commitments to acquire $22.7 million of commercial mortgage loans from Redwood Trust for settlement during the fourth quarter of 2000. Holdings intends to sell all $55.0 million of commercial loans within six months. Some of these loans may be sold to Redwood Trust for its portfolio.

The loans owned by Holdings were funded with short-term borrowings and equity. Short-term debt was $30.9 million, accrued restructuring charges were $0.9 million, holdback accounts totaled $1.3 million, and other liabilities totaled $0.7 million, for total liabilities of $33.7 million. Redwood Trust expects to continue to provide liquidity to Holdings, when necessary, during the year 2000. Holdings' total equity at September 30, 2000 was $2.0 million.

At December 31, 1999, Holdings owned $4.4 million of residential mortgage loans, $29.6 million of commercial mortgage loans, $2.0 million in cash, and $1.3 million in other assets, for total assets of $39.0 million. Short-term debt totaled $22.4 million, loans from Redwood Trust totaled $6.5 million, receivables due Redwood Trust were $0.5 million, accrued restructuring charges totaled $4.0 million, other liabilities were $2.1 million, and total equity totaled $3.4 million.

RESULTS OF OPERATIONS

For the quarter ended September 30, 2000, Holdings' operations consisted almost entirely of RCF. Net interest income for Holdings was $0.3 million, including interest income of $1.1 million and interest expense of $0.8 million. Holdings had net gains on sales of $0.1 million during the third quarter of 2000, resulting in net

revenues of $0.2 million. Operating expenses at Holdings totaled $0.5 million for the three months ended September 30, 2000. Holdings' net loss for the quarter ended September 30, 2000 was $0.3 million.

In the third quarter of 2000, RCF originated $16.8 million of commercial mortgage loans and sold $13.1 million, of which $10.1 million was sold to Redwood's portfolio. At September 30, 2000, commercial mortgage loans originated or acquired by RCF that had not yet been sold totaled $55.0 million, of which $22.7 million were held by Redwood Trust and $32.3 million were held at Holdings. These loans are all held for future sale. RCF expects to recognize sale revenues upon the sale of the commercial loan portfolio.

For the quarter ended June 30, 2000, Holdings' net interest income for Holdings was $0.2 million, including interest income of $0.7 million and interest expenses of $0.5 million. Holdings also had net losses as a result of mortgage asset sales and market value adjustments of $0.1 million during the second quarter of 2000, resulting in net revenues of $0.1 million. Operating expenses at Holdings totaled $0.6 million for this quarter. Holdings' net loss for the quarter ended June 30, 2000 was $0.5 million.

For the quarter ended September 30, 1999, net interest income for Holdings was $0.4 million, including interest income of $1.2 million and interest expense of $0.9 million. Holdings also had net losses as a result of commercial and residential mortgage loan sales and market value adjustments of $0.5 million during the third quarter of 1999, resulting in net revenues of negative $0.1 million. Operating expenses at Holdings totaled $4.0 million for the third quarter of 1999 and there was a $2.2 million restructuring charge. Holdings' net loss for the quarter ended September 30, 1999 was $6.4 million.

In the first nine months of 2000, Holdings generated net income of $0.5 million on $2.3 million of interest income and $1.8 million of interest expenses. Holdings also had net gains as a result of mortgage asset sales and market value adjustments of $0.1 million during the first nine months of 2000, resulting in net revenues of $0.6 million. Operating expenses totaled $2.0 million, resulting in net losses of $1.4 million being recorded at Holdings during the first nine months of 2000.

In the first nine months of 1999, Holdings generated net income of $0.9 million on $2.7 million of interest income and $1.8 million of interest expenses. Holdings also had net gains as a result of mortgage asset sales and market value adjustments of $0.1 million during the first nine months of 1999, resulting in net revenues of $1.0 million. Operating expenses totaled $11.5 and there was a $2.2 million restructuring charge, resulting in net losses of $12.7 million being recorded at Holdings during the first nine months of 1999.

Holdings' losses in the 1999 were mostly associated with operations that were subsequently shut-down in the third and fourth quarter of 1999.

At December 31, 1999, Holdings had net operating loss carryforwards of approximately $19.5 million for federal tax purposes and $9 million for state income tax purposes. The federal carryforwards expire through 2019 and the state carryforwards expire through 2004. We have established a reserve related to the net operating loss carryforwards, as we do not believe this asset is realizable.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

At September 30, 2000, there were no pending legal proceedings to which the Company was a party or of which any of its property was subject.

ITEM 2. CHANGES IN SECURITIES

Not applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit 11.1 to Part I -- Computation of Earnings Per Share for the three and nine months ended September 30, 2000 and September 30, 1999.

Exhibit 27 -- Financial Data Schedule

(b) Reports

None

SIGNATURES

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

REDWOOD TRUST, INC.

Dated: November 10, 2000 By: /s/ DOUGLAS B. HANSEN

Douglas B. Hansen
President
(authorized officer of registrant)

Dated: November 10, 2000 By: /s/ HAROLD F. ZAGUNIS

Harold F. Zagunis
Vice President, Chief Financial Officer
Secretary, Treasurer and Controller
(principal financial and accounting officer)

REDWOOD TRUST, INC.
INDEX TO EXHIBIT

<TABLE>
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27	Financial Data Schedule	52

</TABLE>

EXHIBIT 11.1

REDWOOD TRUST, INC.
STATEMENT RE: COMPUTATION OF PER SHARE EARNINGS

	Three Months Ended September 30, 2000	Nine Months Ended September 30, 2000
BASIC:		
Average common shares outstanding	8,789,966	8,788,127
Total	8,789,966	8,788,127
Net Income	$ 4,878,324	$11,248,733
Per Share Amount	$ 0.55	$ 1.28
DILUTED:		
Average common shares outstanding	8,789,966	8,788,127
Net effect of dilutive stock options outstanding during the period -- based on the treasury stock method	118,433	90,252
Total	8,908,399	8,878,379
Net Income	$ 4,878,324	$11,248,733
Per Share Amount	$ 0.55	$ 1.27

REDWOOD TRUST, INC.
STATEMENT RE: COMPUTATION OF PER SHARE EARNINGS

	Three Months Ended September 30, 1999	Nine Months Ended September 30, 1999
BASIC:		
Average common shares outstanding	9,481,418	10,090,305
Total	9,481,418	10,090,305
Net Income	($3,738,178)	$ 4,625,047
Per Share Amount	$ (0.39)	$ 0.46
DILUTED:		
Average common shares outstanding	9,481,418	10,090,305
Net effect of dilutive stock options outstanding during the period -- based on the treasury stock method	89,513	99,320
Total	9,570,931	10,189,625
Net Income	($3,738,178)	$ 4,625,047

Per Share Amount	$ (0.39)	$ 0.45

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM SEPTEMBER 30, 2000 QUARTERLY REPORT ON FORM 10-Q.

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<EPS-BASIC>	.55
<EPS-DILUTED>	.55

</TABLE>