UNITED STATES OF AMERICA
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended: September 30, 2011

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	**68-0329422**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
One Belvedere Place, Suite 300 **Mill Valley, California**	**94941**
(Address of Principal Executive Offices)	(Zip Code)

(415) 389-7373

(Registrant's Telephone Number, Including Area Code)

Not Applicable

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

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

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

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐

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

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

Common Stock, $0.01 par value per share	78,686,426 shares outstanding as of November 2, 2011

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2011 FORM 10-Q REPORT

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

REDWOOD TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Data) (Unaudited)	September 30, 2011	December 31, 2010
ASSETS		
Residential real estate loans	$ 4,157,583	$ 3,797,095
Commercial real estate loans (includes $12,563 and $19,850 at fair value)	110,624	50,386
Real estate securities, at fair value:		
Trading securities	278,391	329,717
Available-for-sale securities	754,862	825,119
Total real estate securities	1,033,253	1,154,836
Other investments	—	—
Cash and cash equivalents	133,446	46,937
Total earning assets	5,434,906	5,049,254
Restricted cash	17,011	24,524
Accrued interest receivable	14,699	13,782
Derivative assets	2,718	8,051
Deferred tax asset	—	3,487
Deferred securities issuance costs	8,819	5,928
Other assets	76,180	38,662
Total Assets[(1)]	$ 5,554,333	$ 5,143,688
LIABILITIES AND EQUITY		
Liabilities		
Short-term debt	$ —	$ 44,137
Accrued interest payable	7,607	5,930
Derivative liabilities	127,220	83,115
Accrued expenses and other liabilities	8,413	14,305
Dividends payable	19,624	19,531
Asset-backed securities issued (includes $234,235 and $303,077 at fair value)	4,293,024	3,761,578
Long-term debt	139,500	139,500
Total liabilities[(2)]	4,595,388	4,068,096
Equity		
Common stock, par value $0.01 per share, 125,000,000 shares authorized; 78,494,886 and 78,124,668 issued and outstanding	785	781
Additional paid-in capital	1,695,642	1,689,851
Accumulated other comprehensive income	32,309	112,339
Cumulative earnings	503,841	474,940
Cumulative distributions to stockholders	(1,273,632)	(1,213,158)
Total stockholders' equity	958,945	1,064,753
Noncontrolling interest	—	10,839
Total equity	958,945	1,075,592
Total Liabilities and Equity	$ 5,554,333	$ 5,143,688

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(1) Our consolidated balance sheets include assets of consolidated variable interest entities (VIEs) that can only be used to settle obligations of these VIEs. At September 30, 2011 and December 31, 2010, these assets totaled $4,592,312 and $3,941,212, respectively.

(2) Our consolidated balance sheets include liabilities of consolidated VIEs for which creditors do not have recourse to the primary beneficiary (Redwood Trust, Inc.). At September 30, 2011 and December 31, 2010, these liabilities totaled $4,370,490 and $3,838,386, respectively.

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

REDWOOD TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In Thousands, Except Share Data) (Unaudited)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Interest Income				
Residential real estate loans	$ 20,192	$ 17,514	$ 57,564	$ 47,749
Commercial real estate loans	2,353	323	5,379	895
Real estate securities	30,845	41,083	97,703	125,439
Other investments	—	2	—	14
Cash and cash equivalents	6	93	38	204
Total interest income	53,396	59,015	160,684	174,301
Interest Expense				
Short-term debt	(78)	(2)	(267)	(38)
Asset-backed securities issued	(21,855)	(21,074)	(62,526)	(57,127)
Long-term debt	(2,384)	(2,619)	(7,130)	(5,875)
Total interest expense	(24,317)	(23,695)	(69,923)	(63,040)
Net Interest Income	29,079	35,320	90,761	111,261
Provision for loan losses	(3,978)	(2,436)	(8,367)	(16,233)
Market valuation adjustments	(12,365)	1,007	(25,164)	(11,193)
Other-than-temporary impairments[1]	(1,083)	(2,580)	(5,171)	(8,742)
Market valuation adjustments, net	(13,448)	(1,573)	(30,335)	(19,935)
Net Interest Income After Provision and Market Valuation Adjustments	11,653	31,311	52,059	75,093
Operating expenses	(11,507)	(12,245)	(35,107)	(40,778)
Realized gains on sales and calls, net	1,145	1,566	10,844	61,985
Net income before provision for income taxes	1,291	20,632	27,796	96,300
Provision for income taxes	(14)	(202)	(42)	(254)
Net income	1,277	20,430	27,754	96,046
Less: Net (loss) income attributable to noncontrolling interest	(20)	532	(1,147)	703
Net Income Attributable to Redwood Trust, Inc.	$ 1,297	$ 19,898	$ 28,901	$ 95,343
Basic earnings per common share	$ 0.01	$ 0.25	$ 0.35	$ 1.19
Diluted earnings per common share	$ 0.01	$ 0.25	$ 0.35	$ 1.18
Regular dividends declared per common share	$ 0.25	$ 0.25	$ 0.75	$ 0.75
Basic weighted average shares outstanding	78,470,625	77,901,970	78,275,796	77,794,106
Diluted weighted average shares outstanding	78,470,625	78,961,205	78,275,796	78,763,689

(1) For the three months ended September 30, 2011, other-than-temporary impairments were $1,372, of which $289 thousand were recognized in Accumulated Other Comprehensive Income. For the three months ended September 30, 2010, other-than-temporary impairments were $6,287, of which $3,707 were recognized in Accumulated Other Comprehensive Income.

For the nine months ended September 30, 2011, other-than-temporary impairments were $7,339, of which $2,168 were recognized in Accumulated Other Comprehensive Income. For the nine months ended September 30, 2010, other-than-temporary impairments were $16,988, of which $8,246 were recognized in Accumulated Other Comprehensive Income.

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

REDWOOD TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EQUITY AND COMPREHENSIVE INCOME

For the Nine Months Ended September 30, 2011

(In Thousands, Except Share Data) (Unaudited)	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income	Cumulative Earnings	Cumulative Distributions to Stockholders	Noncontrolling Interest	Total
	Shares	Amount						
December 31, 2010	78,124,668	$ 781	$1,689,851	$ 112,339	$ 474,940	$(1,213,158)	$ 10,839	$1,075,592
Net income (loss)	—	—	—	—	28,901	—	(1,147)	27,754
Net unrealized (loss) gain on available-for-sale securities	—	—	—	(47,049)	—	—	4,164	(42,885)
Reclassification of other-than-temporary impairments to net income	—	—	—	3,306	—	—	—	3,306
Net unrealized loss on interest rate agreements	—	—	—	(39,498)	—	—	—	(39,498)
Reclassification of unrealized loss on interest rate agreements to net income	—	—	—	3,211	—	—	—	3,211
Total other comprehensive loss				(80,030)				
Total comprehensive loss								(48,112)
Issuance of common stock:								
Dividend reinvestment & stock purchase plans	310,146	3	4,580	—	—	—	—	4,583
Employee stock purchase and incentive plans	282,458	3	(2,857)	—	—	—	—	(2,854)
Non-cash equity award compensation	—	—	6,764	—	—	—	—	6,764
Share repurchases	(222,386)	(2)	(2,696)	—	—	—	—	(2,698)
Distributions to noncontrolling interest, net	—	—	—	—	—	—	(14,112)	(14,112)
Common dividends declared	—	—	—	—	—	(60,474)	—	(60,474)
Deconsolidation elimination	—	—	—	—	—	—	256	256
September 30, 2011	78,494,886	$ 785	$1,695,642	$ 32,309	$ 503,841	$(1,273,632)	$ —	$ 958,945

For the Nine Months Ended September 30, 2010

(In Thousands, Except Share Data) (Unaudited)	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income	Cumulative Earnings	Cumulative Distributions to Stockholders	Noncontrolling Interest	Total
	Shares	Amount						
December 31, 2009	77,737,130	$ 777	$1,674,367	$ 64,860	$ 364,888	$(1,133,171)	$ 17,370	$ 989,091
Net income	—	—	—	—	95,343	—	703	96,046
Net unrealized gain on available-for-sale securities	—	—	—	15,090	—	—	2,044	17,134
Reclassification of other-than-temporary impairments to net income	—	—	—	9,695	—	—	—	9,695
Net unrealized loss on interest rate agreements	—	—	—	(31,451)	—	—	—	(31,451)
Reclassification of unrealized loss on interest rate agreements to net income	—	—	—	2,604	—	—	—	2,604
Total other comprehensive loss				(4,062)				
Total comprehensive gain								94,028
Issuance of common stock:								
Dividend reinvestment & stock purchase plans	194,017	3	2,995	—	—	—	—	2,998
Employee stock purchase and incentive plans	53,075	—	(156)	—	—	—	—	(156)
Non-cash equity award compensation	—	—	9,757	—	—	—	—	9,757
Distributions to noncontrolling interest, net	—	—	—	—	—	—	(8,998)	(8,998)
Common dividends declared	—	—	—	—	—	(59,929)	—	(59,929)
September 30, 2010	77,984,222	$ 780	$1,686,963	$ 60,798	$ 460,231	$(1,193,100)	$ 11,119	$1,026,791

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

REDWOOD TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands, Except Share Data) (Unaudited)	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Cash Flows From Operating Activities:		
Net income attributable to Redwood Trust, Inc.	$ 28,901	$ 95,343
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of premiums, discounts, and debt issuance costs, net	(24,618)	(25,508)
Depreciation and amortization of non-financial assets	768	624
Provision for loan losses	8,367	16,233
Non-cash equity award compensation	6,764	9,757
Market valuation adjustments, net	30,335	19,935
Realized gains on sales and calls, net	(10,844)	(61,985)
Net change in:		
Accrued interest receivable	(1,405)	3,967
Deferred tax asset	3,487	1,885
Other assets	(31,672)	(25,900)
Accrued interest payable	11,301	9,095
Accrued expenses and other liabilities	(5,892)	(56,398)
Net cash provided by (used in) operating activities	15,492	(12,952)
Cash Flows From Investing Activities:		
Purchases of loans held-for-investment	(724,950)	(300,211)
Principal payments on loans held-for-investment	282,126	260,493
Proceeds from sales of loans held-for-sale	1,857	—
Purchases of available-for-sale securities	(90,512)	(235,876)
Proceeds from sales of available-for-sale securities	72,666	248,491
Principal payments on available-for-sale securities	86,734	104,987
Purchases of trading securities	—	(17,137)
Proceeds from sales of trading securities	13,588	6,119
Principal payments on trading securities	43,104	45,067
Principal payments on other investments	—	12,513
Net decrease in restricted cash	7,513	70,178
Net cash (used in) provided by investing activities	(307,874)	194,624
Cash Flows From Financing Activities:		
Net repayments on short-term debt	(44,137)	—
Proceeds from issuance of asset-backed securities	884,771	211,178
Repurchase of asset-backed securities issued	—	(8,639)
Repayments on asset-backed securities issued	(350,246)	(330,864)
Deferred securities issuance costs	(4,598)	(1,667)
Net settlements of derivatives	(30,291)	(39,916)
Net proceeds from issuance of common stock	1,729	2,842
Net payments on repurchase of common stock	(2,696)	—
Dividends paid	(60,382)	(59,865)
Change in noncontrolling interests	(15,259)	(8,296)
Net cash provided by (used in) financing activities	378,891	(235,227)
Net increase (decrease) in cash and cash equivalents	86,509	(53,555)
Cash and cash equivalents at beginning of period	46,937	242,818
Cash and cash equivalents at end of period	$ 133,446	$ 189,263
Supplemental Disclosures:		
Cash paid for interest	$ 55,809	$ 51,807
Cash paid for taxes	$ 48	$ 186
Dividends declared but not paid at end of period	$ 19,624	$ 19,496
Transfers from real estate loans to real estate owned	$ 8,418	$ 13,658

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

REDWOOD TRUST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2011
(Unaudited)

Note 1. Redwood Trust

Redwood Trust, Inc., together with its subsidiaries (Redwood, we, or us), invests in, finances, and manages real estate assets. We invest in residential and commercial real estate loans and in asset-backed securities backed by real estate loans. We seek to invest in assets that have the potential to generate sufficient long-term cash flow returns to support our goal of distributing an attractive level of dividends per share to shareholders over time. For tax purposes, we are structured as a real estate investment trust (REIT).

Redwood was incorporated in the State of Maryland on April 11, 1994, and commenced operations on August 19, 1994. Our executive offices are located at One Belvedere Place, Suite 300, Mill Valley, California 94941.

Note 2. Basis of Presentation

The consolidated financial statements presented herein are at September 30, 2011 and December 31, 2010, and for the three and nine months ended September 30, 2011 and 2010. These consolidated financial statements have been prepared in conformity with generally accepted accounting principles (GAAP) in the United States of America — as prescribed by the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) — and using the Securities and Exchange Commission's (SEC) instructions to Form 10-Q. All amounts presented herein, except share data, are shown in thousands.

Organization

Our consolidated financial statements include the accounts of Redwood, its direct and indirect wholly-owned subsidiaries, and other entities in which we have a controlling financial interest. All significant intercompany balances and transactions have been eliminated. A number of Redwood's consolidated subsidiaries are qualifying REIT subsidiaries and the remainder are taxable subsidiaries. References to the Redwood REIT include Redwood and its qualifying REIT subsidiaries, excluding taxable subsidiaries.

We sponsor two securitization programs. Our Sequoia program is used for the securitization of residential mortgage loans. References to Sequoia refer collectively to all the consolidated Sequoia securitization entities. Our Acacia program was used for the securitization of mortgage-backed securities and other types of financial assets. References to Acacia refer collectively to all the consolidated Acacia securitization entities. We also consolidate the assets and liabilities of the resecuritization we engaged in during the third quarter of 2011.

Principles of Consolidation

We apply FASB guidance to determine whether we must consolidate transferred financial assets and variable interest entities (VIEs) for financial reporting purposes. We currently consolidate the assets and liabilities of the Sequoia and the Acacia securitization entities where we maintain a continuing involvement, as well as the resecuritization entity we engaged in during the third quarter of 2011. Each securitization entity is independent of Redwood and of each other and the assets and liabilities are not owned by and are not legal obligations of Redwood, although we are exposed to certain financial risks associated with our role as the sponsor or manager of these entities. Prior to the third quarter of 2011, we also consolidated the assets, liabilities, and noncontrolling interests of the Opportunity Fund (Fund).

For financial reporting purposes, the underlying loans and securities owned at the Sequoia, Acacia, and resecuritization entities are shown on our consolidated balance sheets under real estate loans and real estate securities, and the asset-backed securities (ABS) issued to third-parties by these entities are shown under ABS issued. In our consolidated statements of income, we record interest income on the loans and securities owned by consolidated Sequoia, Acacia, and resecuritization entities and interest expense on the ABS issued by these entities. Prior to the third quarter of 2011, the real estate securities owned at the Fund were shown on our consolidated balance sheets under real estate securities and the portion of the Fund owned by third-parties was shown under noncontrolling interest. In our consolidated statements of income, we recorded interest income on the securities owned at the Fund.

REDWOOD TRUST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2011
(Unaudited)

Note 2. Basis of Presentation – (continued)

See *Note 4* for further discussion on principles of consolidation.

Note 3. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements requires us to make a number of significant estimates. These include estimates of fair value of certain assets and liabilities, amount and timing of credit losses, prepayment rates, and other estimates that affect the reported amounts of certain assets and liabilities as of the date of the consolidated financial statements and the reported amounts of certain revenues and expenses during the reported period. It is likely that changes in these estimates (e.g., valuation changes due to supply and demand, credit performance, prepayments, interest rates, or other reasons) will occur in the near term. Our estimates are inherently subjective in nature and actual results could differ from our estimates and the differences could be material.

Fair Value Measurements

Our financial statements include assets and liabilities that are measured at their estimated fair values in accordance with GAAP. A fair value measurement represents the price at which an orderly transaction would occur between willing market participants at the measurement date. We develop fair values for financial assets or liabilities based on available inputs and pricing that is observed in the marketplace. Examples of market information that we attempt to obtain include the following:

- Quoted prices for the same or similar securities;
- Relevant reports issued by analysts and rating agencies;
- The current level of interest rates and any directional movements in relevant indices, such as credit risk indices;
- Information about the performance of the underlying mortgage loans, such as delinquency and foreclosure rates, loss experience, and prepayment rates;
- Indicative prices or yields from broker/dealers; and,
- Other relevant observable inputs, including nonperformance risk and liquidity premiums.

After considering all available indications of the appropriate rate of return that market participants would require, we consider the reasonableness of the range indicated by the results to determine an estimate that is most representative of fair value.

The markets for many of the real estate securities that we invest in and issue are generally illiquid. Establishing fair values for illiquid assets and liabilities is inherently subjective and is often dependent upon our estimates and modeling assumptions. If we determine that either the volume and/or level of trading activity for an asset or liability has significantly decreased from normal market conditions, or price quotations or observable inputs are not associated with orderly transactions, the market inputs that we obtain might not be relevant. For example, broker or pricing service quotes might not be relevant if an active market does not exist for the financial asset or liability. The nature of the quote (for example, whether the quote is an indicative price or a binding offer) is also evaluated.

In circumstances where relevant market inputs cannot be obtained, increased analysis and management judgment are required to estimate fair value. This generally requires us to establish the use of our internal assumptions about future cash flows and appropriate risk-adjusted discount rates. Regardless of the valuation inputs we apply, the objective of fair value measurement is unchanged from what it would be if markets were operating at normal activity levels and/or transactions were orderly; that is, to determine the current exit price.

Note 3. Summary of Significant Accounting Policies – (continued)

See *Note 5* for further discussion on fair value measurements.

Fair Value Option

We have the option to measure eligible financial assets, financial liabilities, and commitments at fair value on an instrument-by-instrument basis. This option is available when we first recognize a financial asset or financial liability or enter into a firm commitment. Subsequent changes in the fair value of assets, liabilities, and commitments where we have elected the fair value option are recorded in our consolidated statements of income.

Our decision to apply the fair value option for new financial instruments is generally based upon our funding strategy for the specific financial asset acquired. For example, securities that we anticipate funding with equity will generally be accounted for as available-for-sale (AFS) securities. Securities that we anticipate funding with a combination of debt and equity or those financed through the issuance of asset-backed liabilities will generally be accounted for in a manner consistent with the associated liabilities. Additionally, we may elect to apply the fair value option for financial instruments that may not perform similarly to our traditional real estate investments or are particularly volatile or complex.

See *Note 5* for further discussion on the fair value option.

Real Estate Loans

Residential and Commercial Real Estate Loans — Fair Value

Residential and commercial real estate loans at fair value include loans where we have elected the fair value option. Coupon interest is recognized as revenue when earned and deemed collectible or until a loan becomes more than 90 days past due. Changes in fair value are recurring and are reported through our consolidated statements of income in market valuation adjustments, net.

Residential and Commercial Real Estate Loans — Held-for-Sale

Residential and commercial real estate loans held-for-sale include loans that we are marketing for sale to third-parties. These loans are carried at the lower of their cost or fair value, as measured on an individual basis. If the fair value of a loan held-for-sale is lower than its amortized cost basis, this difference is reported as a negative market valuation adjustment through our consolidated statements of income. Coupon interest for loans held-for-sale is recognized as revenue when earned and deemed collectible or until a loan becomes more than 90 days past due. Gains or losses on the sale of real estate loans are based on the specific identification method.

Residential and Commercial Real Estate Loans — Held-for-Investment

Real estate loans held-for-investment include residential real estate loans owned at Sequoia entities and residential and commercial real estate loans owned at Redwood. These loans are carried at their unpaid principal balances adjusted for net unamortized premiums or discounts and net of any allowance for loan losses. Coupon interest is recognized as revenue when earned and deemed collectible or until a loan becomes more than 90 days past due or when a loan has been individually impaired, at which point the loan is placed on nonaccrual status. Interest previously accrued for loans that have become greater than 90 days past due or individually impaired is reserved for in the allowance for loan losses. Loans delinquent more than 90 days or in foreclosure are characterized as seriously delinquent. Cash principal and interest that is advanced from servicers subsequent to a loan becoming greater than 90 days past due or individually impaired is used to reduce the outstanding loan principal balance. When a seriously delinquent loan previously placed on nonaccrual status has cured, meaning all delinquent principal and interest have been remitted by the borrower, the loan is placed back on accrual status. Loans that have been individually impaired are placed back on accrual status once the loan is considered reperforming.

Note 3. Summary of Significant Accounting Policies – (continued)

We use the interest method to determine an effective yield to amortize the premium or discount on real estate loans held-for-investment. For residential loans acquired prior to July 1, 2004, we use coupon interest rates as they change over time and anticipated principal payments to determine periodic amortization. For loans acquired after July 1, 2004, we use the initial coupon interest rate of the loans (without regard to future changes in the underlying indices) and anticipated principal payments, if any, to determine periodic amortization.

We reclassify loans held-for-investment as loans held-for-sale if we determine that these loans will be sold to third-parties. This may occur, for example, if we exercise our right to call ABS issued by a Sequoia securitization trust and decide to subsequently sell the underlying loans to third-parties.

See *Note 6* for further discussion on residential real estate loans. See*Note 7* for further discussion on commercial real estate loans.

Residential Real Estate Loans — Allowance for Loan Losses

For residential real estate loans classified as held-for-investment, we establish and maintain an allowance for loan losses based on our estimate of credit losses inherent in our loan portfolios at the reporting date. To calculate the allowance for loan losses, we assess inherent losses by determining loss factors (defaults, the timing of defaults, and loss severities upon defaults) that can be specifically applied to each of the consolidated loans or pools of loans.

We consider the following factors in evaluating the allowance for loan losses:

- Ongoing analyses of loans, including, but not limited to, the age of loans and year of origination, underwriting standards, business climate, economic conditions, and other observable data;
- Historical loss rates and past performance of similar loans;
- Relevant environmental factors;
- Relevant market research and publicly available third-party reference loss rates;
- Trends in delinquencies and charge-offs;
- Effects and changes in credit concentrations;
- Information supporting a borrower's ability to meet obligations;
- Ongoing evaluations of fair values of collateral using current appraisals and other valuations; and,
- Discounted cash flow analyses.

Once we determine the amount of defaults, the timing of the defaults, and severity of losses upon the defaults, we estimate expected losses for each individual loan or pool of loans over its expected life. We then estimate the timing of these losses and the losses probable to occur over an appropriate loss confirmation period. This period is defined as the range of time between the occurrence of a credit loss (such as the initial deterioration of the borrower's financial condition) and the confirmation of that loss (the actual impairment or charge-off of the loan). The losses expected to occur within the estimated loss confirmation period are the basis of our allowance for loan losses, since we believe these losses exist at the reported date of the financial statements. We re-evaluate the adequacy of our allowance for loan losses quarterly.

As part of the loss mitigation efforts undertaken by servicers of residential loans owned by Sequoia securitization entities, a growing number of loan modifications have been completed to help make mortgage loans more affordable for certain borrowers. Loan modifications may include, but are not limited to: (i) conversion of a floating rate mortgage loan into a fixed rate mortgage loan; (ii) reduction in the contractual

Note 3. Summary of Significant Accounting Policies – (continued)

interest rate of a mortgage loan; (iii) forgiveness of a portion of the contractual interest and/or principal amounts owed on a mortgage loan; and, (iv) extension of the contractual maturity of a mortgage loan. We evaluate all loan modifications performed by servicers to determine if they constitute troubled debt restructurings according to GAAP. If a loan is determined to be a troubled debt restructuring (TDR), it is removed from the general loan pools used for calculating allowances for loan losses and assessed for impairment on an individual basis based upon any adverse change in the expected future cash flows resulting from the modification. This difference is recorded to the provision for loan losses in our consolidated statements of income.

When foreclosed property is received in full satisfaction for a defaulted loan, we estimate the specific loan loss, if any, based on estimated net proceeds from the sale of the property (including accrued but unpaid interest and other costs) and charge this specific estimated loss against the allowance for loan losses. Foreclosed property is subsequently recorded as real estate owned (REO), a component of other assets on our consolidated balance sheets. Actual losses incurred on loans liquidated through a short-sale are also charged against the allowance for loan losses.

Repurchase Reserves

We do not currently maintain a loan repurchase reserve and management is not aware of any outstanding repurchase claims against Redwood that would require the establishment of such a reserve. We do not originate residential loans and believe that risk of loss due to loan repurchases (i.e., due to breach of representations and warranties) would generally be a contingency to the companies from whom we acquired the loans and therefore would be covered by our recourse to those companies.

In circumstances where we believe that there is a risk of loss due to a loan repurchase demand (i.e., due to an allegation of a breach of representations and warranties) and we do not believe that full recourse to the company from whom we acquired the loan exists or is enforceable, we will review the need for any loan repurchase reserve in accordance with FASB guidance on accounting for contingencies and establish reserves when, in the opinion of management, it is probable that a matter would result in a liability and the amount of loss, if any, can be reasonably estimated.

See *Note 6* for further discussion on the allowance for loan losses for residential real estate loans.

Commercial Real Estate Loans — Allowance for Loan Losses

For commercial real estate loans classified as held-for-investment, we evaluate the need for an allowance for loan losses on a quarterly basis. We will establish and maintain an allowance for loan losses for any loans we have determined to be impaired as of the reporting date.

We consider the following factors in evaluating the allowance for loan losses:

- Ongoing analysis of the most recent financial information for each loan and associated properties, including net operating income, debt service coverage ratios, occupancy rates, rent rolls, as well as any other loss factors we consider relevant, such as, but not limited to, specific loan trigger events that would indicate an adverse change in expected cash flows or payment delinquency;
- Ongoing analysis of economic trends, both macroeconomic as well as those directly affecting the properties associated with our loans, and the supply and demand of competing projects in the sub-market in which the subject property is located; and,
- Ongoing evaluation of each loan sponsor’s ability to ensure that associated properties are managed and operated sufficiently.

REDWOOD TRUST, INC. AND SUBSIDIARIES

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Note 3. Summary of Significant Accounting Policies – (continued)

Based on the above review, a loan is impaired when it is deemed probable that we will not be able to collect all amounts due according to the contractual terms of the loan. We record an allowance to reduce the carrying value of any impaired loan to the present value of expected future cash flows discounted at the loan’s effective rate.

Such impairment analyses are completed and reviewed by asset management and finance personnel and reviewed and approved by senior management. Significant judgment is required when evaluating loans for impairment.

See *Note 7* for further discussion on the allowance for loan losses for commercial real estate loans.

Real Estate Securities, at Fair Value

Trading Securities

Trading securities include residential, commercial, and collateralized debt obligation (CDO) securities. Trading securities are carried at their estimated fair values. Coupon interest is recognized as interest income when earned and deemed collectible. All changes in fair value are reported through our consolidated statements of income in market valuation adjustments, net.

We primarily denote trading securities as those securities where we have adopted the fair value option. We currently account for certain securities at Redwood and all securities at Acacia entities as trading securities, at fair value.

Available-for-Sale (AFS) Securities

AFS securities include certain residential, commercial, and CDO securities. AFS securities are carried at their estimated fair values with cumulative unrealized gains and losses reported as a component of accumulated other comprehensive income in our consolidated statements of equity. Coupon interest is recognized as interest income when earned and deemed collectible, and the interest method is used to determine an effective yield to amortize purchase premiums, discounts, and fees associated with these securities into income over time. This requires us to project cash flows over the remaining life of each security and make assumptions with regards to interest rates, prepayment rates, the timing and amount of credit losses, and other factors. We review our cash flow projections on an ongoing basis and monitor these projections based on input and analyses received from external sources, internal models, and our own judgment and experience.

For an AFS security where its fair value has declined below its amortized cost basis, we evaluate the security for other-than-temporary impairment (OTTI). If we either — (i) intend to sell the impaired security; (ii) will more likely than not be required to sell the impaired security before it recovers in value; or, (iii) do not expect to recover the impaired security’s amortized cost basis even if we do not intend to sell the security — the impairment is deemed an OTTI and we record the entire difference between the security’s fair value and its amortized cost in our consolidated statements of income. Conversely, if none of these three conditions is met, we analyze the expected cash flows, or cost recovery of the security, to determine what, if any, OTTI is recognized through our consolidated statements of income. This analysis includes an assessment of any changes in the regulatory and/or economic environment that might affect the performance of the security.

If we conclude through our analysis that there has been no significant adverse change in our cash flow assumptions for the security, then the impairment is deemed temporary in nature and the associated difference between the security’s fair value and its amortized cost basis is recorded as an unrealized loss through accumulated other comprehensive income, a component of equity. Alternatively, if we conclude that there has been a significant adverse change in our cash flow assumptions for the security, then the impairment is

REDWOOD TRUST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 3. Summary of Significant Accounting Policies – (continued)

deemed an OTTI and we perform an additional analysis to determine what portion of OTTI, if any, should be recorded through our consolidated statements of income. This analysis entails discounting the security's cash flows to a present value using the prior period yield for the security to determine an "expected recoverable value." The difference between this expected recoverable value and the amortized cost basis of the security is deemed to be the "credit" component of the OTTI that is recorded in our consolidated statements of income. The amortized cost of the security is then adjusted to the expected recoverable value, and the difference between this expected recoverable value and the fair value is deemed to be the "non-credit" component of the OTTI that is recorded to accumulated other comprehensive income. Future amortization and accretion for the security is computed based upon the new amortized cost basis.

See *Note 8* for further discussion on real estate securities.

Other Investments

Other investments included a guaranteed investment contract (GIC) entered into by an Acacia securitization entity that we consolidate for financial reporting purposes. At December 31, 2010, the GIC had been drawn down completely to cover credit losses and principal reductions on the referenced securities. We accounted for this investment at its estimated fair value. Changes in fair value were reported through our consolidated statements of income through market valuation adjustments, net. Interest income was reported through our consolidated statements of income through interest income, other investments. This GIC represented a deposit certificate issued by a rated investment bank and served as collateral to cover realized losses on credit default swaps (CDS) entered into by this same Acacia entity.

Cash and Cash Equivalents

Cash and cash equivalents include non-restricted cash and highly liquid investments with original maturities of three months or less. At September 30, 2011, we did not have any significant concentrations of credit risk arising from cash deposits as all of our cash and cash equivalents were invested in FDIC-insured bank products.

Restricted Cash

Restricted cash primarily includes principal and interest payments that are collateral for, or payable to, owners of ABS issued by consolidated securitization entities. Restricted cash may also include cash retained in the Acacia or Sequoia securitization entities or in the resecuritization entity prior to the payments on or redemptions of outstanding ABS issued. At September 30, 2011, we did not have any significant concentrations of credit risk arising from restricted cash deposits as all of our restricted cash was held in custodial accounts or FDIC-insured bank products.

Accrued Interest Receivable

Accrued interest receivable includes interest that is due and payable to us. Cash interest is generally received within thirty days of recording the receivable. For financial assets where we have elected the fair value option, the associated accrued interest on these assets is measured at fair value. For financial assets where we have not elected the fair value option, the associated accrued interest carrying values approximate fair values.

Derivative Financial Instruments

Derivative financial instruments include risk management derivatives — namely interest rate agreements — and credit derivatives. All derivative financial instruments are recorded at fair value in our consolidated balance sheets. Derivatives with a positive fair value to us are reported as an asset and derivatives with a negative fair value to us are reported as a liability. We classify each of our derivative

Note 3. Summary of Significant Accounting Policies – (continued)

financial instruments as either (i) a trading instrument (no hedging designation) or (ii) 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).

Changes in fair value of derivatives accounted for as trading instruments, including any associated interest income or expense, are recorded in our consolidated statements of income through market valuation adjustments, net. Changes in the fair value of derivatives accounted for as cash flow hedges, to the extent they are effective, are recorded in accumulated other comprehensive income, a component of equity. Interest income or expense and any ineffectiveness associated with these hedging derivatives are recorded as a component of net interest income in our consolidated statements of income. We measure the effective portion of cash flow hedges by comparing the change in fair value of the expected future variable cash flows of the derivative hedging instruments with the change in fair value of the expected future variable cash flows of the hedged liabilities.

We will discontinue cash flow hedge accounting if (i) we determine that the hedging derivative is no longer expected to be effective in offsetting changes in the cash flows of the designated hedged item; (ii) the derivative expires or is sold, terminated, or exercised; (iii) the derivative is de-designated as a cash flow hedge; or, (iv) it is probable that a forecasted transaction associated with the hedged item will not occur by the end of the originally specified time period. To the extent we de-designate a cash flow hedging relationship but the associated hedged item continues to exist, the fair value of the cash flow hedge at the time of de-designation remains in accumulated other comprehensive income and is amortized using the straight-line method through interest expense over the remaining life of the hedged liability.

Risk Management Derivatives

Risk management derivatives that we currently utilize include interest rate swaps and caps. Interest rate swaps are derivative contracts in which (i) one party exchanges a stream of fixed interest payments for another party's stream of variable interest cash flows; or, (ii) each party exchanges variable interest cash flows that are referenced to different indices. Interest rate caps are derivative contracts in which the buyer receives payments at the end of each period in which the interest rate exceeds an agreed upon strike price. We enter into interest rate swaps and caps primarily to reduce significant changes in our income or equity caused by interest rate volatility. Certain of these interest rate agreements may be designated as cash flow hedges.

Other risk management derivatives we currently utilize include "To Be Announced" (TBA) contracts and financial futures contracts such as Eurodollar futures and Treasury futures. (Eurodollar futures contracts, unlike our other derivatives, have maturities of only three months. Therefore, in order to achieve the desired interest rate offset necessary to manage our risk, consecutively maturing contracts are required resulting in a stated notional amount higher than would be needed with our other derivatives.) TBA contracts are forward commitments to purchase U.S. government agency mortgage-backed securities to be issued in the future. Financial futures are futures contracts on short-term benchmark interest rates. We purchase or sell these hedging instruments to offset — to varying degrees — changes in the values of mortgage products for which we have exposure. We account for our risk management derivatives as trading instruments, and record any changes in value (including any associated interest income or expense) in our consolidated statements of income through market valuation adjustments, net.

Credit Derivatives

Credit derivatives that we have historically utilized include CDS, which are agreements to pay (receive) credit event protection based on a financial index or specific security in exchange for receiving (paying) a fixed-rate fee or premium over the term of the contract. These instruments enable us, or our consolidated securitization entities, to synthetically assume the credit risk of a reference security or index of securities. The estimated fair values of these contracts fluctuate for a variety of reasons, such as the likelihood or occurrence

REDWOOD TRUST, INC. AND SUBSIDIARIES

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Note 3. Summary of Significant Accounting Policies – (continued)

of a qualifying credit event (e.g., an interest shortfall, a failure to pay principal, or a distressed rating downgrade), the market perception of default risk and counterparty risk, and supply and demand changes. We do not designate any credit derivatives as cash flow hedges.

See *Note 9* for further discussion on derivative financial instruments.

Deferred Tax Assets

Our deferred tax assets are generated by temporary differences in GAAP and taxable income at our taxable subsidiaries. These differences generally reflect differing accounting treatments for tax and GAAP, such as accounting for discount and premium amortization, credit losses, equity awards, asset impairments, and certain valuation estimates. As a result of these differences, we may recognize taxable income in periods prior to when we recognize income for GAAP. When this occurs, we pay the tax liability and establish a deferred tax asset for GAAP. As the income is subsequently realized in future periods under GAAP, the deferred tax asset is reduced.

Deferred Securities Issuance Costs

Securities issuance costs are expenses associated with the issuance of long-term debt, the resecuritization we engaged in during the third quarter of 2011, and the ABS from the Sequoia securitization entities we sponsor. These expenses typically include underwriting, rating agency, legal, accounting, and other fees. ABS issuance costs associated with liabilities accounted for under the fair value option are expensed as incurred. ABS issuance costs associated with liabilities reported at cost are deferred. Deferred ABS issuance costs are reported on our consolidated balance sheets as deferred charges (an asset) and are amortized as an adjustment to interest expense using the interest method, based upon the actual and estimated repayment schedules of the related debt and ABS issued.

Other Assets

Other assets include REO, margin receivable, fixed assets, principal receivable, and other prepaid expenses. REO property acquired through, or in lieu of, loan foreclosure is initially recorded at fair value, and subsequently reported at the lower of carrying amount or fair value (less estimated cost to sell). Changes in the fair value of an REO property that has a fair value at or below its carrying amount are recorded in our consolidated statements of income as a component of market valuation adjustments, net. Margin receivable reflects cash collateral Redwood has posted with our various derivative and lending counterparties as required to satisfy the minimum margin requirements.

See *Note 10* for further discussion on other assets.

Short-Term Debt

Short-term debt includes borrowings under master repurchase agreements, bank borrowings, and other forms of borrowings that expire within one year with various counterparties. These facilities may be unsecured or collateralized by cash, loans, or securities.

See *Note 11* for further discussion on short-term debt.

Accrued Interest Payable

Accrued interest payable includes interest that is due and payable to third-parties. Interest is generally paid within one to three months of recording the payable, based upon our remittance requirements. For borrowings where we have elected the fair value option, the associated accrued interest on these liabilities is measured at fair value. For financial liabilities where we have not elected the fair value option, the associated accrued interest carrying values approximate fair values.

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Note 3. Summary of Significant Accounting Policies – (continued)

Asset-Backed Securities Issued

The majority of the liabilities reported on our consolidated balance sheets represent ABS issued by bankruptcy-remote entities sponsored by Redwood. Sequoia, Acacia, and the resecuritization assets are held in the custody of securitization trustees and are not owned by Redwood. These trustees collect principal and interest payments (less servicing and related fees) from the assets and make corresponding principal and interest payments to the ABS investors.

Sequoia ABS Issued

Sequoia ABS issued are carried at their unpaid principal balances net of any unamortized discount or premium.

Acacia ABS Issued

Acacia ABS issued are accounted for under the fair value option and carried at their estimated fair values. Changes in fair value (gains or losses) are reported in our consolidated statements of income through market valuation adjustments, net.

Resecuritization ABS Issued

Resecuritization ABS issued are carried at their unpaid principal balances net of any unamortized discount or premium.

See *Note 12* for further discussion on ABS issued.

Long-Term Debt

Long-term debt includes trust preferred securities and subordinated notes at Redwood and is carried at its unpaid principal balance. Our long-term debt is unsecured with quarterly interest payments determined based upon a floating rate equal to the three-month London Interbank Offered Rate (LIBOR) plus a margin until it is redeemed in whole or matures at a future date.

See *Note 13* for further discussion on long-term debt.

Equity

Accumulated Other Comprehensive Income

Net unrealized gains and losses on real estate securities available-for-sale and interest rate agreements previously designated as cash flow hedges are reported as components of accumulated other comprehensive income on our consolidated statements of equity and comprehensive income. Net unrealized gains and losses on securities and interest rate agreements held by our taxable subsidiaries that are reported in other comprehensive income are adjusted for the effects of taxation and may create deferred tax assets or liabilities.

Noncontrolling Interest

Noncontrolling interest represents the aggregate limited partnership interests in the Fund held by third-parties. In accordance with GAAP, the noncontrolling interest of the Fund is shown as a component of equity on our consolidated balance sheets, and the portion of income allocable to third-parties is shown as net income (loss) attributable to noncontrolling interest in our consolidated statements of income. Equity attributable to noncontrolling interest is disclosed in our consolidated statements of equity and comprehensive income. As we deconsolidated the Fund in the third quarter of 2011, there is no longer noncontrolling interest.

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Note 3. Summary of Significant Accounting Policies – (continued)

Earnings Per Common Share

Basic earnings per common share (EPS) is computed by dividing net income allocated to common shareholders by the weighted average common shares outstanding. Net income allocated to common shareholders represents net income applicable to common shareholders, less income allocated to participating securities (as described below). Diluted earnings per common share is computed by dividing income allocated to common shareholders by the weighted average common shares outstanding plus amounts representing the dilutive effect of equity awards.

Accounting guidance on EPS defines unvested share-based payment awards containing nonforfeitable rights to dividends as participating securities that are included in computing EPS using the two-class method. The two-class method is an earnings allocation formula under which EPS is calculated for common stock and participating securities according to dividends declared and participating rights in undistributed earnings. Under this method, all earnings (distributed and undistributed) are allocated to participating securities and common shares based on their respective rights to receive dividends.

See *Note 15* for further discussion on equity.

Incentive Plans

In May 2010, our shareholders approved an amendment to our previously amended 2002 Redwood Trust, Inc. Incentive Plan (Incentive Plan) for executive officers, employees, and non-employee directors. The amendment provided for an increase in the number of shares available for distribution under the plan. The Incentive Plan authorizes our Board of Directors (or a committee appointed by our Board of Directors) to grant incentive stock options (ISOs), non-qualifying stock options (NQSOs), performance stock units (PSUs), deferred stock units (DSUs), restricted stock, performance shares, performance units (including cash), stock appreciation rights, limited stock appreciation rights (awards), and dividend equivalent rights (DERs) to eligible recipients other than non-employee directors. These awards generally vest over a three- or four-year period. Non-employee directors are also provided annual awards under the Incentive Plan that generally vest immediately.

The cost of equity awards is determined in accordance with share-based payment accounting guidance and amortized over the vesting term using an accelerated method for equity awards granted prior to December 1, 2008. For equity awards granted after December 1, 2008, the cost of the awards is amortized over the vesting period on a straight-line basis. Timing differences between the accelerated and straight-line methods of amortization were determined to not be material to our financial statements.

Employee Stock Purchase Plan

In May 2009, our stockholders approved an amendment to our 2002 Redwood Trust, Inc. Employee Stock Purchase Plan (ESPP) to increase the number of shares available under the ESPP. The purpose of the ESPP is to give our employees an opportunity to acquire an equity interest in the Company through the purchase of shares of common stock at a discount. The ESPP allows eligible employees to purchase common stock at 85% of its fair value, subject to certain limits. Fair value as defined under the ESPP is the lesser of the closing market price of the common stock on the first day of the calendar year or the first day of the calendar quarter.

Executive Deferred Compensation Plan

In May 2002, our Board of Directors approved our 2002 Executive Deferred Compensation Plan (EDCP). The EDCP allows eligible employees and directors to defer portions of current salary and certain other forms of compensation. The Company matches some deferrals. Compensation deferred under the EDCP is recorded as an asset on our consolidated balance sheet and subject to the claims of our general creditors. The EDCP allows for the investment of deferrals in either an interest crediting account or DSUs.

Note 3. Summary of Significant Accounting Policies – (continued)

401(k) Plan

We offer a tax-qualified 401(k) Plan to all employees for retirement savings. Under this Plan, employees are allowed to defer and invest up to 100% of their cash earnings, subject to the maximum 401(k) contribution limit set forth by the Internal Revenue Service. We match some employee contributions to encourage participation and to provide a retirement planning benefit to employees. Vesting of the 401(k) Plan matching contributions is based on the employee's tenure at the Company, and over time, an employee becomes increasingly vested in both prior and new matching contributions.

See *Note 16* for further discussion on equity compensation plans.

Taxes

We have elected to be taxed as a REIT under the Internal Revenue Code and the corresponding provisions of state law. To qualify as a REIT we must distribute at least 90% of our annual REIT taxable income to shareholders (not including taxable income retained in our taxable subsidiaries) within the time frame set forth in the tax code and also meet certain other requirements related to assets, income, and stock ownership. We assess our tax positions for all open tax years and determine whether we have any material unrecognized liabilities in accordance with FASB guidance on accounting for uncertainty in income taxes. We record these liabilities to the extent we deem them incurred. We classify interest and penalties on material uncertain tax positions as interest expense and operating expense, respectively, in our consolidated statements of income.

See *Note 18* for further discussion on taxes.

Recent Accounting Pronouncements

In April 2011, the FASB issued Accounting Standards Update (ASU) 2011-02, *A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*, which provides additional guidance to creditors for evaluating troubled debt restructurings. The amendments clarify the guidance in ASC 310-40, *Receivables: Troubled Debt Restructurings by Creditors*, which requires a creditor to classify a restructuring as a TDR if (1) the restructuring includes a concession by the creditor to the borrower and (2) the borrower is experiencing financial difficulties. The amended guidance requires a creditor to consider all aspects of the restructuring to determine whether it has granted a concession, and includes additional guidance to identify concessions, as well as indicators for determining whether the debtor is facing financial difficulties. In addition, ASU 2011-02 ended the public-entity deferral of TDR disclosures in ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses.*

We adopted ASU 2011-02 in the second quarter of 2011. At September 30, 2011, the recorded investment in receivables for which the allowance for loan losses was previously measured under a general allowance for loan losses and are now impaired under ASC 310-10-35 was $5 million, and the allowance for loan losses associated with those receivables, on a basis of current evaluation of loss, was $1 million at September 30, 2011. For additional disclosures related to TDRs, see *Note 6*.

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. This ASU converges fair value measurement and disclosure guidance in U.S. GAAP with the guidance concurrently issued by the International Accounting Standards Board. While the amendments in ASU 2011-04 do not modify the requirements for when fair value measurements apply, they do generally represent clarifications on how to measure and disclose fair value under ASC 820, Fair Value Measurement. This ASU is effective for interim and annual periods beginning after December 15, 2011 and should be applied prospectively. Early adoption is not permitted. ASU 2011-04 may increase our disclosures related to fair value measurements, but will not have an effect on our consolidated financial statements.

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Note 3. Summary of Significant Accounting Policies – (continued)

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income: Presentation of Comprehensive Income.* This ASU eliminates the option to present components of other comprehensive income in the statement of stockholders' equity and requires entities to present all non-owner changes in stockholders' equity either as a single continuous statement of comprehensive income or as two separate but consecutive statements. This ASU is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2011. The amendments should be applied retrospectively and early adoption is permitted. Upon adoption of this ASU, our financial statement presentation will change.

Note 4. Principles of Consolidation

We apply FASB guidance to determine whether we must consolidate transferred financial assets and VIEs for financial reporting purposes. Specifically, GAAP requires us to consider whether securitizations and other transfers of financial assets should be treated as sales or financings, as well as whether any VIEs (e.g., certain legal entities often used in securitization and other structured finance transactions) should be included in our consolidated financial statements.

The tables below present our analysis of VIEs where we maintain an interest, as distinguished by those we have consolidated for financial reporting purposes and those we have not. The principles of consolidation we apply require us to reassess our requirement to consolidate VIEs each quarter and therefore our determination may change based upon new facts and circumstances pertaining to each VIE. This could result in a material impact to our financial statements during subsequent reporting periods.

Analysis of Consolidated VIEs

The VIEs we are required to consolidate include certain Sequoia securitization entities, the Acacia entities, and the resecuritization entity. Each of these entities is independent of Redwood and of each other and the assets and liabilities are not owned by and are not legal obligations of ours, although we are exposed to certain financial risks associated with our role as the sponsor or manager of these entities. The following table presents a summary of the assets and liabilities of these VIEs. Intercompany balances have been eliminated for purposes of this presentation.

Assets and Liabilities of Consolidated VIEs at September 30, 2011

(Dollars in thousands)	Sequoia Entities	Acacia Entities	Resecuritization	Total
Real estate loans	$ 3,928,677	$ 12,563	$ —	$ 3,941,240
Real estate securities	—	256,192	349,764	605,956
Other investments	—	—	—	—
Other assets	21,120	21,734	2,262	45,116
Total Assets	$ 3,949,797	$ 290,489	$ 352,026	$ 4,592,312
Asset-backed securities	$ 3,826,783	$ 234,235	$ 232,006	$ 4,293,024
Other liabilities	6,387	71,007	72	77,466
Total Liabilities	$ 3,833,170	$ 305,242	$ 232,078	$ 4,370,490
Noncontrolling interest	$ —	$ —	$ —	$ —
Number of VIEs	39	10	1	50

We consolidate the assets and liabilities of certain Sequoia securitization entities issued prior to 2010, as we did not meet the sale criteria at the time we transferred financial assets to these entities. Had we not been the transferor and depositor of these securitizations, we would likely not have consolidated them as we determined that we are not the primary beneficiary of these entities in accordance with ASC 810-10. Since 2010, we have sponsored three residential jumbo mortgage securitizations through our Sequoia program

Note 4. Principles of Consolidation – (continued)

totaling $908 million. We recorded the assets and liabilities of these entities on our consolidated balance sheets, as we did not meet the sale criteria at the time we transferred financial assets to these entities. Additionally, we determined that we are the primary beneficiary of these VIEs as our ongoing loss mitigation and resolution responsibilities provide us with the power to direct the activities that most significantly impact the economic performance of these entities and our significant investment interests provide us with the obligation to absorb losses or the right to receive benefits that are significant.

We consolidate the assets and liabilities of the Acacia securitization entities, as we did not meet the sale criteria at the time we transferred financial assets to these entities and we are the primary beneficiary of these VIEs. Our ongoing asset management responsibilities and call options provide us with the power to direct the activities that most significantly impact the economic performance of these individual entities, and our equity investments in each entity provide us with the obligation to absorb losses or the right to receive benefits that are significant.

We consolidate the assets and liabilities of the entity formed in connection with the resecuritization transaction we engaged in during the third quarter of 2011, as we did not meet the sale criteria at the time the financial assets were transferred to this entity and we are the primary beneficiary. We transferred an aggregate of $365 million ($437 million principal value) of residential senior securities to Credit Suisse First Boston Mortgage Securities Corp., which subsequently sold them to CSMC 2011-9R, a resecuritization entity. In connection with this transaction, senior securities of $245 million were issued by CSMC 2011-9R and sold to third-party investors and we acquired $192 million of subordinate securities issued by CSMC 2011-9R. We also received $243 million in cash and acquired $245 million notional amount of variable rate, interest-only senior certificates.

We engaged in the resecuritization primarily for the purpose of obtaining permanent non-recourse financing on a portion of our residential securities portfolio. Our credit risk exposure is largely unchanged as a result of engaging in the transaction, as we remain economically exposed to the financed securities through the first loss position in the structure.

Prior to the third quarter of 2011, we consolidated the assets, liabilities, and noncontrolling interests of the Fund, as we determined that we were the primary beneficiary of this VIE. Our ongoing asset management responsibilities provided us with the power to direct the activities that most significantly impacted the Fund's economic performance, and our general and limited partnership interests provided us with the obligation to absorb losses or the right to receive benefits that were significant. In the second quarter of 2011, the Fund sold all of its remaining investments. As all partners received final cash asset distributions in the third quarter of 2011 and there are no remaining assets or liabilities in the Fund, we deconsolidated the Fund and recognized a loss on deconsolidation of less than $1 million in our consolidated statements of income through realized gains on sales and calls, net.

REDWOOD TRUST, INC. AND SUBSIDIARIES

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Note 4. Principles of Consolidation – (continued)

Analysis of Third-party VIEs

Third-party VIEs are securitization entities in which we maintain an economic interest but do not sponsor. Our economic interest may include several securities from the same third-party VIE, and in those cases, the analysis is performed in consideration of all of our interests. The following table presents a summary of our interest in third-party VIEs at September 30, 2011, grouped by collateral type and ownership interest.

Third-Party VIE Summary

September 30, 2011 (Dollars in Thousands)	Fair Value	Number of VIEs
Real estate securities at Redwood		
Residential		
Senior	$ 226,078	62
Re-REMIC	113,100	13
Subordinate	81,222	173
Commercial	5,887	9
CDO	1,010	8
Total Third-party Real Estate Securities	$ 427,297	265

We determined that we are not the primary beneficiary of any third-party residential, commercial, or CDO entities, as we do not have the required power to direct the activities that most significantly impact the economic performance of these entities. Specifically, we do not service or manage these entities or otherwise hold decision making powers that are significant. As a result of this assessment, we do not consolidate any of the underlying assets and liabilities of these third-party VIEs — we only account for our specific interests in each.

Our assessments of whether we are required to consolidate a VIE may change in subsequent reporting periods based upon changing facts and circumstances pertaining to each VIE. Any related accounting changes could result in a material impact to our financial statements.

Note 5. Fair Value of Financial Instruments

For financial reporting purposes, we follow a fair value hierarchy established under GAAP that is used to measure the fair value of the assets and liabilities. This hierarchy prioritizes relevant market inputs in order to determine an “exit price”, or the price at which an asset could be sold or a liability could be transferred in an orderly process that is not a forced liquidation or distressed sale at the date of measurement. Level 1 inputs are observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets. Level 2 inputs are observable inputs other than quoted prices for an asset or liability that are obtained through corroboration with observable market data. Level 3 inputs are unobservable inputs (e.g., our own data or assumptions) that are used when there is little, if any, relevant market activity for the asset or liability being measured at fair value.

In certain cases, inputs used to measure fair value fall into different levels of the fair value hierarchy. In such cases, the level in which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement. Our assessment of the significance of a particular input requires judgment and considers factors specific to the asset or liability being measured.

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Note 5. Fair Value of Financial Instruments – (continued)

The following table presents the carrying values and estimated fair values of assets and liabilities that are required to be recorded or disclosed at fair value at September 30, 2011 and December 31, 2010.

(In Thousands)	September 30, 2011		December 31, 2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Residential real estate loans (held-for-sale)	$ 2,178	$ 2,178	$ 1,855	$ 1,855
Residential real estate loans (held-for-investment)	4,155,405	3,693,867	3,795,240	3,367,340
Commercial real estate loans (fair value)	12,563	12,563	19,850	19,850
Commercial real estate loans (held-for-investment)	98,061	98,533	30,536	30,887
Trading securities	278,391	278,391	329,717	329,717
Available-for-sale securities	754,862	754,862	825,119	825,119
Cash and cash equivalents	133,446	133,446	46,937	46,937
Derivative assets	2,718	2,718	8,051	8,051
Restricted cash	17,011	17,011	24,524	24,524
Accrued interest receivable	14,699	14,699	13,782	13,782
REO (included in other assets)	6,554	6,554	14,481	14,481
Liabilities				
Short-term debt	—	—	44,137	44,137
Accrued interest payable	7,607	7,607	5,930	5,930
Derivative liabilities	127,220	127,220	83,115	83,115
ABS issued	4,293,024	3,711,728	3,761,578	3,263,074
Long-term debt	139,500	57,195	139,500	75,330

We did not elect the fair value option for any financial instruments that we acquired in the first nine months of 2011. We have elected the fair value option for all of the commercial loans, trading securities, and ABS issued at Acacia, as well as certain residential securities and CDOs at Redwood.

The following table presents assets and liabilities recorded at fair value on our consolidated balance sheets on a recurring basis and indicates the fair value hierarchy of the valuation techniques used to measure fair value.

Assets and Liabilities Measured at Fair Value on a Recurring Basis at September 30, 2011

September 30, 2011 (In Thousands)	Carrying Value	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Assets				
Commercial real estate loans	$ 12,563	$ —	$ —	$ 12,563
Trading securities	278,391	—	—	278,391
Available-for-sale securities	754,862	—	—	754,862
Derivative assets	2,718	302	2,416	—
Liabilities				
Derivative liabilities	127,220	2,465	104,755	20,000
ABS issued – Acacia	234,235	—	—	234,235

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Note 5. Fair Value of Financial Instruments – (continued)

The following table presents additional information about Level 3 assets and liabilities for the nine months ended September 30, 2011.

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis

	Assets				Liabilities	
(In Thousands)	Commercial Real Estate Loans	Trading Securities	AFS Securities	Derivative Assets	Derivative Liabilities	ABS Issued – Acacia
Beginning balance – December 31, 2010	$ 19,850	$329,717	$825,119	$ 1	$ —	$ 303,077
Transfer to Level 3	—	—	—	—	20,052	—
Principal paydowns	(8,730)	(43,104)	(86,735)	—	—	(68,698)
Gains (losses) in net income, net	1,443	4,962	28,991	—	1,651	(9,773)
Losses in OCI, net	—	—	(39,581)	—	—	—
Acquisitions	—	—	90,512	—	—	—
Sales	—	(13,588)	(63,525)	—	—	—
Other settlements, net	—	404	81	(1)	(1,703)	9,629
Ending Balance – September 30, 2011	$ 12,563	$278,391	$754,862	$ —	$20,000	$ 234,235

The following table presents the portion of gains or losses included in our consolidated statements of income that were attributable to Level 3 assets and liabilities recorded at fair value on a recurring basis and still held at September 30, 2011 and 2010. Gains or losses incurred on assets or liabilities sold, matured, called, or fully written down during the three and nine months ended September 30, 2011 and 2010 are not included in this presentation.

Portion of Net Gains (Losses) Attributable to Level 3 Assets and Liabilities Still Held at September 30, 2011 and 2010 Included in Net Income

	Included in Net Income			
	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2011	2010	2011	2010
Assets				
Real estate loans	$ (184)	$ 3	$ 1,358	$ 7,347
Trading securities	(5,207)	46,819	(3,938)	64,531
Available-for-sale securities	(1,083)	(2,580)	(3,551)	(8,361)
Derivative assets	—	16	—	16
Liabilities				
Derivative liabilities	1,651	19	1,651	129
ABS issued – Acacia	16,530	(25,703)	9,773	(19,699)

REDWOOD TRUST, INC. AND SUBSIDIARIES

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Note 5. Fair Value of Financial Instruments – (continued)

The following table presents information on assets and liabilities recorded at fair value on a non-recurring basis at September 30, 2011.

Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis at September 30, 2011

(In Thousands)	Carrying Value	Fair Value Measurements Using			Gain (Loss)	
		Level 1	Level 2	Level 3	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Assets						
Real estate loans (held-for-sale)	$ 2,178	$ —	$ —	$ 2,178	$ 363	$ 374
REO	6,554	—	—	6,554	(255)	(1,416)

The following table presents the components of market valuation adjustments, net, recorded in our consolidated statements of income for the three and nine months ended September 30, 2011 and 2010.

Market Valuation Adjustments, Net

(In Thousands)	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Assets				
Real estate loans (fair value)	$ (184)	$ 3	$ 1,358	$ 7,347
Real estate loans (held-for-sale)	363	159	374	335
Trading securities	(5,359)	47,375	4,963	65,854
REO	(255)	(620)	(1,416)	(1,979)
Impairments on AFS securities	(1,083)	(2,580)	(5,171)	(8,742)
Liabilities				
Derivative instruments, net	(23,460)	(20,207)	(40,216)	(63,051)
ABS issued – Acacia	16,530	(25,703)	9,773	(19,699)
Market Valuation Adjustments, Net	$ (13,448)	$ (1,573)	$ (30,335)	$ (19,935)

A description of the instruments measured at fair value as well as the general classification of such instruments pursuant to the Level 1, Level 2, and Level 3 valuation hierarchy is listed below.

- Real estate loans
  - Residential real estate loan fair values are determined by available market quotes and discounted cash flow analyses (Level 3).
  - Commercial real estate loan fair values are determined by available market quotes and discounted cash flow analyses (Level 3). The availability of market quotes for all of our commercial loans is limited. Any changes in fair value are primarily a result of instrument specific credit risk.
- Real estate securities
  - Real estate securities are residential, commercial, CDO, and other asset-backed securities that are illiquid in nature and trade infrequently. Fair values are determined by discounted cash flow analyses and other valuation techniques using market pricing assumptions that are confirmed by third-party dealer/pricing indications, to the extent available. Significant inputs in the valuation analysis are predominantly Level 3 in nature, due to the lack of readily available market quotes

Note 5. Fair Value of Financial Instruments – (continued)

and related inputs. Relevant market indicators that are factored in the analyses include bid/ask spreads, credit losses, interest rates, and prepayment speeds. Estimated fair values are based on applying the market indicators to generate discounted cash flows (Level 3).

- We request and consider indications of value (marks) from third-party dealers to assist us in our valuation process. For September 30, 2011, we received dealer marks on 82% of our securities. In the aggregate, our internal valuations of the securities on which we received dealer marks were within 1% of the aggregate dealer marks.

- Derivative assets and liabilities
  - Our derivative instruments include interest rate agreements, TBAs, and financial futures. Fair values of derivative instruments are determined using quoted prices from active markets when available or valuation models and are verified by valuations provided by dealers active in derivative markets. TBA and financial futures fair values are generally obtained using quoted prices from active markets (Level 1). Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates, and correlations of such inputs. Model inputs for interest rate agreements can generally be verified and model selection does not involve significant management judgment (Level 2). For other derivatives, valuations are based on various factors such as liquidity, bid/offer spreads, and credit considerations for which we rely on available market evidence. In the absence of such evidence, management's best estimate is used (Level 3).
- Cash and cash equivalents
  - Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less. Fair values equal carrying values.
- Restricted cash
  - Restricted cash primarily includes interest-earning cash balances in ABS entities and the Fund for the purpose of distribution to bondholders or limited partners, and reinvestment. Due to the short-term nature of the restrictions, fair values approximate carrying values.
- Accrued interest receivable and payable
  - Accrued interest receivable and payable includes interest due on our assets and payable on our liabilities. Due to the short-term nature of when these interest payments will be received or paid, fair values approximate carrying values.
- Short-term debt
  - Short-term debt includes our credit facilities that mature within one year. Short-term debt is generally at an adjustable rate. Fair values approximate carrying values.
- ABS issued
  - ABS issued includes asset-backed securities issued through our Sequoia, Acacia, and resecuritization programs. These instruments are illiquid in nature and trade infrequently, if at all. Fair values are determined by discounted cash flow analyses and other valuation techniques using market pricing assumptions that are confirmed by third-party dealer/pricing indications, to the extent available. Significant inputs in the valuation analysis are predominantly Level 3, due to the nature of these instruments and the lack of readily available market quotes. Relevant market indicators factored into the analyses include dealer price indications to the extent

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Note 5. Fair Value of Financial Instruments – (continued)

available, bid/ask spreads, external spreads, collateral credit losses, interest rates and collateral prepayment speeds. Estimated fair values are based on applying the market indicators to generate discounted cash flows (Level 3).

- We request and consider indications of value (marks) from third-party dealers to assist us in our valuation process. For September 30, 2011, we received dealer marks on 93% of our ABS issued. Our internal valuations of our ABS issued on which we received dealer marks were 3% higher (i.e., more conservative) than the aggregate dealer marks.

- Long-term debt
  - Long-term debt includes our subordinated notes and trust preferred securities. Fair values are determined using comparable market indicators of current pricing. Significant inputs in the valuation analysis are predominantly Level 3 due to the nature of these instruments and the lack of readily available market quotes. Estimated fair values are based on applying the market indicators to generate discounted cash flows (Level 3).
- REO
  - REO includes properties owned in satisfaction of foreclosed loans. Fair values are determined using available market quotes, appraisals, broker price opinions, comparable properties, or other indications of value (Level 3).

Note 6. Residential Real Estate Loans

We invest in residential real estate loans that we acquire from third-party originators. These loans are financed through the Sequoia entities that we sponsor or with equity and long-term debt. We do not currently service any residential loans, although we may from time to time acquire the rights to service loans purchased from third-party originators. The following table summarizes the classifications and carrying value of the residential real estate loans at September 30, 2011 and December 31, 2010.

September 30, 2011 (In Thousands)	Redwood	Sequoia	Total
Held-for-sale	$ 2,178	$ —	$ 2,178
Held-for-investment	226,728	3,928,677	4,155,405
Total Residential Real Estate Loans	$ 228,906	$ 3,928,677	$ 4,157,583
December 31, 2010 (In Thousands)	**Redwood**	**Sequoia**	**Total**
Held-for-sale	$ 1,855	$ —	$ 1,855
Held-for-investment	253,081	3,542,159	3,795,240
Total Residential Real Estate Loans	$ 254,936	$ 3,542,159	$ 3,797,095

Residential Real Estate Loans Held-for-Sale

Residential real estate loans held-for-sale are owned at Redwood and financed with equity and long-term debt. At both September 30, 2011 and December 31, 2010, there were eleven residential loans held-for-sale with $3 million in outstanding principal value and a lower of cost or fair value of $2 million.

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Note 6. Residential Real Estate Loans – (continued)

Residential Real Estate Loans Held-for-Investment

During the three and nine months ended September 30, 2011, we purchased $402 million and $656 million, respectively, of residential loans in connection with our Sequoia securitization program. The following table provides additional information for total residential real estate loans held-for-investment at September 30, 2011 and December 31, 2010.

(In Thousands)	September 30, 2011	December 31, 2010
Principal balance	$ 4,181,061	$ 3,815,273
Unamortized premium, net	38,341	42,399
Recorded investment	4,219,402	3,857,672
Allowance for loan losses	(63,997)	(62,432)
Carrying Value	$ 4,155,405	$ 3,795,240

Of the $4.2 billion of principal value and $38 million of unamortized premium on loans held-for-investment at September 30, 2011, $1.6 billion of principal value and $24 million of unamortized premium relate to residential loans acquired prior to July 1, 2004. During the first nine months of 2011, 6% of these residential loans prepaid and we amortized 14% of the premium based upon the accounting elections we apply. For residential loans acquired after July 1, 2004, the principal value was $2.6 billion and the unamortized premium was $14 million. During the first nine months of 2011, 7% of these loans prepaid and we amortized 9% of the premium.

Of the $3.8 billion of principal value and $42 million of unamortized premium on loans held-for-investment at December 31, 2010, $1.7 billion of principal value and $27 million of unamortized premium relate to residential loans acquired prior to July 1, 2004. For residential loans acquired after July 1, 2004, the principal value was $2.1 billion and the unamortized premium was $15 million.

Allowance for Loan Losses on Residential Loans

For residential real estate loans held-for-investment, we establish and maintain an allowance for loan losses. The allowance includes a component for loans collectively evaluated for impairment that includes pools of residential loans owned at Sequoia securitization entities, and a component for loans individually evaluated for impairment that includes modified residential loans from Sequoia entities that have been determined to be troubled debt restructurings.

Activity in the Allowance for Loan Losses on Residential Loans

The following table summarizes the activity in the allowance for loan losses for the three and nine months ended September 30, 2011 and 2010.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2011	2010	2011	2010
Balance at beginning of period	$ 62,306	$ 61,478	$ 62,432	$ 54,220
Charge-offs, net	(2,287)	(4,822)	(6,802)	(11,361)
Provision for loan losses	3,978	2,436	8,367	16,233
Balance at End of Period	$ 63,997	$ 59,092	$ 63,997	$ 59,092

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Note 6. Residential Real Estate Loans – (continued)

During the three months ended September 30, 2011 and 2010, there were $2 million and $5 million of charge-offs, respectively, in our residential loan portfolio that reduced our allowance for loan losses. These charge-offs arose from $8 million and $15 million of defaulted loan principal, respectively. During the nine months ended September 30, 2011 and 2010, there were $7 million and $11 million of charge-offs, respectively, in our residential loan portfolio that reduced our allowance for loan losses. These charge-offs arose from $23 million and $36 million of defaulted loan principal, respectively. For the three and nine months ended, September 30, 2011, we did not record any interest income on individually impaired loans.

Residential Loans Collectively Evaluated for Impairment

We collectively evaluate most of our residential loans for impairment. The following table summarizes the balances for loans collectively evaluated for impairment at September 30, 2011 and December 31, 2010.

(In Thousands)	September 30, 2011	December 31, 2010
Principal balance	$ 4,169,133	$ 3,801,921
Recorded investment	4,208,153	3,844,372
Related allowance	60,795	57,804

The following table summarizes the recorded investment and past due status of residential loans collectively evaluated for impairment at September 30, 2011 and December 31, 2010.

(In Thousands)	30 – 59 Days Past Due	60 – 89 Days Past Due	90+ Days Past Due	Current	Total Loans
September 30, 2011	$ 61,166	$ 14,946	$ 133,450	$ 3,998,591	$ 4,208,153
December 31, 2010	65,708	21,674	133,695	3,623,295	3,844,372

We establish the allowance for residential loan losses based primarily on the characteristics of the loan pools underlying the securitization entities that own the loans, including loan product types, credit characteristics, and origination years. The collective analysis is further divided into two segments. The first segment reflects our estimate of losses on delinquent loans within each loan pool. These loss estimates are determined by applying the loss factors described in *Note 3* to the delinquent loans, including our expectations of the timing of defaults and the loss severities we expect once defaults occur. The second segment relates to our estimate of losses incurred on nondelinquent loans within each loan pool. This estimate is based on losses we expect to realize over a 23-month loss confirmation period, which is based on our historical loss experience as well as consideration of the loss factors described in *Note 3*.

Residential Loans Individually Evaluated for Impairment

If a loan is determined to be a TDR, it is removed from the general loan pools used for calculating the allowance for residential loan losses and assessed for impairment on an individual basis primarily based on any adverse change in the expected future cash flows resulting from the restructuring. The average recorded investment of loans individually evaluated for impairment for the three and nine months ended September 30, 2011 was $11 million and $12 million, respectively. The average recorded investment of loans individually evaluated for impairment for the three and nine months ended September 30, 2010 was $12 million and $10 million, respectively.

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Note 6. Residential Real Estate Loans – (continued)

The following table summarizes the balances for loans individually evaluated for impairment at September 30, 2011 and December 31, 2010.

(In Thousands)	September 30, 2011	December 31, 2010
Principal balance	$ 11,928	$ 13,352
Recorded investment	11,249	13,300
Related allowance	3,202	4,628

The following table summarizes the recorded investment and past due status of residential loans individually evaluated for impairment at September 30, 2011 and December 31, 2010.

(In Thousands)	30 – 59 Days Past Due	60 – 89 Days Past Due	90+ Days Past Due	Current	Total Loans
September 30, 2011	$ 710	$ 1,023	$ 1,331	$ 8,185	$ 11,249
December 31, 2010	2,604	—	1,046	9,650	13,300

Credit Characteristics of Residential Loans Held-for-Investment

As a percentage of total recorded investment, 99% of residential loans held-for-investment at September 30, 2011, were first lien, predominately prime-quality loans at the time of origination. The remaining 1% of loans were second lien, home equity lines of credit. The weighted average original loan-to-value (LTV) ratio for our residential loans held-for-investment outstanding at September 30, 2011 was 66%. The weighted average Fair Isaac Corporation (FICO) score for the borrowers of these loans (at origination) was 739.

We consider the year of origination of our residential loans held-for-investment to be a general indicator of credit performance as loans originated in specific years often had similar product and credit characteristics. The following table displays the recorded investment and year of origination for residential loans held-for-investment at September 30, 2011 and December 31, 2010.

(In Thousands)	September 30, 2011	December 31, 2010
2003 & Earlier	$ 1,806,822	$ 1,939,618
2004	1,064,533	1,116,358
2005	128,508	136,481
2006	184,551	191,945
2007	65,364	75,136
2008	—	—
2009	178,683	189,355
2010	403,451	208,779
2011	387,490	—
Total Recorded Investment	$ 4,219,402	$ 3,857,672

Note 7. Commercial Real Estate Loans

We invest in commercial real estate loans that we originate and service as well as loans that we acquire from third-party originators. These loans are financed with equity and long-term debt or through the Acacia entities that we sponsor. The following table summarizes the classifications and carrying value of the commercial real estate loans at September 30, 2011 and December 31, 2010.

September 30, 2011 (In Thousands)	Redwood	Acacia	Total Loans
Fair value	$ —	$ 12,563	$ 12,563
Held-for-investment	98,061	—	98,061
Total Commercial Real Estate Loans	$ 98,061	$ 12,563	$ 110,624

December 31, 2010 (In Thousands)	Redwood	Acacia	Total Loans
Fair value	$ —	$ 19,850	$ 19,850
Held-for-investment	30,536	—	30,536
Total Commercial Real Estate Loans	$ 30,536	$ 19,850	$ 50,386

Commercial Real Estate Loans at Fair Value

Commercial real estate loans at fair value are owned at the consolidated Acacia securitization entities. At September 30, 2011, there were three commercial real estate loans at fair value with an aggregate outstanding principal value of $14 million and an aggregate fair value of $13 million. At December 31, 2010, there were four commercial real estate loans at fair value with an aggregate outstanding principal value of $23 million and an aggregate fair value of $20 million.

Commercial Real Estate Loans Held-for-Investment

Commercial real estate loans held-for-investment are loans we originate or acquire from third party-originators. At September 30, 2011, there were twelve commercial real estate loans held-for-investment with an outstanding principal value of $99 million and a carrying value of $98 million. Of the $98 million commercial loans held-for-investment at September 30, 2011, 69% were originated in 2011, 31% were originated in 2010, and less than 1% were acquired in 2004. At December 31, 2010, there were four commercial real estate loans held-for-investment with an outstanding principal value and carrying value of $31 million. Of the $31 million of recorded investment in commercial loans held-for-investment at December 31, 2010, 99% were originated in the fourth quarter of 2010 and 1% were originated in 2004.

Allowance for Loan Losses on Commercial Loans

For commercial real estate loans classified as held-for-investment, we establish and maintain an allowance for loan losses for any loans we have determined to be impaired. At September 30, 2011 and December 31, 2010, there were no delinquent or impaired commercial loans.

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Note 8. Real Estate Securities

We invest in third-party residential, commercial, and CDO securities. The following table presents the fair values of our real estate securities by collateral type and entity at September 30, 2011 and December 31, 2010.

September 30, 2011 (In Thousands)	Redwood	The Fund	Acacia	Securities
Residential	$ 770,164	$ —	$ 199,590	$ 969,754
Commercial	5,887	—	39,072	44,959
CDO	1,010	—	17,530	18,540
Total Real Estate Securities	$ 777,061	$ —	$ 256,192	$ 1,033,253

December 31, 2010 (In Thousands)	Redwood	The Fund	Acacia	Securities
Residential	$ 814,683	$ 19,011	$ 248,494	$ 1,082,188
Commercial	7,496	—	43,828	51,324
CDO	1,038	4,245	16,041	21,324
Total Real Estate Securities	$ 823,217	$ 23,256	$ 308,363	$ 1,154,836

At September 30, 2011, there were $4 million of AFS residential securities that had contractual maturities greater than five years but less than ten years, and the remainder of our real estate securities had contractual maturities greater than ten years.

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Note 8. Real Estate Securities – (continued)

The following table presents our securities by accounting classification, collateral type, and ownership entity at September 30, 2011 and December 31, 2010.

September 30, 2011 (In Thousands)	Trading			AFS		
	Redwood	Acacia	Total	Redwood	The Fund	Total
Senior Securities						
Residential prime	$ —	$ 3,327	$ 3,327	$ 276,925	$ —	$ 276,925
Residential non-prime	20,756	100,238	120,994	278,161	—	278,161
Commercial	—	11,216	11,216	—	—	—
Total Senior Securities	20,756	114,781	135,537	555,086	—	555,086
Re-REMIC Securities	—	—	—	113,100	—	113,100
Subordinate Securities						
Residential prime	328	36,987	37,315	70,277	—	70,277
Residential non-prime	155	59,038	59,193	10,462	—	10,462
Commercial	—	27,856	27,856	5,887	—	5,887
CDO	960	17,530	18,490	50	—	50
Total Subordinate Securities	1,443	141,411	142,854	86,676	—	86,676
Total Real Estate Securities	$ 22,199	$ 256,192	$ 278,391	$ 754,862	$ —	$ 754,862

December 31, 2010 (In Thousands)	Trading			AFS		
	Redwood	Acacia	Total	Redwood	The Fund	Total
Senior Securities						
Residential prime	$ —	$ 4,412	$ 4,412	$ 315,891	$ —	$ 315,891
Residential non-prime	19,742	117,623	137,365	326,365	12,915	339,280
Commercial	—	11,000	11,000	—	—	—
Total Senior Securities	19,742	133,035	152,777	642,256	12,915	655,171
Re-REMIC Securities	—	—	—	85,077	—	85,077
Subordinate Securities						
Residential prime	386	49,620	50,006	53,846	—	53,846
Residential non-prime	188	76,839	77,027	13,188	6,096	19,284
Commercial	—	32,828	32,828	7,496	—	7,496
CDO	1,038	16,041	17,079	—	4,245	4,245
Total Subordinate Securities	1,612	175,328	176,940	74,530	10,341	84,871
Total Real Estate Securities	$ 21,354	$ 308,363	$ 329,717	$ 801,863	$ 23,256	$ 825,119

Senior securities are those interests in a securitization that have the first right to cash flows and are last in line to absorb losses. Of the senior securities owned at Redwood at September 30, 2011, $185 million of prime securities and $165 million of non-prime securities were financed through a non-recourse resecuritization entity, as discussed in *Note 4*. Re-REMIC securities, as presented herein, were created through the resecuritization of certain senior interests to provide additional credit support to those interests. These re-REMIC securities are therefore subordinate to the remaining senior interest, but senior to any subordinate tranches of the securitization from which they were created. Subordinate securities are all interests below senior and re-REMIC interests.

Note 8. Real Estate Securities – (continued)

For purposes of the table above, the "prime" or "non-prime" designation used to categorize our residential securities is based upon the general credit characteristics of the residential loans underlying each security at the time of origination. For example, prime residential loans are generally characterized by lower LTV ratios, and are made to borrowers with higher FICO scores. Non-prime residential loans are generally characterized by higher LTV ratios and may have been made to borrowers with lower credit scores or impaired credit histories (while exhibiting the ability to repay their loans). Regardless of whether or not the loans backing a mortgage-backed security were designated as prime or non-prime at origination, there is a risk that the borrower may not be able to repay the loan.

We elected the fair value option for certain securities at Redwood and the Acacia entities, and classify them as trading securities. The unpaid principal balance of these Acacia trading securities was $1.14 billion and $1.55 billion at September 30, 2011 and December 31, 2010, respectively.

AFS Securities

We often purchase AFS securities at a discount to their outstanding principal values. To the extent we purchase an AFS security that has a likelihood of incurring a loss, we generally do not amortize into income the portion of the purchase discount that we do not expect to collect due to the inherent credit risk of the security. We may also expense a portion of our investment in the security to the extent we believe that principal losses will exceed the purchase discount. We designate the amount of unpaid principal balance that we do not expect to receive and will not amortize into income as a credit reserve on the security, with any remaining net unamortized discounts or premiums amortized into income over time using the interest method.

The following table presents the components of carrying value (which equals fair value) of AFS securities at September 30, 2011 and December 31, 2010.

September 30, 2011 (In Thousands)	Residential	Commercial	CDO	Total
Principal balance	$ 1,135,145	$ 54,061	$ 10,689	$ 1,199,895
Credit reserve	(252,854)	(47,197)	(9,607)	(309,658)
Net unamortized (discount)	(229,521)	(2,551)	(1,082)	(233,154)
Amortized cost	652,770	4,313	—	657,083
Gross unrealized gains	112,818	1,788	50	114,656
Gross unrealized losses	(16,663)	(214)	—	(16,877)
Carrying Value	$ 748,925	$ 5,887	$ 50	$ 754,862

December 31, 2010 (In Thousands)	Residential	Commercial	CDO	Total
Principal balance	$ 1,257,601	$ 89,103	$ 89,476	$ 1,436,180
Credit reserve	(297,849)	(76,979)	(88,394)	(463,222)
Net unamortized (discount) premium	(291,093)	(5,591)	11,485	(285,199)
Amortized cost	668,659	6,533	12,567	687,759
Gross unrealized gains	153,125	1,604	—	154,729
Gross unrealized losses	(8,406)	(641)	(8,322)	(17,369)
Carrying Value	$ 813,378	$ 7,496	$ 4,245	$ 825,119

REDWOOD TRUST, INC. AND SUBSIDIARIES

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Note 8. Real Estate Securities – (continued)

The following table presents the changes for the three and nine months ended September 30, 2011, of the unamortized discount and designated credit reserves on AFS securities.

Changes in Unamortized Discount and Designated Credit Reserves on AFS Securities

Three Months Ended September 30, 2011 (In Thousands)	Residential		Commercial		CDO	
	Credit Reserve	Unamortized Discount, Net	Credit Reserve	Unamortized Discount, Net	Credit Reserve	Unamortized Premium, Net
Beginning balance – June 30, 2011	$240,899	$ 243,662	$ 48,987	$ 4,362	$ 10,780	$ 1,083
Amortization of net (discount) premium	—	(10,138)	—	(69)	—	26
Realized credit losses	(19,258)	—	(4,066)	—	(1,200)	—
Acquisitions	17,104	10,388	—	—	—	—
Sales, calls, other	(329)	(502)	—	—	—	—
Impairments	549	—	534	—	—	—
Transfers to (release of) credit reserves	13,889	(13,889)	1,742	(1,742)	27	(27)
Ending Balance – September 30, 2011	$252,854	$ 229,521	$ 47,197	$ 2,551	$ 9,607	$ 1,082

Nine Months Ended September 30, 2011 (In Thousands)	Residential		Commercial		CDO	
	Credit Reserve	Unamortized Discount, Net	Credit Reserve	Unamortized Discount, Net	Credit Reserve	Unamortized Discount, Net
Beginning balance – December 31, 2010	$297,849	$ 291,093	$ 76,979	$ 5,591	$ 88,394	$ (11,485)
Amortization of net discount	—	(32,602)	—	(138)	—	(59)
Realized credit losses	(75,523)	—	(30,018)	—	(4,205)	—
Acquisitions	18,280	21,989	—	—	—	—
Sales, calls, other	(20,517)	(21,379)	(2,653)	(1,439)	(74,662)	12,146
Impairments	3,185	—	1,426	—	560	—
Transfers to (release of) credit reserves	29,580	(29,580)	1,463	(1,463)	(480)	480
Ending Balance – September 30, 2011	$252,854	$ 229,521	$ 47,197	$ 2,551	$ 9,607	$ 1,082

The loans underlying our residential subordinate securities totaled $26 billion at September 30, 2011. These loans are located nationwide with a large concentration in California (41%). Serious delinquencies (90+ days, in foreclosure or REO) at September 30, 2011 were 5.74% of current principal balances. The loans underlying our commercial subordinate securities totaled $19 billion at September 30, 2011, and consist primarily of office (29%), retail (35%), and multifamily (12%) loans. These loans are located nationwide with the highest concentration in California (15%). Serious delinquencies (60+ days, in foreclosure or REO) at September 30, 2011 were 6.0% of current principal balances.

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Note 8. Real Estate Securities – (continued)

AFS Securities with Unrealized Losses

The following table presents the components comprising the total carrying value of AFS securities that were in a gross unrealized loss position at September 30, 2011 and December 31, 2010.

September 30, 2011 (In Thousands)	Less Than 12 Consecutive Months			12 Consecutive Months or Longer		
	Amortized Cost	Unrealized Losses	Fair Value	Amortized Cost	Unrealized Losses	Fair Value
Residential	$ 173,195	$ (6,332)	$ 166,863	$ 58,509	$ (10,331)	$ 48,178
Commercial	422	(67)	355	1,085	(147)	938
CDO	—	—	—	—	—	—
Total Securities	$ 173,617	$ (6,399)	$ 167,218	$ 59,594	$ (10,478)	$ 49,116

December 31, 2010 (In Thousands)	Less Than 12 Consecutive Months			12 Consecutive Months or Longer		
	Amortized Cost	Unrealized Losses	Fair Value	Amortized Cost	Unrealized Losses	Fair Value
Residential	$ 104,154	$ (1,628)	$ 102,526	$ 26,374	$ (6,778)	$ 19,596
Commercial	2,134	(257)	1,877	1,728	(384)	1,344
CDO	—	—	—	12,567	(8,322)	4,245
Total Securities	$ 106,288	$ (1,885)	$ 104,403	$ 40,669	$ (15,484)	$ 25,185

At September 30, 2011, after giving effect to purchases, sales, and extinguishments due to credit losses, our consolidated balance sheet included 438 AFS securities, of which 90 were in an unrealized loss position and 21 were in a continuous unrealized loss position for twelve consecutive months or longer. At December 31, 2010, our consolidated balance sheet included 509 AFS securities, of which 80 were in a continuous unrealized loss position, of which 46 were in a continuous unrealized loss position for twelve consecutive months or longer.

Of the total unrealized losses at September 30, 2011, none related to securities owned at the Fund. At December 31, 2010, $10 million of unrealized losses related to securities owned at the Fund and the remaining unrealized losses related to securities owned at Redwood.

Evaluating AFS Securities for Other-than-Temporary Impairments

When the fair value of an AFS security is below its cost basis, we evaluate the security for OTTI. Part of this evaluation is based upon adverse changes in the assumptions used to value the security. The table below summarizes the significant valuation assumptions we used for our AFS securities at September 30, 2011.

Significant Valuation Assumptions

	Range for Securities		
September 30, 2011	Prime	Non-prime	Commercial
Prepayment rates	4 – 15%	2 – 10%	N/A
Loss severity	16 – 57%	22 – 56%	33 – 50%
Projected losses	0 – 32%	1 – 40%	2 – 7%

The credit component of OTTI is recognized through our consolidated statement of income as a component of market valuation adjustments, net, while the non-credit component of OTTI is recognized through accumulated other comprehensive income, a component of equity. Total credit OTTI for the three and nine months ended September 30, 2011 was $1 million and $5 million, respectively. Total non-credit OTTI for the three and nine months ended September 30, 2011 was less than $1 million and $2 million, respectively.

REDWOOD TRUST, INC. AND SUBSIDIARIES

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Note 8. Real Estate Securities – (continued)

The following table details the activity related to the credit component of OTTI (i.e., OTTI in either current earnings or retained earnings) for AFS securities that also had a non-credit component and were still held at September 30, 2011 and 2010.

Activity of Credit Component of Other-than-Temporary Impairments

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Balance at beginning of period	$ 90,019	$ 132,030	$ 121,016	$ 146,454
Additions				
Initial credit impairments	519	377	982	680
Subsequent credit impairments	217	2,174	1,152	6,613
Reductions				
Securities sold, or expected to sell	—	—	(12,317)	(5,113)
Securities with no outstanding principal at period end	(11,056)	(7,086)	(31,134)	(21,139)
Balance at End of Period	$ 79,699	$ 127,495	$ 79,699	$ 127,495

The credit component is reduced if we sell, intend to sell, or believe we will be required to sell previously credit-impaired debt securities. Additionally, the credit loss component is reduced if we receive or expect to receive cash flows in excess of what we previously expected to receive over the remaining life of the credit-impaired debt security, the security matures, or the security experiences an event (such as full prepayment or principal losses) such that the outstanding principal is reduced to zero.

Gross Realized Gains and Losses

Gains and losses from the sale of AFS securities are recorded as realized gains on sales and calls, net, in our consolidated statements of income. The following table presents the gross realized gains on sales and calls of AFS securities for the three and nine months ended September 30, 2011 and 2010.

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Gross realized gains – sales	$ —	$ 22	$ 12,665	$ 56,546
Gross realized gains – calls	832	1,494	1,365	1,494
Gross realized losses – sales	—	—	(3,523)	(3,335)
Gross realized losses – calls	—	—	(223)	—
Total Realized Gains on Sales and Calls of AFS Securities, net	$ 832	$ 1,516	$ 10,284	$ 54,705

REDWOOD TRUST, INC. AND SUBSIDIARIES

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Note 9. Derivative Financial Instruments

The following table presents the aggregate fair value and notional amount of derivative financial instruments held by Redwood and the consolidated Acacia entities at September 30, 2011 and December 31, 2010. The derivatives held at Acacia entities are not assets or legal obligations of Redwood.

September 30, 2011 (In Thousands)	Redwood		Acacia		Total	
	Fair Value	Notional Amount	Fair Value	Notional Amount	Fair Value	Notional Amount
Assets – Risk Management Derivatives						
Interest rate swaps	$ —	$ —	$ 912	$ 5,601	$ 912	$ 5,601
TBAs	289	124,000	—	—	289	124,000
Futures	13	126,000	—	—	13	126,000
Interest rate caps purchased	—	—	1,504	703,400	1,504	703,400
Total Assets	302	250,000	2,416	709,001	2,718	959,001
Liabilities – Cash Flow Hedges						
Interest rate swaps	(51,977)	165,000	—	—	(51,977)	165,000
Liabilities – Risk Management Derivatives						
Interest rate swaps	(4,875)	154,500	(67,902)	582,794	(72,777)	737,294
TBAs	(2,397)	301,000	—	—	(2,397)	301,000
Futures	(69)	198,000	—	—	(69)	198,000
Total Liabilities	(59,318)	818,500	(67,902)	582,794	(127,220)	1,401,294
Total Derivative Financial Instruments, Net	$(59,016)	$1,068,500	$(65,486)	$1,291,795	$(124,502)	$2,360,295

December 31, 2010 (In Thousands)	Redwood		Acacia		Total	
	Fair Value	Notional Amount	Fair Value	Notional Amount	Fair Value	Notional Amount
Assets – Risk Management Derivatives						
Interest rate swaps	$ 175	$ 44,000	$ 813	$ 18,037	$ 988	$ 62,037
TBAs	348	35,000	—	—	348	35,000
Futures	703	433,000	—	—	703	433,000
Interest rate caps purchased	—	—	6,012	703,400	6,012	703,400
Total Assets	1,226	512,000	6,825	721,437	8,051	1,233,437
Liabilities – Cash Flow Hedges						
Interest rate swaps	(11,449)	155,500	—	—	(11,449)	155,500
Liabilities – Risk Management Derivatives						
Interest rate swaps	(1,283)	26,000	(69,373)	663,604	(70,656)	689,604
TBAs	(951)	124,000	—	—	(951)	124,000
Futures	(59)	225,000	—	—	(59)	225,000
Total Liabilities	(13,742)	530,500	(69,373)	663,604	(83,115)	1,194,104
Total Derivative Financial Instruments, Net	$(12,516)	$1,042,500	$(62,548)	$1,385,041	$(75,064)	$2,427,541

REDWOOD TRUST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 9. Derivative Financial Instruments – (continued)

Risk Management Derivatives

To offset — to varying degrees — the changes in the value of mortgage products to which we have exposure, we may enter into interest rate agreements, TBA contracts, and Eurodollar futures contracts.

Certain Risks Related to Unsecuritized Residential and Commercial Loans at Redwood

In order to manage certain risks associated with residential loans we own or plan to acquire and securitize, and commercial loans we invest in, at September 30, 2011, we were party to interest rate agreements with an aggregate notional amount of $154 million, TBA contracts sold, net with a notional amount of $177 million, and financial futures with an aggregate notional amount of $324 million. Net negative market valuation adjustments on these derivatives were $13 million and $16 million for the three and nine months ended September 30, 2011, respectively.

Certain Risks Related to Liabilities at Acacia Entities

Net valuation adjustments on interest rate agreements at Acacia were negative $10 million and negative $18 million for the three months ended September 30, 2011 and 2010, respectively. Net valuation adjustments on interest rate agreements at Acacia were negative $24 million and negative $59 million for the nine months ended September 30, 2011 and 2010, respectively.

Derivatives Designated as Cash Flow Hedges

To hedge the variability in interest expense related to our long-term debt and certain adjustable-rate securitization entity liabilities that are included in our consolidated balance sheets for financial reporting purposes, we designated interest rate swaps as cash flow hedges during 2010 and during the second quarter of 2011 with an aggregate notional balance of $165 million. For the three and nine months ended September 30, 2011, these hedges decreased in value by $38 million and $40 million, respectively, which was recorded as a decrease to accumulated other comprehensive income, a component of equity.

For interest rate agreements currently or previously designated as cash flow hedges, our total unrealized loss reported in accumulated other comprehensive income was $65 million at September 30, 2011 and $29 million at December 31, 2010. For both the three months ended September 30, 2011 and 2010 we reclassified $1 million of unrealized losses on derivatives to interest expense. For both the nine months ended September 30, 2011 and 2010, we reclassified $3 million of unrealized losses on derivatives to interest expense.

The following table illustrates the impact on interest expense of our interest rate agreements accounted for as cash flow hedges for the three and nine months ended September 30, 2011 and 2010.

Impact on Interest Expense of Our Interest Rate Agreements Accounted for as Cash Flow Hedges

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	**2011**	**2010**	**2011**	**2010**
Net interest expense on cash flow interest rate agreements	$ (1,637)	$ (1,486)	$ (4,803)	$ (2,523)
Realized net (expense) income due to net ineffective portion of hedges	(5)	19	(18)	(7)
Realized net losses reclassified from other comprehensive income	(1,067)	(1,058)	(3,211)	(2,604)
Total Interest Expense	$ (2,709)	$ (2,525)	$ (8,032)	$ (5,134)

REDWOOD TRUST, INC. AND SUBSIDIARIES

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Note 9. Derivative Financial Instruments – (continued)

Credit Derivatives

At September 30, 2011 and December 31, 2010, we had no outstanding CDS contracts or obligations. During the nine months ended September 30, 2010, the reference securities underlying our CDS experienced principal losses and corresponding obligations of $20 million.

Derivative Counterparty Credit Risk

We incur credit risk to the extent that counterparties to our derivative financial instruments do not perform their obligations under specified contractual agreements. If a derivative counterparty does not perform, we may not receive the proceeds to which we may be entitled under these agreements. To mitigate this risk, we enter into agreements that are either a) transacted on a national exchange or b) transacted with counterparties that are either i) designated by the Federal Reserve Bank of New York as a primary government dealer, ii) affiliates of primary government dealers, or iii) rated A or higher. We also attempt to transact with several different counterparties in order to reduce our specific counterparty exposure. We consider counterparty risk as part of our fair value assessments of all derivative financial instruments.

At September 30, 2011, Redwood had outstanding derivative agreements with eight bank counterparties and Acacia entities had outstanding derivative agreements with five bank counterparties. At September 30, 2011, Redwood and the Acacia entities were in compliance with International Swaps and Derivatives Association (ISDA) agreements governing these open derivative positions.

Note 10. Other Assets

Other assets at September 30, 2011 and December 31, 2010, are summarized in the following table.

Other Assets

(In Thousands)	September 30, 2011	December 31, 2010
REO	$ 6,554	$ 14,481
Fixed assets and leasehold improvements	2,967	3,692
Margin posted, net	57,080	16,233
Investment receivable	2,241	883
Income tax receivables	4,736	1,243
Prepaid expenses	2,221	1,973
Other	381	157
Total Other Assets	$ 76,180	$ 38,662

REO consists of foreclosed properties received in full satisfaction of defaulted real estate loans. The carrying value of REO at September 30, 2011 was $7 million, which includes the net effect of $8 million related to transfers into REO during the first nine months of 2011, offset by $15 million of REO liquidations and $1 million of negative market valuation adjustments. At September 30, 2011, there were 49 REO properties recorded on our consolidated balance sheet, all of which were owned at Sequoia. At December 31, 2010, there were 83 REO properties recorded on our balance sheet, of which 81 were owned at Sequoia and two were owned at Redwood. Properties located in Michigan, Georgia, Ohio, and California accounted for 65% of our REO properties at September 30, 2011.

Margin posted, net, was $57 million at September 30, 2011, resulting from margin calls from our swap and master repurchase agreement counterparties that required us to post collateral.

REDWOOD TRUST, INC. AND SUBSIDIARIES

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Note 11. Short-term Debt

At September 30, 2011, we had no short-term debt outstanding. For the three months ended September 30, 2011, the average balance of short-term debt outstanding was $18 million, with a weighted average interest rate of 1.72%. For the nine months ended September 30, 2011, the average balance of short-term debt outstanding was $23 million, with a weighted average interest rate of 1.58%. At December 31, 2010, we had short-term debt outstanding of $44 million, which was repaid in March 2011.

Note 12. Asset-Backed Securities Issued

The Sequoia and Acacia securitization entities issue ABS to acquire assets from us and from third-parties. Each series of ABS issued consists of various classes that pay interest on a monthly or quarterly basis. Substantially all ABS issued pay variable rates of interest, which are indexed to one, three, or six-month LIBOR. Some ABS issued pay fixed rates of interest or pay hybrid rates, which are fixed rates that subsequently adjust to variable rates. ABS issued also include some interest-only classes with coupons set at a fixed-rate or a fixed spread to a benchmark rate, or set at a spread to the interest rates earned on the assets less the interest rates paid on the liabilities of a securitization entity.

In 2011, we securitized $671 million of loans through our Sequoia program and issued $640 million of ABS to third-parties. In July 2011, we transferred $365 million of residential securities into a resecuritization, with $245 million of ABS issued to third-parties. The components of ABS issued by consolidated securitization entities we sponsored at September 30, 2011 and December 31, 2010, along with other selected information, are summarized in the following table.

Asset-Backed Securities Issued

	September 30, 2011			
(In Thousands)	**Sequoia**	**Acacia**	**Resecuritization**	**Total**
Certificates with principal balance	$ 3,813,642	$ 2,894,156	$ 232,006	$ 6,939,804
Interest-only certificates	17,950	—	—	17,950
Unamortized premium	1,357	—	—	1,357
Unamortized discount	(6,166)	—	—	(6,166)
Fair value adjustment, net	—	(2,659,921)	—	(2,659,921)
Total ABS Issued	$ 3,826,783	$ 234,235	$ 232,006	$ 4,293,024
Range of weighted average interest rates, by series	0.38% to 4.39%	0.76% to 1.93%	2.19%	
Stated maturities	2014 – 2047	2039 – 2052	2046	
Number of series	39	10	1	

	December 31, 2010			
(In Thousands)	**Sequoia**	**Acacia**	**Resecuritization**	**Total**
Certificates with principal balance	$ 3,445,882	$ 2,956,657	$ —	$ 6,402,539
Interest-only certificates	15,587	—	—	15,587
Unamortized premium	1,726	—	—	1,726
Unamortized discount	(4,694)	—	—	(4,694)
Fair value adjustment, net	—	(2,653,580)	—	(2,653,580)
Total ABS Issued	$ 3,458,501	$ 303,077	$ —	$ 3,761,578
Range of weighted average interest rates, by series	0.45% to 4.40%	0.76% to 1.88%	—	
Stated maturities	2014 – 2047	2039 – 2052	—	
Number of series	37	10	—	

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Note 12. Asset-Backed Securities Issued – (continued)

The maturity of each class of ABS issued is primarily determined by the rate of principal prepayments on the assets of the issuing entity. Each series is also subject to redemption (call) according to the specific terms of the respective governing documents. As a result, the actual maturity of ABS issued will often occur earlier than its stated maturity. At September 30, 2011, $4.2 billion of ABS issued ($6.89 billion principal balance) had contractual maturities of over five years and $51 million of ABS issued ($51 million principal balance) had contractual maturities of one to five years. Amortization of the resecuritization and Sequoia deferred ABS issuance costs was $1 million and $2 million for the nine months ended September 30, 2011 and 2010, respectively.

The following table summarizes the accrued interest payable on ABS issued at September 30, 2011 and December 31, 2010. Interest due on Sequoia and resecuritization ABS issued is payable monthly and interest due on Acacia ABS issued is payable quarterly.

Accrued Interest Payable on Asset-Backed Securities Issued

(In Thousands)	September 30, 2011	December 31, 2010
Sequoia	$ 4,236	$ 2,356
Acacia	2,687	2,911
Resecuritization	72	—
Total Accrued Interest Payable on ABS Issued	$ 6,995	$ 5,267

The following table summarizes the carrying value components of the collateral for ABS issued and outstanding at September 30, 2011 and December 31, 2010.

Collateral for Asset-Backed Securities Issued

	September 30, 2011			
(In Thousands)	Sequoia	Acacia	Resecuritization	Total
Real estate loans	$ 3,928,677	$ 12,563	$ —	$ 3,941,240
Real estate securities	—	272,222	349,764	621,986
REO	6,554	—	—	6,554
Restricted cash	283	16,632	—	16,915
Accrued interest receivable	7,925	2,082	987	10,994
Total Collateral for ABS Issued	$ 3,943,439	$ 303,499	$ 350,751	$ 4,597,689

	December 31, 2010			
(In Thousands)	Sequoia	Acacia	Resecuritization	Total
Real estate loans	$ 3,542,159	$ 19,850	$	$ 3,562,009
Real estate securities	—	327,919		327,919
Other investments	—	—		—
REO	14,241	—		14,241
Restricted cash	331	21,790		22,121
Accrued interest receivable	6,264	2,735		8,999
Total Collateral for ABS Issued	$ 3,562,995	$ 372,294	$ —	$ 3,935,289

REDWOOD TRUST, INC. AND SUBSIDIARIES

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Note 13. Long-Term Debt

In 2006, we issued $100 million of trust preferred securities through Redwood Capital Trust I, a Delaware statutory trust, in a private placement transaction. These trust preferred securities require quarterly distributions at a floating coupon rate equal to three-month LIBOR plus 2.25% until the notes are redeemed, which will be no later than January 30, 2037. The interest expense yield on our trust preferred securities was 2.62% and 3.34% for the nine months ended September 30, 2011 and 2010, respectively. Including hedging costs and amortization of deferred securities issuance costs, the interest expense yield on our trust preferred securities was 6.88% for the nine months ended September 30, 2011. The earliest optional redemption date without penalty is January 30, 2012. In December 2010, we repurchased $500 thousand principal amount of these trust preferred securities.

In 2007, we issued an additional $50 million of subordinated notes. These subordinated notes require quarterly distributions at a floating interest rate equal to three-month LIBOR plus 2.25% until the notes are redeemed, which will be no later than July 30, 2037. The interest expense yield on our subordinated notes was 2.62% and 3.34% for the nine months ended September 30, 2011 and 2010, respectively. Including hedging costs, and amortization of deferred securities issuance costs, the interest expense yield on our trust preferred securities was 6.88% for the nine months ended September 30, 2011. The earliest optional redemption date without a penalty is July 30, 2012. In July 2009, we repurchased $10 million principal amount of this subordinated debt.

At both September 30, 2011 and December 31, 2010, the accrued interest payable balance on long-term debt was less than $1 million. Under the terms of our long-term debt, we covenant to, among other things, use our best efforts to continue to qualify as a REIT. If an event of default were to occur in respect of our long-term debt, we would generally be restricted under its terms (subject to certain exceptions) from making dividend distributions to stockholders, from repurchasing common stock or repurchasing or redeeming any other then-outstanding equity securities, and from making any other payments in respect of any equity interests in us or in respect of any then-outstanding debt that is *pari passu* or subordinate to our long-term debt.

Note 14. Commitments and Contingencies

Lease Commitments

At September 30, 2011, we were obligated under non-cancelable operating leases with expiration dates through 2018 for $11 million. Operating lease expense was $1 million for both the nine months ended September 30, 2011 and 2010.

The following table presents our future lease commitments at September 30, 2011, giving effect to the amendment.

Future Lease Commitments by Year

(In Thousands)	September 30, 2011
2011 (three months)	$ 533
2012	1,913
2013	1,759
2014	1,800
2015	1,756
2016 and thereafter	3,691
Total	$ 11,452

REDWOOD TRUST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note 14. Commitments and Contingencies – (continued)

In the third quarter of 2011, we entered into a follow-on lease agreement for our executive office. The new lease, which goes into effect in the second quarter of 2012, will replace our existing lease at that time and expire in 2018. The total payments required under both the current and follow-on lease will be recognized as office rent expense on a straight-line basis over the respective lease terms. In the third quarter of 2011, we also relocated our New York office and entered into a new lease agreement. This lease expires in 2015 and accounts for approximately ten percent of our future lease obligation.

Leasehold improvements for our offices are amortized into expense over the prior lease term, expiring in 2012. The unamortized leasehold improvement balance was $2 million and $3 million, respectively, at September 30, 2011 and December 31, 2010.

Loss Contingencies — Litigation

On December 23, 2009, the Federal Home Loan Bank of Seattle (the "FHLB-Seattle") filed a claim in Superior Court for the State of Washington (case number 09-2-46348-4 SEA) against Redwood Trust, Inc., our subsidiary, Sequoia Residential Funding, Inc. ("SRF"), Morgan Stanley & Co., and Morgan Stanley Capital I, Inc. (collectively, the "FHLB-Seattle Defendants"). The FHLB-Seattle alleges claims under the Securities Act of Washington (Section 21.20.005, *et seq.*) and seeks to rescind the purchase of a mortgage pass-through certificate (or, residential mortgage backed securities, "RMBS") issued through our Sequoia RMBS platform as part of the Sequoia Mortgage Trust 2005-4 securitization transaction and purchased by the FHLB-Seattle. The FHLB-Seattle also seeks to collect interest on the original purchase price at the statutory interest rate of 8% per annum from the date of original purchase (net of interest received), as well as attorneys' fees and costs. On June 10, 2010, the FHLB-Seattle filed an amended complaint. Subsequently, on October 18, 2010, the FHLB-Seattle Defendants filed motions to dismiss the FHLB-Seattle's complaint. Redwood Trust, Inc. and SRF additionally moved to dismiss the complaint for lack of personal jurisdiction. The FHLB-Seattle alleges that the FHLB-Seattle Defendants' offering materials for this RMBS contained materially untrue statements and omitted material facts about this RMBS and the loans securitized in this transaction. Among other things, the FHLB-Seattle alleges that the FHLB-Seattle Defendants made untrue statements or omissions regarding the (1) loan-to-value ratios of these mortgage loans and the appraisals of the properties that secured these mortgage loans, (2) occupancy status of those properties, (3) underwriting standards of the originators of these mortgage loans, and (4) ratings assigned to this RMBS. In a series of rulings issued between June 23, 2011 and August 15, 2011, the Washington State Superior Court dismissed the allegations relating to occupancy status and denied other grounds for dismissal. On July 19, 2011, the Court granted Redwood Trust, Inc.'s and SRF's motion to dismiss for lack of personal jurisdiction. Redwood Trust, Inc. does not know whether the FHLB-Seattle will appeal or otherwise contest the dismissal, or file a claim in another jurisdiction. The Sequoia RMBS that is the subject of the FHLB-Seattle's claim was issued with an original principal balance of approximately $133 million and, at September 30, 2011, had a remaining outstanding principal balance of approximately $29 million. We believe that this claim is without merit and we intend to defend the action vigorously. In connection with the issuance of the Sequoia RMBS that is the subject of the FHLB-Seattle's claim, Redwood agreed to indemnify the underwriters of this RMBS for certain losses and expenses they might incur as a result of claims made against them relating to this RMBS, including, without limitation, certain legal expenses. The FHLB-Seattle's claims against the underwriters of this RMBS were not dismissed for lack of personal jurisdiction. Regardless of the outcome of this litigation, Redwood could incur a loss as a result of these indemnities.

On August 18, 2010, Redwood Trust, Inc.'s subsidiary, SRF, received service of process with respect to a claim filed on July 15, 2010 in Superior Court for the State of California in San Francisco (case number CGC-10-501610) by The Charles Schwab Corporation ("Schwab"). In the complaint, Schwab is suing SRF and 26 other named defendants (collectively, the "Schwab Defendants") in relation to RMBS sold or issued by the Schwab Defendants. With respect to SRF, Schwab alleges a cause of action of negligent

Note 14. Commitments and Contingencies – (continued)

misrepresentation under California state law and seeks unspecified damages and attorneys' fees and costs with respect to a RMBS issued through the Sequoia RMBS platform as part of the Sequoia Mortgage Trust 2005-4 securitization transaction (which is the same transaction at issue in the litigation initiated by the FHLB-Seattle described in the preceding paragraph). Among other things, Schwab alleges that the offering materials for this Sequoia RMBS contained materially untrue statements or omissions regarding this RMBS and the loans securitized in this securitization transaction, including untrue statements or omissions regarding the (1) loan-to-value ratios of these mortgage loans and the appraisals of the properties that secured these mortgage loans, (2) occupancy status of those properties, (3) underwriting standards of the originators of these mortgage loans, and (4) ratings assigned to this RMBS. On September 22, 2011, the Schwab Defendants moved to dismiss the complaint, which motions are now pending. The Sequoia RMBS that is the subject of Schwab's claim was issued with an original principal balance of approximately $14.8 million and, at September 30, 2011, had a remaining outstanding principal balance of approximately $3.2 million. We believe that this case is without merit and we intend to defend the action vigorously. In connection with the issuance of the Sequoia RMBS that is the subject of Schwab's claim, Redwood agreed to indemnify the underwriters of this RMBS for certain losses and expenses they might incur as a result of claims made against them relating to this RMBS, including, without limitation, certain legal expenses. Regardless of the outcome of this litigation, Redwood could incur a loss as a result of these indemnities.

On July 12, 2010, two notices of "Election to Void Sale of Securities" pursuant to Illinois Securities Law (815 ILCS Section 5/13(A)) were received from the Federal Home Loan Bank of Chicago (FHLB-Chicago). In the notices, the FHLB-Chicago sought to void its purchase of two RMBS that were issued in 2006 by a securitization trust with respect to which Redwood Trust, Inc.'s subsidiary, SRF, was the depositor. Subsequently, on October 15, 2010, the FHLB-Chicago filed a claim in the Circuit Court of Cook County, Illinois (case number 10-CH-45033) against SRF and more than 45 other named defendants (collectively, the "FHLB-Chicago Defendants") in relation to RMBS sold or issued by the FHLB-Chicago Defendants or by entities controlled by the FHLB-Chicago Defendants. In an amended complaint filed on March 16, 2011, FHLB-Chicago added as defendants Redwood Trust, Inc. and another one of our subsidiaries, RWT Holdings, Inc. With respect to Redwood Trust, Inc. and SRF, the FHLB-Chicago alleges that the offering materials for two RMBS issued through the Sequoia RMBS platform as part of the Sequoia Mortgage Trust 2006-1 securitization transaction contained untrue and misleading statements and material representations in violation of Illinois Securities Law (815 ILCS Sections 5/12(F)-(H)) and North Carolina Securities Law (N.C.G.S.A. § 78A-8(2) & § 78A-56(a)) and also alleges a claim of negligent misrepresentations under Illinois common law. On some of the causes of action, the FHLB-Chicago seeks to rescind the purchase of these RMBS and to collect interest on the original purchase price at the statutory interest rate of 10% per annum from the date of original purchase (net of interest received). On one cause of action, the FHLB-Chicago seeks unspecified damages. The FHLB-Chicago also seeks attorneys' fees and costs. Among other things, the FHLB-Chicago alleges that the offering materials for this RMBS contained materially untrue statements or omissions regarding this RMBS and the loans securitized in this transaction, including untrue statements or omissions regarding the (1) loan-to-value ratios of these mortgage loans and the appraisals of the properties that secured these mortgage loans, (2) occupancy status of those properties, (3) underwriting standards of the originators of these mortgage loans, (4) ratings assigned to these RMBS, and (5) due diligence performed on these mortgage loans. The first of these two Sequoia RMBS was issued with an original principal balance of approximately $105 million and, at September 30, 2011, had a remaining outstanding principal balance of approximately $43 million. The second of these two Sequoia RMBS was issued with an original principal balance of approximately $379 million and, at September 30, 2011, had a remaining outstanding principal balance of approximately $155 million. On March 27, 2011, the FHLB-Chicago Defendants moved to dismiss the amended complaint, which motions are now pending. We believe that this case is without merit, and we intend to defend the action vigorously. In connection with the issuance of the Sequoia RMBS that is the

REDWOOD TRUST, INC. AND SUBSIDIARIES

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Note 14. Commitments and Contingencies – (continued)

subject of the FHLB-Chicago's claim, Redwood agreed to indemnify the underwriters of these RMBS for certain losses and expenses they might incur as a result of claims made against them relating to these RMBS, including, without limitation, certain legal expenses. Regardless of the outcome of this litigation, Redwood could incur a loss as a result of these indemnities.

We cannot determine the outcome of any of the above-referenced litigation matters at this time or predict the results with certainty. We cannot be certain that any of these matters will not have a material adverse effect on our results of operations in any future period, and any loss or expense related to any of this litigation could have a material adverse impact on our consolidated financial statements.

In accordance with FASB guidance on accounting for contingencies, we review the need for any loss contingency reserves and establish reserves when, in the opinion of management, it is probable that a matter would result in a liability, and the amount of loss, if any, can be reasonably estimated. Additionally, we record receivables for insurance recoveries relating to litigation-related losses and expenses if and when such amounts are covered by insurance and recovery of such losses or expenses are due. If, with respect to a matter, it is not both probable to result in liability and the amount of loss cannot be reasonably estimated (as is the case for each of the above-referenced litigation matters), FASB guidance on accounting for contingencies provides that an estimate of possible loss or range of loss be disclosed unless such an estimate cannot be made. There are numerous factors that make it difficult to meaningfully estimate possible loss or range of loss at this stage of these litigation matters, including that: the proceedings are in relatively early stages, there are significant factual and legal issues to be resolved, information obtained or rulings made during the lawsuits could affect the methodology for calculation of rescission and the related statutory interest rate, our belief that these litigations are without merit, and our intent to defend these actions vigorously. In addition, with respect to claims where damages are the requested relief, no amount of loss or damages has been specified. We also may have additional rights and/or obligations pursuant to indemnity agreements, representations and warranties, and other contractual provisions with other parties relating to these litigation matters. These rights and obligations could offset or increase our potential losses. We are unable at this time to estimate the potential amount of any such offset or loss.

Note 15. Equity

The following table provides a summary of changes to stockholders' equity for the three and nine months ended September 30, 2011.

Stockholders' Equity

(In Thousands)	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Balance at beginning of period	$ 1,024,510	$ 1,064,753
Net income attributable to Redwood Trust, Inc.	1,297	28,901
Distributions to shareholders	(20,114)	(60,474)
Unrealized gains on securities and derivatives, net	(48,312)	(80,030)
Other changes in equity, net	1,564	5,795
Balance at End of Period	$ 958,945	$ 958,945

REDWOOD TRUST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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(Unaudited)

Note 15. Equity – (continued)

Accumulated Other Comprehensive Income

The following table provides a summary of the components of accumulated other comprehensive income at September 30, 2011 and December 31, 2010.

(In Thousands)	September 30, 2011	December 31, 2010
Net unrealized gains on real estate securities	$ 97,779	$ 137,360
Less: Unrealized losses attributable to noncontrolling interest	—	(4,164)
Net unrealized gains on real estate securities recognized in equity	97,779	141,524
Net unrealized losses on interest rate agreements accounted for as cash flow hedges	(65,470)	(29,185)
Total Accumulated Other Comprehensive Income	$ 32,309	$ 112,339

Noncontrolling Interest

Noncontrolling interest represents the aggregate limited partnership (LP) interests in the Fund held by third-parties. During the second quarter of 2011, the Fund sold all remaining securities and during the third quarter of 2011, the Fund distributed all remaining cash to investors, and had no assets or liabilities at September 30, 2011. There was no noncontrolling interest on our consolidated balance sheet at September 30, 2011. Of the total equity recorded on our consolidated balance sheet at December 31, 2010, $11 million was noncontrolling interest. Income allocated to the noncontrolling interest is based on the 48% third-party LP ownership percentage. The ownership percentage is determined by dividing the number of units held by third-party LP investors by the total units outstanding.

Earnings Per Common Share

The following table provides the basic and diluted earnings per common share computations for the three and nine months ended September 30, 2011 and 2010.

Basic and Diluted Earnings Per Common Share

(In Thousands, Except Share Data)	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Basic Earnings Per Common Share:				
Net income attributable to Redwood	$ 1,297	$ 19,898	$ 28,901	$ 95,343
Less: Dividends and undistributed earnings allocated to participating securities	520	539	1,659	2,655
Net income allocated to common shareholders	$ 777	$ 19,359	$ 27,242	$ 92,688
Basic weighted average common shares outstanding	78,470,625	77,901,970	78,275,796	77,794,106
Basic Earnings Per Common Share	$ 0.01	$ 0.25	$ 0.35	$ 1.19
Diluted Earnings Per Common Share:				
Net income attributable to Redwood	$ 1,297	$ 19,898	$ 28,901	$ 95,343
Less: Dividends and undistributed earnings allocated to participating securities	520	541	1,659	2,235
Net income allocated to common shareholders	$ 777	$ 19,357	$ 27,242	$ 93,108
Basic weighted average common shares outstanding	78,470,625	77,901,970	78,275,796	77,794,106
Net effect of dilutive equity awards	—	1,059,235	—	969,583
Diluted weighted average common shares outstanding	78,470,625	78,961,205	78,275,796	78,763,689
Diluted Earnings Per Common Share	$ 0.01	$ 0.25	$ 0.35	$ 1.18

REDWOOD TRUST, INC. AND SUBSIDIARIES

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Note 15. Equity – (continued)

For the three and nine months ended September 30, 2011, there were no dilutive equity awards determined under the two-class method as dividend distributions were greater than net income for each of these periods. Therefore, diluted earnings per common share was computed in the same manner as basic earnings per share. For the three and nine months ended September 30, 2010, there were 1,059,235 and 969,583, respectively, of dilutive equity awards determined under the two-class method. We included participating securities in the calculation of diluted earnings per common share as we determined that the two-class method was more dilutive than the alternative treasury stock method. For the three and nine months ended September 30, 2011, the number of outstanding equity awards that were antidilutive totaled 1,689,546 and 1,850,659, respectively, under the two-class method. For the three and nine months ended September 30, 2010, the number of outstanding equity awards that were antidilutive totaled 648,963 and 590,578, respectively, under the two-class method. There were no other participating securities during these periods.

Stock Repurchases

We announced a stock repurchase authorization in November 2007 for the repurchase of up to 5,000,000 common shares. This plan replaced all previous share repurchase plans and has no expiration date. During the three and nine months ended September 30, 2011, there were 222,386 shares acquired under the plan. At September 30, 2011, there remained 4,435,685 shares available for repurchase under this plan.

Note 16. Equity Compensation Plans

At September 30, 2011 and December 31, 2010, 1,192,148 and 1,052,826 shares of common stock, respectively, were available for grant under Redwood's Incentive Plan. The unamortized compensation cost under the Incentive Plan and the Employee Stock Purchase Plan totaled $13 million at September 30, 2011, as shown in the following table.

(In Thousands)	Nine Months Ended September 30, 2011					
	Stock Options	Restricted Stock	Deferred Stock Units	Performance Stock Units	Employee Stock Purchase Plan	Total
Unrecognized compensation cost at beginning of period	$ —	$ 1,390	$14,420	$ 3,320	$ —	$19,130
Equity grants	—	7	637	—	120	764
Equity compensation cost	—	(355)	(5,397)	(854)	(90)	(6,696)
Unrecognized Compensation Cost at End of Period	$ —	$ 1,042	$ 9,660	$ 2,466	$ 30	$13,198

At September 30, 2011, the weighted average amortization period remaining for all of our equity awards was less than two years.

Stock Options

At September 30, 2011 and December 31, 2010, there were 455,115 and 459,115, respectively, of fully vested stock options outstanding. There was no aggregate intrinsic value for the options outstanding and exercisable at September 30, 2011.

For the three and nine months ended September 30, 2011 and 2010, there were no stock options exercised. For the nine months ended September 30, 2010, there were 11,500 stock options exercised with an intrinsic value or gain (fair market value less exercise price) of a negligible amount.

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Note 16. Equity Compensation Plans – (continued)

Restricted Stock

At September 30, 2011 and December 31, 2010, there were 100,871 and 119,071 shares, respectively, of restricted stock awards outstanding. Restrictions on these shares lapse through 2015. There were no restricted stock awards granted during the three months ended September 30, 2011. There were 1,647 restricted stock awards granted during the nine months ended September 30, 2011.

Deferred Stock Units

At September 30, 2011 and December 31, 2010, there were 1,943,599 and 2,351,804 DSUs outstanding, respectively, of which 1,000,963 and 1,042,341, respectively, had vested. There were 5,803 and 65,971 DSUs granted during the three and nine months ended September 30, 2011, respectively. During the three and nine months ended September 30, 2011, the number of DSUs distributed to participants in the Executive Deferred Compensation Plan (EDCP) totaled 3,098 and 456,640, respectively. During the three months ended September 30, 2011, there were no cash distributions to participants in the EDCP. Cash distributions to EDCP participants of some of their previously deferred compensation totaled less than $1 million during the nine months ended September 30, 2011.

In March 2010, vesting of 376,564 DSUs previously awarded to Mr. George E. Bull, III, was accelerated to June 1, 2010, in connection with the announcement that he would retire from serving as Chief Executive Officer in the second quarter of 2010. We recorded a $4 million equity compensation expense during the three months ended March 31, 2010, related to the modification of these DSUs. No such equity award modifications occurred during the nine months ended September 30, 2011.

Performance Stock Units

At both September 30, 2011 and December 31, 2010, there were 243,754 PSUs outstanding, none of which had vested. These PSUs may cliff vest on November 30, 2013, the third anniversary of their grant date, with vesting contingent on total stockholder return (defined as the change in our common stock price plus dividends paid on our common stock relative to the per share price of our common stock on the date of the PSU grant) over the three-year vesting period (Three-Year TSR). The number of underlying shares of our common stock that will vest on November 30, 2013, will vary between 0% (if Three-Year TSR is negative) and 200% (if Three-Year TSR is greater than or equal to 125%) of the number of these PSUs originally granted on November 30, 2010, adjusted (if vesting is greater than 0%) to reflect the value of dividends paid during the three-year vesting period.

Employee Stock Purchase Plan

The ESPP allows a maximum of 200,000 shares of common stock to be purchased in aggregate for all employees. At September 30, 2011 and December 31, 2010, 143,546 and 121,643 shares have been purchased, respectively, and there remained a negligible amount of uninvested employee contributions in the ESPP.

REDWOOD TRUST, INC. AND SUBSIDIARIES

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Note 17. Operating Expenses

Components of our operating expenses for the three and nine months ended September 30, 2011 and 2010 are presented in the following table.

Operating Expenses

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	**2011**	**2010**	**2011**	**2010**
Fixed compensation expense	$ 3,702	$ 3,362	$ 11,643	$ 11,444
Variable compensation expense	863	2,206	2,109	5,389
Equity compensation expense	1,929	1,507	6,696	9,643
Total compensation expense	6,494	7,075	20,448	26,476
Systems	2,124	2,220	5,979	5,531
Office costs	1,517	1,791	4,838	5,338
Accounting and legal	1,022	852	2,566	2,362
Other operating expenses	350	307	1,276	1,071
Total Operating Expenses	$ 11,507	$ 12,245	$ 35,107	$ 40,778

Note 18. Taxes

For each of the three and nine months ended September 30, 2011 and 2010, we recognized a provision for income taxes of less than $1 million. The following is a reconciliation of the statutory federal and state tax rates to our projected annual effective rate at September 30, 2011 and 2010.

Reconciliation of Statutory Tax Rate to Effective Tax Rate

	September 30,	
	2011	**2010**
Federal statutory rate	34.0%	34.0%
State statutory rate, net of Federal tax effect	7.2%	7.2%
Differences in taxable income from GAAP income	(41.1)%	(41.1)%
Effective Tax Rate	0.1%	0.1%

We assessed our tax positions for all open tax years (Federal — years 2006 to 2010, State — years 2005 to 2010) and concluded at September 30, 2011 and December 31, 2010, that we had no material unrecognized tax liabilities.

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

Introduction

Redwood Trust, Inc., together with its subsidiaries, is a financial institution that seeks to invest in real estate related assets that have the potential to provide attractive cash flows over a long period of time and support our goal of distributing attractive levels of dividends to our stockholders. For tax purposes, we are structured as a real estate investment trust (REIT). We are able to pass through substantially all of our earnings generated at our REIT to our stockholders without paying income tax at the corporate level. We pay income tax on the REIT taxable income we retain and on the income we earn at our taxable subsidiaries. Redwood was incorporated in the State of Maryland on April 11, 1994, and commenced operations on August 19, 1994. Our executive offices are located at One Belvedere Place, Suite 300, Mill Valley, California 94941.

References herein to "Redwood," the "company," "we," "us," and "our" include Redwood Trust, Inc. and its consolidated subsidiaries, unless the context otherwise requires. Financial information concerning our business is set forth in "*Management's Discussion and Analysis of Financial Condition and Results of Operations*," the consolidated financial statements and notes thereto, and the supplemental financial information, which is included in Part I, Items 1 and 2 of this Quarterly Report on Form 10-Q.

Our website can be found at*www.redwoodtrust.com*. We make available, free of charge through the investor information section of our website, access to our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the U.S. Securities Exchange Act of 1934, as well as proxy statements, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the U.S. Securities and Exchange Commission (SEC). We also make available, free of charge, access to our Corporate Governance Standards, charters for our Audit Committee, Compensation Committee, and Corporate Governance and Nominating Committee, our Corporate Governance Standards, and our Code of Ethics governing our directors, officers, and employees. Within the time period required by the SEC and the New York Stock Exchange, we will post on our website any amendment to the Code of Ethics and any waiver applicable to any executive officer, director, or senior officer (as defined in the Code). In addition, our website includes information concerning purchases and sales of our equity securities by our executive officers and directors, as well as disclosure relating to certain non-GAAP and financial measures (as defined in the SEC's Regulation G) that we may make public orally, telephonically, by webcast, by broadcast, or by similar means from time to time. Through the commercial section of our website, we also disclose information about our origination or acquisition of new commercial real estate loans, generally within five business days of origination or acquisition. We believe that this information may be of interest to investors in Redwood, although we may not always disclose on our website each new commercial loan we originate or acquire (or we may not disclose them on our website within the five business day period described above) due to, among other reasons, confidentiality obligations to the borrowers of those loans. The information on our website is not part of this Quarterly Report on Form 10-Q.

Our Investor Relations Department can be contacted at One Belvedere Place, Suite 300, Mill Valley, CA 94941, Attn: Investor Relations, telephone (866) 269-4976.

Cautionary Statement

This Quarterly Report on Form 10-Q and the documents incorporated by reference herein contain forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve numerous risks and uncertainties. Our actual results may differ from our beliefs, expectations, estimates, and projections and, consequently, you should not rely on these forward-looking statements as predictions of future events. Forward-looking statements are not historical in nature and can be identified by words such as "anticipate," "estimate," "will," "should," "expect," "believe," "intend," "seek," "plan" and similar expressions or their negative forms, or by references to strategy, plans, or intentions. These forward-looking statements are subject to risks and uncertainties, including, among other things, those described in Part II, Item 1A of this quarterly report on Form 10-Q and those described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, under the caption "*Risk Factors.*" Other risks, uncertainties, and factors that could cause actual results

to differ materially from those projected may be described from time to time in reports we file with the SEC, including reports on Forms 10-Q and 8-K. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

Statements regarding the following subjects, among others, are forward-looking by their nature: (i) our competitive position and our ability to compete in the future, including our ability to effectively compete to acquire residential mortgage loans and our ability to compete to originate and acquire commercial real estate loans; (ii) our future investment strategy and our ability to find investments with attractive risk return profiles, including, without limitation, statements relating to our efforts to acquire residential mortgage loans, make commercial real estate investments, and make residential investments in the secondary market; (iii) statements relating to our plan to acquire loans included in our pipeline of residential mortgage loans that, as of the end of the third quarter of 2011, we planned to purchase through our conduit program and our plan to acquire additional loans that we have already added, or plan in the future to add, to our pipeline after the end of the third quarter of 2011, including loan included in our pipeline of residential mortgage loans as of October 31, 2011; (iv) our statements that changes in the conforming loan limits are expected to result in incremental volume for our residential loan conduit and that our residential loan conduit could also benefit from banks exiting the correspondent mortgage lending business or otherwise refocusing their business on retail customers; (v) our statement, in respect of the risk management activities we carry out relating to our pipeline of residential mortgage loans we own or plan to acquire for future securitization, that under normal market conditions and assuming we have hedged well, we would expect our risk management derivatives to keep our pipeline economically neutral to changing interest rates (i.e., that the gain or loss on our derivatives would roughly match a loss or gain in the value of our pipeline of loans); (vi) our expectations relating to income statement volatility; (vii) future securitization transactions, the timing of the completion of those future securitization transactions, and the number and size of such transactions we expect to complete in 2011 and future periods, which future securitizations may not be completed when planned or at all, and, more generally, statements regarding the likelihood and timing of, and our participation in, future securitization transactions and our ability to finance loan acquisitions through the execution of securitization transactions; (viii) our statement that we expect to reverse an aggregate of $7 million of loan loss reserves that relate to eleven Sequoia securitization entities in future periods upon the retirement or deconsolidation of those entities; (ix) that we do not expect to need to raise equity capital financing over the next couple of quarters (which expectation, we note, could change as 2012 unfolds), that we would consider raising equity or another form of long-term capital only when investment opportunities make raising capital attractive, and that we have exhausted our ability to raise financing through other sources; (x) statements relating to our estimates of our investment capacity (including that we estimate our investment capacity was $206 million at September 30, 2011), our short-term borrowing capacity, our excess capital, and the amount of cash we need to cover short-term operations, working capital, and a liquidity cushion; (xi) our statement that we may use mortgage warehouse borrowing facilities to finance the acquisition of residential mortgage loans in the future; (xii) future market and economic conditions and the future volume of transactions in those markets, including, without limitation, future conditions in the residential and commercial real estate markets and related financing markets (e.g., the CMBS market), and the related potential opportunities for our residential and commercial businesses; (xiii) our beliefs about, and our outlook for, the future direction of housing market fundamentals, including, without limitation, home prices, demand for housing, delinquency rates, foreclosure rates, prepayment rates, inventory of homes for sale, and mortgage interest rates and their potential impact on our business and results of operations and our belief that the housing market is in the process of forming a bottom and our expectation that housing, in general, will not be a significantly appreciating asset class for several years; (xiv) our beliefs about the future direction of commercial real estate fundamentals and statements regarding the competitive landscape for and availability of financing for commercial real estate; (xv) our expectation that in the near term our commercial real estate loan originations are likely to be in the range of $25 million to $50 million per quarter in the near future and our statement that we could see origination volumes at the higher end of this range; (xvi) statements relating to the impact of recent and future legislative and regulatory changes that affect our business, the regulation of securitization transactions, and the mortgage finance markets, the manner in which the reform of the GSEs, including Fannie Mae and Freddie Mac, may take place and the timeline for that reform; (xvii) our statement that we are optimistic that any regulatory changes relating to the Investment Company Act exclusion that we rely on will not have a negative impact on us or companies like us; (xviii) our expectations regarding credit reserves, credit losses, the adequacy of credit support, and impairments and their impact on our investments (including as compared to our original expectations and credit reserve levels) and the timing of losses and impairments, and statements that the amount of credit reserves we designate may require changes in the future; (xix) expectations regarding future interest income, future earnings, future earnings volatility, and future trends in operating expenses and the factors that may affect those trends; and (xx) our expectations and estimates relating to tax accounting and our anticipation of additional credit losses for tax purposes in 2011 and future periods and the level of those losses.

Important factors, among others, that may affect our actual results include: general economic trends, the performance of the housing, commercial real estate, mortgage, credit, and broader financial markets, and their effects on the prices of earning assets and the credit status of borrowers; federal and state legislative and regulatory developments, and the actions of governmental authorities, including those affecting the mortgage industry or our business; our exposure to credit risk and the timing of credit losses within our portfolio; the concentration of the credit risks we are exposed to, including due to the structure of assets we hold and the geographical concentration of real estate underlying assets we own; our exposure to adjustable-rate and negative amortization mortgage loans; the efficacy and expense of our efforts to manage or hedge credit risk, interest rate risk, and other financial and operational risks; changes in credit ratings on assets we own and changes in the rating agencies' credit rating methodologies; changes in interest rates; changes in mortgage prepayment rates; the availability of assets for purchase at attractive prices and our ability to reinvest cash we hold; changes in the values of assets we own; changes in liquidity in the market for real estate securities and loans; our ability to finance the acquisition of real estate-related assets with short-term debt; the ability of counterparties to satisfy their obligations to us; our involvement in securitization transactions and the risks we are exposed to in engaging in securitization transactions; exposure to litigation arising from our involvement in securitization transactions; whether we have sufficient liquid assets to meet short-term needs; our ability to successfully compete and retain or attract key personnel; our ability to adapt our business model and strategies to changing circumstances; changes in our investment, financing, and hedging strategies and new risks we may be exposed to if we expand our business activities; exposure to environmental liabilities and the effects of global climate change; failure to comply with applicable laws and regulations; our failure to maintain appropriate internal controls over financial reporting and disclosure controls and procedures; the impact on our reputation that could result from our actions or omissions or from those of others; changes in accounting principles and tax rules; our ability to maintain our status as a REIT for tax purposes; limitations imposed on our business due to our REIT status and our status as exempt from registration under the Investment Company Act of 1940; decisions about raising, managing, and distributing capital; and other factors not presently identified.

This Quarterly Report on Form 10-Q may contain statistics and other data that in some cases have been obtained from or compiled from information made available by servicers and other third-party service providers.

Our Business

Redwood invests in, finances, and manages real estate assets. We invest in residential and commercial real estate loans and in securities backed by real estate loans. We seek to invest in assets that have the potential to generate sufficient long-term cash flow returns to support our goal of distributing an attractive level of dividends per share to shareholders over time.

Our primary source of income is typically net interest income, which consists of the interest income we earn from our investments less the interest expenses we incur on borrowed funds and other liabilities. We assume a range of risks in our investments and the level of risk is influenced by the manner in which we finance our purchases of, and derive income from, our investments.

Our investments include residential and commercial real estate loans and securities backed by residential and commercial loans. The securities include both senior securities and subordinate securities. Senior securities are those interests in a securitization that have the first right to cash flows and are last to absorb losses. Subordinate securities are those interests in a securitization that have the last right to cash flows and are first in line to absorb losses. We may also invest in re-REMIC securities, or securities that were created

through the resecuritization of certain senior interests in residential mortgage securitizations to provide additional credit support to those interests.

Residential securities we invest in are generally acquired by us from third-parties or by retaining mortgage-backed securities issued by Sequoia securitization trusts, which are securitization entities we sponsor. The process of sponsoring a Sequoia securitization includes the acquisition of residential loans, which we generally fund with equity and short-term debt during the accumulation period, the transfer of a pool of those loans to a Sequoia securitization entity, and the structuring and issuance by the Sequoia securitization entity of mortgage-backed securities collateralized by that pool of loans. Senior securities issued by Sequoia securitization entities are generally issued to third-parties, while the subordinate securities issued by these entities are generally retained by us.

Historically, we have also sponsored other entities: a private limited partnership fund that we managed, the Redwood Opportunity Fund, LP (the Fund), and Acacia securitization entities that we also manage. The Fund was and the Acacia securitization entities are generally invested in a variety of real estate related assets. Our investments in these entities are currently financed with equity and long-term debt. We are not currently seeking to sponsor other entities like the Fund and the Acacia securitization entities. During the third quarter of 2011, we engaged in a resecuritization transaction primarily for the purpose of obtaining permanent non-recourse financing on a portion of our residential securities portfolio.

Each securitization and resecuritization entity is independent of Redwood and of each other and the assets and liabilities are not owned by and are not legal obligations of Redwood, although we are exposed to certain financial risks associated with our role as the sponsor or manager of these entities. For financial reporting purposes, we are required to consolidate the assets and liabilities of the resecuritization we engaged in during the third quarter of 2011, and the assets and liabilities of many of the Sequoia and Acacia securitization entities we have sponsored. Prior to the third quarter of 2011, we consolidated the assets, liabilities, and noncontrolling interests of the Fund.

The commercial real estate loans we invest in are primarily originated by us and any commercial mortgage-backed securities we invest in are acquired from third-parties. Our commercial investments are currently financed with equity and long-term debt.

For tax purposes, we are structured as a REIT. As a REIT, we are able to pass through substantially all of our earnings to our stockholders without paying income tax at the corporate level. We pay income tax on the REIT taxable income we retain and on the income we earn at our taxable subsidiaries.

Business Update — Third Quarter 2011

We made steady progress building our residential and commercial businesses in the third quarter despite challenging market conditions. We completed another residential mortgage securitization, continued to put capital to work in our commercial business, and were able to invest additional capital in secondary residential mortgage securities at attractive yields. When it comes to our financial performance, we are not satisfied with our third quarter results. While the negative impact of market conditions combined with our accounting treatment for certain risk management derivatives (which is discussed in the *"Hedging our Residential Loan Pipeline"* section of this *Management's Discussion and Analysis of Financial Condition and Results of Operation*) certainly contributed to these results, we believe we need to put more capital to work at attractive levels and further leverage our cost structure. Progress has been slower than we would like, but we are encouraged by the operating progress in our businesses and believe we are headed in the right direction.

Our GAAP net income for the third quarter of 2011 was $1 million (or $0.01 per share), down from $9 million (or $0.11 per share) reported for the second quarter of 2011. The decline in net income was largely driven by falling interest rates, which resulted in a $13 million ($0.17 per share) negative mark-to-market adjustment on derivatives primarily used to manage risks associated with the residential loans we owned or planned to purchase for securitization. Our financial results are presented in more detail throughout this quarter's *Management's Discussion and Analysis of Financial Condition and Results of Operations*.

The third quarter can be characterized by the significant market dislocation evident throughout the credit markets. The well-documented causes of the dislocation include the debt crisis in Europe, the debt ceiling conflicts in the U.S., and deteriorating global economic fundamentals. These factors, among others, caused

investors to pursue safer and more liquid investments, driving the 10-year Treasury bond from an interest yield of 3.16% at the beginning of the third quarter, to a low of 1.72% later in the quarter. With this challenging environment as a backdrop, we were encouraged by our ability to invest capital. Our long-term investments increased by $70 million in the third quarter, which is net of $20 million of paydown (there were no sales). This capital was invested across our businesses — in commercial loans ($27 million), residential securities acquired in the secondary markets ($44 million), and securities created through our residential loan business ($19 million).

Residential Mortgage Loan Business

We completed our second residential securitization of 2011 in September, marking our third securitization since we restarted our residential mortgage loan business in 2010. While we take some satisfaction from completing the transaction and from being the first and only company to securitize newly originated residential mortgage loans without government subsidies since 2008, there are still many issues to be resolved before the market recovers and we are potentially joined by other issuers. Presumably, regulators from several government agencies are trying to absorb and analyze the numerous highly detailed comment letters submitted by market participants related to risk retention and the definition of a qualified mortgage in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). We will not be surprised if the process is delayed or if another request for comment is issued by these agencies. There are other long-pending issues related to mortgage servicing, disclosure, and the role of the credit rating agencies that also need to be resolved. Although we don't expect these issues will be resolved soon, they have not stopped us from moving ahead with our residential loan business.

During the third quarter we added five loan originators, bringing the total number of originators that we may purchase loans to ten. Additionally, there were sixteen originators that were in various stages of implementation. We purchased $405 million of loans in the third quarter, as compared to $152 million in the second quarter, and finished the third quarter with $227 million in loans on our consolidated balance sheet and an additional $295 million of loans we plan to purchase. At October 31, 2011, loans held on our balance sheet for future securitization and loans we plan to purchase totaled $570 million. We expect to complete our next securitization late in the fourth quarter of 2011 or in the first quarter of 2012.

Residential Portfolio Business

The third quarter was a difficult quarter for credit markets, including the market for non-agency Residential Mortgage-Backed Securities (RMBS). Non-agency RMBS backed by subprime and option ARM loans declined by 5% to 10% in price, while higher credit quality RMBS did not, in general, experience the same magnitude of price declines, as investors sought safety and limited their risk exposure. Bid-ask spreads widened in the third quarter, making it more difficult to transact on securities. Despite these challenges, we managed to invest $43 million of capital in prime RMBS at yields not attainable in the first two quarters of 2011.

For the remainder of the 2011, we believe there will be additional opportunities to make residential investments at attractive risk return profiles. We believe that Wall Street dealers are holding a higher inventory of RMBS than they might by year-end as a result of increased funding pressures and the prospect of higher capital requirements. Making long-term investments in securities with credit-risk profiles we find attractive — especially during periods of illiquidity when returns relative to credit risk are often most attractive — has been a core investment philosophy of ours. We hope to be able to apply that discipline in the months ahead.

Commercial Loan Business

Our commercial group continued to patiently invest capital in the third quarter, and it appears the turbulence we see in the commercial markets may increase our opportunities in the near term. With credit spreads increasing in the Commercial Mortgage-Backed Securities (CMBS) market, issuers have been forced to increase subordination levels in recent deals. As a result, the surge in CMBS volume that began in late 2010 had slowed significantly by the third quarter and continued at a more moderate pace through October 2011. Despite the slowdown in activity, forecasters are calling for CMBS issuance volume of $30 billion for 2011, which would still be a threefold increase from the prior year.

The slowdown in CMBS issuance has enabled portfolio lenders to increase their market share. We expect the demand for mezzanine financing will grow and the relative predictability of high quality commercial real estate cash flows will continue to attract capital. During the third quarter, we invested $27 million of capital through the origination of three commercial mezzanine loans. We also originated a $15 million mezzanine loan early in the fourth quarter, bringing the portfolio total to $113 million at October 31, 2011. These loans are, for example, backed by stabilized multi-family properties, central business district office buildings in major markets, necessity/grocery-anchored retail centers, and hotels with strong brands and operators. Our portfolio has a weighted average maturity of over five years, an average yield above 10%, an average LTV ratio of 73% at origination, and an average debt service coverage ratio of 1.15x at origination, as determined in accordance with our underwriting guidelines for commercial loans.

Looking forward, competition for higher quality assets in specific markets may continue to drive asset values up and capitalization rates down. We continue to observe significant transaction activity, particularly for stabilized income-producing assets against a backdrop of improving fundamentals on a property level. In the near term, we expect to be able to originate commercial loans in the aggregate amount of $25 million to $50 million per quarter.

Outlook

We continue to proceed with building our residential conduit and commercial businesses. As we move forward with these goals in mind, we remain focused on the challenges we continue to face, such as the current level of federal government intervention in the mortgage market. While the temporary increase in the size limits for loans eligible for purchase by Fannie Mae and Freddie Mac ("conforming limits") was allowed to expire at the end of September 2011, efforts have been undertaken by various lobbyists to restore the higher limit. In late October 2011, the United States Senate voted in favor of a measure to raise the limit back to recent levels for two more years. To be enacted, the U.S. House of Representatives and the President would need to approve the increase. We do not believe the proposed increase is likely to be approved, as both the Republican-controlled House of Representatives and the Obama Administration have consistently been in favor of lowering the conforming limits over time, but we can't be sure. Regardless of where the conforming loan limits ultimately settle, we continue to believe that the best way to bring more private capital to the mortgage market is for the government to begin reducing its approximately 90% share of the residential mortgage market.

In the third quarter, the SEC published a Concept Release relating to the status of companies, like Redwood, that rely on a certain exclusion from the definition of an "investment company" in the Investment Company Act. In summary, this exclusion exempts companies that are primarily engaged in the mortgage banking business. Registered investment companies, such as mutual funds, are subjected to a high level of SEC regulatory oversight — generally including, daily disclosure of changes in net asset values and limitations on financial leverage and transactions with affiliates. We believe that the SEC's Concept Release was prompted by a concern for protecting retail investors in externally-managed, leveraged, fund-like companies whose business is exclusively focused on investing in mortgage-backed securities. In contrast, we believe that our residential and commercial mortgage businesses are of the types of businesses that were intended to be within the scope of the exemption. We are optimistic that any regulatory changes that may eventually result from the SEC's Concept Release will not have a negative impact on companies such as ours. If we are wrong, it may require wholesale and adverse changes to our business model and operations.

In the fourth quarter, regulatory changes were enacted to the Home Affordable Refinance Program (the "Program"). We do not expect these changes to have a significant impact on our residential loan business. The revisions to the Program are intended to increase refinance opportunities for current borrowers whose loans are owned or guaranteed by Fannie Mae or Freddie Mac. Refinance help for similarly situated borrowers who were financed through private RMBS is not currently available.

Summary of Results of Operations

Net Income

Our reported GAAP net income was $1 million ($0.01 per share) for the third quarter of 2011, as compared to $20 million ($0.25 per share) for the third quarter of 2010. We declared regular quarterly dividends of $0.25 per share for both the third quarters of 2011 and 2010.

The following table presents the components of our GAAP net income for the three and nine months ended September 30, 2011 and 2010.

Table 1 Net Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands, Except Share Data)	**2011**	**2010**	**2011**	**2010**
Interest income	$ 53,396	$ 59,015	$ 160,684	$ 174,301
Interest expense	(24,317)	(23,695)	(69,923)	(63,040)
Net interest income	29,079	35,320	90,761	111,261
Provision for loan losses	(3,978)	(2,436)	(8,367)	(16,233)
Market valuation adjustments, net	(13,448)	(1,573)	(30,335)	(19,935)
Net interest income after provision and market valuation adjustments	11,653	31,311	52,059	75,093
Operating expenses	(11,507)	(12,245)	(35,107)	(40,778)
Realized gains on sales and calls, net	1,145	1,566	10,844	61,985
Provision for income taxes	(14)	(202)	(42)	(254)
Less: Net (loss) income attributable to noncontrolling interest	(20)	532	(1,147)	703
Net Income	$ 1,297	$ 19,898	$ 28,901	$ 95,343
Diluted weighted average common shares outstanding	78,470,625	78,961,205	78,275,796	78,763,689
Net earnings per share	$ 0.01	$ 0.25	$ 0.35	$ 1.18

The “*Results of Operations and Financial Condition*” section of this “*Management's Discussion and Analysis of Financial Condition and Results of Operations*” contains a detailed analysis of the components of our GAAP net income.

Net Interest Income after Provision and Market Valuation Adjustments (MVA)

Net interest income after provision and MVA was $12 million for the third quarter of 2011, as compared to $31 million for the third quarter of 2010, a decrease of $19 million. This decrease was primarily due to declining benchmark interest rates that reduced the market values of our risk management derivatives, a decrease in our average holdings of securities that reduced interest income, and a modestly higher provision for our legacy Sequoia entities.

Market valuation adjustments, net, were negative $13 million for the third quarter of 2011, as compared to negative $2 million for the third quarter of 2010, an adverse change of $11 million. The following table details the components of the change for both the three and nine months ended September 30, 2011 and 2010.

Table 2 Components of MVA

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	**2011**	**2010**	**2011**	**2010**
Commercial real estate loans (fair value)	$ (184)	$ 3	$ 1,358	$ 7,347
Residential real estate loans (held-for-sale)	363	159	374	335
Trading securities	(5,359)	47,375	4,963	65,854
Impairment on AFS securities	(1,083)	(2,580)	(5,171)	(8,742)
REO	(255)	(620)	(1,416)	(1,979)
Risk management derivatives	(23,460)	(20,207)	(40,216)	(63,051)
ABS issued – Acacia	16,530	(25,703)	9,773	(19,699)
Total Market Valuation Adjustments, Net	$ (13,448)	$ (1,573)	$ (30,335)	$ (19,935)

In order to manage certain risks associated with residential and commercial loans we own or plan to acquire at Redwood, we may enter into various interest-rate derivatives, since the value of our loans changes with the level of interest rates. When we incur a gain or loss on these derivatives due to a change in interest rates, this amount is generally intended to offset a corresponding change in the value of the loans. For financial reporting purposes, the periodic gain or loss on derivatives classified as trading instruments is reflected in our consolidated statements of income as it is incurred, while any corresponding change in the value of the loans may be taken through lower or higher interest income over time. Thus, while risk management derivatives are intended to protect economic values, the accounting treatment can result in unavoidable periodic mismatches that affect our reported results. See the "*Hedging our Residential Loan Pipeline*" section of this Management's Discussion and Analysis for additional analysis of risk management derivatives.

Operating Expenses

Operating expenses were $12 million for both the third quarters of 2011 and 2010.

Realized Gains on Sales and Calls, Net

Realized gains on sales and calls, net, were $1 million for the third quarter of 2011, a slight decline from the third quarter of 2010. During the third quarter of 2011, we recognized a $256 thousand loss upon deconsolidation of the Fund. The following table details the components of realized gains on sales and calls, net, for the three and nine months ended September 30, 2011 and 2010.

Table 3 Realized Gains on Sales and Calls, Net

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	**2011**	**2010**	**2011**	**2010**
Net gains on sales of real estate securities	$ —	$ 22	$ 9,141	$ 53,213
Net gains on repurchase of Sequoia ABS	—	—	—	6,959
Net gains on extinguishment of debt	569	39	817	317
Net gains on calls	832	1,494	1,142	1,494
Loss on deconsolidation	(256)	—	(256)	—
Net losses on U.S. Treasuries	—	11	—	2
Total Realized Gains on Sales and Calls, Net	$ 1,145	$ 1,566	$ 10,844	$ 61,985

Estimated Taxable Income (Loss) for Federal Tax Purposes

Our estimated total taxable income was $6 million ($0.07 per share) for the third quarter of 2011, as compared to a taxable loss of $9 million ($0.11 per share) for the third quarter of 2010. Our estimated REIT taxable income was $7 million ($0.09 per share) for the third quarter of 2011, as compared to a REIT taxable loss of $9 million ($0.11 per share) for the third quarter of 2010. Total realized credit losses on subordinate securities for the third quarters of 2011 and 2010 were $12 million ($0.15 per share) and $31 million ($0.40 per share), respectively.

Our REIT taxable income is that portion of our total taxable income that we earn at Redwood and its qualifying REIT subsidiaries and determines the minimum amount of dividends we must distribute to shareholders in order to maintain our tax status as a REIT.

Summary of Financial Condition, Capital Resources, and Liquidity

At September 30, 2011, our total capital was $1.1 billion, including $959 million in stockholders' equity and $140 million of long-term debt. We use our capital to invest in earning assets, meet lender capital requirements, and fund our operations and working capital needs. We do not expect a need to raise equity capital over the next couple of quarters, but that could change as 2012 unfolds. We would consider raising equity or another form of long-term capital only when investment opportunities make raising equity capital attractive, providing we have exhausted our ability to raise financing through other sources. We estimate that our investment capacity — or the amount of capital we have readily available to support long-term investments — was $206 million at September 30, 2011. We estimate our investment capacity as (1) cash on hand, plus (2) cash we believe we could raise by increasing short-term borrowings to finance all of our residential mortgage loans held for securitization, less (3) cash needed to cover short-term operations, working capital, and a liquidity cushion. We will continue to look for ways to leverage our capital without taking undue funding risk before raising new capital.

We are engaged in negotiations with financial institution counterparties to establish one or more warehouse credit facilities that will allow us to incur short-term borrowings secured by pledges of residential mortgage loans and we currently anticipate establishing one or more of these facilities during the fourth quarter of 2011. We may also establish other additional short-term borrowing facilities.

Components of Book Value

The following supplemental components of book value table presents our assets and liabilities at September 30, 2011 and June 30, 2011. We show our investments in the Sequoia and Acacia entities and the Fund as separate line items, as estimated under GAAP, to highlight our specific ownership interests, as the underlying assets and liabilities of these entities are legally not ours even though we are required to consolidate them for financial reporting purposes. For all other components of book value, the values in the table below equal GAAP values.

Table 4 Components of Book Value

(In Millions, Except per Share Data)	September 30, 2011	June 30, 2011
Cash and cash equivalents	$ 133	$ 80
Real estate loans		
Residential	229	205
Commercial	98	71
Total real estate loans at Redwood	327	276
Real estate securities at Redwood		
Residential[1]	770	754
Commercial	6	6
CDO	1	1
Total real estate securities at Redwood	777	761
Investments in Sequoia	101	90
Investments in Acacia	1	1
Investments in the Fund	—	3
Other assets	77	39
Total assets	1,416	1,250
Short-term debt	—	(41)
Long-term debt	(140)	(140)
Asset-backed securities issued – Resecuritization[1]	(232)	—
Other liabilities	(85)	(44)
Stockholders' Equity	**$ 959**	**$ 1,025**
Book Value Per Share	**$ 12.22**	**$ 13.04**

(1) The assets and liabilities of the resecuritization we engaged in during the third quarter of 2011 are included in Real estate securities at Redwood — Residential and Asset-backed securities issued — Resecuritization, respectively, although these assets and liabilities are owned by the resecuritization entity and are legally not ours and we own only the securities and interests that we acquired from the resecuritization entity. At September 30, 2011, the resecuritization accounted for $350 million of real estate securities and $232 million of asset-backed securities issued and our investment in this resecuritization is reflected in the difference between these assets and liabilities.

Changes in Book Value and Estimated Non-GAAP Economic Value

During the third quarter of 2011, our GAAP book value decreased by $0.82 per share to $12.22 per share. The net decrease resulted from $0.01 per share increase from reported earnings, $0.15 per share in net negative valuation decreases on securities not reflected in earnings, $0.47 per share in decreases in value of derivative hedges related to long-term debt not reflected in earnings, $0.25 per share from dividends paid to shareholders, and $0.04 from other net positive items.

At September 30, 2011, our estimate of non-GAAP economic value was $13.33 per share, or $1.11 per share higher than our reported GAAP book value. Approximately $1.06 of this per share difference relates to an economic valuation of our long-term debt of $57 million, which was $83 million below the unamortized cost basis used to determine GAAP book value. An additional $0.06 per share relates to an economic valuation of our net investment in Sequoia of $106 million, which was $5 million above the unamortized cost basis used to determine GAAP book value. These amounts were offset by $0.01 per share relating to an economic valuation of our net investment in the resecuritization we engaged in during the third quarter of 2011 that was $1 million above the unamortized cost basis used to determine GAAP book value. A further discussion of our estimate of non-GAAP economic value is set forth below under "*Investments in Securitization Entities*" and "*Factors Affecting Management's Estimate of Economic Book Value*"

Cash and Cash Equivalents

At September 30, 2011, we had $133 million in cash and cash equivalents, as compared to $80 million at June 30, 2011, an increase of $53 million. The increase was primarily attributable to cash raised during the third quarter of 2011 from a Sequoia loan securitization and a resecuritization of certain of our senior securities, offset by the acquisition of residential mortgage loans and securities, originations of commercial loans, and posting of margin.

As a supplement to the Consolidated Statements of Cash Flows included in this Quarterly Report on Form 10-Q, the following table details our sources and uses of cash for the three and nine months ended September 30, 2011. This table illustrates our cash balances at September 30, 2011, June 30, 2011, and December 31, 2010 (each a GAAP amount), and the components of sources and uses of cash organized in a manner consistent with the way management analyzes them by aggregating and netting all items within our GAAP Consolidated Statements of Cash Flows that were attributable to the periods presented.

Table 5 Sources and Uses of Cash

(In Millions)	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Beginning Cash Balance	$ 80	$ 47
Sources of Cash[(1)]		
Loans at Redwood – Principal and Interest	11	22
Proceeds from New Sequoia securitization	379	675
Proceeds from resecuritization	243	243
Securities at Redwood – Principal and Interest[(2)]		
Residential senior	28	91
Residential re-REMIC	2	5
Residential subordinate	7	24
Commercial and CDO	1	2
Sales of securities	—	44
Investments in Consolidated Entities[(3)]	11	42
Short-term debt	—	41
Margin returned, net	—	3
Changes in working capital	2	4
Total Sources of Cash	$ 684	$ 1,196
Uses of Cash		
Acquisitions of residential loans	(405)	(658)
Originations of commercial loans	(27)	(68)
Acquisitions of securities[(4)]	(48)	(90)
Investment in New Sequoia	(19)	(34)
Short-term debt repayment	(41)	(85)
Cash operating expenses	(10)	(39)
Margin posted, net	(33)	(44)
Derivative pair-off	(9)	(9)
Interest expense on long-term debt	(2)	(6)
ABS issued – Principal and Interest[(2)]	(14)	(14)
Dividends	(20)	(60)
Common share repurchase	(3)	(3)
Total Uses of Cash	(631)	(1,110)
Net Sources of Cash	53	86
Ending Cash Balance	$ 133	$ 133

(1) Cash flow from securities and investments can be volatile from quarter to quarter depending on the level of invested capital, the timing of credit losses, acquisitions, sales, and changes in prepayments and interest rates. Therefore, (i) cash flow generated by these investments in a given period is not necessarily reflective of the long-term economic return we will earn on the investments; and (ii) it is difficult to determine what portion of the cash received from an investment is a return "of" principal and what portion is a return "on" principal in a given period.

(2) Sources of cash from residential securities include the cash received from the securities that were included in the resecuritization we engaged in during the third quarter of 2011, and ABS issued — principal and interest reflect payments in respect of ABS issued in that resecuritization.

(3) This table excludes the gross cash flow generated by our investments in the Sequoia and Acacia entities

and the Fund (cash flow that is not available to Redwood), but does include the cash flow distributed to Redwood as a result of our investments in these entities.

(4) Total acquisitions of securities in the third quarter of 2011 were $44 million. Securities acquisitions of $4 million made in the second quarter that settled in July are reflected in the third quarter. There were no unsettled trades at the end of the third quarter.

Real Estate Securities at Redwood

The following table presents the components of fair value (which equals GAAP carrying value) for real estate securities at Redwood at September 30, 2011. We categorize our securities by portfolio vintage (the year(s) the securities were issued), by priority of cash flows — senior, re-REMIC, and subordinate — and, for residential, by quality of underlying loans — prime and non-prime.

Table 6 Securities at Redwood by Vintage and as a Percentage of Total Securities

September 30, 2011 (In Millions)	2004 & Earlier	2005	2006 – 2008	Total	% of Total Securities
Residential					
Senior					
Prime	$ 12	$ 202	$ 63	$ 277	36%
Non-prime	104	189	6	299	38%
Total Senior	116	391	69	576	74%
Re-REMIC prime	2	19	92	113	15%
Subordinate					
Prime	61	6	4	71	9%
Non-prime	10	—	—	10	1%
Total Subordinate	71	6	4	81	10%
Total Residential	189	416	165	770	99%
Commercial	6	—	—	6	1%
CDO	—	1	—	1	—%
Total Securities at Redwood	$ 195	$ 417	$ 165	$ 777	100%

During the third quarter of 2011, our securities portfolio increased from $761 million to $777 million. This increase is attributable to acquisitions of $44 million, offset by $20 million from the effect of principal paydowns and $8 million from the net effect of gains on sales, calls and valuation changes. Our third quarter acquisitions included $3 million of prime subordinate securities, $3 million of prime senior securities, $1 million of non-prime senior securities, and $37 million of re-REMIC securities. Through October 31, 2011, we acquired $14 million of securities at Redwood.

Unrealized Gains and Losses on Real Estate Securities and Derivatives

At September 30, 2011, we had net unrealized gains of $32 million recorded to accumulated other comprehensive income, a component of stockholders' equity, an $80 million decrease from the net unrealized gains of $112 million at December 31, 2010. The following table presents the activity related to unrealized gains and losses on securities and derivatives for the nine months ended September 30, 2011.

Table 7 Accumulated Other Comprehensive Income

(In Millions)	Senior Residential	Re-REMIC Residential	Subordinate			Derivatives	Total
			Residential	Commercial	CDO		
December 31, 2010	$ 87	$ 52	$ 5	$ 1	$ (4)	$ (29)	$112
OTTI recognized in OCI	—	—	(1)	—	—	—	(1)
Net unrealized loss on real estate securities	(36)	(6)	(8)	—	—	—	(50)
Net unrealized loss on interest rate agreements	—	—	—	—	—	(40)	(40)
Reclassification:							
Other-than-temporary impairment to net income	1	—	2	1	—	—	4
Unrealized loss to noncontrolling interest	—	—	—	—	4	—	4
Unrealized loss on interest rate agreements to net income	—	—	—	—	—	3	3
Accumulated Income (Loss) Recognized in Stockholders' Equity at September 30, 2011	$ 52	$ 46	$ (2)	$ 2	$ —	$ (66)	$ 32

During the first nine months of 2011, $4 million of net unrealized losses were reclassified to earnings upon recognition of other-than-temporary impairment (OTTI), $1 million of OTTI were recognized in unrealized losses, and $50 million of fair value decreases on securities were recognized in net unrealized gains. A portion of these fair value changes, $4 million, was attributable to AFS securities owned at the Fund and reclassified to noncontrolling interest.

A significant aspect of our ongoing risk management activities entails managing the interest-rate exposure brought about by long-term liabilities, primarily our $140 million of long-term debt. Changes in the values of derivatives designated as cash flow hedges used to offset changes in future payment obligations currently flow — to the extent effective — through our consolidated balance sheet and not our consolidated income statement. The significant decline in benchmark interest rates during the third quarter of 2011 caused a $37 million decline in the value of these derivatives, accounting for 56% of the book value decline in the third quarter. At September 30, 2011, interest rate agreements previously or currently accounted for as cash flow hedges had an unrealized loss of $66 million, a $37 million reduction from the net unrealized loss of $29 million at December 31, 2010. During the first nine months of 2011, $3 million of net unrealized losses on interest rate agreements related to derivatives previously designated as cash flow hedges were reclassified to earnings, and $40 million of valuation decreases associated with derivatives currently accounted for cash flow hedges were recognized in other comprehensive income.

While changes in the value of derivatives designated as cash flow hedges affect reported book value from quarter to quarter, we have a long-term view on the underlying hedging relationships. For instance, the derivative hedges closely match the terms of our long-term debt, which has a remaining life of approximately 26 years. At some point during this time frame, interest rates may rise, increasing the value of these hedges. Through October 31, 2011, as a result of the recent rise in rates, our long-term debt hedges have recovered in value by approximately $9 million quarter-to-date.

Investments in Securitization Entities

The estimated carrying value of our investments in the Sequoia and Acacia entities totaled $102 million, or 11% of our equity at September 30, 2011. During the third quarter of 2011, cash flow generated by our investments on these entities totaled $8 million.

At September 30, 2011, the estimated carrying value of our investments in Sequoia entities was $101 million and management's estimate of the non-GAAP economic value was $106 million. The non-GAAP economic value of New Sequoia was $49 million and the non-GAAP economic value of Legacy Sequoia was $57 million. The $101 million estimate of carrying value represents the difference between the carrying costs of the assets ($3.9 billion at September 30, 2011) and liabilities ($3.8 billion at September 30, 2011) owned at the consolidated Sequoia entities. The $106 million estimate of economic value consists of $53 million of interest-only securities (IOs) and $53 million of senior and subordinate securities and is calculated using the same valuation process that we follow to fair value our other real estate securities.

At September 30, 2011, the estimated carrying value of our investments in the Acacia entities was $1 million.

Factors Affecting Management's Estimate of Economic Book Value

In reviewing our non-GAAP estimate of economic value, there are a number of important factors and limitations to consider. The estimated economic value of our stockholders' equity is calculated as of a particular point in time based on our existing assets and liabilities or, in certain cases, our estimate of economic value of our existing assets and liabilities, and does not incorporate other factors that may have a significant impact on that value, most notably the impact of future business activities and cash flows. As a result, the estimated economic value of our stockholders' equity does not necessarily represent an estimate of our net realizable value, liquidation value, or our market value as a whole. Amounts we ultimately realize from the disposition of assets or settlement of liabilities may vary significantly from the estimated economic values of those assets and liabilities. Because temporary changes in market conditions can substantially affect our estimate of the economic value of our stockholders' equity, we do not believe that short-term fluctuations in the economic value of our assets and liabilities are necessarily representative of the effectiveness of our investment strategy or the long-term underlying value of our business.

Our estimated non-GAAP economic value is calculated using bid-side asset marks (or estimated bid-side values) and offer-side marks for our financial liabilities (or estimated offered-side values), as required to determine fair value under GAAP. When quoted market prices or observable market data are not available to estimate fair value, we rely on Level 3 inputs. Because assets and liabilities classified as Level 3 are generally based on unobservable inputs, the process of calculating economic value is generally subjective and involves a high degree of management judgment and assumptions. These assumptions may have a significant effect on our estimates of economic value, and the use of different assumptions as well as changes in market conditions could have a material effect on our results of operations or financial condition.

For GAAP, we report as a liability the $140 million outstanding principal amount of our long-term debt. We calculated the $57 million estimate of non-GAAP economic value of our long-term debt based on its stated interest rate using the same valuation process used to fair value our other financial assets and liabilities. The differences between the GAAP carrying value of our investments in Sequoia entities and management's estimate of the non-GAAP economic value of those investments is set forth above under "*Investments in Securitization Entities*."

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Results of Operations and Financial Condition

The following tables present the results of Redwood (Parent), New Sequoia (Sequoia securitization entities issued in 2010 and subsequent periods), and Other Consolidated Entities in order to supplement our consolidated GAAP results for the three and nine months ended September 30, 2011 and 2010. The interest income and expense related to the resecuritization we engaged in during the third quarter of 2011 are included at Redwood (Parent). Additionally, these tables present the New Sequoia securitization entities separately from Other Consolidated Entities to highlight our renewed focus on growing our core business of creating residential credit investments. Other Consolidated Entities include Sequoia entities issued prior to 2010, Acacia entities, and the Fund.

Table 8 Consolidating Income Statements

(In Thousands)	Three Months Ended September 30, 2011				
	Redwood (Parent)	New Sequoia	Other Consolidated Entities	Intercompany Adjustments	Redwood Consolidated
Interest income	$ 28,220	$ 4,648	$ 20,528	$ —	$ 53,396
Interest expense	(3,583)	(3,928)	(16,806)	—	(24,317)
Net interest income	24,637	720	3,722	—	29,079
Provision for loan losses	—	(8)	(3,970)	—	(3,978)
Market valuation adjustments, net	(12,337)	—	(1,111)	—	(13,448)
Net interest income (loss) after provision and market valuation adjustments	12,300	712	(1,359)	—	11,653
Operating expenses	(11,451)	—	(56)	—	(11,507)
Realized gains on sales and calls, net	576	—	569	—	1,145
Income from New Sequoia	712	—	—	(712)	—
Loss from Other Consolidated Entities	(826)	—	—	826	—
Noncontrolling interest	—	—	20	—	20
Net income (loss) before provision for taxes	1,311	712	(826)	114	1,311
Provision for income taxes	(14)	—	—	—	(14)
Net Income (Loss)	$ 1,297	$ 712	$ (826)	$ 114	$ 1,297

(In Thousands)	Three Months Ended September 30, 2010				
	Redwood (Parent)	New Sequoia	Other Consolidated Entities	Intercompany Adjustments	Redwood Consolidated
Interest income	$ 26,445	$ 2,315	$ 30,255	$ —	$ 59,015
Interest expense	(2,621)	(1,760)	(19,314)	—	(23,695)
Net interest income	23,824	555	10,941	—	35,320
Provision for loan losses	—	(9)	(2,427)	—	(2,436)
Market valuation adjustments, net	114	—	(1,687)	—	(1,573)
Net interest income after provision and market valuation adjustments	23,938	546	6,827	—	31,311
Operating expenses	(12,207)	—	(38)	—	(12,245)
Realized gains on sales and calls, net	1,505	—	61	—	1,566
Income from New Sequoia	546	—	—	(546)	—
Income from Other Consolidated Entities	6,318	—	—	(6,318)	—
Noncontrolling interest	—	—	(532)	—	(532)
Net income before provision for taxes	20,100	546	6,318	(6,864)	20,100
Provision for income taxes	(202)	—	—	—	(202)
Net Income	$ 19,898	$ 546	$ 6,318	$ (6,864)	$ 19,898

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(In Thousands)	Nine Months Ended September 30, 2011				
	Redwood (Parent)	New Sequoia	Other Consolidated Entities	Intercompany Adjustments	Redwood Consolidated
Interest income	$ 82,042	$ 11,964	$ 66,678	$ —	$ 160,684
Interest expense	(8,518)	(10,208)	(51,197)	—	(69,923)
Net interest income	73,524	1,756	15,481	—	90,761
Provision for loan losses	—	(21)	(8,346)	—	(8,367)
Market valuation adjustments, net	(18,406)	—	(11,929)	—	(30,335)
Net interest income (loss) after provision and market valuation adjustments	55,118	1,735	(4,794)	—	52,059
Operating expenses	(34,859)	(7)	(241)	—	(35,107)
Realized gains (losses) on sales and calls, net	11,583	—	(739)	—	10,844
Income from New Sequoia	1,728	—	—	(1,728)	—
Loss from Other Consolidated Entities	(4,627)	—	—	4,627	—
Noncontrolling interest	—	—	1,147	—	1,147
Net income (loss) before provision for taxes	28,943	1,728	(4,627)	2,899	28,943
Provision for income taxes	(42)	—	—	—	(42)
Net Income (Loss)	$ 28,901	$ 1,728	$ (4,627)	$ 2,899	$ 28,901

(In Thousands)	Nine Months Ended September 30, 2010				
	Redwood (Parent)	New Sequoia	Other Consolidated Entities	Intercompany Adjustments	Redwood Consolidated
Interest income	$ 79,292	$ 3,905	$ 91,104	$ —	$ 174,301
Interest expense	(5,913)	(3,147)	(53,980)	—	(63,040)
Net interest income	73,379	758	37,124	—	111,261
Provision for loan losses	—	(21)	(16,212)	—	(16,233)
Market valuation adjustments, net	(6,543)	—	(13,392)	—	(19,935)
Net interest income after provision and market valuation adjustments	66,836	737	7,520	—	75,093
Operating expenses	(40,272)	—	(506)	—	(40,778)
Realized gains on sales and calls, net	55,543	—	6,442	—	61,985
Income from New Sequoia	737	—	—	(737)	—
Income from Other Consolidated Entities	12,753	—	—	(12,753)	—
Noncontrolling interest	—	—	(703)	—	(703)
Net income before provision for taxes	95,597	737	12,753	(13,490)	95,597
Provision for income taxes	(254)	—	—	—	(254)
Net Income	$ 95,343	$ 737	$ 12,753	$ (13,490)	$ 95,343

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At September 30, 2011, 77% of our consolidated assets and 90% of our consolidated liabilities were owned at the consolidated Sequoia and Acacia entities that we sponsor. Although we consolidate these assets and liabilities for financial reporting purposes, they are bankruptcy-remote from us. That is, they are structured so that Redwood's obligations are not liabilities of the consolidated entities and the liabilities of the consolidated entities are not legal obligations of Redwood.

The following table presents the components of our non-GAAP consolidating balance sheet at September 30, 2011.

Table 9 Consolidating Balance Sheet

September 30, 2011 (In Thousands)	Redwood (Parent)[1]	New Sequoia	Other Consolidated Entities	Intercompany Adjustments	Redwood Consolidated
Residential real estate loans	$ 228,906	$ 742,931	$ 3,185,746	$ —	$ 4,157,583
Commercial real estate loans	98,061	—	12,563		110,624
Real estate securities, at fair value:					
Trading securities	22,199	—	256,192	—	278,391
Available-for-sale securities	754,862	—	—	—	754,862
Cash and cash equivalents	133,446	—	—	—	133,446
Investment in New Sequoia	53,696	—	—	(53,696)	—
Investment in Other Consolidated Entities	48,178	—	—	(48,178)	—
Total earning assets	1,339,348	742,931	3,454,501	(101,874)	5,434,906
Other assets	76,573	6,646	36,208	—	119,427
Total Assets	$ 1,415,921	$ 749,577	$ 3,490,709	$ (101,874)	$ 5,554,333
Short-term debt	$ —	$ —	$ —	$ —	$ —
Other liabilities	85,470	2,488	74,906	—	162,864
Asset-backed securities issued	232,006	693,393	3,367,625	—	4,293,024
Long-term debt	139,500	—	—	—	139,500
Total liabilities	456,976	695,881	3,442,531	—	4,595,388
Stockholders' equity	958,945	53,696	48,178	(101,874)	958,945
Noncontrolling interest	—	—	—	—	—
Total equity	958,945	53,696	48,178	(101,874)	958,945
Total Liabilities and Equity	$ 1,415,921	$ 749,577	$ 3,490,709	$ (101,874)	$ 5,554,333

(1) The consolidating balance sheet presents the assets and liabilities of the resecuritization we engaged in during the third quarter of 2011 under Redwood (Parent), although these assets and liabilities are owned by the resecuritization entity and are legally not ours and we own only the securities and interests that we acquired from the resecuritization entity. At September 30, 2011, the resecuritization accounted for $350 million of available-for-sale securities and $232 million of asset-backed securities issued and our investment in this resecuritization is reflected in the difference between these assets and liabilities.

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Results of Operations — Redwood (Parent)

Net Interest Income after MVA at Redwood (Parent)

Net interest income after MVA at Redwood was $12 million and $24 million for the three months ended September 30, 2011 and 2010, respectively. Net interest income after MVA at Redwood was $55 million and $67 million for the nine months ended September 30, 2011 and 2010, respectively. The interest income and interest expense related to the resecuritization we engaged in during the third quarter of 2011 are included in Redwood (Parent). The following table presents the components of net interest income after MVA at Redwood for the three and nine months ended September 30, 2011 and 2010.

Table 10 Net Interest Income after MVA at Redwood (Parent)

(Dollars in Thousands)	Three Months Ended September 30, 2011 Interest Income/ (Expense)	2011 Average Amortized Cost	2011 Yield	2010 Interest Income/ (Expense)	2010 Average Amortized Cost	2010 Yield
Interest Income						
Residential real estate loans	$ 3,583	$ 313,763	4.57%	$ 271	$ 16,463	6.58%
Commercial real estate loans	2,158	79,445	10.87%	60	242	99.17%
Trading securities	2,032	21,014	38.68%	2,351	20,540	45.78%
Available-for-sale securities	20,442	637,180	12.83%	23,674	652,438	14.51%
Cash and cash equivalents	5	124,467	0.02%	89	241,278	0.15%
Total Interest Income	28,220	1,175,869	9.60%	26,445	930,961	11.36%
Interest Expense						
Short-term debt	(78)	18,116	(1.72)%	(2)	—	(0.00)%
ABS issued	(1,121)	181,776	(2.47)%	—	—	—
Long-term debt[1]	(907)	138,242	(2.62)%	(1,198)	138,620	(3.46)%
Interest rate agreements[1]	(1,477)	138,242	(4.27)%	(1,421)	138,620	(4.10)%
Total Interest Expense	(3,583)	338,134	(4.24)%	(2,621)	138,620	(7.56)%
Net Interest Income	24,637			23,824		
Market valuation adjustments, net	(12,337)			114		
Net Interest Income After MVA at Redwood	$ 12,300			$23,938		

(Dollars in Thousands)	Nine Months Ended September 30, 2011 Interest Income/ (Expense)	2011 Average Amortized Cost	2011 Yield	2010 Interest Income/ (Expense)	2010 Average Amortized Cost	2010 Yield
Interest Income						
Residential real estate loans	$ 7,562	$ 214,574	4.70%	$ 332	$ 7,077	6.26%
Commercial real estate loans	4,688	58,632	10.66%	74	243	40.65%
Trading securities	6,164	20,862	39.40%	7,866	19,592	52.80%
Available-for-sale securities	63,597	635,338	13.35%	70,826	659,603	14.34%
Cash and cash equivalents	31	108,865	0.04%	194	249,745	0.10%
Total Interest Income	82,042	1,038,271	10.54%	79,292	936,260	11.29%
Management fees						
Interest Expense						
Short-term debt	(267)	22,520	(1.58)%	(38)	2,640	(1.92)%
ABS issued	(1,121)	61,258	(2.44)%	—	—	—
Long-term debt[1]	(2,716)	138,231	(2.62)%	(3,467)	138,384	(3.34)%
Interest rate agreements[1]	(4,414)	138,231	(4.26)%	(2,408)	138,384	(2.32)%
Total Interest Expense	(8,518)	222,009	(5.12)%	(5,913)	141,024	(5.59)%
Net Interest Income	73,524			73,379		
Market valuation adjustments, net	(18,406)			(6,543)		
Net Interest Income After MVA at Redwood	$ 55,118			$66,836		

(1) Interest rate agreement expense relates to cash-flow hedges on long-term debt. The combined expense yield on our hedged long-term debt is 6.89% and 6.88% for the three and nine months ended September 30, 2011, respectively.

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The $12 million decrease in net interest income after MVA for the three months ended September 30, 2011, was primarily due to an increase in negative MVA during the third quarter of 2011 as a result of valuation decreases on risk management derivatives.

Net Interest Income at Redwood (Parent)

Net interest income at Redwood was $25 million and $24 million for the three months ended September 30, 2011 and 2010, respectively. Net interest income at Redwood was $74 million and $73 million for the nine months ended September 30, 2011 and 2010, respectively. Higher interest income from commercial and residential loans was partially offset by lower interest income from real estate securities. In future periods, we expect our expanding residential and commercial loan businesses to represent a larger portion of our net interest income.

The following tables present the components of the interest income we earned on AFS securities for the three and nine months ended September 30, 2011 and 2010.

Table 11 Interest Income — AFS Securities at Redwood (Parent)

Three Months Ended September 30, 2011

(Dollars in Thousands)	Interest Income	Discount (Premium) Amortization	Total Interest Income	Average Amortized Cost	Yield as a Result of [1] Interest Income	Discount (Premium) Amortization	Total Interest Income
Residential							
Senior	$ 5,473	$ 8,621	$ 14,094	$508,262	4.31%	6.78%	11.09%
Re-REMIC	1,737	(62)	1,675	41,598	16.70%	(0.60)%	16.10%
Subordinate	2,541	1,579	4,120	82,600	12.31%	7.65%	19.96%
Total Residential	9,751	10,138	19,889	632,460	6.17%	6.41%	12.58%
Commercial	484	69	553	4,720	41.02%	5.85%	46.87%
CDO	26	(26)	—	—	N/A	N/A	N/A
Total AFS Securities	$ 10,261	$ 10,181	$ 20,442	$637,180	6.44%	6.39%	12.83%

Three Months Ended September 30, 2010

(Dollars in Thousands)	Interest Income	Discount (Premium) Amortization	Total Interest Income	Average Amortized Cost	Yield as a Result of [1] Interest Income	Discount (Premium) Amortization	Total Interest Income
Residential							
Senior	$ 6,583	$ 9,617	$ 16,200	$567,483	4.64%	6.78%	11.42%
Re-REMIC	1,794	(336)	1,458	33,250	21.59%	(4.04)%	17.55%
Subordinate	3,002	871	3,873	44,431	27.02%	7.84%	34.86%
Total Residential	11,379	10,152	21,531	645,164	7.05%	6.29%	13.34%
Commercial	2,137	(2)	2,135	7,274	117.50%	(0.10)%	117.40%
CDO	34	(26)	8	—	N/A	N/A	N/A
Total AFS Securities	$ 13,550	$ 10,124	$ 23,674	$652,438	8.31%	6.21%	14.52%

Nine Months Ended September 30, 2011

(Dollars in Thousands)	Interest Income	Discount (Premium) Amortization	Total Interest Income	Average Amortized Cost	Yield as a Result of[1] Interest Income	Discount (Premium) Amortization	Total Interest Income
Residential							
Senior	$ 17,236	$ 27,193	$ 44,429	$521,278	4.41%	6.96%	11.37%
Re-REMIC	4,750	(159)	4,591	34,930	18.13%	(0.61)%	17.52%
Subordinate	7,976	4,965	12,941	73,733	14.42%	8.98%	23.40%
Total Residential	29,962	31,999	61,961	629,941	6.34%	6.77%	13.11%
Commercial	1,465	138	1,603	5,397	36.22%	3.38%	39.60%
CDO	112	(79)	33	—	N/A	N/A	N/A
Total AFS Securities	$ 31,539	$ 32,058	$ 63,597	$635,338	6.62%	6.73%	13.35%

Nine Months Ended September 30, 2010

(Dollars in Thousands)	Interest Income	Discount (Premium) Amortization	Total Interest Income	Average Amortized Cost	Yield as a Result of[1] Interest Income	Discount (Premium) Amortization	Total Interest Income
Residential							
Senior	$ 21,598	$ 30,141	$ 51,739	$569,338	5.06%	7.06%	12.12%
Re-REMIC	6,237	(1,471)	4,766	37,783	22.01%	(5.19)%	16.82%
Subordinate	9,658	1,013	10,671	45,030	28.60%	3.00%	31.60%
Total Residential	37,493	29,683	67,176	652,151	7.67%	6.07%	13.74%
Commercial	3,838	(290)	3,548	7,452	68.67%	(5.20)%	63.47%
CDO	179	(77)	102	—	N/A	N/A	N/A
Total AFS Securities	$ 41,510	$ 29,316	$ 70,826	$659,603	8.39%	5.93%	14.32%

(1) Cash flow from many of our subordinate securities can be volatile and in certain cases (e.g., when the fair values of certain securities are close to zero) any interest income earned can result in unusually high reported yields that are not sustainable and not necessarily meaningful.

Interest income from available-for-sale securities at Redwood was $20 million for the third quarter of 2011, a decline of $4 million from the third quarter of 2010. Interest income from available-for-sale securities at Redwood was $64 million for the nine months ended September 30, 2011, a decline of $7 million from the nine months ended September 30, 2010. These decreases were primarily the result of declining security balances as proceeds from the sales and paydowns from this portfolio were reinvested in our expanding residential and commercial loans businesses.

Interest income from trading securities at Redwood was $2 million in both the third quarter of 2011 and 2010. Interest income from trading securities at Redwood was $6 million for the nine months ended September 30, 2011, as compared to $8 million for the nine months ended September 30, 2010. We have not acquired or otherwise added to our trading securities at Redwood since early in the first quarter of 2010. The decline in interest income from these securities is a result of principal paydowns on the notional balances of these investments. The decline in reported yield is a result of the appreciation in value of these securities since early in 2010. The appreciation in value during this time period was recorded as market valuation adjustments through our consolidated statements of income.

Market Valuation Adjustments (MVA) at Redwood (Parent)

The following table shows the impact of market valuation adjustments and impairments (including those of the resecuritization we engaged in during the third quarter of 2011) on our consolidated statements of income for the three and nine months ended September 30, 2011 and 2010.

Table 12 MVA at Redwood (Parent)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	**2011**	**2010**	**2011**	**2010**
Residential real estate loans (held-for-sale)	$ 363	$ 159	$ 374	$ 335
Trading securities	1,765	5,022	912	5,271
Impairment on AFS securities	(1,083)	(2,514)	(3,551)	(7,442)
Risk management derivatives	(13,093)	(2,538)	(15,843)	(4,635)
REO	(289)	(15)	(298)	(72)
Total Market Valuation Adjustments, Net	$ (12,337)	$ 114	$ (18,406)	$ (6,543)

Trading Securities and Derivatives

Negative market valuation adjustments on trading securities and derivatives were $11 million in the third quarter of 2011, an increase in expense of $14 million from the third quarter of 2010. Market valuation adjustments on trading securities were $2 million in the third quarter of 2011, a decrease of $3 million from the third quarter of 2010. Over the past several quarters we have increased the balances of our risk management derivatives as part of our ongoing efforts to manage certain risks associated with the residential loans we own or plan to acquire and securitize, and our investments in commercial loans.

Hedging our Residential Loan Pipeline

As part of our ongoing risk management activities, we hedge against potential decreases in the value of our pipeline of fixed-rate and hybrid loans awaiting securitization that would result primarily from a rise in benchmark interest rates. We are exposed to this risk between the time we lock the mortgage rate on loans we plan to acquire, through the time these loans are securitized through our Sequoia program. Under normal market conditions and assuming we have hedged well, we would expect our risk management derivatives to minimize our risk to changing interest rates so that the gain or loss in the value of our derivatives would roughly match a loss or gain in the value of our pipeline of loans. Under more difficult market conditions, such as those we have experienced over recent quarters, navigating through our GAAP results can become increasingly complex.

One complexity results from our current method of accounting for Sequoia securitizations — GAAP financing treatment. With financing (as opposed to sale) treatment, there are timing differences between when the changes in value of our loan pipeline derivatives are recognized in our consolidated income statement versus the recognition of changes in value of the related loans. The relatively long periods, on average, between when the interest rate is locked on a loan we plan to acquire and when that loan is securitized through our Sequoia program has resulted in significant timing differences using GAAP financing treatment that we would not expect once the loan volume through our Sequoia securitization program increases and accumulation periods shorten.

Another complexity related to our residential loan pipeline results from adverse market conditions observed recently as interest rates moved sharply lower while credit spreads widened. As a result of these movements, loan values did not increase sufficiently to offset the $12 million mark-to-market loss on loan pipeline derivatives. Such a directional trend can reverse however, at any time. For example, at September 30, 2011, our pipeline hedges had declined in value by $12 million for the third quarter while, at October 31, 2011, our pipeline hedges had recovered $2 million of value as a result of the rise in benchmark interest rates during the month of October.

To reduce these complexities, management analyzes our loan securitization activities in an alternative manner that measures each securitization transaction from what we believe to be its economic contribution. That is, we determine whether an economic gain or loss resulted from a securitization transaction after

considering net securitization proceeds, the net coupon interest earned on accumulated loans prior to securitization, loan acquisition costs, and the net effect of pipeline hedging activities. On this economic basis, our September 2011 securitization, which was done amid much market turmoil, resulted in an economic loss. On this same economic basis, our March 2011 securitization, which was done during more favorable conditions, resulted in an economic gain. Overall, for 2011, the net of these results for the two transactions was a modest economic gain and we achieved our primary goal of creating long-term investments (approximately $34 million) that we could retain at attractive levels.

We continue to reassess our disclosures with the goal of making our GAAP accounting as reflective of the economics of our business as possible. One specific change we are contemplating is moving from a financing accounting model for some future securitizations, to a sale accounting model in order to significantly reduce the timing differences that prevail in our GAAP results as a result of the complexities described herein. We are aware of the negative connotations often associated with sale accounting in the wake of the subprime collapse in 2007. However, a combination of accounting rule changes, significant new disclosures, a robust methodology for valuing retained securities, and greater auditor and regulatory scrutiny has us contemplating whether a sale accounting framework might help our readers to better understand and evaluate our reported results.

Impairment on AFS securities

At Redwood, we classify most securities as AFS and report any unrealized gains and losses, as well as any OTTI not related to credit factors, as components of equity in our consolidated balance sheets. Any OTTI on AFS securities that is related to adverse credit factors is recorded through our consolidated statements of income. Similarly, any unrealized losses on AFS securities that we no longer intend to hold at the date of the financial statements are recorded as OTTI through our consolidated statements of income.

During the third quarter of 2011, we recognized an aggregate $1 million of OTTI on AFS securities at Redwood. Of this amount, $1 million was related to credit factors and recognized in our consolidated statements of income, and less than $1 million was recognized as a reduction in stockholders' equity. During the third quarter of 2010, we recognized an aggregate $6 million of OTTI on AFS securities at Redwood. Of this amount, $3 million was related to credit factors and recognized in our consolidated statements of income, and the remaining $3 million was recognized as a reduction in equity.

During the first nine months of 2011, we recognized an aggregate $6 million of OTTI on AFS securities at Redwood. Of this amount, $4 million was related to credit factors and recognized in our consolidated statements of income, and $2 million was recognized as a reduction in stockholders' equity. During the nine months of 2010, we recognized an aggregate $15 million of OTTI on AFS securities at Redwood. Of this amount, $7 million was related to credit factors and recognized in our consolidated statements of income, and the remaining $8 million was recognized as a reduction in stockholders' equity.

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Earning Assets — Redwood (Parent)

Residential Real Estate Loans Held-for-Investment at Redwood (Parent)

During the third quarter of 2011, we continued to purchase newly originated jumbo loans through our Sequoia securitization program. At September 30, 2011, residential loans held-for-investment had an outstanding principal balance of $226 million and a carrying value of $227 million. The following table provides the activity of residential real estate loans held-for-investment during the three and nine months ended September 30, 2011.

Table 13 Residential Real Estate Loans Held-for-Investment at Redwood (Parent) — Activity

(In Thousands)	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Balance at beginning of period	$ 203,465	$ 253,081
Acquisitions	404,597	657,457
Sequoia securitization	(376,226)	(671,329)
Principal repayments	(5,099)	(10,608)
Transfers to held-for-sale	—	(1,861)
Premium amortization	(9)	(12)
Balance at End of Period	$ 226,728	$ 226,728

The following table details outstanding balances for these loans by product type at September 30, 2011.

Table 14 Characteristics of Residential Real Estate Loans Held-for-Investment at Redwood (Parent)

September 30, 2011 (Dollars In Thousands)	Principal Value	Weighted Average Coupon
First Lien Prime		
Fixed	$ 153,958	4.49%
Hybrid	72,486	4.27%
Total Outstanding Principal	$ 226,444	4.42%

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Commercial Real Estate Loans Held-for-Investment at Redwood (Parent)

At September 30, 2011, there were twelve commercial loans held-for-investment with an outstanding principal balance of $99 million and a carrying value of $98 million. The following table provides the activity of commercial real estate loans held-for-investment during the three and nine months ended September 30, 2011.

Table 15 Commercial Real Estate Loans at Redwood (Parent) — Activity

(In Thousands)	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Balance at beginning of period	$ 71,168	$ 30,536
Originations/Acquisitions	26,908	67,493
Principal repayments	(24)	(28)
Discount amortization	9	60
Balance at End of Period	**$ 98,061**	**$ 98,061**

The following table details outstanding balances for these loans by product type at September 30, 2011.

Table 16 Commercial Real Estate Loans Characteristics at Redwood (Parent)

September 30, 2011 (Dollars In Thousands)	Principal Value	Percent of Total
Office	$ 36,949	37.47%
Hospitality	17,700	17.95%
Multi-family	14,000	14.20%
Retail	29,951	30.38%
Total Outstanding Principal	**$ 98,600**	**100.00%**

Derivative Financial Instruments at Redwood (Parent)

Risks Related to Unsecuritized Residential and Commercial Loans

In order to manage risks associated with residential loans we own or plan to acquire and securitize, and commercial loans we invest in, at September 30, 2011, we were party to interest rate agreements with an aggregate notional amount of $154 million, TBA contracts sold, net with a notional amount of $177 million, and financial futures with an aggregate notional amount of $324 million. Net negative market valuation adjustments on these derivatives were $13 million and $16 million for the three and nine months ended September 30, 2011, respectively.

Derivatives Designated as Cash Flow Hedges

To fix the interest expense related to our long-term debt we entered into interest rate swaps during 2010 with an aggregate notional balance of $140 million at September 30, 2011. We designated these derivatives as cash flow hedges. For the three and nine months ended September 30, 2011, these hedges decreased in value by $38 million and $40 million, respectively, which was recorded to accumulated other comprehensive income, a component of equity.

Securities at Redwood (Parent)

We classify most senior, re-REMIC, and subordinate securities as AFS securities under GAAP. Senior securities are those interests in a securitization that have the first right to cash flows and are last in line to absorb losses. Of the senior securities owned at Redwood at September 30, 2011, $185 million of prime securities and $165 million of non-prime securities were financed through a non-recourse resecuritization entity. Re-REMIC securities, as presented herein, were created through the resecuritization of certain senior interests to provide additional credit support to those interests. These re-REMIC securities are therefore subordinate to the remaining senior interest, but senior to any subordinate tranches of the securitization from which they were created. Subordinate securities are all interests below senior and re-REMIC interests. The commercial and CDO securities that we own are subordinate securities.

The following table provides real estate securities activity at Redwood for the three and nine months ended September 30, 2011.

Table 17 Real Estate Securities Activity at Redwood (Parent)

Three Months Ended September 30, 2011

	Residential			Commercial	CDO	Total
(In Thousands)	**Senior**	**Re-REMIC**	**Subordinate**			
Beginning fair value	$ 593,350	$ 77,575	$ 82,881	$ 5,865	$ 1,403	$ 761,074
Acquisitions	3,635	36,888	3,491	—	—	44,014
Sales	—	—	—	—	—	—
Gains on sales and calls, net	—	—	832	—	—	832
Effect of principal payments	(17,745)	—	(2,282)	—	—	(20,027)
Change in fair value, net	(3,398)	(1,363)	(3,700)	22	(393)	(8,832)
Ending Fair Value	$ 575,842	$ 113,100	$ 81,222	$ 5,887	$ 1,010	$ 777,061

Nine Months Ended September 30, 2011

	Residential			Commercial	CDO	Total
(In Thousands)	**Senior**	**Re-REMIC**	**Subordinate**			
Beginning fair value	$ 661,998	$ 85,077	$ 67,608	$ 7,496	$ 1,038	$ 823,217
Acquisitions	18,950	36,888	34,674	—	—	90,512
Sales	(35,865)	(5,230)	(703)	(2,116)	—	(43,914)
Gains on sales and calls, net	6,276	3,006	1,595	1,185	—	12,062
Effect of principal payments	(57,065)	—	(6,788)	—	—	(63,853)
Change in fair value, net	(18,452)	(6,641)	(15,164)	(678)	(28)	(40,963)
Ending Fair Value	$ 575,842	$ 113,100	$ 81,222	$ 5,887	$ 1,010	$ 777,061

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The following tables present the carrying value (which equals fair value) as a percent of principal balance for securities owned at Redwood at September 30, 2011 and December 31, 2010.

Table 18 Fair Value as Percent of Principal Balance for Real Estate Securities at Redwood (Parent)

September 30, 2011 (Dollars in Millions)	2004 & Earlier		2005		2006 – 2008		Total	
	Value	%	Value	%	Value	%	Value	%
Residential Senior								
Prime	$ 12	84%	$ 202	83%	$ 63	89%	$ 277	84%
Non-prime	104	85%	189	83%	6	82%	299	84%
Total	116	85%	391	83%	69	88%	576	84%
Residential Re-REMIC	2	60%	19	54%	92	59%	113	58%
Residential Subordinate								
Prime	61	36%	6	21%	4	12%	71	31%
Non-prime	10	44%	—	—	—	—	10	28%
Total	71	37%	6	21%	4	9%	81	31%
Commercial	6	18%	—	—	—	—	6	18%
CDO	—	—	1	5%	—	—	1	5%
Total Securities at Redwood	$ 195		$ 417		$ 165		$ 777	

December 31, 2010 (Dollars in Millions)	2004 & Earlier		2005		2006 – 2008		Total	
	Value	%	Value	%	Value	%	Value	%
Residential Senior								
Prime	$ 13	85%	$ 228	88%	$ 75	90%	$ 316	88%
Non-prime	117	86%	220	82%	9	79%	346	83%
Total	130	86%	448	85%	84	89%	662	85%
Residential Re-REMIC	6	64%	12	66%	67	60%	85	61%
Residential Subordinate								
Prime	42	25%	7	17%	5	8%	54	20%
Non-prime	13	46%	—	—	—	—	13	46%
Total	55	28%	7	17%	5	7%	67	21%
Commercial	7	17%	1	1%	—	—	8	8%
CDO	—	—	1	6%	—	—	1	6%
Total Securities at Redwood	$ 198		$ 469		$ 156		$ 823	

Residential Securities

At September 30, 2011, the residential securities held at Redwood (as a percentage of current market value) consisted of fixed-rate assets (37%), adjustable-rate assets (13%), hybrid assets that reset within the next year (29%), hybrid assets that reset between 12 and 36 months (4%), and hybrid assets that reset after 36 months (17%).

The following tables present the components of carrying value at September 30, 2011 and December 31, 2010 for our residential securities.

Table 19 Carrying Value of Residential Securities at Redwood (Parent)

September 30, 2011 (In Thousands)	Residential		
	Senior	Re-REMIC	Subordinate
Principal balance of AFS securities	$ 687,275	$ 194,245	$ 253,625
Credit reserve	(52,993)	(58,106)	(141,755)
Net unamortized discount	(130,780)	(68,861)	(29,880)
Amortized cost	503,502	67,278	81,990
Gross unrealized gains	59,509	45,829	7,479
Gross unrealized losses	(7,925)	(7)	(8,730)
Carrying value of AFS securities	555,086	113,100	80,739
Carrying value of trading securities	20,756	—	483
Total Carrying Value of Residential Securities	$ 575,842	$ 113,100	$ 81,222

December 31, 2010 (In Thousands)	Residential		
	Senior	Re-REMIC	Subordinate
Principal balance of AFS securities	$ 774,852	$ 139,426	$ 304,598
Credit reserve	(31,594)	(44,182)	(208,983)
Net unamortized discount	(187,983)	(62,471)	(34,431)
Amortized cost	555,275	32,773	61,184
Gross unrealized gains	88,339	52,304	11,499
Gross unrealized losses	(1,358)	—	(5,649)
Carrying value of AFS securities	642,256	85,077	67,034
Carrying value of trading securities	19,742	—	574
Total Carrying Value of Residential Securities	$ 661,998	$ 85,077	$ 67,608

Senior Securities

The fair value of our senior AFS securities was equal to 81% of their principal balance at September 30, 2011, while our amortized cost was equal to 73% of the principal balance. The fair value of our senior securities accounted for as trading securities was $21 million. Volatility in income recognition for these securities is most affected by changes in prepayment rates and, to a lesser extent, credit results and interest rates.

The loans underlying all of our residential senior securities totaled $19 billion at September 30, 2011, consisting of $11 billion prime and $8 billion non-prime. These loans are located nationwide with a large concentration in California (43%). Serious delinquencies (90+ days, in foreclosure or REO) at September 30, 2011 were 12.15% of current balances. Serious delinquencies were 9.80% of current balances for loans in prime pools and 15.15% of current balances for loans in non-prime pools.

Re-REMIC Securities

Our re-REMIC portfolio consists of prime residential senior securities that were pooled and re-securitized in 2009 and 2010 by third-parties to create two-tranche structures; we own support securities within those structures. There were no credit losses in our re-REMIC portfolio during the first nine months of 2011. We anticipate losses, which were included in our acquisition assumptions, and have allocated $58 million of the purchase discount to credit reserves of the $194 million principal balance.

The fair value of our re-REMIC AFS securities was equal to 58% of the principal balance of the portfolio at September 30, 2011, while our amortized cost was equal to 35% of the principal balance. The loans underlying all of our residential re-REMIC securities totaled $8 billion at September 30, 2011, and were all prime credit quality at time of origination. These loans are located nationwide with a large concentration in California (44%). Serious delinquencies (90+ days, in foreclosure or REO) at September 30, 2011 were 9.00% of current balances.

Subordinate Securities

The fair value of our subordinate AFS securities was equal to 32% of the principal balance at September 30, 2011, while our amortized cost was also equal to 32% of the principal balance. Credit losses totaled $19 million in our residential subordinate portfolio during the third quarter of 2011, as compared to $28 million of losses during the third quarter of 2010. We expect future losses will extinguish the majority of the outstanding principal of these securities, as reflected by the $142 million of credit reserves we have provided for on the $254 million principal balance of those securities.

The loans underlying all of our residential subordinate securities totaled $26 billion at September 30, 2011, consisting of $24 billion prime and $2 billion non-prime (at origination). These loans are located nationwide with a large concentration in California (41%). Serious delinquencies (90+ days, in foreclosure or REO) at September 30, 2011 were 5.82% of current balances. Serious delinquencies were 5.16% of current balances for loans in prime pools and 15.43% of current balances for loans in non-prime pools.

Commercial Securities

At September 30, 2011, all of our commercial securities at Redwood were subordinate securities predominantly issued in 2004 and 2005. The fair value of these securities totaled $6 million and $8 million at September 30, 2011 and December 31, 2010, respectively. These securities provided credit enhancement on $19 billion of underlying loans on office, retail, multifamily, industrial, and other income-producing properties nationwide. Seriously delinquent loans (60+ days delinquent, in foreclosure or real estate owned) underlying commercial subordinate securities were $1.1 billion at September 30, 2011, a decrease of $63 million from December 31, 2010. Our credit reserve of $47 million on the current principal balance of $54 million at September 30, 2011, reflects our expectation that we will only receive a small amount of principal over the remaining life of these securities. Credit losses in excess of our investments in each securitization will be borne by senior securities once losses extinguish our subordinate investments. Accordingly, most of the remaining expected cash flow from commercial securities will come from coupon interest payments. Realized credit losses on our commercial securities were $4 million and $30 million in the three and nine months ended September 30, 2011, respectively, and were charged against our designated credit reserve.

Results of Operations — New Sequoia

Net interest income at New Sequoia was less than $1 million for both the three months ended September 30, 2011 and 2010. Net interest income at New Sequoia was $2 million and less than $1 million for the nine months ended September 30, 2011 and 2010, respectively. The following table presents the net interest income after provision at New Sequoia for the three and nine months ended September 30, 2011 and 2010.

Table 20 Net Interest Income After Provision at New Sequoia

	Three Months Ended September 30,					
	2011			2010		
(Dollars in Thousands)	Interest Income/ (Expense)	Average Amortized Cost	Yield	Interest Income/ (Expense)	Average Amortized Cost	Yield
Interest Income						
Residential real estate loans	$ 4,648	$392,622	4.74%	$ 2,315	$204,504	4.53%
Interest Expense						
ABS issued	(3,928)	356,429	(4.41)%	(1,760)	184,615	(3.81)%
Net Interest Income	720			555		
Provision for loan losses	(8)			(9)		
Net Interest Income After Provision	$ 712			$ 546		

	Nine Months Ended September 30,					
	2011			2010		
(Dollars in Thousands)	Interest Income/ (Expense)	Average Amortized Cost	Yield	Interest Income/ (Expense)	Average Amortized Cost	Yield
Interest Income						
Residential real estate loans	$ 11,964	$338,922	4.71%	$ 3,905	$122,751	4.24%
Interest Expense						
ABS issued	(10,208)	305,241	(4.46)%	(3,147)	110,282	(3.81)%
Net Interest Income	1,756			758		
Provision for loan losses	(21)			(21)		
Net Interest Income After Provision	$ 1,735			$ 737		

During the third quarter of 2011, we transferred $376 million of fixed rate, first-lien, residential mortgage loans originated in 2010 and 2011 with a weighted average loan size of $793,292, into a Sequoia securitization entity that we sponsored and consolidated for financial reporting purposes. The weighted average FICO score for those securitized loans outstanding at September 30, 2011, was 773 at origination and the weighted average original LTV ratio was 61%. During the first quarter of 2011, we transferred $295 million of fixed rate and hybrid, first-lien, residential mortgage loans originated in 2009 and 2010 into a Sequoia securitization entity that we sponsored and consolidated for financial reporting purposes. The weighted average FICO score for those loans outstanding at September 30, 2011, was 775 at origination and the weighted average original LTV ratio was 59%.

Voluntary prepayments of loans at the Sequoia entity issued in 2010 have been high due to an increase in borrower refinancing activity, largely as a result of declining interest rates since the middle of 2010. At September 30, 2011, $151 million of outstanding principal had prepaid since issuance and the annualized prepayment rate was 51% constant prepayment rate (CPR) for the third quarter of 2011. The annualized prepayment rate for the Sequoia entity issued in the first quarter of 2011 was 10% CPR in the third quarter of 2011. At September 30, 2011, the current outstanding principal balance of loans at New Sequoia entities totaled $742 million. At September 30, 2011, none of these loans were delinquent.

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Earning Assets — New Sequoia

The following table provides details of residential real estate loans activity at New Sequoia during the three and nine months ended September 30, 2011.

Table 21 Residential Real Estate Loans at New Sequoia — Activity

(In Thousands)	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Balance at beginning of period	$ 391,728	$ 145,028
New securitization issuance	376,226	671,329
Principal repayments	(25,032)	(73,447)
Premium amortization	17	41
Provision for credit losses	(8)	(20)
Balance at End of Period	$ 742,931	$ 742,931

Results of Operations — Other Consolidated Entities

The following table presents the net interest income (loss) after provision and MVA at our other consolidated entities for the three and nine months ended September 30, 2011 and 2010. These entities include all consolidated Sequoia entities issued prior to 2010, the Acacia entities, and the Fund. Net interest income at other consolidated entities will vary from period to period and depend primarily on the net effect of changes in the market values of trading securities, risk management derivatives and ABS issued at Acacia, changes in the levels of delinquencies and loss severities for loans held-for-investment, and changes in the rates of principal repayments or the investments held at these entities.

Table 22 Net Interest Income (Loss) After Provision and MVA at Other Consolidated Entities

	Three Months Ended September 30,					
	2011			2010		
(Dollars in Thousands)	Interest Income/ (Expense)	Average Amortized Cost	Yield	Interest Income/ (Expense)	Average Amortized Cost	Yield
Interest Income						
Residential real estate loans	$ 11,961	$3,207,500	1.49%	$ 14,928	$3,505,497	1.70%
Commercial real estate loans	195	12,647	6.17%	263	19,460	5.41%
Trading securities	8,371	270,716	12.37%	13,875	270,386	20.53%
Available-for-sale securities	—	—	—	1,183	34,334	13.78%
Other investments	—	—	—	2	2,622	0.31%
Cash and cash equivalents	1	20,817	0.02%	4	23,434	0.07%
Total Interest Income	20,528	3,511,680	2.34%	30,255	3,855,733	3.14%
Interest Expense						
ABS issued – Sequoia	(8,601)	3,153,659	(1.09)%	(9,261)	3,439,201	(1.08)%
ABS issued – Acacia	(6,972)	257,872	(10.81)%	(8,948)	254,244	(14.08)%
Interest rate agreements – Sequoia	(161)	3,153,659	(0.02)%	(33)	3,439,201	(0.00)%
Interest rate agreements – Acacia	(1,072)	257,872	(1.66)%	(1,072)	254,244	(1.69)%
Total Interest Expense	(16,806)	3,411,531	(1.97)%	(19,314)	3,693,445	(2.09)%
Net Interest Income	3,722			10,941		
Provision for loan losses	(3,970)			(2,427)		
Market valuation adjustments, net	(1,111)			(1,687)		
Net Interest (Loss) Income After Provision and MVA	$ (1,359)			$ 6,827		

(Dollars in Thousands)	Nine Months Ended September 30, 2011 Interest Income/ (Expense)	2011 Average Amortized Cost	2011 Yield	2010 Interest Income/ (Expense)	2010 Average Amortized Cost	2010 Yield
Interest Income						
Residential real estate loans	$ 38,038	$3,281,691	1.55%	$ 43,512	$3,586,830	1.62%
Commercial real estate loans	691	15,003	6.14%	821	16,954	6.46%
Trading securities	26,975	291,439	12.34%	42,680	267,445	21.28%
Available-for-sale securities	967	8,994	14.34%	4,067	37,303	14.54%
Other investments	—	—	—	14	9,698	0.19%
Cash and cash equivalents	7	27,668	0.03%	10	55,358	0.02%
Total Interest Income	66,678	3,624,795	2.45%	91,104	3,973,588	3.06%
Interest Expense						
ABS issued – Sequoia	(26,107)	3,223,705	(1.08)%	(27,428)	3,515,198	(1.04)%
ABS issued – Acacia	(21,472)	285,624	(10.02)%	(23,826)	270,276	(11.75)%
Interest rate agreements – Sequoia	(390)	3,223,705	(0.02)%	44	3,515,198	0.00%
Interest rate agreements – Acacia	(3,228)	285,624	(1.51)%	(2,770)	270,276	(1.37)%
Total Interest Expense	(51,197)	3,509,329	(1.95)%	(53,980)	3,785,474	(1.90)%
Net Interest Income	15,481			37,124		
Provision for loan losses	(8,346)			(16,212)		
Market valuation adjustments, net	(11,929)			(13,392)		
Net Interest (Loss) Income After Provision and MVA	$ (4,794)			$ 7,520		

Net interest loss after provision and MVA at other consolidated entities was negative $1 million for the third quarter of 2011, a decrease of $8 million from the third quarter of 2010. Net interest loss after provision and MVA at other consolidated entities was negative $5 million for the first nine months of 2011, a decrease of $12 million from the first nine months of 2010. We have not acquired or otherwise added to our assets and liabilities at other consolidated entities since late 2008. The decline in net interest income after provision and MVA over both the three and nine month periods is primarily due to declining net interest income as result of principal paydowns of the securities and loans consolidated at these entities. The decline in reported yield on trading securities is a result of the appreciation in value of these assets since early 2010. The decline in net interest income was partially offset by lower provision for loan losses at legacy Sequoia entities.

Market Valuation Adjustments at Other Consolidated Entities

We apply the fair value option provided under GAAP to account for the assets (e.g., loans and securities) and liabilities (e.g., ABS issued) at the consolidated Acacia entities. This option requires that changes in the fair value of these assets and liabilities be recorded in the consolidated statements of income each reporting period. Derivative assets and liabilities at Acacia securitization entities are accounted for as trading instruments with all changes in the fair value of these assets and liabilities recorded as market valuation adjustments through our consolidated statements of income.

The following table shows the impact of MVA and impairments at our other consolidated entities for the three and nine months ended September 30, 2011 and 2010.

Table 23 MVA at Other Consolidated Entities

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	**2011**	**2010**	**2011**	**2010**
Commercial real estate loans – fair value	$ (184)	$ 3	$ 1,358	$ 7,347
Trading securities	(7,124)	42,353	4,050	60,583
Impairment on AFS securities	—	(66)	(1,619)	(1,300)
Risk management derivatives	(10,368)	(17,669)	(24,373)	(58,416)
ABS issued – Acacia	16,530	(25,703)	9,773	(19,699)
REO	35	(605)	(1,118)	(1,907)
Total Market Valuation Adjustments, Net	$ (1,111)	$ (1,687)	$ (11,929)	$ (13,392)

For the three months ended September 30, 2011 and 2010, there were (i) $1 million of net negative market valuation adjustments on the assets and liabilities at the Acacia entities for both periods; (ii) zero and less than $1 million of, respectively, impairments at the Fund; and, (iii) less than $1 million and negative $1 million, respectively, of net market valuation adjustments on REO properties at the legacy Sequoia entities. For the nine months ended September 30, 2011 and 2010, there were (i) $9 million and $10 million, respectively, of net negative market valuation adjustments on the assets and liabilities at the Acacia entities; (ii) $2 million and $1 million, respectively, of impairments at the Fund; and, (iii) $1 million and $2 million, respectively, of net negative market valuation adjustments on REO properties at the legacy Sequoia entities.

Loan Loss Provision at Legacy Sequoia Entities

Each quarter we perform a process to provide management with a reasonable and adequate estimate of loan loss reserving needs. This methodology is disclosed in *Note 3* and *Note 6* to the financial statements included in Part I, Item I of this Quarterly Report on Form 10-Q.

The provision for loan losses at legacy Sequoia entities (Sequoia securitizations issued prior to 2009 that we consolidate for financial reporting purposes) was $4 million for the three months ended September 30, 2011, as compared to $2 million for the three months ended September 30, 2010. The provision for loan losses at legacy Sequoia entities was $8 million for the nine months ended September 30, 2011, as compared to $16 million for the nine months ended September 30, 2010.

The increase in the provision from the third quarter of 2010 to the third quarter of 2011 was primarily attributable to an increase in observed loss severities on our loans originated in 2004 or prior. The provision for loan losses was greater than the net charge-offs of $2 million (or 0.07% of outstanding loan balances) for the three months ended September 30, 2011, and less than the charge-offs of $5 million (or 0.13% of outstanding loan balances) for the three months ended September 30, 2010. This resulted in an increase of $2 million and a decrease of $2 million in our allowance for loan losses for the third quarters of 2011 and 2010, respectively. These charge-offs were generated by $8 million and $15 million of defaulted loan principal during the third quarters of 2011 and 2010, respectively, for average implied loss severities of 29% and 33%, respectively.

The allowance for loan losses increased to $64 million (or 1.62% of outstanding loan balances) at September 30, 2011, from $59 million (or 1.60% of the outstanding loan balances) at September 30, 2010. Serious delinquencies on loans held by consolidated Sequoia entities (90+ days delinquent) increased to $133 million (or 3.37% of outstanding loan balances) at September 30, 2011, from $131 million (or 3.55% of outstanding loan balances) at September 30, 2010. Credit deterioration in the loan portfolio has been most notable in certain states. While loans originated in California, Florida, Georgia, and Ohio accounted for 45% of total loans held by Sequoia entities, loans in these states made up 52% of the seriously delinquent loan balance at September 30, 2011.

At September 30, 2011, there were eleven Sequoia entities that we consolidated for which the carrying value of the liabilities at each entity exceeded the corresponding carrying value of the entity's assets. This is primarily attributable to the continued building of loan loss allowances in accordance with GAAP, resulting in lower asset carrying values. The aggregate estimated net assets (or equity) at these eleven consolidated entities was negative $7 million at September 30, 2011, an amount we expect to reverse through positive adjustments to earnings in future periods as the entities are retired or deconsolidated for financial reporting purposes.

Earning Assets — Other Consolidated Entities

Real Estate Loans at Legacy Sequoia Entities

The following table provides details of residential real estate loans activity at the legacy Sequoia securitization entities for the three and nine months ended September 30, 2011.

Table 24 Residential Real Estate Loans at Legacy Sequoia Entities — Activity

(In Thousands)	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Balance at beginning of period	$ 3,263,203	$ 3,397,130
Principal repayments	(70,251)	(189,995)
Charge-offs, net	2,287	6,802
Transfers to REO	(3,628)	(14,397)
Premium amortization	(1,895)	(5,447)
Provision for credit losses	(3,970)	(8,347)
Balance at End of Period	$ 3,185,746	$ 3,185,746

Loan Characteristics

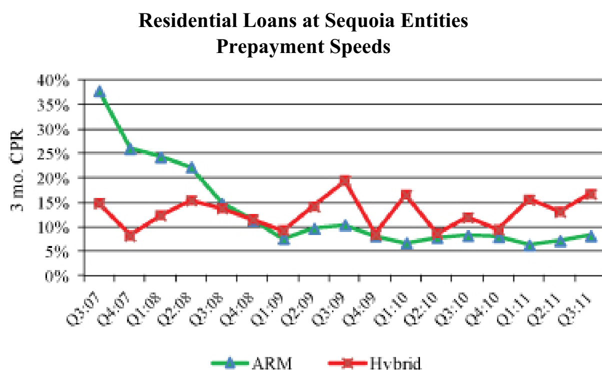
The following table highlights principal balances for consolidated loans at legacy Sequoia entities by product type. First lien adjustable rate mortgage (ARM) loans comprise 95% of this portion of our consolidated Sequoia loan portfolio. Of the $123 million of hybrid loans held at Sequoia securitization entities at September 30, 2011, $57 million (or 46%) had reset as of September 30, 2011, and now act as ARM loans.

Table 25 Loan Characteristics at Legacy Sequoia Entities

September 30, 2011 (Dollars In Thousands)	Principal Value	Percent of Total
First Lien		
ARM	$3,051,153	94.98%
Hybrid (Years to Reset)		
Reset	56,900	1.77%
0 – 4	52,074	1.62%
5 – 8	14,454	0.45%
Second Lien		
ARM	37,840	1.18%
Total Outstanding Principal	$3,212,421	100.00%

At September 30, 2011, $2.96 billion of legacy Sequoia loans (92% of outstanding principal balances) were originated in 2005 or prior and have many years of demonstrated payment histories. At September 30, 2011, the weighted average FICO score (at origination) for our legacy Sequoia loans outstanding was 730 and the weighted average original LTV ratio was 67%.

The following chart presents the weighted average prepayment speeds of loans held at these Sequoia securitization entities over the past four years.



Prepayment speeds on ARM loans held at legacy Sequoia entities remained relatively low during the first nine months of 2011 as one-month and six-month LIBOR rates have remained low relative to historical averages. Prepayment speeds on hybrid loans outstanding increased modestly during this period. At September 30, 2011, LIBOR ARM loans at legacy Sequoia entities had a weighted average coupon of 1.66%, and hybrid loans at legacy Sequoia entities had a weighted average coupon of 3.98%.

Loan Repurchase Risk

Prior to 2008, subsidiaries of Redwood purchased and deposited residential mortgage loans into Sequoia securitization trusts sponsored by RWT Holdings, Inc., a Redwood subsidiary, and subsequently issued residential mortgage backed securities, some of which are not currently consolidated on our balance sheet for financial reporting purposes. In connection with these securitizations, these subsidiaries of Redwood made certain representations and warranties related to these loans which could result in an obligation to repurchase these loans to the extent a violation of these representations and warranties occurred. We do not originate residential loans and believe that risk of loss due to loan repurchases (i.e., due to breach of representations and warranties) would generally be a contingency to the third-party entity from whom we acquired the loans. However, in some cases, where loans were acquired from entities that have since become insolvent, repurchase claims would not be a contingency to a third-party and may result in repurchase claims made against us. As of September 30, 2011, there have been no loan-level repurchase claims made to Redwood by investors where the entity that originated the loans in question was insolvent. As a result, while it is possible that we may receive repurchase claims related to these securitizations in the future, Redwood cannot make a reasonable estimate of potential future liabilities based on historical experience to date.

We do not currently maintain a loan repurchase reserve and management is not aware of any outstanding repurchase claims against Redwood that would require the establishment of such a reserve. In circumstances where we believe that there is a risk of loss due to a specific loan repurchase demand (i.e., due to an allegation of a breach of representations and warranties), we will review the need for any loan repurchase reserve in accordance with FASB guidance on accounting for contingencies and establish reserves when, in the opinion of management, it is probable that a matter would result in a liability and the amount of loss, if any, can be reasonably estimated.

In addition, with respect to residential mortgage-backed securities issued by Sequoia securitization trusts prior to 2008, we believe that investors seeking recovery for any losses they incur on investments in these securities may be more likely to pursue remedies through securities-related litigation rather than through specific loan repurchase claims. We separately evaluate our exposure to such litigation when assessing whether the establishment of a litigation reserve is necessary under GAAP. For further discussion on litigation related contingencies see *Note 14* to the financial statements included in Part I, Item I of this Quarterly Report on Form 10-Q.

Real Estate Securities at Other Consolidated Entities

The following table provides information on the activity at the other consolidated entities for the three and nine months ended September 30, 2011.

Table 26 Securities at Other Consolidated Entities — Activity

Three Months Ended September 30, 2011

	Residential		Commercial	CDO	Total
(In Thousands)	**Senior**	**Subordinate**			
Beginning fair value	$ 107,755	$ 106,000	$ 42,274	$ 20,498	$ 276,527
Sales	—	(553)	—	—	(553)
Gains on sales, net	—	—	—	—	—
Effect of principal payments	(2,273)	(3,551)	(228)	(298)	(6,350)
Change in fair value, net	(1,917)	(5,871)	(2,974)	(2,670)	(13,432)
Ending Fair Value	$ 103,565	$ 96,025	$ 39,072	$ 17,530	$ 256,192

Nine Months Ended September 30, 2011

	Residential		Commercial	CDO	Total
(In Thousands)	**Senior**	**Subordinate**			
Beginning fair value	$ 134,950	$ 132,555	$ 43,828	$ 20,286	$ 331,619
Sales	(14,141)	(10,889)	(3,398)	(13,913)	(42,341)
Gains (losses) on sales, net	728	588	—	(2,872)	(1,556)
Effect of principal payments	(6,501)	(11,911)	(3,981)	(1,427)	(23,820)
Change in fair value, net	(11,471)	(14,318)	2,623	15,456	(7,710)
Ending Fair Value	$ 103,565	$ 96,025	$ 39,072	$ 17,530	$ 256,192

During the second quarter of 2011, we sold all remaining securities at the Fund. We recognized $2 million of OTTI on these securities in the nine months ended September 30, 2011. In addition to the $256 million of real estate securities included in the table above, consolidated Acacia securitization entities owned $16 million of ABS issued by Sequoia securitization entities, and $13 million in commercial loans at September 30, 2011.

Derivative Financial Instruments at Acacia Securitization Entities

At September 30, 2011, consolidated Acacia securitization entities were party to interest rate agreements with a notional value of $1.3 billion and a net aggregate fair value of negative $65 million. Derivative obligations of Acacia entities are payable solely from the assets of those Acacia entities that have entered into the corresponding derivative contracts and are not legal obligations of Redwood. These derivatives are accounted for as trading instruments with all changes in value and any net payments and receipts recognized through market valuation adjustments, net, in our consolidated statements of income.

Capital Resources and Liquidity

Set forth below is a discussion of our short- and long-term debt and contractual obligations and commitments, as well as a discussion of asset-backed securities issued. For additional discussion of our capital resources and liquidity see "*Summary of Financial Condition, Capital Resources, and Liquidity*" above.

Debt at Redwood

At September 30, 2011, we had no short-term debt. For the three and nine months ended September 30, 2011, we recorded interest expense on short-term debt of $78 thousand and $267 thousand, respectively, on an average balance of $18 million and $23 million, respectively, for weighted average expense yields of 1.72% and 1.58%, respectively. For both the three and nine months ended September 30, 2011, the highest balance of our short-term debt outstanding was $89 million. At December 31, 2010, we had $44 million of short-term debt (collateralized by mortgage-backed securities) that was used to fund the acquisition of mortgage loans that we intended to securitize. This debt matured and was repaid in March 2011, near the time those mortgage loans were securitized.

In 2006 and 2007, we issued a total of $100 million and $50 million of long-term debt, respectively. This debt requires quarterly distributions at a floating rate equal to three-month LIBOR plus 2.25% until the notes are redeemed in whole.

Beginning in the first quarter of 2010, we entered into interest rate swaps with aggregate notional values currently totaling $140 million to hedge the variability in our long-term debt interest expense, fixing our gross interest expense yield at 6.75%. These swaps are accounted for as cash flow hedges with all interest income recorded as a component of net interest income and other valuation changes recorded as a component of equity.

As noted above, in the ordinary course of our business, we may incur short-term recourse debt through several different types of borrowing facilities and use cash borrowings under these facilities to, among other things, fund the acquisition of residential loans we acquire in anticipation of securitization, fund the origination of commercial real estate loans, finance investments in securities and other investments, and otherwise fund our business and operations. During the third quarter of 2011, we established a $10 million short-term line of credit with a bank, which is collateralized by our pledge of certain securities. During the third quarter of 2011, we also utilized short-term debt financing available to us through five securities repurchase facilities we previously established with financial institution counterparties.

Asset-Backed Securities Issued at Resecuritization

In July 2011, Redwood transferred $365 million of residential securities into a resecuritization trust, with $245 million of ABS issued to third-parties. At September 30, 2011, there were $350 million of securities owned at the resecuritization, which were funded with $232 million of ABS issued. Since resecuritization, the ABS issued has paid down $13 million.

Asset-Backed Securities Issued at Securitization Entities

At September 30, 2011, there were $3.9 billion of loans owned at Sequoia securitization entities, which were funded with $3.8 billion of ABS issued at Sequoia entities. These loans and ABS issued are reported at their unpaid principal balances net of any unamortized premium or discount. To date, credit losses have not yet been incurred on any of the senior securities issued by consolidated Sequoia securitization entities, although we expect that some of these senior securities may incur losses in the future, depending on the magnitude and timing of additional credit losses incurred on the underlying loans. At September 30, 2011, there were $256 million of securities owned by Acacia securitization entities and reported at fair value, which were funded with $234 million of ABS issued by Acacia entities that were also reported at fair value.

The following tables provide detail on the activity for asset-backed securities issued by the Sequoia and Acacia securitization entities we consolidate for financial reporting purposes for the three and nine months ended September 30, 2011.

Table 27 ABS Issued Activity — Securitization Entities

Three Months Ended September 30, 2011

(In Thousands)	New Sequoia	Legacy Sequoia	Acacia	Total
Balance at beginning of period	$ 357,853	$ 3,208,148	$ 273,325	$ 3,839,326
New issuance, net of discount	358,524	—	—	358,524
Paydowns	(22,998)	(73,689)	(25,825)	(122,512)
Extinguishment of debt	—	(569)	—	(569)
Amortization	14	(500)	—	(486)
Valuation adjustments	—	—	(13,265)	(13,265)
Balance at End of Period	$ 693,393	$ 3,133,390	$ 234,235	$ 4,061,018

Nine Months Ended September 30, 2011

(In Thousands)	New Sequoia	Legacy Sequoia	Acacia	Total
Balance at beginning of period	$ 123,146	$ 3,335,355	$ 303,077	$ 3,761,578
New issuance	638,635	1,345	—	639,980
Paydowns	(68,419)	(200,343)	(68,698)	(337,460)
Extinguishment of debt	—	(817)	—	(817)
Amortization	31	(2,150)	—	(2,119)
Valuation adjustments	—	—	(144)	(144)
Balance at End of Period	$ 693,393	$ 3,133,390	$ 234,235	$ 4,061,018

The following table presents our contractual obligations and commitments at September 30, 2011, as well as the obligations of the securitization entities that we sponsor and consolidate for financial reporting purposes.

Table 28 Contractual Obligations and Commitments

September 30, 2011	Payments Due or Commitment Expiration by Period				
(In Millions)	Less Than 1 Year	1 to 3 Years	3 to 5 Years	After 5 Years	Total
Obligations of Redwood					
Short-term debt	$ —	$ —	$ —	$ —	$ —
Long-term debt	—	—	—	140	140
Anticipated interest payments on long-term debt	4	8	11	155	178
Accrued interest payable	1	—	—	—	1
Operating leases	2	4	3	1	10
Purchase commitments	—	—	—	—	—
Total Redwood Obligations and Commitments	$ 7	$ 12	$ 14	$ 296	$ 329
Obligations of Consolidated Entities					
Consolidated ABS[1]	$ —	$ —	$ —	$ 7,172	$ 7,172
Anticipated interest payments on ABS[2]	372	867	661	443	2,343
Accrued interest payable	7	—	—	—	7
Total obligations of Securitization Entities	379	867	661	7,615	9,522
Total Consolidated Obligations and Commitments	$ 386	$ 879	$ 675	$ 7,911	$ 9,851

(1) All consolidated ABS issued are collateralized by real estate loans and securities. Although the stated maturity is as shown, the ABS obligations will pay down as the principal of these real estate loans or securities pay down. The amount shown is the principal balance of the ABS issued and not necessarily the value reported in our consolidated financial statements.

(2) The anticipated interest payments on consolidated ABS issued is calculated based on the contractual maturity of the ABS and therefore assumes no prepayments of the principal outstanding at September 30, 2011.

Potential GAAP Earnings Volatility

We expect quarter-to-quarter GAAP earnings volatility from our business activities. This volatility can occur for a variety of reasons, including the timing and amount of purchases, sales, calls, and repayment of consolidated assets, changes in the fair values of consolidated assets and liabilities, and certain non-recurring events. In addition, the amount or timing of our reported earnings may be impacted by technical accounting issues, some of which are described below.

Changes in Premium Amortization for Loans

The net unamortized premium for loans owned by Sequoia and Redwood was $38 million at September 30, 2011. The amount of periodic premium amortization expense we recognize is volatile and dependent on a number of factors, including credit performance of the underlying loans, changes in prepayment speeds, and changes in short-term interest rates. Loan premium amortization was $5 million in the both the first nine months of 2011 and 2010.

Changes in Allowance for Loan Losses

For real estate loans classified as held-for-investment, we establish and maintain an allowance for loan losses based on our estimate of credit losses inherent in our loan portfolios at the reporting date. To calculate the allowance for loan losses, we assess inherent losses by determining loss factors (defaults, loss severities on default liquidations, and the timing of default liquidations) that can be specifically applied to each of the consolidated loans or pools of loans.

Changes in actual defaults or our expectations on loss severities and default timing can have a significant effect on periodic income.

Changes in Yields for Securities

The yields we project on real estate securities can have a significant effect on the periodic interest income we recognize for financial reporting purposes. Yields can vary as a function of credit results, prepayment rates, and interest rates. If estimated future credit losses are less than our prior estimate, credit losses occur later than expected, or prepayment rates are faster than expected (meaning the present value of projected cash flows is greater than previously expected for assets acquired at a discount to principal balance), the yield over the remaining life of the security may be adjusted upwards. If estimated future credit losses exceed our prior expectations, credit losses occur more quickly than expected, or prepayments occur more slowly than expected (meaning the present value of projected cash flows is less than previously expected for assets acquired at a discount to principal balance), the yield over the remaining life of the security may be adjusted downward.

Changes in the actual maturities of real estate securities may also affect their yields to maturity. Actual maturities are affected by the contractual lives of the associated mortgage collateral, periodic payments of principal, and prepayments of principal. Therefore, actual maturities of AFS securities are generally shorter than stated contractual maturities. Stated contractual maturities are generally greater than ten years. There is no assurance that our assumptions used to estimate future cash flows or the current period’s yield for each asset will not change in the near term, and any change could be material.

Changes in Fair Values of Securities

All securities owned at Redwood and consolidated entities are classified as either trading or AFS securities, and in both cases are carried on our consolidated balance sheets at their estimated fair values. For trading securities, changes in fair values are recorded in the consolidated statements of income. Periodic fluctuations in the values of these investments are inherently volatile and thus can lead to significant GAAP earnings volatility each quarter.

For AFS securities, cumulative unrealized gains and losses are recorded as a component of accumulated other comprehensive income in our consolidated statements of equity. Unrealized gains and losses are not charged against current earnings to the extent they are temporary in nature. Certain factors may require us, however, to recognize these amounts as other-than-temporary impairments and record them through our current earnings. Factors that determine other-than-temporary-impairment include a change in our ability or intent to hold assets, adverse changes to projected cash flows of assets, or the likelihood that declines in the

fair values of assets would not return to their previous levels within a reasonable time. Impairments can lead to significant GAAP earnings volatility each quarter.

Changes in Fair Values of Derivative Financial Instruments

We can experience significant earnings volatility from our use of derivatives. We generally use derivatives to manage risks associated with residential loans we own or plan to acquire and securitize, commercial loans we own, variability in interest expense indexed to adjustable rates, and cash flows on assets and liabilities that have different coupon rates (fixed rates versus floating rates, or floating rates based on different indices). The nature of the instruments we use and the accounting treatment for the specific assets, liabilities, and derivatives may therefore lead to volatility in our periodic earnings, even when we are meeting our hedging objectives.

Some of our derivatives are accounted for as trading instruments with all associated changes in value recorded through our consolidated statements of income. Changes in value of the assets and liabilities we manage by using derivatives may not be accounted for similarly. This could lead to reported income and book values in specific periods that do not necessarily reflect the economics of our risk management strategy. Even when the assets and liabilities are similarly accounted for as trading instruments, periodic changes in their values may not coincide as other market factors (e.g., supply and demand) may affect certain instruments and not others at any given time.

Changes in Loss Contingency Reserves

We may be exposed to various loss contingencies, including, without limitation, those described in*Note 14 — Commitments and Contingencies* within the financial statements included in this Quarterly Report on Form 10-Q. In accordance with FASB guidance on accounting for contingencies, we review the need for any loss contingency reserves and establish them when, in the opinion of management, it is probable that a matter would result in a liability, and the amount of loss, if any, can be reasonably estimated. The establishment of a loss contingency reserve, the subsequent increase in a reserve or release of reserves previously established, or the recognition of a loss in excess of previously established reserves, can occur as a result of various factors and events that affect management's opinion of whether the standard for establishing, increasing, or continuing to maintain, a reserve has been met. Changes in the loss contingency reserves can lead to significant GAAP earnings volatility each quarter.

Proposed Regulatory Rules Relating to Securitization

As further described in*Management's Discussion and Analysis of Financial Condition and Results of Operations* in our Quarterly Report on Form 10-Q for the three months ended March 31, 2011, under the heading "Proposed Regulatory Rules Relating to Securitization," a consortium of federal regulators recently released a joint Notice of Proposed Rulemaking (NPR) related to securitization. The proposed rule will require securitization sponsors to retain an economic interest in the assets they securitize incentivizing sponsors to control the quality of the assets being securitized and aligning the interests of sponsors with those of investors. It is too early to determine exactly how the NPR will affect our securitization business since not only are the final rules unknown, there is substantial confusion over how to interpret some of the proposed rules. We currently expect that the final rules for residential mortgage securitizations will go into effect one year after they are published by the federal regulators.

Results of Operations — Taxable Income

The following table summarizes our estimated taxable income and distributions to shareholders for the three and nine months ended September 30, 2011 and 2010. At both September 30, 2011 and December 31, 2010, we had no undistributed REIT taxable income.

Table 29 Estimated Taxable Income and Distributions to Shareholders

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	**2011**	**2010**	**2011**	**2010**
REIT taxable income (loss)	$ 7,364	$ (8,763)	$ 16,205	$ 3,951
Taxable REIT subsidiary (loss) income	(1,728)	191	(6,129)	(13,926)
Total Estimated Taxable Income (Loss)	$ 5,636	$ (8,572)	$ 10,076	$ (9,975)
Distributions to shareholders	$ 19,624	$ 19,517	$ 58,798	$ 58,491

Our tax results for the three and nine months ended September 30, 2011, are estimates until we file tax returns for this year. Our estimated total taxable income for the three months ended September 30, 2011, was $6 million ($0.07 per share) and included $12 million in credit losses. This compared to a total taxable loss for the three months ended September 30, 2010, of $9 million ($0.11 per share). Estimated total taxable income for the nine months ended September 30, 2011, was $10 million ($0.13 per share) and included $43 million in credit losses. This compared to a total taxable loss for the nine months ended September 30, 2010, of $10 million ($0.13 per share).

For the nine months ended September 30, 2011, we declared three regular quarterly dividends totaling $0.75 per share. In November 2010, our board of directors announced its intention to pay a regular dividend of $0.25 per share, per quarter in 2011. Our dividends may be characterized as ordinary income to the extent the REIT has taxable income or net capital gains. Dividends paid in excess of REIT taxable income or net capital gains may be characterized as a return of capital. The portion of our dividends characterized as return of capital is not taxable, and reduces the basis of shares held at each quarterly distribution date. For the nine months ended September 30, 2011, our estimated REIT taxable income was $16 million and there were no net capital gains.

Differences between Estimated Taxable Income and GAAP Income

Differences between estimated taxable income and GAAP income are largely due to the following: (i) we cannot establish loss reserves for future anticipated events for tax but can for GAAP as realized credit losses are expensed when incurred for tax and these losses are anticipated through lower yields on assets or through loss provisions for GAAP; (ii) the timing, and possibly the amount, of some expenses (e.g., compensation expenses) are different for tax than for GAAP; (iii) since amortization and impairments differ for tax and GAAP, the tax and GAAP gains and losses on sales may differ, resulting in differences in realized gains on sale; for tax, realized capital gains on sales may be offset by prior capital losses; and, (iv) for tax, we do not consolidate noncontrolling interests or securitization entities as we do under GAAP. As a result of these differences in accounting, our estimated taxable income can vary significantly from our GAAP income during certain reporting periods.

The tables below reconcile our estimated taxable income to our GAAP income for the three and nine months ended September 30, 2011 and 2010.

Table 30 Differences between Estimated Taxable Income and GAAP Net Income

	Three Months Ended September 30, 2011		
(In Thousands, Except per Share Data)	**Tax (Est.)**	**GAAP**	**Differences**
Interest income	$ 33,341	$ 53,396	$ (20,055)
Interest expense	(4,574)	(24,317)	19,743
Net interest income	28,767	29,079	(312)
Provision for loan losses	—	(3,978)	3,978
Realized credit losses	(11,748)	—	(11,748)
Market valuation adjustments, net	—	(13,448)	13,448
Operating expenses	(11,411)	(11,507)	96
Realized gains on sales and calls, net	—	1,145	(1,145)
Benefit from (provision for) income taxes	28	(14)	42
Less: Net loss attributable to noncontrolling interest	—	(20)	20
Net Income	$ 5,636	$ 1,297	$ 4,339
Income per share	$ 0.07	$ 0.01	$ 0.06

	Three Months Ended September 30, 2010		
(In Thousands, Except per Share Data)	**Tax**	**GAAP**	**Differences**
Interest income	$ 36,957	$ 59,015	$ (22,058)
Interest expense	(2,921)	(23,695)	20,774
Net interest income	34,036	35,320	(1,284)
Provision for loan losses	—	(2,436)	2,436
Realized credit losses	(31,232)	—	(31,232)
Market valuation adjustments, net	—	(1,573)	1,573
Operating expenses	(11,376)	(12,245)	869
Realized gains on sales and calls, net	—	1,566	(1,566)
Provision for income taxes	—	(202)	202
Less: Net income attributable to noncontrolling interest	—	532	(532)
Net (Loss) Income	$ (8,572)	$ 19,898	$ (28,470)
(Loss) income per share	$ (0.11)	$ 0.25	$ (0.36)

	Nine Months Ended September 30, 2011		
(In Thousands, Except per Share Data)	**Tax (Est.)**	**GAAP**	**Differences**
Interest income	$ 96,948	$ 160,684	$ (63,736)
Interest expense	(10,201)	(69,923)	59,722
Net interest income	86,747	90,761	(4,014)
Provision for loan losses	—	(8,367)	8,367
Realized credit losses	(42,638)	—	(42,638)
Market valuation adjustments, net	—	(30,335)	30,335
Operating expenses	(34,033)	(35,107)	1,074
Realized gains on sales and calls, net	—	10,844	(10,844)
Provision for income taxes	—	(42)	42
Less: Net loss attributable to noncontrolling interest	—	(1,147)	1,147
Net Income	$ 10,076	$ 28,901	$ (18,825)
Income per share	$ 0.13	$ 0.35	$ (0.22)

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(In Thousands, Except per Share Data)	Nine Months Ended September 30, 2010		
	Tax	GAAP	Differences
Interest income	$ 108,461	$ 174,301	$ (65,840)
Interest expense	(6,379)	(63,040)	56,661
Net interest income	102,082	111,261	(9,179)
Provision for loan losses	—	(16,233)	16,233
Realized credit losses	(79,909)	—	(79,909)
Market valuation adjustments, net	—	(19,935)	19,935
Operating expenses	(32,148)	(40,778)	8,630
Realized gains on sales and calls, net	—	61,985	(61,985)
Provision for income taxes	—	(254)	254
Less: Net income attributable to noncontrolling interest	—	703	(703)
Net (Loss) Income	$ (9,975)	$ 95,343	$ (105,318)
(Loss) income per share	$ (0.13)	$ 1.18	$ (1.31)

Potential Taxable Income Volatility

We expect period-to-period estimated taxable income volatility for a variety of reasons, including those described below.

Credit Losses on Securities and Loans

To determine estimated taxable income we are generally not permitted to anticipate, or reserve for, credit losses on investments which are generally purchased at a discount. For tax purposes, we accrue the entire purchase discount on a security into taxable income over the expected life of the security. Estimated taxable income is reduced when actual credit losses occur. For GAAP purposes, we establish a credit reserve and only accrete a portion of the purchase discount, if any, into income and write-down securities that become impaired. Our income recognition is therefore faster for tax as compared to GAAP, especially in the early years of owning a security (when there are generally few credit losses). At September 30, 2011, the cumulative difference between the GAAP and tax amortized cost basis of our residential, commercial, and CDO subordinate securities (excluding our investments in our securitization entities) was $136 million.

As we have no credit reserves or allowances for tax, any future credit losses on securities or loans will have a more significant impact on tax earnings than on GAAP earnings and may create significant taxable income volatility to the extent the level of credit losses fluctuates during reporting periods. During the three months ended September 30, 2011 and 2010, we realized $12 million and $31 million, respectively, of credit losses on securities for tax that we had previously provisioned for under GAAP. During the nine months ended September 30, 2011 and 2010, we realized $43 million and $80 million, respectively, of credit losses on securities for tax that we had previously provisioned for under GAAP. We anticipate that credit losses will continue to be a significant factor for determining 2011 taxable income. Credit losses are based on our tax basis, which differs materially from our basis for GAAP purposes. We anticipate an additional $147 million of credit losses for tax on securities, based on our projection of principal balance losses and assuming a similar tax basis as we have recently experienced, although the timing of actual losses is difficult to accurately project. At September 30, 2011, for GAAP we had a designated credit reserve of $310 million on our securities, and an allowance for loan losses of $64 million for our consolidated residential and commercial loans.

Recognition of Gains and Losses on Sale

Since amortization and impairments on assets differ for tax and GAAP, the tax and GAAP basis on assets sold or called may differ, resulting in differences in gains and losses on sale or call. In addition, gains realized for tax may be offset by prior capital losses and, thus, not affect taxable income. At September 30, 2011, the REIT had an estimated $104 million in capital loss carry-forwards ($1.32 per share) that can be used to offset future capital gains over the next three to five years. Since our intention is to generally invest in assets for the long-term, it is difficult to anticipate when sales may occur and, thus, when or whether we might exhaust these capital loss carry-forwards.

Prepayments on Securities

As part of our investment in Sequoia securitization entities, we have retained IOs at the time they are issued. Our current tax basis in these securities is $26 million. The return on IOs is sensitive to prepayments, and, to the extent prepayments vary period to period, income from these IOs will vary. Typically, fast prepayments reduce yields and slow prepayments increase yields. We are not permitted to recognize a negative yield under tax accounting rules, so during periods of fast prepayments our periodic premium expense for tax purposes can be relatively low and the tax cost basis for these securities may not be significantly reduced. In periods prior to 2008, we did experience fast prepayments on the loans underlying our IOs. More recently, prepayments have been slowing, and our tax basis is now below the fair values for these IOs in the aggregate. Most of our Sequoia securitizations are callable or will become callable over the next two years, although we do not currently anticipate calling any Sequoia securitizations in the foreseeable future. If we do call a Sequoia securitization, the remaining tax basis in the IO is written off, creating an ordinary loss at the call date.

Prepayments also affect the taxable income recognition on other securities we own. We are required to use particular prepayment assumptions for the remaining lives of each security. As actual prepayment speeds vary, the yield we recognize for tax purposes will be adjusted accordingly. Thus, to the extent prepayments differ from our long-term assumptions or vary from period to period, the yield recognized will also vary and this difference could be material for a specific security.

Compensation Expense

The total tax expense for equity award compensation is dependent upon varying factors such as the timing of payments of dividend equivalent rights, the exercise of stock options, the distribution of deferred stock units and preferred stock units, and the cash deferrals to and withdrawals from our Executive Deferred Compensation Plan. For GAAP, the total expense associated with an equity award is determined at the award date and is recognized over the vesting period. For tax, the total expense is recognized at the date of distribution or exercise, not the award date. In addition, some compensation may not be deductible for tax if it exceeds certain levels and is not performance-based. Thus, the total amount of compensation expense, as well as the timing, could be significantly different for tax than for GAAP.

As an example, for GAAP we expense the grant date fair value of PSUs granted over the vesting term of those PSUs (regardless of the degree to which the performance conditions for vesting are ultimately satisfied, if at all), whereas for tax the value of the PSUs that actually vest in accordance with the performance conditions of those awards and are subsequently distributed to the award recipient is recorded as an expense on the date of distribution. If no PSUs under a particular grant ultimately vest, due to the failure to satisfy the performance conditions, no tax expense will be recorded for those PSUs, even though we would have already recorded expense for GAAP equal to the grant date fair value of the PSU awards. Conversely, if performance is such that a number of shares of common stock equal to 200% of the PSU award ultimately vest and are delivered to the award recipient, expense for tax will equal the common stock value on the date of distribution of 200% of the number of PSUs originally granted. This expense for tax could significantly exceed the recorded expense for GAAP.

In addition, since the decision to exercise options or distribute deferred stock units, preferred stock units, or cash out of the Executive Deferred Compensation Plan is an employee’s, it can be difficult to project when the tax expense will occur.

Critical Accounting Policies

See the "Critical Accounting Policies" section in "Management's Discussion and Analysis of Financial Condition and Results of Operations", as well as *Note* 3 to the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2010, for a detailed discussion of the Company's critical accounting policies. Since the issuance of our Annual Report on Form 10-K for the year ended December 31, 2010, any changes to our critical accounting policies or the methodologies or assumptions we apply under them are noted in *Note* 3 to the consolidated financial statements presented in this Quarterly Report on Form 10-Q. We also describe in *Note* 3 certain recent accounting pronouncements that will amend the critical accounting policies we apply in future periods.

Market Risks

We seek to manage the risks inherent in our business — including but not limited to credit risk, interest rate risk, prepayment risk, liquidity risk, and fair value risk — in a prudent manner designed to enhance our earnings and dividends and preserve our capital. In general, we seek to assume risks that can be quantified from historical experience, to actively manage such risks, and to maintain capital levels consistent with these risks.

Credit Risk

Integral to our core business is assuming the credit risk of real estate loans primarily through the ownership of residential and commercial real estate loans and securities. Some of our capital base is employed in owning credit enhancement securities that have below investment-grade credit ratings due to their concentrated credit risks with respect to underlying real estate loans and investment-grade securities. We believe that many of the loans underlying these securities are above-average in credit quality as compared to U.S. real estate loans in general (although there may nevertheless be significant credit losses related to these loans). We may also own residential real estate loans that are not securitized.

Credit losses from the loans in securitized loan pools, in general, first reduce the principal value of and economic returns on the lower-rated securities in these pools. Credit losses on real estate loans can occur for many reasons, including: poor origination practices; fraud; faulty appraisals; documentation errors; poor underwriting; legal errors; poor servicing practices; weak economic conditions; decline in the value of homes, businesses, or commercial properties; special hazards; earthquakes and other natural events; over-leveraging of the borrower or on the property; reduction in market rents and occupancies and poor property management practices; changes in legal protections for lenders; reduction in personal incomes; job loss; and personal events such as divorce or health problems. In addition, if the U.S. economy or the housing market weakens further than we have anticipated, our credit losses could increase beyond levels that we have anticipated. Credit losses on real estate loans can vary for reasons not related to the general economy.

With respect to most of the loans securitized by securitization entities sponsored by us and for a portion of the loans underlying residential loan securities we have acquired from securitizations sponsored by others, the interest rate is adjustable. Accordingly, when short-term interest rates rise, required monthly payments from homeowners may rise under the terms of these loans, and this may increase borrowers' delinquencies and defaults.

We also own securities backed by negative amortization adjustable-rate loans made to residential borrowers, some of which are prime-quality loans while many are Alt-A quality loans (and a few are subprime loans). We invest in these riskier loan types with the expectation of significantly higher delinquencies and losses as compared to regular amortization loans, but believe these securities offer us the opportunity to generate attractive risk-adjusted returns as a result of attractive pricing and the manner in which these securitizations are structured. Nevertheless, there remains substantial uncertainty about the future performance of these assets.

The commercial loans we credit-enhance are fixed-rate loans, the majority of which are interest-only loans. In general, these loans are not fully amortizing and therefore require balloon payments at maturity. Consequently, we could be exposed to credit losses at the maturity of these loans if the borrower is unable to repay or refinance the borrowing with another third-party lender.

We will experience credit losses on residential and commercial loans and securities, and to the extent the losses are consistent with the amount and timing of our assumptions, we expect to earn attractive returns on our investments. We manage our credit risks by analyzing the extent of the risk we are taking and reviewing whether we believe the appropriate underwriting criteria are met, and we utilize systems and staff to monitor the ongoing credit performance of each loan and security. To the extent we find the credit risks on specific assets are changing adversely, we may be able to take actions (which may include selling the assets) to mitigate potential losses. However, we may not always be successful in analyzing risks, reviewing underwriting criteria, foreseeing adverse changes in credit performance or in effectively mitigating future credit losses and the ability to sell an asset may be limited due to the structure of the asset or the absence of a liquid market for the asset.

In addition to residential and commercial subordinate securities, Redwood and Acacia own senior and other securities issued by securitization entities that are sponsored by others. A risk we face with respect to these securities is that we do not generally control or influence the underwriting, servicing, management, or loss mitigation with respect to these underlying loans.

The Acacia entities and Redwood also own securities backed by subprime and Alt-A residential loans that have substantially higher credit risk characteristics than prime-quality loans. Consequently, we can expect these lower-quality loans to have higher rates of delinquency and loss, and if such losses differ from our assumptions, Acacia, and Redwood could suffer losses.

The Acacia entities also own certain senior securities and subordinate securities purchased from the Sequoia securitization entities we sponsor. If the pools of residential and commercial loans underlying these securities were to experience poor credit results, these securities could suffer decreases in fair value, or could experience principal losses. If any of these events occurs, it would likely reduce our returns from these investments.

Interest Rate Risk

Changes in interest rates and the shape of the yield curve can affect the cash flows and fair values of our assets, liabilities, and interest rate agreements and, consequently, affect our earnings and reported equity. Our general strategy with respect to interest rates is to maintain an asset/liability posture (including hedges) on a consolidated basis that assumes some interest rate risks but not to such a degree that the achievement of our long-term goals would likely be affected by changes in interest rates. Accordingly, we are willing to accept short-term volatility of earnings and changes in our reported equity in order to accomplish our goal of achieving attractive long-term returns.

To implement our interest rate risk strategy, we may use interest rate agreements in an effort to maintain a close match between pledged assets and debt, as well as between the interest rate characteristics of the assets in the securitization entities and the corresponding ABS issued. However, we generally do not attempt to completely hedge changes in interest rates, and at times, we may be subject to more interest rate risk than we generally desire in the long term. Changes in interest rates will have an impact on the values and cash flows of our assets and corresponding liabilities.

Prepayment Risk

We seek to maintain an asset/liability posture that benefits from investments in prepayment-sensitive assets while limiting the risk of adverse prepayment fluctuations to an amount that, in most circumstances, can be absorbed by our capital base while still allowing us to make regular dividend payments.

Prepayments affect GAAP earnings in the near-term primarily through the timing of the amortization of purchase premium and discount and through triggering market valuation adjustments. For example, amortization income from discount assets may not necessarily offset amortization expense from premium assets, and vice-versa. In addition, variations in current and projected prepayment rates for individual assets

and changes in interest rates (as they affect projected coupons on ARMs and other assets and thus change effective yield calculations) may cause net premium amortization expense or net discount amortization income to vary substantially from quarter to quarter. Moreover, the timing of premium amortization on assets may not always match the timing of the premium amortization on liabilities even when the underlying assets and liabilities are in the same securitization and pay down at the same rate.

Prepayment risks exist in the assets and associated liabilities consolidated on our balance sheets. In general, discount securities benefit from faster prepayment rates on the underlying real estate loans while premium securities (such as IOs) benefit from slower prepayments on the underlying loans. We are currently biased in favor of faster prepayment speeds with respect to the long-term economic effect of residential loan prepayments. We note that changes in residential loan prepayment rates could result in GAAP and tax earnings volatility.

With respect to securities backed by residential mortgage loans (and in particular, IOs), changes in prepayment forecasts by market participants could affect the market values of those securities sold by securitization entities, and thus could affect the economics associated with securitizing assets.

Our credit results and risks can also be affected by prepayments. For example, credit risks for the securities we own are reduced each time a loan prepays. All other factors being equal, faster prepayment rates reduce our credit risks on our existing portfolio.

We caution that prepayment rates are difficult to predict or anticipate, and variations in prepayment rates can materially affect our earnings and dividend distribution requirements. ARM prepayment rates, for example, are driven by many factors, one of which is the steepness of the yield curve. As the yield curve flattens (short-term interest rates rise relative to longer-term interest rates), ARM prepayments typically increase. However, for borrowers who have impaired credit or who otherwise do not meet loan underwriting criteria, the ability to refinance (i.e., prepay) a loan even when interest rates decline may be limited.

Fair Value and Liquidity Risks

The securities that we acquire are generally funded with equity or long-term debt and we may also use short-term recourse debt that might affect our liquidity position. The assets and liabilities at Acacia are accounted for under the fair value option, with all changes in market values being recorded through our income statement. Though this potentially creates earnings volatility, the securities and ABS issued by Acacia entities have no recourse to us that would otherwise affect our liquidity position.

Most of the real estate loans that we consolidate are accounted for using the “held-for-investment” GAAP classification and are reported at their amortized cost. Most of these loans have been sold to Sequoia entities and, thus, changes in the fair value of the loans do not have an impact on our liquidity. However, changes in fair values during the accumulation period (while these loans are funded with short-term debt before they are sold to a Sequoia entity) may have a short-term effect on our liquidity. We may also own some real estate loans accounted for as held-for-sale and adverse changes in their value would be recognized through our income statement and may have an impact on our ability to obtain financing for them.

Our consolidated obligations consist primarily of ABS issued. Changes in fair value of ABS issued have no impact on our liquidity. ABS issued by Sequoia and the resecuritization we engaged in during the third quarter of 2011 are reported at amortized cost as are the residential loans collateralizing these ABS. We report at fair value the ABS issued by Acacia and also report the underlying securities collateralizing the ABS issued at fair value. In either case, the resulting net equity (assets less liabilities) may not necessarily be reflective of the fair value of our interests in these securitization entities. However, since the ABS issued can only look to the cash flows generated by the assets within that securitization for payments of interest and repayments of the principal balance of the ABS, the changes in fair value do not have an effect on Redwood’s liquidity. Only to the extent that changes in fair values affect the timing of the cash flows we might receive on our investments in the Acacia entities is there an effect to Redwood from changes in fair values of these securities.

We may fund some assets with a combination of short-term debt and equity that is recourse to Redwood. This generally increases our fair value and liquidity risks. We manage these risks by maintaining what we believe to be conservative capital levels under our internal risk-adjusted capital and risk management policies and by ensuring we have a variety of financing facilities available to fund each of our assets. We also manage risk by hedging the loans held for securitization to minimize the fluctuations in value prior to securitization.

Under short-term borrowing facilities and swap and other derivatives agreements, we pledge assets as security for our payment obligations and make various representations and warranties and agree to certain covenants, events of default, and other terms. In addition, our short-term borrowing facilities are generally uncommitted, meaning that each time we request a new borrowing under a facility the lender has the option to decline to extend credit to us. The terms of these facilities and agreements typically include financial covenants (such as covenants to maintain a minimum amount of tangible net worth or stockholders' equity and/or a minimum amount of liquid assets), margin requirements (which typically require us to pledge additional collateral if and when the value of previously pledged collateral declines), operating covenants (such as covenants to conduct our business in accordance with applicable laws and regulations and covenants to provide notice of certain events to creditors), representations and warranties (such as representations and warranties relating to characteristics of pledged collateral, our exposure to litigation and/or regulatory enforcement actions and the absence of material adverse changes to our financial condition, our operations, or our business prospects), and events of default (such as a breach of covenant or representation/warranty and cross defaults, under which an event of default is triggered under a credit facility if an event of default or similar event occurs under another credit facility).

Notwithstanding our efforts to manage fair value and liquidity risks, we are exposed to these types of risks due to, among other things, our use of short-term borrowing facilities and our use of interest rate swaps and other derivatives. For example, if there is a decline in value of assets we have pledged to collateralize our obligations under a swap or other derivative or to collateralize our borrowings under a short-term borrowing facility, we would be obligated in response to a margin call to pledge additional collateral, which could occur at a time when we do not have additional collateral available to pledge. As another example, if we breach a covenant or representation/warranty in a short-term borrowing facility, or if a default occurs under one of these facilities or agreements, we could be obligated to repay all outstanding borrowings under that credit facility, which could occur at a time when we do not have cash or other liquid assets in an amount sufficient to satisfy our obligations. Similarly, under a swap or derivative agreement, following a breach or default, we could be obligated to make a termination payment to our counterparty, which could also occur at a time when we do not have cash or other liquid assets in an amount sufficient to satisfy our obligations. In addition, because these borrowing facilities and swap and derivatives agreements generally contain cross-default provisions, if we become obligated to repay borrowings under one facility or to make a termination payment under a swap or derivative agreement, our creditors under other facilities or agreements may exercise their right to require us to make payments or repay the borrowings under the agreements they have with us or under borrowing facilities they have extended to us. To the extent we become obligated to pledge assets or make payments at a time when we do not have sufficient cash or assets available, it could have a material adverse effect on our business and results of operations.

Inflation Risk

Virtually all of our consolidated assets and liabilities are financial in nature. As a result, 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. Separately, inflation or deflation in home prices can affect our credit risk.

Our financial statements are prepared in accordance with GAAP. Our activities and balance sheets are measured with reference to historical cost or fair value without considering inflation.

Risks Relating to Litigation and Governmental Investigations and Enforcement Actions

Our business exposes us to risks relating to litigation and governmental investigations and enforcement actions. For example, through certain of our wholly-owned subsidiaries we have engaged in securitization transactions relating to residential mortgage loans and other types of assets. In the future we plan to continue to engage in securitization transactions relating to residential mortgage loans and may also engage in other types of securitization transactions or other similar types of transactions. As a result of engaging in this business, we have already been the subject of litigation and have received an inquiry and a subpoena, respectively, from two different governmental authorities in connection with their broad-based investigations of certain aspects of certain securitization markets and issuances. As another example, Redwood Asset Management, Inc., one of our subsidiaries, is registered with the SEC as an investment adviser and provides investment advisory services to certain entities that we sponsored that issued collateralized debt obligations (and has, in the past, provided investment advisory services to a limited partnership fund we sponsored). Redwood Asset Management could be exposed to litigation by investors in entities to which it provides investment advisory services or it could be the subject of a governmental investigation or enforcement action, in each case, as a result of the manner in which it conducts its advisory activities.

Securitization entities that we sponsored issued ABS backed by residential mortgage loans and other assets held by these entities. As a result of declining property values, the recent economic recession, increased defaults, and other factors, the cash flows from the loans and other assets held by these securitization entities will not be sufficient, in some cases, to repay in full the principal amount of ABS issued by these securitization entities. We are not contractually liable for the principal and interest payments due on the ABS issued by these entities. Nonetheless, third parties who have invested in the ABS issued by these entities could try to hold us liable for any losses they experience, including through claims under federal and state securities laws or claims for breaches of representations and warranties we made in connection with engaging in these securitization transactions. Three lawsuits have been brought by investors in two of our different Sequoia securitizations, with two of these three lawsuits having been brought by members of the Federal Home Loan Bank System — namely, the Federal Home Loan Bank of Seattle and the Federal Home Loan Bank of Chicago. These lawsuits are discussed above in Note 14 — Commitments and Contingencies — Loss Contingencies — Litigation within the Notes to Consolidated Financial Statements set forth within Part I, Item 1 of this Quarterly Report on Form 10-Q and are also discussed below within Part II, Item 1 of this Quarterly Report on Form 10-Q. Defending a lawsuit can consume significant resources and may divert management's attention from our operations. To the extent we are unsuccessful in our defense of any lawsuit, we could suffer losses, which could be material.

In addition to the Federal Home Loan Banks noted above, various other Federal Home Loan Banks that make up the Federal Home Loan Bank System are pursuing litigation against various parties in relation to their respective portfolio holdings of RMBS. We have not been named in litigation brought by these other Federal Home Loan Banks to date, although some of them did purchase Sequoia RMBS at original issuance. As examples, (i) in September and October 2009, the Federal Home Loan Bank of Pittsburgh initiated litigation against various RMBS market participants relating to RMBS held within its portfolio, (ii) in March 2010, the Federal Home Loan Bank of San Francisco initiated litigation against various RMBS market participants relating to RMBS held within its portfolio, (iii) in January 2011, the Federal Home Loan Bank of Atlanta initiated litigation against various RMBS market participants relating to RMBS held within its portfolio, and (iv) in April 2011, the Federal Home Loan Bank of Boston initiated litigation against various RMBS market participants relating to RMBS held within its portfolio. There are a total of twelve Federal Home Loan Banks within the Federal Home Loan Bank System and those that have not yet initiated litigation or demands of the type described above may do so in the future and those that have already initiated litigation or demands of the type described above may expand the scope of the litigation or demands that they have initiated to date. Any newly initiated or expanded litigation or demands by the Federal Home Loan Banks may include new or additional demands or litigation against us or our subsidiaries to the extent that Federal Home Loan Banks purchased at issuance or in the secondary market RMBS issued through our Sequoia RMBS platform. Other investors in RMBS and other types of ABS have also initiated various legal actions against participants in the market for these types of ABS and those that invested in RMBS and collateralized

debt obligations issued in transactions we sponsored may initiate legal actions against us, particularly if the parties who have already initiated legal actions against us or others are successful, in whole or in part, in the pursuit of their claims.

Various governmental authorities have also initiated investigations, enforcement actions, and litigation with respect to, among other things, the mortgage finance markets, RMBS transactions, and collateralized debt obligation transactions and the market participants who structured, sponsored, marketed, or sold transactions or securities relating to these markets and securities. For example in 2010, Goldman Sachs reached a $550 million settlement relating to civil charges brought by the SEC relating to Goldman Sachs' role in structuring and marketing a synthetic collateralized debt obligation transaction referred to as Abacus 2007-AC1. Other examples relating to collateralized debt obligations include: (i) in 2010 the SEC initiated an action against an asset management firm named ICP Asset Management (and certain other related entities and individuals) alleging violations of law by ICP in the conduct of its business as the collateral manager of various collateralized debt obligation transactions and (ii) in October 2011, the SEC charged Citigroup's principal U.S. broker-dealer subsidiary with misleading investors about a $1 billion collateralized debt obligation transaction, which charges were settled pursuant to an agreement under which Citigroup paid a total of $285 million to be distributed to investors in that transaction. Another example relating to RMBS is that in 2010 the Federal Housing Finance Agency (FHFA), which is the federal agency that regulates Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, issued 64 subpoenas to institutions that participated in RMBS transactions in which Fannie Mae or Freddie Mac invested, as part of a financial inquiry that is seeking information to determine whether losses sustained by Fannie Mae and Freddie Mac from these investments are the legal responsibility of others and to ensure that the obligations of the various parties involved have been met. In September 2011, the FHFA filed lawsuits against 17 financial institutions, certain of their officers and various unaffiliated lead underwriters, which suits allege violations of Federal securities laws and common law in the sale of RMBS to Fannie Mae and Freddie Mac.

Our business has included, and continues to include, activities relating to securitization transactions, an area that is the focus of various governmental authorities. Because of our involvement in the securitization business, we could become the subject of governmental investigations, enforcement actions, or lawsuits, and governmental authorities could allege that we violated applicable law or regulation in the conduct of our business. If violations are so alleged, we might not be successful in defending any related action brought against us, and any losses incurred as a result of the resolution of any such action against us could have a material adverse effect on our results of operations in future periods. In any case, regardless of the merits of any allegation or legal action that may be brought against us, or of our success in defending against it, the costs of defending against any such allegation or legal action made or brought against us may be significant or material and could have a material adverse effect on our results of operations in future periods. To the extent that any action is brought against us or other market participants by any governmental authority, regardless of whether that action is successful or not, it could result in non-governmental litigants bringing similar actions against us to the extent the law permits private parties to pursue legal action to address alleged violations of law or regulation.

As part of investigations they have been conducting, we have been required to provide information to two different federal agencies. Within Part II, Item 1 of this Quarterly Report on Form 10-Q, we describe (i) the inquiry we received from the SEC, which inquiry took the form of an order to provide certain information regarding our past business activities with respect to sponsoring collateralized debt obligation transactions, and (ii) the subpoena we received from the National Credit Union Administration relating to certain RMBS transactions we sponsored in the past. We have responded to the order from the SEC and the subpoena from the NCUA. Both the subpoena from the NCUA and the order from the SEC state that they should not be construed as an indication that any violation of law has occurred, however, these regulatory agencies could, in the future, allege that we did violate applicable law or regulation in the conduct of our securitization business and, if either of them were to make such an allegation, it is possible that we might not be successful in defending any related action brought against us and any losses incurred as a result of the resolution of any such action against us could have a material adverse effect on our results of operations in future periods. As an example, in June 2011 the NCUA filed federal and state securities law claims in U.S. District Court in Kansas City, Kansas against, among others, certain subsidiaries of J.P. Morgan Chase & Co.

and Royal Bank of Scotland Group PLC alleging that the offering documents relating to certain RMBS transactions that they sponsored and/or underwrote contained untrue statements of material fact or omitted to state material facts (and on July 18, 2011 the NCUA filed an additional and similar lawsuit against certain subsidiaries of Royal Bank of Scotland Group PLC and certain other entities in U.S. District Court in Los Angeles, California). At the same time the NCUA filed its June 2011 claims, it announced that it expects to file additional similar lawsuits against other financial institutions. On June 21, 2011, The Wall Street Journal reported that the NCUA is engaged in settlement discussions with financial institutions relating to other RMBS transactions and subsequently the media has reported that the NCUA has indicated that it anticipates filing another five to 10 lawsuits relating to the failure of wholesale credit unions.

There have also recently been several notable proposed settlements by large financial institutions of claims related to RMBS transactions. For example:

- In June 2011, Bank of America Corporation and certain of its subsidiaries (collectively referred to as “Bank of America”) reported that it entered into a proposed settlement agreement and a related agreement with certain institutional investors relating to claims for loan servicing breaches relating to, and breaches of representations and warranties made in connection with, certain securitization transactions that had been sponsored by subsidiaries of Countrywide Financial Corporation (prior to the acquisition of Countrywide Financial by Bank of America). The proposed settlement agreement is subject to satisfaction of certain conditions, including court approval. The proposed settlement agreement provides for the release of claims related to: breaches of representations and warranties in the covered securitization transactions, all past servicing of loans underlying the covered securitization transactions, and all future servicing of loans underlying the covered securitization transactions (to the extent that future servicing complies with newly agreed-to standards). Under the proposed settlement, Bank of America would make an aggregate payment of $8.5 billion, which would be allocated among the covered securitization transactions.
- In July 2011, subsidiaries of Wells Fargo & Company (collectively referred to as “Wells Fargo”) entered into a proposed settlement of a class action lawsuit brought by investors in 28 different RMBS transactions sponsored by Wells Fargo, which class action lawsuit included claims under the federal securities laws that the offering documents for those RMBS transactions contained untrue statements and omitted material facts. In settling these claims, Wells Fargo agreed to a settlement payment to the plaintiff class of approximately $125 million dollars. The proposed settlement is subject to court approval.

As settlements such as those described above are proposed or entered into, we may analyze them, the nature of the claims and RMBS they relate to, and the circumstances under which they were entered into. In some cases, these settlements may affect the value of third-party issued RMBS that we hold. We also may seek to determine the extent to which these settlements are relevant to the defense of the lawsuits that we have been named in, to other aspects of our business, and to the reporting of our financial results. We may not analyze all future settlements that relate to asset-backed securities, or we may analyze them but not describe them in future public disclosures we make.

Other Risks

In addition to the market risks and risks relating to litigation and governmental investigations and enforcement actions described above, our business and results of operations are subject to a variety of types of risks and uncertainties, including, among other things, those described in Part II, Item 1A of this Quarterly Report on Form 10-Q and those described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, under the caption “Risk Factors.”

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Information concerning market risk is incorporated herein by reference to Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2010, as supplemented by the information under "*Management's Discussion and Analysis of Financial Condition and Results of Operations — Market Risks*" within Item 2 above. Other than the developments described thereunder, including changes in the fair values of our assets, there have been no other material changes in our quantitative or qualitative exposure to market risk since December 31, 2010.

Item 4. Controls and Procedures

We have adopted and maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed on our reports under the Securities Exchange Act of 1934, as amended (the Exchange Act) is recorded, processed, summarized, and reported within the time periods specified in the U.S. Securities and Exchange Commission's rules and forms and that the information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rule 13a-15(b) of the Exchange Act, we have carried out an evaluation, under the supervision and with the participation of management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the quarter covered by this report. Based on the foregoing, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective at a reasonable assurance level.

There have been no changes in our internal control over financial reporting during the third quarter of 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

Item 1. Legal Proceedings

As described in Part I, Item 3 of our Annual Report on Form 10-K for the year ended December 31, 2010, on December 23, 2009, the Federal Home Loan Bank of Seattle (the "FHLB-Seattle") filed a claim in Superior Court for the State of Washington (case number 09-2-46348-4 SEA) against Redwood Trust, Inc., our subsidiary, Sequoia Residential Funding, Inc. ("SRF"), Morgan Stanley & Co., and Morgan Stanley Capital I, Inc. (collectively, the "FHLB-Seattle Defendants"). The FHLB-Seattle alleges claims under the Securities Act of Washington (Section 21.20.005, et seq.) and seeks to rescind the purchase of a mortgage pass-through certificate (or, residential mortgage backed securities, "RMBS") issued through our Sequoia RMBS platform as part of the Sequoia Mortgage Trust 2005-4 securitization transaction and purchased by the FHLB-Seattle. The FHLB-Seattle also seeks to collect interest on the original purchase price at the statutory interest rate of 8% per annum from the date of original purchase (net of interest received), as well as attorneys' fees and costs. On June 10, 2010, the FHLB-Seattle filed an amended complaint. Subsequently, on October 18, 2010, the FHLB-Seattle Defendants filed motions to dismiss the FHLB-Seattle's complaint. Redwood Trust, Inc. and SRF additionally moved to dismiss the complaint for lack of personal jurisdiction. The FHLB-Seattle alleges that the FHLB-Seattle Defendants' offering materials for this RMBS contained materially untrue statements and omitted material facts about this RMBS and the loans securitized in this transaction. Among other things, the FHLB-Seattle alleges that the FHLB-Seattle Defendants made untrue statements or omissions regarding the (1) loan-to-value ratios of these mortgage loans and the appraisals of the properties that secured these mortgage loans, (2) occupancy status of those properties, (3) underwriting standards of the originators of these mortgage loans, and (4) ratings assigned to this RMBS. In a series of rulings issued between June 23, 2011 and August 15, 2011, the Washington State Superior Court dismissed the allegations relating to occupancy status and denied other grounds for dismissal. On July 19, 2011, the Court granted Redwood Trust, Inc. and SRF's motion to dismiss for lack of personal jurisdiction. Redwood Trust, Inc. does not know whether the FHLB-Seattle will appeal or otherwise contest the dismissal, or file a claim in another jurisdiction. The Sequoia RMBS that is the subject of the FHLB-Seattle's claim was issued with an original principal amount of approximately $133 million and, at September 30, 2011, had a remaining outstanding principal amount of approximately $29 million. We believe that this claim is without merit and we intend to defend any action related to it vigorously. In connection with the issuance of the Sequoia RMBS that is the subject of the FHLB-Seattle's claim, Redwood agreed to indemnify the underwriters of this RMBS for certain losses and expenses they might incur as a result of claims made against them relating to this RMBS, including, without limitation, certain legal expenses. The FHLB-Seattle's claims against the underwriters of this RMBS were not dismissed for lack of personal jurisdiction. Regardless of the outcome of this litigation, Redwood could incur a loss as a result of these indemnities.

As described in Part I, Item 3 of our Annual Report on Form 10-K for the year ended December 31, 2010, on August 18, 2010, Redwood Trust, Inc.'s subsidiary, SRF, received service of process with respect to a claim filed on July 15, 2010 in Superior Court for the State of California in San Francisco (case number CGC-10-501610) by The Charles Schwab Corporation ("Schwab"). In the complaint, Schwab is suing SRF and 26 other named defendants (collectively, the "Schwab Defendants") in relation to RMBS sold or issued by the Schwab Defendants. With respect to SRF, Schwab alleges a cause of action of negligent misrepresentation under California state law and seeks unspecified damages and attorneys' fees and costs with respect to a RMBS issued through the Sequoia RMBS platform as part of the Sequoia Mortgage Trust 2005-4 securitization transaction (which is the same transaction at issue in the litigation initiated by the FHLB-Seattle described in the preceding paragraph). Among other things, Schwab alleges that the offering materials for this Sequoia RMBS contained materially untrue statements or omissions regarding this RMBS and the loans securitized in this securitization transaction, including untrue statements or omissions regarding the (1) loan-to-value ratios of these mortgage loans and the appraisals of the properties that secured these mortgage loans, (2) occupancy status of those properties, (3) underwriting standards of the originators of these mortgage loans, and (4) ratings assigned to this RMBS. On September 22, 2011, the Schwab Defendants moved to dismiss the complaint, which motions are now pending. The Sequoia RMBS that is the subject of Schwab's claim was issued with an original principal amount of approximately $14.8 million and, at September 30, 2011, had a remaining outstanding principal amount of approximately $3.2 million. We believe that this case is without merit and we intend to defend the action vigorously. In connection with the issuance

of the Sequoia RMBS that is the subject of Schwab's claim, Redwood agreed to indemnify the underwriters of this RMBS for certain losses and expenses they might incur as a result of claims made against them relating to this RMBS, including, without limitation, certain legal expenses. Regardless of the outcome of this litigation, Redwood could incur a loss as a result of these indemnities.

As described in Part I, Item 3 of our Annual Report on Form 10-K for the year ended December 31, 2010, on July 12, 2010, two notices of "Election to Void Sale of Securities" pursuant to Illinois Securities Law (815 ILCS Section 5/13(A)) were received from the Federal Home Loan Bank of Chicago ("FHLB-Chicago"). In the notices, the FHLB-Chicago sought to void its purchase of two RMBS that were issued in 2006 by a securitization trust with respect to which Redwood Trust, Inc.'s subsidiary, SRF, was the depositor. Subsequently, on October 15, 2010, the FHLB-Chicago filed a claim in the Circuit Court of Cook County, Illinois (case number 10-CH-45033) against SRF and more than 45 other named defendants (collectively, the "FHLB-Chicago Defendants") in relation to RMBS sold or issued by the FHLB-Chicago Defendants or by entities controlled by the FHLB-Chicago Defendants. In an amended complaint filed on March 16, 2011, FHLB-Chicago added as defendants Redwood Trust, Inc. and another one of our subsidiaries, RWT Holdings, Inc. With respect to Redwood Trust, Inc. and SRF, the FHLB-Chicago alleges that the offering materials for two RMBS issued through the Sequoia RMBS platform as part of the Sequoia Mortgage Trust 2006-1 securitization transaction contained untrue and misleading statements and material representations in violation of Illinois Securities Law (815 ILCS Sections 5/12(F)-(H)) and North Carolina Securities Law (N.C.G.S.A. §78A-8(2) & §78A-56(a)) and also alleges a claim of negligent misrepresentations under Illinois common law. On some of the causes of action, the FHLB-Chicago seeks to rescind the purchase of these RMBS and to collect interest on the original purchase price at the statutory interest rate of 10% per annum from the date of original purchase (net of interest received). On one cause of action, the FHLB-Chicago seeks unspecified damages. The FHLB-Chicago also seeks attorneys' fees and costs. Among other things, the FHLB-Chicago alleges that the offering materials for this RMBS contained materially untrue statements or omissions regarding this RMBS and the loans securitized in this transaction, including untrue statements or omissions regarding the (1) loan-to-value ratios of these mortgage loans and the appraisals of the properties that secured these mortgage loans, (2) occupancy status of those properties, (3) underwriting standards of the originators of these mortgage loans, (4) ratings assigned to these RMBS, and (5) due diligence performed on these mortgage loans. The first of these two Sequoia RMBS was issued with an original principal amount of approximately $105 million and, at September 30, 2011, had a remaining outstanding principal amount of approximately $43 million. The second of these two Sequoia RMBS was issued with an original principal amount of approximately $379 million and, at September 30, 2011, had a remaining outstanding amount balance of approximately $155 million. On March 27, 2011, the FHLB-Chicago Defendants moved to dismiss the amended complaint, which motions are now pending. We believe that this case is without merit, and we intend to defend the action vigorously. In connection with the issuance of the Sequoia RMBS that is the subject of the FHLB-Chicago's claim, Redwood agreed to indemnify the underwriters of these RMBS for certain losses and expenses they might incur as a result of claims made against them relating to these RMBS, including, without limitation, certain legal expenses. Regardless of the outcome of this litigation, Redwood could incur a loss as a result of these indemnities.

As described in Part I, Item 3 of our Annual Report on Form 10-K for the year ended December 31, 2010, in May 2010, we received an Order from the SEC, pursuant to Section 21(a)(1) of the Securities Exchange Act of 1934. The SEC's Order required us to provide information regarding, among other things, our trading practices and valuation policies relating to our business of sponsoring and managing collateralized debt obligation issuers. We have responded to the Order. The Order from the SEC indicates that it should not be construed as an indication by the SEC or its staff that any violations of law have occurred. The SEC could, however, as a result of our response to this Order or otherwise, allege that we violated applicable law or regulation in the conduct of our collateralized debt obligation business.

As described in Part I, Item 3 of our Annual Report on Form 10-K for the year ended December 31, 2010, in November 2009, we received a subpoena from the National Credit Union Administration (NCUA), which is the federal agency that charters and supervises federal credit unions, as part of its investigation of the circumstances relating to the U.S. Central Federal Credit Union being placed into conservatorship in March 2009, including the U.S. Central Federal Credit Union's investment in various RMBS. The NCUA

requested information relating to, among other things, two RMBS (i) issued by a securitization trust with respect to which SRF was the depositor and (ii) purchased at the time of issuance by the U.S. Central Federal Credit Union. We have responded to the subpoena. The subpoena from the NCUA states that it should not be construed as an indication by the NCUA or its staff that any violation of law has occurred. The NCUA could, however, as a result of our response to this subpoena or otherwise, allege that we did violate applicable law or regulation in the conduct of our securitization business.

Other than as disclosed in the preceding paragraphs of this Item 1, there are no material pending legal proceedings, or material changes with respect to pending legal proceedings, in each case, to which we or any of our subsidiaries is a party or of which our property is the subject.

Item 1A. Risk Factors

Our risk factors are discussed under Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2010. In addition, the following risk factor reflects recent developments.

A recently initiated SEC review of the section of the Investment Company Act of 1940 (“Investment Company Act”) and the regulations and regulatory interpretations promulgated thereunder that we rely on to exempt us from regulation under the Investment Company Act could eventually result in regulatory changes relating thereto, which could require us to change our business and operations in order for us to continue to rely on that exemption or operate without the benefit of that exemption.

On August 31, 2011, the SEC published a Concept Release within which it reviews interpretive issues under the Investment Company Act relating to the status under the Investment Company Act of companies that are engaged in the business of acquiring mortgages and mortgage-related instruments and that rely on the exemption set forth in Section 3(c)(5)(C) of the Investment Company Act from requirements under the Investment Company Act. Among other things, the SEC is “concerned that certain types of mortgage-related pools today appear to resemble in many respects investment companies such as closed-end funds and may not be the kinds of companies that were intended to be excluded from regulation under the Investment Company Act by Section 3(c)(5)(C).” Although we believe that we are properly relying on Section 3(c)(5)(C) of the Investment Company Act to exempt us from regulation under the Investment Company Act, this SEC review could eventually affect our ability to rely on that exemption or could eventually require us to change our business and operations in order for us to continue to rely on that exemption. Even if the SEC review of this exemption does not eventually have these effects on us, in the interim, while the SEC is carrying out its review, the uncertainty created by the SEC’s review could negatively impact the ability of companies, such as us, that rely on this exemption to raise capital or borrow money, which could negatively impact our business and results of operations.

The foregoing risk factor should be read together with the risk factor set forth within Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2010 under the heading “*Conducting our business in a manner so that we are exempt from registration under and compliance with the Investment Company Act of 1940 may reduce our flexibility and could limit our ability to pursue certain opportunities. At the same time, failure to continue to qualify for exemption from the Investment Company Act of 1940 (Investment Company Act) could adversely affect us*.”

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the three months ended September 30, 2011, we did not sell any equity securities that were not registered under the Securities Act of 1933, as amended. We announced a stock repurchase plan on November 5, 2007 for the repurchase of up to a total of 5,000,000 shares. This plan replaced all previous share repurchase plans and has no expiration date. We repurchased 222,386 shares during the three months ended September 30, 2011. At September 30, 2011, 4,435,685 shares remained available for repurchase under our stock repurchase plan.

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The following table contains information on the shares of our common stock that we purchased or otherwise acquired during the three months ended September 30, 2011.

	Total Number of Shares Purchased or Acquired	Average Price per Share Paid	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
July 1, 2011 – July 31, 2011	123[(1)]	$ 15.12	—	4,658,071
August 1, 2011 – August 31, 2011	223,220[(2)]	$ 12.096	222,386	4,435,685
September 1, 2011 – September 30, 2011	36[(3)]	$ 0.01		4,435,685
	933	$ 12.03	222,386	4,435,685

(1) The 123 shares repurchased during July 2011 represent shares acquired to satisfy tax withholding requirements on the vesting of restricted shares.

(2) Includes 834 shares acquired in August 2011 due to unvested shares being forfeited upon termination of employees.

(3) The 36 shares acquired in September 2011 represent unvested shares forfeited upon termination of employees.

Item 3. Defaults Upon Senior Securities

None.

Item 4. (Removed and Reserved)

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Exhibit
3.1	Articles of Amendment and Restatement of the Registrant, effective July 6, 1994 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 3.1, filed on August 6, 2008)
3.1.1	Articles Supplementary of the Registrant, effective August 10, 1994 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 3.1.1, filed on August 6, 2008)
3.1.2	Articles Supplementary of the Registrant, effective August 11, 1995 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 3.1.2, filed on August 6, 2008)
3.1.3	Articles Supplementary of the Registrant, effective August 9, 1996 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 3.1.3, filed on August 6, 2008)
3.1.4	Certificate of Amendment of the Registrant, effective September 30, 1998 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 3.1.4, filed on August 6, 2008)
3.1.5	Articles Supplementary of the Registrant, effective April 7, 2003 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 3.1.5, filed on August 6, 2008)
3.1.6	Articles Supplementary of the Registrant, effective June 12, 2008 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q, Exhibit 3.1.6, filed on August 6, 2008)
3.1.7	Articles of Amendment effective May 19, 2009 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 3.1, filed on May 21, 2009)
3.1.8	Articles of Amendment effective May 24, 2011 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 3.1, filed on May 20, 2011)
3.2	Amended and Restated Bylaws, as adopted on March 5, 2008 (incorporated by reference to the Registrant's Current Report on Form 8-K, Exhibit 3.1, filed on March 11, 2008)
10.1	Office Building Lease, effective as of and dated as of June 1, 2012
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	Pursuant to Rule 405 of Regulation S-T, the following financial information from the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2011, is furnished in XBRL-formatted interactive data files: (i) Consolidated Statements of Income for the three and nine months ended September 30, 2011 and 2010; (ii) Consolidated Balance Sheets at September 30, 2011 and December 31, 2010; (iii) Consolidated Statements of Changes in Equity and Comprehensive Income for the nine months ended September 30, 2011 and 2010; (iv) Consolidated Statements of Cash Flows for the nine months ended September 30, 2011 and 2010; and, (v) Notes to Financial Statements.

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SIGNATURES

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

	REDWOOD TRUST, INC.
Date: November 3, 2011	By: /s/ Martin S. Hughes
	Martin S. Hughes President and Chief Executive Officer (Principal Executive Officer)
Date: November 3, 2011	By: /s/ Diane L. Merdian
	Diane L. Merdian Chief Financial Officer (Principal Financial Officer)
Date: November 3, 2011	By: /s/ Christopher J. Abate
	Christopher J. Abate Controller (Principal Accounting Officer)

Item 6. Exhibits

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Exhibit 10.1

BELVEDERE PLACE

DATED AS OF JUNE 1, 2012

BETWEEN

BENTLY HOLDINGS CALIFORNIA LP,

AS LANDLORD,

AND

REDWOOD TRUST, INC.,

AS TENANT.

BELVEDERE PLACE

BASIC LEASE INFORMATION

1.	Date:	June 1, 2012
2.	Landlord:	Bently Holdings California LP
3.	Tenant:	Redwood Trust, Inc.
4.	Property:	The real property legally described on Exhibit A attached hereto
5.	Project:	The Property, together with the buildings known as One and Two Belvedere Place and all other improvements located thereon, commonly known as the Belvedere Place Office Center containing 103,598 rentable square feet.
6.	Building:	That certain office building located within the Project located at One Belvedere Place, Mill Valley, California
7.	Premises:	Subject to Section 1(b) of the Lease, 27,292 rentable square feet located on the entire third floor and the designated portion of the second floor of the Building, as outlined on the floor plan attached hereto as Exhibit B
8.	Load Factor:	Twenty-three percent (23%) for suite 200 and ten percent (10%) for suite 300
9.	Initial Term:	Six years
10.	Estimated Delivery Date:	June 1, 2012
11.	Outside Delivery Date:	June 1, 2012
12.	Commencement Date:	June 1, 2012
13.	Expiration Date:	May 31, 2018
14.	Initial Basic Rental Rate:	$121,381.17 per month, or $53.37 per square foot.

15.	Fair Market Rental Value:	The rental rate per rentable square foot per month (taking into account additional rent and all other monetary payments and considering any base year or expense stop applicable thereto), including all escalations, for all leases for comparable, unencumbered space for approximately the same lease term, executed at the Project and/or any other comparable Class A building in terms of size, quality, level of services, amenities, age and appearance located within the Southern Marin County area from the northern border of Corte Madera and Larkspur south to the Golden Gate Bridge (collectively, "**Comparable Buildings**"), during the twelve (12) month period immediately preceding the date upon which the determination of Fair Market Rental Value is made, and having a commencement date within six (6) months of the date that the Fair Market Rental Value will commence under this Lease, and taking into account any free rent, tenant improvements, tenant improvement allowances, moving allowances and other concessions granted to tenants under leases of such comparable space in Comparable Buildings and the value, if any, of the existing tenant improvements (with such value being judged with respect to the utility of such existing tenant improvements to the general business office user and not this particular Tenant), The Fair Market Rental Value shall be determined in accordance with the terms and provisions of this Lease below.
16.	Security Deposit:	$364,143.51, in the form of company check, cashier's check, or direct deposit, net of existing security deposit, which will become part of the Security Deposit as further described in Section 5 below
17.	Base Year:	2012
18.	Tenant's Proportionate Share:	The ratio which the rentable area of the Premises bears to the rentable area of the entire Project, which, subject to Section 1(b) of the Lease, is agreed to be 27.4%.
19.	Tenant Improvement Allowance:	None
20.	Space Plan Deadline:	N/A

21.	Working Drawing Deadline:	N/A
22.	Landlord’s Broker:	N/A
23.	Tenant’s Broker:	Aaron Wright and Brad Hedrick of Studley, 150 California Street, 14th Floor, San Francisco, CA 94111
24.	Extension Term:	One (1) five-year option.
25.	Guarantor:	None

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EXHIBITS

Exhibit A Legal Description of Property

Exhibit B Description of Premises

Exhibit C Notice of Lease Term Dates

Exhibit D Form of Tenant Estoppel Certificate

Exhibit E Rules and Regulations

Exhibit F Second Floor Build-Out/Improvement Plans

BELVEDERE PLACE OFFICE LEASE

THIS LEASE is entered into by and between Landlord and Tenant, as specified in the Basic Lease Information, which is incorporated herein by reference, as of the date shown in Paragraph 1 of the Basic Lease Information.

1. PREMISES.

(a) *Initial Premises*. Landlord hereby leases to Tenant and Tenant hereby leases from Landlord the Premises (as defined in Paragraph 7 of the Basic Lease Information) upon and subject to the terms, covenants and conditions herein set forth. Tenant covenants, as a material part of the consideration for this Lease, to keep and perform each and all of said terms, covenants and conditions for which Tenant is responsible and that this Lease is entered into upon the condition of such performance.

(b) *Verification of Usable Square Feet of Premises, Building and Project*. For the purposes of this Lease, "**usable square feet**" for the Premises shall be calculated pursuant to the Standard Method for Measuring Floor Area in Office Buildings, [ANSI Z65.1 — 1996], and "**rentable square feet**" shall equal (i) the usable square feet contained within the Premises multiplied by (ii) the sum of (x) one (1) plus (y) the Load Factor (as defined in Paragraph 8 of the Basic Lease Information). The usable square feet and rentable square feet of the Premises, Building and the Project are subject to verification by Tenant's architect within ninety (90) days following the Commencement Date. The usable square feet and rentable square feet of the Premises are subject to verification from time to time by Landlord's planner/designer only in the event of a change in the boundaries of the Premises and the parties hereby agree that the usable square footage and rentable square footage of the Premises shall be as specified in the Basic Lease Information unless and until (i) there is such a change in the boundaries of the Premises from as shown on Exhibit B attached hereto and/or (ii) Tenant exercises its right to remeasure as provided above. Notwithstanding the foregoing, Landlord shall have the right to verify the usable and rentable square feet in the Premises after completion of the Tenant Improvements. In the event either Landlord or Tenant elects to remeasure as provided herein, Tenant's architect may consult with Landlord's planner/designer regarding any such verification (if applicable) as it pertains to the Premises and such verification shall be subject to the approval of Tenant's architect (which approval shall not be unreasonably withheld, conditioned or delayed), and Landlord's architect may consult with Tenant's architect regarding any such verification as it pertains to the Premises and such verification shall be subject to the approval of Landlord's architect. In the event Landlord's architect and Tenant's architect cannot agree on the square footage of the Premises, Landlord and Tenant shall select a mutually acceptable independent architect to measure the Premises in accordance with this Section 1(b) and the decision of such architect shall be binding on Landlord and Tenant. Landlord and Tenant shall equally share the cost of such independent architect. In the event of such a change in the usable and rentable square footage in the Premises as provided herein, all amounts, percentages and figures appearing or referred to in this Lease based upon such incorrect amount (including, without limitation, the amount of rent) shall be modified in accordance with such determination. If such determination is made, it will be confirmed in writing by Landlord to Tenant.

2. TERM.

(a) *Initial Term*. Except as otherwise provided herein, the term of this Lease shall be the Initial Term as set forth in Paragraph 9 of the Basic Lease Information, commencing on the Commencement Date, and ending as of the Expiration Date, as set forth in Paragraph 12 and Paragraph 13, respectively, of the Basic Lease Information. The Initial Term, together with any extension term as to which a right has been properly exercised, shall be referred to as the "**Term**." Notwithstanding anything to the contrary set forth in this Lease, in the event that Landlord has not delivered the Premises to Tenant in the Delivery Condition by the Outside Delivery Date, as set forth in Paragraph 11 of the Basic Lease Information, Tenant shall have the right, at Tenant's sole option, to elect to terminate this Lease by delivery to Landlord of a notice (the "**Termination Notice**"), which termination shall be effective thirty (30) days after Tenant's delivery of the Termination Notice to Landlord, unless within such thirty (30) day period Landlord shall deliver the Premises to Tenant in the Delivery Condition. In the event Tenant shall elect to terminate this Lease, Tenant must deliver to Landlord the Termination Notice prior to the date the Premises are delivered to Tenant in the Delivery Condition.

(b) *Confirmation of Lease Term*. When the Commencement Date and the Expiration Date have been ascertained, the parties shall promptly complete and execute a Notice of Lease Term Dates in the form of Exhibit C attached hereto; provided, however, that the failure of the parties to confirm same shall not affect the Commencement Date or otherwise invalidate this Lease.

(c) *Lease Years*. The term "**Lease Year**" when used herein shall mean the twelve months commencing on the Commencement Date and each subsequent period of twelve months; provided, however, that if the Commencement Date does not occur on the first day of the calendar month, the first Lease Year shall mean the twelve months commencing on the first day of the calendar month following the Commencement Date. As provided above, if the Commencement Date does not occur on the first day of the calendar month, the first Lease Year shall include the period, if any, from the Commencement Date to the end of the month in which the Commencement Date occurs.

3. BASIC RENT.

(a) *Basic Rent Payments*. Tenant agrees to pay Landlord each calendar month, as base monthly rent, the Basic Rent as set forth in Paragraph 14 of the Basic Lease Information, subject to adjustment pursuant to subsection (b) below. Each monthly installment of Basic Rent shall be payable in advance on the first day of each calendar month during the Term. If the Term commences or ends on a day other than the first day of a calendar month, then the rent for the months in which this Lease commences or ends shall be prorated (and paid at the beginning of each such month) in the proportion that the number of days this Lease is in effect during such month bears to the total number of days in such month, and such partial month's installment shall be paid no later than the commencement of the subject month except for the first month's rent which shall be paid no later than the Commencement Date. In addition to the Basic Rent, Tenant agrees to pay as additional rent the amount of additional rent and rent adjustments and other charges required by this Lease. All rent shall be paid to Landlord, without prior demand and without any deduction or offset (except as otherwise provided in this Lease), in lawful money of the United States of America, at the address of Landlord designated in Section 31 below or to such other person or at such other place as Landlord may from time to time designate in writing. Except as otherwise provided in this Lease, in the event of a remeasurement or adjustment of the area of the Premises, the Basic Rent shall be recalculated using the Basic Rental Rate referenced in Paragraph 14 of the Basic Lease Information.

(b) *Adjustment in Basic Rent*. Basic Rent shall be modified, per rentable foot, pursuant to the following schedule:

June 1, 2012-May 31, 2013:	$	53.37
June 1, 2013-May 31, 2014:	$	54.85
June 1, 2014-May 31, 2015:	$	56.38
June 1, 2015-May 31, 2016:	$	53.95
June 1, 2016-May 31, 2017:	$	55.57
June 1, 2017-May 31, 2018:	$	57.23

(c) *Late Charge*. If Tenant fails to pay any installment of Basic Rent, additional rent or other changes or otherwise fails to make any other payment for which Tenant is obligated under this Lease within five (5) days after Tenant's receipt of notice that Tenant failed to pay same when due, then Tenant shall pay to Landlord a late charge equal to five percent (5%) of the amount so payable; provided, however, that if Tenant fails to pay any installment of Basic Rent or additional rent when due more than three (3) times in any twelve (12) month period, Landlord shall no longer be required to give Tenant notice before imposing the late charge and Tenant shall pay to Landlord a late charge equal to five percent (5%) of the amount due for any amount not paid within five (5) days after the date due. Tenant acknowledges that late payments will cause Landlord to incur costs not contemplated by this Lease, the exact amount of which costs are extremely difficult and impracticable to calculate. The parties agree that the late charge described above represents a fair and reasonable estimate of the extra costs incurred by Landlord as a result of such late payment. Such late charge shall not be deemed a consent by Landlord to any late payment, nor a waiver of Landlord's right to insist upon timely payments at any time, nor a waiver of any remedies to which Landlord is entitled hereunder. In addition, all amounts payable by Tenant to Landlord hereunder, exclusive of the late change described above, if not paid within five *(5)* days after such amounts are due, shall bear interest from the due date until paid at the lesser of (i) the rate of ten percent (10%) per annum or (ii) the maximum rate of interest permitted to be collected by the Landlord by law ("**Interest Rate**").

4 . ADDITIONAL RENT. In addition to the Basic Rent provided in Section 3 of this Lease, Tenant shall pay Tenant's Proportionate Share as specified in Paragraph 18 of the Basic Lease Information, of the increase in Actual Operating Expenses for each Operating Year over the Base Amount (as such terms are defined below). Tenant's Proportionate Share of the Building may change based on remeasurement or adjustment of the area of the Project or the Premises as described in Section 1(b). In addition, whenever additional space is added to the Premises, Tenant's Proportionate Share of the Project shall increase accordingly.

(a) *Estimated Operating Expenses*. Within ninety (90) days after the close of each Operating Year during the Term following the Base Year, Landlord shall furnish Tenant a written statement of the "**Estimated Operating Expenses**" for the then current Operating Year, and a corresponding calculation of additional rent, which shall be one-twelfth (1/12) of Tenant's Proportionate Share of the amount, if any, by which the Estimated Operating Expenses exceed the Base Amount. Such additional amount shall be added to the monthly installment of Basic Rent payable by Tenant under this Lease for each month during such Operating Year.

(b) *Actual Operating Expenses*. Within ninety (90) days after the close of each Operating Year (including the Base Year) during the Term, Landlord shall deliver to Tenant a written statement setting forth the Actual Operating Expenses during the preceding Operating Year and the amount by which the Actual Operating Expenses exceed the Base Amount . If such expenses for any Operating Year exceed the Estimated Operating Expenses paid by Tenant to Landlord pursuant to Section 4(a), Tenant shall pay the amount of such excess to Landlord as additional rent within thirty (30) days after receipt by Tenant of such statement. If such statement shows such expenses to be less than the amount paid by Tenant to Landlord pursuant to Section 4(a), then the amount of such overpayment shall be paid by Landlord to Tenant within thirty (30) days following the date of such statement or, at Landlord's option, credited by Landlord to the payment of rent next due. Additionally, promptly following the reassessment of the value of the Project by any such governmental authority subsequent to the leasing and occupancy of a substantial portion of the Project, Landlord shall provide Tenant with a written statement reflecting the adjusted Actual Operating Expenses for the Base Year. If, as a result of Landlord's recalculation of the Actual Operating Expenses for the Base Year Landlord determines that the amount paid by Tenant pursuant to this Section 4 for any Operating Year was less than the amount owed by Tenant for such Operating Year, Tenant shall pay to Landlord the amount of such shortfall within thirty (30) days after the date of Tenant's receipt of such statement, and if, as a result of Landlord's recalculation of the Actual Operating Expenses for the Base Year Landlord determines that amounts paid by Tenant pursuant to this Section 4 for any Operating Year exceeded the amount owed by Tenant for such Operating Year, then the amount of such overpayment shall be paid by Landlord to Tenant within thirty (30) days following the date of such statement or, at Landlord's option, credited by Landlord to the payment of rent next due. Prior to the date that is one (1) year after Tenant's receipt of Landlord's statement of Actual Operating Expenses for any Operating Year, Landlord shall provide Tenant with reasonable access, upon reasonable prior notice amid during normal business hours, to inspect and photocopy Landlord's books and records with respect to the Actual Operating Expenses for such Operating Year ("**Tenant's Audit**"), provided: (i) Tenant is not in default under any of the material provisions of the Lease (remaining uncured following the expiration of any applicable period for cure under this Lease), (ii) Tenant shall pay any amounts owing hereunder when due, (iii) Tenant's Audit is performed by an employee of Tenant or certified, public accountant who is not paid on a contingency fee basis, (iv) Tenant and any Tenant Party (as defined in Section 6(c) hereof) performing Tenant's Audit execute a confidentiality agreement in a form reasonably acceptable to Landlord and Tenant, (v) Tenant's Audit shall be performed at Tenant's sole cost and expense unless otherwise provided herein and (vi) Tenant's Audit shall be completed within such sixty (60) days after Landlord gives Tenant access to its books and records. If, within such sixty (60) day period, Tenant delivers to Landlord the written results of Tenant's Audit which states that Actual Operating Expenses are less than Landlord's determination of Actual Operating Expenses (the "**Discrepancy**"), Landlord shall, promptly after its receipt of the written results of Tenant's Audit either (A) reimburse Tenant for the amount of any overpayment made by Tenant to Landlord pursuant to this Section 4(b) and for Tenant's reasonable out-of-pocket costs and expenses incurred in performing the Tenant's Audit in the event the Discrepancy is greater than five percent (5%) or (B) notify Tenant in writing that Landlord disagrees with the result of Tenant's Audit, in which event the Landlord and Tenant shall submit their respective calculations of the Actual Operating Expenses to a neutral certified public accountant appointed with the consent of both Landlord and Tenant, who shall review the respective determinations of Actual Operating Expenses, and shall make a final determination of the Actual Operating Expenses for the year in question which shall be binding on both Landlord and Tenant, and if such accountant determines that there is a Discrepancy, Landlord, promptly after its receipt of such final determination, shall reimburse Tenant for the amount of any overpayment made by Tenant to Landlord pursuant to this Section 4(b) and for Tenant's reasonable out-of-pocket costs and expenses incurred in performing the Tenant's Audit in the event the Discrepancy is greater than five percent (5%).

(c) *Determinations*. The determination of Actual Operating Expenses and Estimated Operating Expenses shall be made by Landlord reasonably and in good faith. Any payments pursuant to this Section 4 shall be additional rent payable by Tenant hereunder, and in the event of nonpayment thereof, Landlord shall have the same rights with respect to such nonpayment as it has with respect to any other nonpayment of rent hereunder.

(d) *End of Term*. If this Lease shall terminate on a day other than the last day of an Operating Year, the amount of any adjustment between Estimated Operating Expenses and Actual Operating Expenses with respect to the Operating Year in which such termination occurs shall be prorated on the basis which the number of days from the commencement of such Operating Year, to and including such termination date, bears to three hundred sixty-five *(365)*; and any amount payable by Landlord to Tenant or Tenant to Landlord with respect to such adjustment shall be payable within thirty (30) days after delivery of the statement of Actual Operating Expenses with respect to such Operating Year.

(e) *Definitions*. The following terms shall have the respective meanings hereinafter specified:

(1) "**Base Amount**" shall mean an amount equal to the Actual Operating Expenses for the Base Year (as defined in Paragraph 17 of the Basic Lease Information); provided that, if the Project is not one hundred percent (100%) occupied (with all tenants paying full rent, as contrasted with free rent, half rent and the like) during the entire Base Year, then the Actual Operating Expenses actually incurred for the Base Year shall be annualized to reflect the Actual Operating Expenses that would have been incurred had the Project been one hundred percent (100%) occupied (with all tenants paying full rent, as contrasted with free rent, half rent and the like).

(2) "**Operating Year**" shall mean a calendar year commencing January 1 and ending December 31.

(3) "**Operating Expenses**" shall mean all expenses paid or incurred by Landlord for maintaining, owning, operating and repairing the Project (as defined in Paragraph 5 of the Basic Lease Information), including, without limitation, the Building, and the personal property used in conjunction therewith, including, but not limited to expenses incurred or paid for: (i) Property Taxes (as hereinafter defined); (ii) utilities for the Project, including but not limited to electricity, power, gas, steam, oil or other fuel, water, sewer, lighting, heating, air conditioning and ventilating; (iii) permits, licenses and certificates necessary to operate, manage and lease the Project; (iv) insurance Landlord reasonably deems appropriate to carry or is required to carry by any mortgagee under any mortgage encumbering the Project or any portion thereof or interest therein or encumbering any of Landlord's or the property manager's personal property used in the operation of the Project; (v) supplies, tools, equipment and materials used in the operation, repair and maintenance of the Project; (vi) accounting, legal, inspection, consulting, concierge and other services; (vii) equipment rental (or installment equipment purchase or equipment financing agreements); (viii) management agreements (including the cost of any management fee actually paid thereunder and the fair rental value of any office space provided thereunder, up to customary and reasonable amounts); (ix) wages, salaries and other compensation and benefits (including the fair value of any parking privileges provided) for all persons (not higher than Project manager) engaged in the operation, maintenance or security of the Project, and employer's Social Security taxes, unemployment taxes or insurance, and any other taxes which may be levied on such wages, salaries, compensation and benefits (provided that if an employee spends a portion of his or her time on projects other than the Project, then the wages, salaries, compensation and benefits of such employee and taxes thereon pursuant hereto shall be reasonably and equitably prorated); (x) payments under any easement, operating agreement, declaration, restrictive covenant, or instrument pertaining to the sharing of costs in any planned development or similar arrangement; (xi) operation, repair, and maintenance of all systems and equipment and components thereof (including replacement of components); (xii) janitorial service, alarm and security service, window cleaning, trash removal, elevator maintenance, and cleaning of walks, parking facilities and building walls (provided that janitorial service to the premises of other Project occupants shall not be included in Operating Expenses if Tenant separately provides janitorial service to the Premises at Tenant's cost); (xiii) replacement of wall and floor coverings, ceiling tiles and fixtures in lobbies, corridors, restrooms and other common or public areas or facilities; (xiv) maintenance and replacement of shrubs, trees, grass, sod and other landscape items, irrigation systems, drainage facilities, fences, curbs, and walkways; (xv) maintenance of parking facilities; (xvi) roof repairs and (xvii) capital expenditures, which capital expenditures shall be amortized for purposes of this Lease over their respective useful lives (together with interest thereon at the rate of 10% per annum), made (A) primarily to reduce Operating Expenses, or (B) to comply with any laws or other governmental requirements (except that Operating Expenses shall specifically exclude work required to correct any non-compliance of the Project with applicable laws or requirements existing as of the Commencement Date where correction of such noncompliance was then legally required as of the Commencement Date). Notwithstanding the foregoing, Operating Expenses shall not include (a) depreciation, interest and amortization on mortgages or other debt costs or ground lease payments, if any; (b) legal fees in connection with leasing, tenant disputes or enforcement of leases; (c) real estate brokers' leasing commissions; (d) improvements or alterations to tenant spaces or allowances, inducements or other concessions for any tenant; (e) the cost of providing any service directly to and paid directly by, any tenant; (f) costs of any items to the extent Landlord receives reimbursement from insurance proceeds or from a third party (such proceeds to be deducted from Operating Expenses in the year in which received); (g) costs incurred by Landlord in connection with the correction of structural and/or latent defects in the original construction materials or installations for the Building; (h) costs incurred by Landlord to lease space to new tenants or to retain existing tenants including all marketing, advertising and promotional expenditures; (i) costs arising from the presence of Hazardous Materials on or about the Building, the Project or the land not placed on or about the Premises, Project, land or the Building by the Tenant or any Tenant Panty; (j) any amount billed separately to another tenant, whether or not the tenant actually pays such amount; (k) the cost of charitable or political contributions; (1) the cost of sculpture, paintings or other objects of art; (m) expenses incurred by Landlord in respect of a development or buildings other than the Project; (n) salaries and benefits of executives and management personnel above the level of the Project manager; (o) increased costs of performance to the extent resulting from the negligence or willful misconduct of Landlord or its agents, employees or contractors; (p) capital expenditures except those capital expenditures made primarily to reduce Operating Expenses (as to which the amortized cost to be included in Operating Expenses in any Operating Year shall be limited to the amount of the actual reduction in Operating Expenses during such Operating Year as a result thereof), or to comply with any laws or other governmental requirements (provided that Operating Expenses shall specifically exclude costs of work required to correct any non-compliance of the Project with applicable laws or requirements existing as of the Commencement Date where correction of such noncompliance was then legally required as of the Commencement Date), which capital expenditures (together with interest thereon at the rate of 10% per annum) shall be amortized for purposes of this Lease over their respective useful lives; (q) rentals for items (except when needed in connection with normal repairs and maintenance of permanent systems) which if purchased, rather than rented, would constitute a capital expenditure which is specifically excluded in (p) above (excluding, however, equipment not affixed to the Building or Project which is used in providing janitorial or similar services); (r) costs incurred by Landlord for the repair of damage to the Building or Project, to the extent that Landlord is or should be reimbursed by insurance proceeds, and costs of all capital repairs, replacements or restorations resulting from a casualty, regardless of whether such repairs are covered by insurance and costs due to repairs resulting from an earthquake or flood to the extent such costs exceed $25,000; (s) expenses in connection with services or other benefits which are not offered to Tenant or for which Tenant is charged for directly; (t) overhead and profit increment paid to Landlord or to subsidiaries or affiliates of Landlord for goods and/or services in or to the Building and Project to the extent the same exceeds the costs of such goods and/or services rendered by unaffiliated third parties on a competitive basis; (u) Landlord's general corporate overhead and general and administrative expenses; (v) advertising and promotional expenditures, and costs of signs in or on the Project or the Building identifying the owner of the Project or Building or other tenants' signs; (w) costs incurred in connection with upgrading the Building or Project to comply with life, fire and safety codes, ordinances, statutes or other laws in effect prior to the Commencement Date, including, without limitation, the ADA, including penalties or damages incurred due to such non compliance; (x) tax penalties incurred as a result of Landlord's failure to make payments and/or to file any tax or informational returns when due; (y) costs for which Landlord has been compensated by a management fee, and any management fees in excess of those management fees which are normally and customarily charged by landlords of Comparable Buildings; (z) costs associated with the operation of the business of the partnership or entity which constitutes Landlord as the same are distinguished from the costs of operation of the Building and Project, including partnership accounting and legal matters, costs of defending any lawsuits with or claims by any mortgagee (except as the actions of Tenant may be in issue), costs of selling, syndicating, financing, mortgaging or hypothecating any of Landlord's interest in the Building or Project, costs of any disputes between Landlord and its employees (if any) not engaged in Building or Project operation, disputes of Landlord with Building or Project management, or outside fees paid in connection with disputes with other tenants; (aa) any increase of, or reassessment in, real property taxes and assessments in excess of two percent (2%) of the taxes for the previous year, resulting from either (1) any sale, transfer, or other change in ownership of the Building or the Project during the Term or from major alterations, improvements, modifications or renovations to the Building or the Project; (bb) the cost of any item included in Operating Expenses to the extent that such cost is attributable solely to the use, management, repair, service, insurance, condition, operation or maintenance of other office buildings in the Project; or (cc) reserves for bad debts or for future improvements, repairs, additions, etc.

(4) "**Estimated Operating Expenses**" shall mean Landlord's estimate of Operating Expenses for the following Operating Year, adjusted as if one hundred percent (100%) of the total rentable area of the Property will be occupied for the entire Operating Year, Base Year or Operating Year, as applicable, with all tenants paying full rent, as contrasted with free rent, half rent and the like.

(5) "**Actual Operating Expenses**" shall mean the actual Operating Expenses for the Base Year or any Operating Year, as applicable, adjusted, (a) if less than one hundred percent *(100%)* of the total rentable area of the Project had been occupied for the entire Base Year or Operating Year, as applicable, as if one hundred percent (100%) of the total rentable area of the Project had been occupied for the entire Base Year or Operating Year, with all tenants paying full rent, as contrasted with free rent, half rent and the like, and (b) if the Property Taxes component of the Base Year or Operating Year, as applicable, are based on an assessment of the value of the Project made by a governmental authority prior to completion of the Project and/or prior to leasing and occupancy of a substantial portion of the Project, then the Property Taxes component of the Actual Operating Expenses for such Operating Year or Base Year, as applicable, shall be adjusted by Landlord, in Landlord's reasonable discretion, as if the Project had been fully assessed in such Base Year or Operating Year with all improvements completed therein.

(6) "**Property Taxes**" shall mean all real and personal property taxes and assessments imposed by any governmental authority or agency on the Project; any assessments levied in lieu of such taxes; any non-progressive tax on or measured by gross rents received from the rental of space in the Project; and any other costs levied or assessed by, or at the direction of, any federal, state, or local government authority in connection with the use or occupancy of the Project or the Premises or the parking facilities serving the Project; any tax on any document to which Tenant is a party creating or transferring an interest in the Premises, and any expenses, including the reasonable cost of attorneys or experts, incurred by Landlord in seeking reduction by the taxing authority of the above-referenced taxes, less any tax refunds obtained as a result of an application for review thereof; but shall not include any net income, franchise, estate, excess profits, documentary transfer or inheritance taxes.

5. SECURITY DEPOSIT

Tenant shall remit $364,143.51, equal to three months of initial Basic Rent, as a security deposit in either cash or a letter of credit. No interest shall be paid on said deposit. At the end of the tenancy, or any holdover thereof, the deposit shall be returned to Tenant within fourteen days of Tenant's departure provided that Landlord may deduct from the deposit any amounts to compensate Landlord for the Basic Rent, any additional rent, cleaning costs, or costs to repair damages to the Building or the Premises caused by Tenant or Tenant's agents, invitees and/or licensees. Landlord currently holds a security deposit in the amount of $141,512.00 under Tenant's existing lease with Landlord. Tenant shall increase the existing security deposit by $222,631.51, so that the total Security Deposit held by Landlord equals $364,143.51.

6. USES; HAZARDOUS MATERIAL.

(a) *Use*. Landlord agrees that the Premises may be used for (i) the sale and trading of securities (including, without limitation) stocks and bonds), (ii) providing private banking services, investment banking services, trust services and other diversified financial services, (iii) the sale of insurance, (iv) office use, including conference and computer facilities, employee and visitor cafeteria and dining areas (including related kitchen facilities) and/or (vi) and other legally permitted use consistent with the character of the Project and Comparable Buildings. Tenant, at its sole cost and expense, shall promptly comply with all local, state and federal laws, statutes, ordinances and governmental rules, regulations or requirements now in force or which may hereinafter be in force relating to the use of the Premises, including, without limitation, the Americans with Disabilities Act, 42 U. S .C. § 12101 et seq. and any governmental regulations relating thereto (collectively, the "**ADA**"), including any required alterations within the Premises for purposes of "public accommodations" under such statute. However, notwithstanding anything to the contrary contained in this Lease, Landlord (and not Tenant), at Landlord's cost but as an item of Operating Expenses (subject to the provisions of Section 4(e) above establishing certain exclusions from Operating Expenses), shall be required to make any alterations or improvements to the Premises constituting capital expenditures (including, without limitation, alterations or improvements to the Premises in order to comply with the ADA constituting capital expenditures) and to the Building Structure and Building Systems (as those terms are defined in Section 7(a) below) to the extent such alterations or improvements are required to cause the Premises to comply with applicable laws, except that Tenant (and not Landlord), at Tenant's sole cost, shall be responsible for performing such alterations or improvements work to the extent such compliance work is necessitated by the particular use of the Premises by Tenant, any subtenant of Tenant or any of their respective employees, agents, contractors, licensees or invitees (collectively, "**Tenant Parties**") (as opposed to mere occupancy for general office use) or by any Alterations to the Premises under Section 8 below to the extent such Alterations are not normal and customary business office improvements. Tenant shall not use or permit the Premises to be used in any manner nor do any act which would increase the existing rate of insurance on the Project (unless Tenant agrees to pay such increased cost) or cause the cancellation of any insurance policy covering the Project, nor shall Tenant permit to be kept, used or sold, in or about the Premises, any article which may be prohibited by the standard form of fire insurance policy, unless Tenant obtains an endorsement to the policy allowing such activity. Tenant shall not during the Term (i) commit or allow to be committed any waste upon the Premises, or any public or private nuisance in or around the Project, (ii) allow any sale by auction upon the Premises, (iii) place any loads upon the floor, walls, or ceiling of the Premises which endanger the Building, (iv) use any apparatus, machinery or device in or about the Premises which will cause any substantial noise or vibration or in any manner damage the Building, (v) place any harmful liquids in the drainage system or in the soils surrounding the Project, or (vi) disturb or unreasonably interfere with other tenants of the Project. If any of Tenant's office machines or equipment unreasonably disturbs the quiet enjoyment of any other tenant in the Building, then Tenant shall provide adequate insulation, or take such other action as may be reasonably necessary to eliminate the disturbance, all at Tenant's sole cost and expense.

(b) *Hazardous Material*. As used herein, the term "Hazardous Material" means any hazardous or toxic substance, material or waste which is or becomes regulated by, or is dealt with in, any local governmental authority, the State of California or the United States Government. Accordingly, the term "Hazardous Material" includes, without limitation, any material or substance which is (i) defined as a "hazardous waste," "extremely hazardous waste" or "restricted hazardous waste" under Sections 25115, 25117 or 25122.7, or listed pursuant to Section 25140 of the California Health and Safety Code, Division 20, Chapter 6.5 (Hazardous Waste Control Law), (ii) defined as a "hazardous substance" under Section 25316 of the California Health and Safety Code, Division 20, Chapter 6.95 (Hazardous Materials Release Response Plans and Inventory), (iii) defined as a "hazardous substance" under Section 25281 of the California Health and Safety Code, Division 20, Chapter 6.7 (Underground Storage of Hazardous Substances), (iv) petroleum, (v) asbestos, (vi) listed under Article 9 or defined as hazardous or extremely hazardous pursuant to Article 11 of Title 22 of the California Administrative Code, Division 4, Chapter 20, (vii) designated as a "hazardous substance" pursuant to Section 311 of the Federal Water Pollution Control Act (33 U.S.C. § 1317), (viii) defined as a "hazardous waste" pursuant to Section 1004 of the Federal Resource Conservation and Recovery Act, 42 U.S.C. § 6902 et seq., or (ix) defined as a "hazardous substance" pursuant to Section 101 of the Compensation and Liability Act, 42 U.S.C. § 9601 et seq. Tenant shall not (either with or without negligence) cause or permit the escape, disposal or release of any Hazardous Materials in or on the Premises or the Project by any Tenant Parties. Tenant shall not allow the storage or use of Hazardous Materials in any manner not sanctioned by law or by the highest standards prevailing in the industry for the storage or use of such substances or materials, nor allow to be brought onto the Building or Project any such materials or substances, except that Tenant may maintain products in the Premises which are incidental to the operation of its offices, such as photocopy supplies, secretarial supplies and limited janitorial supplies which products contain chemicals which are categorized as Hazardous Materials, provided that the use of such products in the Premises by Tenant shall be in compliance with applicable laws and shall be in the manner in which such products are designed to be used. In addition, Tenant shall execute affidavits, representations and the like from time to time at Landlord's request concerning Tenant's best knowledge and belief with no independent investigation regarding the presence of Hazardous Materials on the Premises. The covenants of this Section 6(b) shall survive the expiration or earlier termination of the Lease. To the best of Landlord's actual knowledge, there are no Hazardous Materials in the Building, the Project or the Premises as of the date hereof.

(c) *Environmental Obligations*. Landlord and Tenant shall notify each other in writing of (i) any enforcement, clean-up, removal or other governmental action instituted with regard to Hazardous Materials involving the Project, (ii) any claim made by any person against either of the parties related to Hazardous Materials in the Premises or the Project, (iii) any reports made to any governmental agency arising out of or in connection with Hazardous Materials in the Premises or the Project including, without limitation, any complaints, notices or warnings, and (iv) any spill, release, discharge or disposal of Hazardous Materials in the Premises or the Project that is required to be reported to any governmental agency or authority under any applicable governmental law, rule or regulation. Tenant shall indemnify and hold Landlord and its affiliates harmless with respect to any environmental claims or liabilities which occur as a result of the breach by Tenant of any of Tenant's covenants set forth in Section 6(b) above or this Section 6(c) and from any escape, seepage, leakage, spillage, discharge, emission, release from, onto or into the Premises, the Building or the Project of any Hazardous Materials to the extent caused by Tenant or any of Tenant Parties. Landlord shall indemnify and hold Tenant and the Tenant Parties harmless with respect to any environmental claims or liabilities which occur as a result of the breach by Landlord of any of Landlord's covenants, representations or warranties set forth in Section 6(b) above or this Section 6(c) and from any escape, seepage, leakage, spillage, discharge, emission, release from, onto or into the Premises, the Building or the Project of any Hazardous Materials to the extent caused by Landlord or its employees, agents, contractors, licensees or invitees.

7. MAINTENANCE AND REPAIRS

(a) *Landlord's Obligations*. Landlord shall maintain and keep in first-class condition and state of repair (comparable to other Comparable Buildings) and, subject to Section 6 above, in compliance with applicable laws, the foundations, exterior walls, structural portions of the roof and other structural portions of the Building (including the floor/ceiling slabs, curtain wall, exterior glass and mullions, columns, beams, shafts (including elevator shafts), stairs, parking facilities, stairwells, escalators, elevator cabs, plazas, pavement, sidewalks, curbs, entrances, landscaping, art work, sculptures, restrooms, mechanical, electrical and telephone closets, and all common and public areas) (collectively, the "**Building Structure**"), and shall maintain the electrical, plumbing, heating, ventilating, sprinkler and life-safety equipment in the Building (collectively, the '**Building Systems**"); and except that all damage or injury to the Premises, the Building or the equipment and improvements therein caused by any act, neglect, misuse or omission of any duty by Tenant Parties shall be paid by Tenant except to the extent the cost of same is covered by insurance carried by Landlord hereunder (or would have been covered had Landlord carried the insurance required hereunder). Subject to the provisions of Section 42(i) below, Landlord shall commence performance of any such required repairs promptly (but in any event within ten (10) days or sooner if required by reason of an emergency situation, unsafe condition or threat to person or property) following receipt of written notice from Tenant of the need for such repairs and shall thereafter diligently prosecute the work of such repairs to completion. Subject to the following provisions of this Section 7(a), Tenant hereby waives and releases its right to make repairs at Landlord's expense under Sections 1941 and 1942 of the California Civil Code or under any similar law, statute or ordinance now or hereafter in effect. Landlord makes no warranty as to the quality, continuity or availability of the telecommunications services in the Building, and Tenant hereby waives any claim against Landlord for any actual or consequential damages (including damages for loss of business) if Tenant's telecommunications services in any way are interrupted, damaged or rendered less effective, except to the extent caused by the negligence or willful misconduct of Landlord, its agents, contractors or employees. However, if Landlord fails to perform any of Landlord's obligations under this Section 7(a) promptly after receipt of written notice of the need therefore from Tenant, and (1) such failure results in a situation which materially and adversely affects the operation of Tenant's business from the Premises or an material risk of injury to persons or material property damage, (2) such failure is susceptible of cure by Tenant without work upon or otherwise affecting the exterior appearance of the Building, or adversely affecting the structural elements of the Building or the integrated Building mechanical or utility systems, and (3) within three (3) business days (or such shorter period as is reasonable under the circumstances if relating to an emergency situation, unsafe condition or threat to person or property) following Landlord's receipt of a second written notice from Tenant of the existence of such situation stating Tenant's intent to exercise its rights under this Section if such situation is not cured, Landlord fails to commence and thereafter diligently prosecute to completion the cure thereof, then Tenant shall have the right, but not the obligation, to promptly take such measures as are necessary to cure such situation (using qualified, licensed contractors reasonably experienced in performance of comparable work in Comparable Buildings), and Landlord shall reimburse Tenant for the reasonable costs of completing such cure, plus interest at the ten percent (10%) per annum (or such lesser rate as is the then maximum lawful rate of interest) from the date such costs were incurred by Tenant until such reimbursement by Landlord, within thirty (30) days following Tenant's submission to Landlord of reasonable evidence of the amount of such costs. If within thirty (30) days following Tenant's completion of such cure and submission of such evidence of the costs thereof, Landlord does not either pay to Tenant the amount requested or deliver written notice (an "**Objection Notice**") to Tenant objecting to Tenant's claim that Landlord was required to perform such work under this Lease and/or the amount requested for reimbursement (provided that if Landlord so objects to a portion of the amount requested for reimbursement, Landlord shall pay to Tenant the undisputed amount), then, notwithstanding anything to the contrary contained in this Lease, Tenant may offset the amount so requested, including interest, for reimbursement from Tenant's rental obligations next coming due under this Lease; provided that if Landlord so delivers an Objection Notice, Tenant shall not be entitled to any such offset (other than as to undisputed amounts if the Objection Notice objects only to a portion of the amount requested for reimbursement) and as Tenant's sole remedy for amounts not so reimbursed or offset, Tenant may proceed to claim a default by Landlord. Any dispute as to which Landlord delivers an Objection Notice pursuant hereto shall be resolved by arbitration in accordance with the provisions of Section 37 below.

(b) *Tenant's Obligations*. Tenant shall at its expense maintain, repair and replace all portions of the Premises and the equipment or fixtures therein, except to the extent specified in Section 7(a), above, at all times in first-class condition and state of repair, all in accordance with the laws of the State of California and all health, fire, police and other ordinances, regulations and directives of governmental agencies having jurisdiction over such matters. However, notwithstanding anything to the contrary contained in this Lease, Landlord (and not Tenant), at Landlord's cost as an item of Operating Expenses (subject to the provisions of Section 4(e) above establishing certain exclusions from Operating Expenses), shall be required to make any alterations, additions or improvements to the Premises constituting capital expenditures (including, without limitation, alterations, additions or improvements to the Premises constituting capital expenditures required in order to comply with the ADA) and to the Building Structure and Building Systems to the extent such alterations, additions or improvements are required to cause the Premises to comply with applicable laws, except that Tenant (and not Landlord), at Tenant's sole cost, shall be responsible for performing such alterations, additions or improvements work to the extent such compliance work is necessitated by the particular use of the Premises by Tenant or any of the Tenant Parties (as opposed to mere occupancy for general office use) or by any Alterations to the Premises under Section 8 below to the extent such Alterations are not normal and customary business office improvements. Tenant shall replace at Tenant's sole expense any glass that may be broken in the Premises with glass of the same size, specifications and quality, with signs thereon, if required. At the expiration of the Term, Tenant shall surrender the Premises in good and reasonably clean condition, normal wear and tear and damage by fire, other casualty or condemnation excepted; provided, however, that Tenant shall have no obligation to repaint, install new floor coverings or patch wall and floor penetrations.

8. ALTERATIONS.

(a) *Landlord's Consent*. Tenant shall not make any alterations, additions or improvements (collectively, "**Alterations**") in or to the Premises or make changes to locks on doors or add, disturb or in any way change any plumbing or wiring without obtaining the prior written consent of Landlord, which consent shall not be withheld provided that the Alterations would (i) not adversely affect the Building Structure or Building Systems, (ii) not affect the exterior appearance of the Building or (iii) comply with applicable laws (individually and collectively, a "**Design Problem**"). Notwithstanding anything to the contrary set forth herein, Tenant shall not be required to obtain Landlord's prior consent with respect to any strictly cosmetic work performed within the Premises by Tenant (i.e., paint, carpet and other similar alterations that do not affect the Building Systems and Building Standard items).

(b) *Performance of Work*. All Alterations shall be made at Tenant's sole expense and by contractors or mechanics selected by Tenant, subject to Landlord's reasonable approval, except that Landlord shall have the right to require use of Building standard contractors or mechanics for work affecting the Building Systems or items under warranty (including, but not limited to, the Building roof). All Alterations shall be made at such times and in such manner as Landlord may from time to time reasonably designate, and shall become the property of Landlord without its obligation to pay therefore at the expiration or earlier termination of this Lease. All work with respect to any Alterations shall be performed in a good and workmanlike manner, shall be of a quality equal to or exceeding the then existing construction standards for the Project and must be of a type, and the floors and ceilings must be finished in a manner, customary for general office use. Alterations shall be diligently prosecuted to completion to the end that the Premises shall be at all times a complete unit except during the period necessarily required for such work. All Alterations shall be made strictly in accordance with all laws, regulations and ordinances relating thereto and if interior improvements installed in the Premises shall be removed, Tenant shall either replace same with interior improvements of the same or better quality or repair the damage caused by the removal so the Premises is in good condition. Landlord hereby reserves the right to require any contractor or mechanic working in the Premises to provide lien waivers and liability insurance covering the Alterations to the Premises. In addition to the foregoing, Tenant shall provide Landlord with evidence that Tenant or its contractor carries "Builder's All Risk" insurance in an amount reasonably approved by the Landlord covering the construction of such Alterations, and such other insurance as the Landlord may reasonably require, it being understood and agreed that all of such Alterations shall be insured by Tenant pursuant to Section 14(a) of this Lease immediately upon completion thereof. Prior to the performance of any Alterations, Tenant shall allow Landlord to enter the Premises and post appropriate notices to avoid liability to contractors or material suppliers for payment for any Alterations. All Alterations shall remain in and be surrendered with the Premises as a part thereof at the expiration or earlier termination of this Lease, without disturbance, molestation or injury; provided, however, that all of Tenant's personal property, including furniture, trade fixtures, and equipment, may be removed by Tenant at any time during the Term. Landlord may not require Tenant to remove any Alterations (including cabling) or the Tenant Improvements from the Premises upon the expiration or earlier termination of this Lease.

(c) *Landlord's Expenses; Administrative Fee*. Tenant shall pay to Landlord, as additional rent, any out-of-pocket costs incurred by Landlord in connection with the review and approval of the Alterations and for any additional Building services provided to Tenant or to the Premises in connection with any such alterations, additions or improvements which are beyond the normal services provided to occupants of the Building as part of Operating Expenses. Under no circumstances shall Landlord be liable to Tenant for any damage, loss, cost or expense incurred by Tenant on account of Tenant's plans and specifications, Tenant's contractors or subcontractors, or Tenant's design of any work, construction of any work or delay in completion of any work.

(d) *Second Floor Build-Out*. Tenant shall, at its sole cost, build out and improve that designated portion of the second floor in the Building in accordance with a work plan that is submitted by Tenant and agreed to by Landlord. Tenant's proposed plan is attached hereto as Exhibit F and has been approved by Landlord. All work contemplated in Exhibit F shall be completed prior to the Commencement Date, and Landlord agrees to cooperate with Tenant to accomplish timely fulfillment of this deadline.

9. TENANT'S PROPERTY

(a) *Removal Upon Expiration of Lease*. All articles of personal property and all business and trade fixtures, machinery and equipment, furniture and movable partitions owned by Tenant or installed by Tenant at its expense in the Premises shall be and remain the property of Tenant and may be removed by Tenant at any time during the Term, subject to the other requirements of this Lease. If Tenant shall fail to remove all of such property from the Premises at the expiration of the Term or within ten (10) days after any earlier termination of this Lease for any cause whatsoever, Landlord may, at its option, on five (5) days' notice to Tenant, remove the same in any manner that Landlord shall choose, and store such property without liability to Tenant for loss thereof. In such event, Tenant agrees to pay Landlord upon demand any and all reasonable expenses incurred in such removal, including reasonable court costs and attorneys' fees and storage charges on such property for any length of time that the same shall be in Landlord's possession. Landlord may, at its option, without notice, sell said property or any of the same, at private sale and without legal process, for such price as Landlord may obtain and apply the proceeds of such sale to any amounts due under this Lease from Tenant to Landlord and to the expense incident to the removal and sale of said property.

(b) *Personal Property Taxes*. Tenant shall be liable for and shall pay, at least five (5) days before delinquency, all taxes levied against any personal property or trade fixtures placed by Tenant in or about the Premises. If any such taxes on Tenant's personal property or trade fixtures are levied against Landlord or Landlord's property or if the assessed value of the Premises or Landlord's obligations are increased by a value placed upon such personal property or trade fixtures of Tenant and if Landlord, after written notice to Tenant, pays the taxes or obligations based upon Tenant's personal property or trade fixtures, which Landlord shall have the right to do regardless of the validity thereof, but only under proper protest if requested by Tenant, Tenant shall, within thirty (30) days of Landlord's demand, repay to Landlord the taxes or obligations so levied against Landlord, or the portion of such taxes or obligations resulting from such increase in the assessment.

(c) *Existing Furniture in Suite 200*. As referenced herein, Tenant is a pre-existing tenant of Landlord in portions of the second floor of the Building ("**old space**"). Notwithstanding any provision herein to the contrary, the parties agree that Tenant will leave substantially all of its furnishings in the old space, which is being re-let by Landlord once Tenant vacates the old space. Tenant may sell the furnishings to Landlord for $1 upon Landlord's election to purchase; if Landlord declines to make this purchase election, Tenant must, at its sole cost, dispose of all furnishings in the old space within sixty (60) from Landlord's notice of its intent not to purchase the furnishings. Landlord may make its purchase election, or impose the requirement that Tenant sell the furnishings, at any time after June 1, 2012. Upon requiring Tenant to dispose of its furnishings through delivery of written notice pursuant to the notice requirements contained within this Lease, Tenant shall thereafter have thirty (30) days to remove the furnishings from the Building and Property. This is a material lease covenant.

10. ENTRY BY LANDLORD. After not less than twenty four (24) hours prior notice (which may be oral or written notice, notwithstanding anything to the contrary in this Lease governing the manner of delivery of notices, and except that in the event of an emergency, Landlord may provide shorter notice as may be required under the circumstances, which may be no prior notice, if applicable under the circumstances of the applicable emergency situation), Landlord, its authorized agents, contractors, and representatives shall at any and all times have the right to enter the Premises to inspect the same, to supply janitorial service and any other service to be provided by Landlord to Tenant hereunder, to show the Premises to prospective purchasers or (only during the final six (6) months of the Term) tenants, to post notices, to alter, improve or repair the Premises or any other portion of the Building, all without being deemed guilty of any eviction of Tenant and without abatement of rent (except as otherwise provided in this Lease). Except in the event of an emergency, Landlord shall endeavor to coordinate any such entry with Tenant, so as to minimize the extent of any unreasonable interference with Tenant's business operations to the extent practicable under the circumstances. Landlord may, in order to carry out such purposes, erect scaffolding and other necessary structures where reasonably required by the character of the work to be performed, provided that the business of Tenant shall be interfered with as little as is reasonably practicable. Landlord shall at all times have and retain a key with which to unlock all doors in the Premises, excluding Tenant's vaults and safes, Landlord shall have the right to use any and all means which Landlord may deem proper to open said doors in an emergency in order to obtain entry to the Premises. Any entry to the Premises obtained by Landlord pursuant to the terms hereof shall not be deemed to be a forcible or unlawful entry into the Premises, or an eviction of Tenant from the Premises or any portion thereof, and Tenant hereby waives any claim for damages for any injury or inconvenience to or interference with Tenant's business, any loss of occupancy or quiet enjoyment of the Premises, and any other loss in, upon and about the Premises. Notwithstanding anything to the contrary set forth above, Tenant may designate certain areas of the Premises as "**Secured Areas**" should Tenant require such areas for the purpose of securing certain valuable property or confidential information. Landlord may not enter such Secured Areas except in the case of emergency or in the event of a Landlord inspection, in which case Landlord shall provide Tenant with five (5) days' prior written notice of the specific date and time of such Landlord inspection.

11. LIENS. Tenant shall keep the Premises, the Building and the Project free from any liens or encumbrances of any kind or nature arising out of any work performed, materials ordered or obligations incurred by or on behalf of Tenant.

12. INDEMNIFICATION.

(a) *Indemnity by Tenant*. Except to the extent caused by the negligence or willful misconduct of Landlord or its members, partners, managers, shareholders, officers, directors, trustees, employees, agents or contractors (collectively, the "**Landlord Parties**") and not covered by the insurance maintained by Tenant (and which would not have been so covered had Tenant maintained the insurance required to be maintained by Tenant under this Lease), Tenant shall indemnify, defend, and hold harmless Landlord, Landlord's members, shareholders, partners, trustees and the Landlord's Parties from and against all losses, liabilities, damages, costs, expenses and claims arising from or relating to (a) Tenant's use of the Premises or the conduct of its business or any activity, work, or thing done, permitted or suffered by Tenant in or about the Premises, (b) any act, neglect, fault or omission of any of the Tenant Parties, and (c) all reasonable costs, attorneys' fees, expenses and liabilities incurred in or about such claims or any action or proceeding brought thereon. In case any action or proceeding shall be brought against any of the Landlord Parties by reason of any such claim, Tenant upon written notice from Landlord shall defend the same at Tenant's expense by counsel reasonably approved in writing by Landlord. Tenant, as a material part of the consideration to Landlord, hereby assumes all risk of and waives all claims against the Landlord Parties with respect to damage to property or injury to persons in, upon or about the Premises from any cause whatsoever except that which is caused by the negligence or willful misconduct of Landlord or the Landlord Parties or by the failure of Landlord to observe any of the terms and conditions of this Lease where such failure has persisted for an unreasonable period of time after written notice to Landlord of such failure.

(b) *Indemnity by Landlord*. Except to the extent caused by the negligence or willful misconduct of Tenant or any of the Tenant Parties or any of Tenant's members, partners, managers, shareholders, officers, directors, trustees or agents (all of the foregoing including Tenant and Tenant Parties are collectively referred to herein as the "**Tenant Indemnitees**") and not covered by the insurance maintained by Landlord (and which would not have been so covered had Landlord maintained the insurance required to be maintained by Landlord under this Lease), Landlord shall indemnify, defend, and hold harmless Tenant and the Tenant Indemnitees from and against all losses, liabilities, damages, costs, expenses and claims arising from or relating to (a) any occurrence on the common areas of the Project, or (b) any claim arising from the negligence or willful misconduct of Landlord or any of the Landlord Parties and not covered by the insurance maintained by Tenant (and which would not have been so covered had Tenant maintained the insurance required to be maintained by Tenant under this Lease), and (c) all reasonable costs, attorneys' fees, expenses and liabilities incurred in or about such claims or any action or proceeding brought thereon. In case any action or proceeding shall be brought against any of the Tenant Indemnitees by reason of any such claim, Landlord upon written notice from Tenant shall defend the same at Landlord's expense by counsel reasonably approved in writing by Tenant.

13. DAMAGE TO TENANT'S PROPERTY. Notwithstanding anything to the contrary in this Lease, the Landlord Parties shall not be liable for (a) any damage to any property entrusted to employees of the Project or its property managers, (b) loss or damage to any property by theft or otherwise, (c) any injury or damage to persons or property resulting from fire, explosion, falling plaster, steam, gas, electricity, water or rain which may leak from any part of the Building or from the pipes, appliances or plumbing work therein or from the roof, street or sub-surface or from any other place or resulting from dampness or any other cause whatsoever, or (d) any damage or loss to the business or occupation of Tenant arising from the acts or neglect of other tenants or occupants of, or invitees to, the Project, except to the extent that such damage is due to the negligence or willful misconduct of Landlord or any of the Landlord Parties or the breach of this Lease by Landlord. Tenant shall give prompt written notice to Landlord in case of fire or accident in the Premises or in the Building or of defects therein or in the fixtures or equipment.

14. INSURANCE.

(a) *Tenant's Insurance*. Tenant shall, during the entire Term of this Lease and any other period of occupancy, at its sole cost and expense, keep in full force and affect the following insurance:

(1) Standard form property insurance insuring against the perils of fire, vandalism, malicious mischief, cause of loss-special form ("**All-Risk**"), sprinkler leakage and earthquake sprinkler leakage. This insurance policy shall be upon all trade fixtures and other property owned by Tenant, for which Tenant is legally liable and/or that was installed by or on behalf of Tenant, and which is located in the Building, including, without limitation, Alterations, furniture, fittings, installations, fixtures, Tenant Improvements and any other personal property, in an amount not less than the full replacement cost thereof. If there shall be a dispute as to the amount which comprises full replacement cost, the decision of Landlord or any mortgagees of Landlord shall be presumptive.

(2) Commercial General Liability Insurance insuring Tenant against any liability arising out of the lease, use, occupancy, or maintenance of the Premises and all areas appurtenant thereto. Such insurance shall be in the amount of Two Million Dollars ($2,000,000) Combined Single Limit for injury to or death of one or more persons in an occurrence and Three Million Dollars ($3,000,000) aggregate, and for damage to tangible property (including loss of use) in an occurrence, with an Additional Insured - Landlord Endorsement. The policy shall insure the hazards of premises and operations, independent contractors, contractual liability (covering the indemnity contained in Section 12 hereof) and shall (i) name Landlord as an additional insured, (ii) contain a cross-liability provision, (iii) contain a provision that "the insurance provided the landlord hereunder shall be primary and noncontributing with any other insurance available to the landlord," and (iv) include fire legal liability coverage in the amount of One Million Dollars ($1,000,000).

(3) Workers' Compensation and Employer's Liability Insurance (as required by state law).

(4) If Tenant installs with prior approval of the Landlord, any boiler, pressure object, machinery, fire suppression system, supplemental air conditioning or other mechanical equipment within the Premises, Tenant shall also obtain and maintain at Tenant's expense, boiler and machinery insurance covering loss arising from the use of such equipment.

(5) All motorized vehicles that Tenant parks at the Building, whether in or outside the parking structure, must be insured at all times. Tenant hereby covenants that every vehicle belonging to Tenant or its agents/employees shall be insured for replacement and casualty in accordance with California law.

(6) Any other form or forms of insurance as Tenant or Landlord or any mortgagees of Landlord may reasonably require from time to time in form, amounts and for insurance risks against which a prudent tenant would protect itself and then being required by other reasonable and prudent landlords of Comparable Buildings of tenants comparable to Tenant.

All such policies shall be written in a form reasonably satisfactory to Landlord and shall be taken out with insurance companies qualified to issue insurance in the State of California and holding an A.M. Best's Rating of "A-" and a Financial Size Rating of "VII" or better, as set forth in the most current issue of Best's Key Rating Guide. Such insurance shall provide that it is primary insurance, and not contributory with any other insurance in force for or on behalf of Landlord. Prior to the commencement of the Term, Tenant shall deliver to Landlord certificates of insurance evidencing the existence of the amounts and forms of coverage required above and, except for the All-Risk insurance, naming Landlord and any other person specified by Landlord, as an additional insured. No such policy shall be cancelable, terminable or reducible in coverage except after thirty (30) days prior written notice to Landlord. Tenant shall, within ten (10) days prior to the expiration of such policies, furnish Landlord with renewals or "binders" thereof, or Landlord may, on five (5) days notice to Tenant, order such insurance and charge the cost thereof to Tenant as additional rent, if Tenant fails to so notify Landlord. If Landlord obtains any insurance that is the responsibility of Tenant under this Section 14, Landlord shall deliver to Tenant a written statement setting forth the cost of any such insurance and showing in reasonable detail the manner in which it has been computed.

(b) *Landlord's Insurance*. Landlord shall, during the entire term of this Lease, as an item of Operating Expenses, keep in full force and affect the following insurance:

(1) All Risk insurance (including a vandalism and malicious mischief endorsement and sprinkler leakage coverage, and also covering such other risks as Landlord or Landlord's lender may require) upon the Project (excluding any property which Tenant is obligated to insure under Section 14(a) above) in an amount not less than the full replacement cost thereof (excluding footings, foundations and excavation), and including commercially reasonable rental loss coverage for losses covered by such insurance policy. Such insurance policy or policies shall name Landlord as a named insured. The deductible under the All Risk policy shall not exceed such commercially reasonable amount as Landlord reasonably determines to be appropriate given prudent risk management practices and the practices of comparable landlords of Comparable Buildings.

(2) Commercial general liability insurance coverage, including personal injury, bodily injury, broad form property damage, automobile, Premises operations hazard, contractual liability, and products and completed operations liability, in the amount of One Million Dollars ($1,000,000) Combined Single Limit for injury to or death of one or more persons in an occurrence and Five Million Dollars ($5,000,000) aggregate.

Landlord may satisfy its insurance obligations under this Lease by blanket, umbrella and/or, as to liability coverage in excess of One Million Dollars ($1,000,000), excess liability coverage. All such policies shall be taken out with insurance companies qualified to issue insurance in the State of California and holding an A.M. Best's Rating of "A" and a Financial Size Rating of "VIII" or better, as set forth in the most current issue of Best's Key Rating Guide. Upon request, Landlord shall deliver to Tenant certificates evidencing Landlord's maintenance of insurance in compliance with Landlord's insurance requirements set forth in this Lease.

15. WAIVER OF SUBROGATION. Whether any loss or damage to or within the Project, the Building and/or the Premises is due to the negligence of either of the parties hereto, their agents or employees, Landlord and Tenant do each herewith and hereby release and relieve the other from responsibility for, and waive their entire claim of recovery, for any loss or damage to the real or personal property of the other located anywhere in the Project and including the Project itself, arising out of or incident to the occurrence of any of the perils which are covered by any fire insurance policy covering the Project (or would have been covered by any fire insurance policy covering the Project had the applicable party carried the insurance required to be carried hereunder). To the extent that such risks above are, in fact, covered by insurance, each party shall cause its insurance carriers to consent to such waiver and to waive all rights of subrogation against the other party. Notwithstanding the foregoing, no such release shall be effective unless the aforesaid insurance policy or policies shall expressly permit such a release or contain a waiver of the carrier's right to be subrogated.

16. CASUALTY. If the Building and/or the Premises are damaged by fire or other perils covered by insurance carried by Landlord, Landlord and Tenant shall have the following rights and obligations:

(a) *Repair and Restoration*

(1) If the Building and/or the Premises are damaged or destroyed by any such peril to the extent that the Building and/or the Premises cannot reasonably be repaired, reconstructed and restored within one hundred eighty (180) days from the date of such damage or destruction, Landlord shall, at its sole option, as soon as reasonably possible thereafter, either (i) commence or cause the commencement of the repair, reconstruction and restoration of the Building and/or the Premises to substantially their condition existing immediately prior to such casualty, and prosecute or cause the same to be prosecuted diligently to completion, in which event this Lease shall remain in full force and effect; or (ii) within thirty (30) days after such damage or destruction, elect not to so repair, reconstruct or restore the Building and/or the Premises, in which event this Lease shall terminate. In either event, Landlord shall give Tenant written notice of its intention within said thirty (30) day period. If Landlord elects not to restore the Building and/or the Premises, this Lease shall be deemed to have terminated as of the date of such damage or destruction.

(2) If the Building and/or the Premises are partially damaged or destroyed by any such peril to the extent that the Building and/or the Premises reasonably may be repaired, reconstructed or restored within a period of one hundred eighty (180) days from the date of such damage or destruction, then Landlord shall commence or cause the commencement of and diligently complete or cause the completion of the work of repair, reconstruction and restoration of the Building and/or the Premises to substantially their condition existing immediately prior to such casualty and this Lease shall continue in full force and effect.

(b) *Uninsured Casualties*. If damage or destruction of the Building and/or the Premises is due to any cause not covered by collectible insurance carried by Landlord at the time of such damage or destruction and the costs of such repair exceed Five Hundred Thousand Dollars ($500,000.00), Landlord may elect to terminate this Lease, provided that Landlord may only elect to terminate this Lease if Landlord also terminates the leases of all of Building tenants. If the repairing or restoring of the damage is delayed or prevented for longer than two hundred forty (240) days after the occurrence of such damage or destruction by reason of weather, acts of God, war, governmental restrictions, inability to procure the necessary labor or materials, or any cause that is beyond the reasonable control of Landlord, Landlord may elect to be relieved of its obligation to make such repairs or restoration and terminate this Lease, in which case Landlord shall provide Tenant with thirty (30) days written notice of its intent to terminate this Lease. Further, Landlord shall not have any obligation to repair, reconstruct or restore the Premises and may terminate this Lease when the damage resulting from any casualty covered under this Section 16 occurs during the last twelve (12) months of the Term and the Premises cannot be repaired, reconstructed or restored within thirty (30) days after the date of the casualty.

(c) *Tenant's Termination Right*. Notwithstanding anything to the contrary contained in this Lease, in the event of material casualty damage to the Premises not resulting in termination of this Lease by Landlord, Landlord shall deliver written notice to Tenant within thirty (30) days following such casualty damage or occurrence setting forth Landlord's good faith estimate of the time required for completion of repair and/or restoration of the Premises, and if such estimated time exceeds one hundred eighty (180) days from the occurrence of the casualty, Tenant may elect to terminate this Lease by written notice to Landlord delivered within twenty (20) days following Tenant's receipt of such estimate notice. In addition, in the event such repair and/or restoration of the Premises is not actually completed within two hundred forty (240) days from the occurrence of the casualty (or such longer time period as may have been estimated in such notice to Tenant), Tenant may elect to terminate this Lease upon thirty (30) days prior written notice to Landlord, provided that if such repair and/or restoration is completed within such thirty (30) day period, such election to terminate shall be nullified and this Lease shall continue in full force and effect. In addition, and notwithstanding anything to the contrary contained in this Lease, if the Premises or the Building is wholly or partially damaged or destroyed within the final twelve (12) months of the Term of this Lease so that Tenant shall be prevented from using the Premises for thirty (30) consecutive days due to such damage or destruction, then Tenant may, at its option, by notice to Landlord within sixty (60) days after the occurrence of such damage or destruction, elect to terminate this Lease.

(d) *Termination of Lease*. Upon any termination of this Lease under any of the provisions of this Section 16, Landlord and Tenant shall each be released without further obligation to the other from the date possession of the Premises is surrendered to Landlord or such other date as is mutually agreed upon by Landlord and Tenant except for payments or other obligations which have theretofore accrued and are then unpaid or unperformed.

(e) *Rent Abatement*. In the event of repair, reconstruction and restoration by or through Landlord as herein provided, the rent payable under this Lease (including Basic Rent and Tenant's Proportionate Share of Operating Expenses) shall be abated in the proportion that the rentable area of the portion of the Premises that Tenant is prevented from using, and does not use, bears to the total rentable area of the Premises. However, in the event that Tenant is prevented from conducting, and does not conduct, its business in any portion of the Premises and the remaining portion of the Premises is not sufficient to allow Tenant to effectively conduct its business therein, and if Tenant does not conduct its business from such remaining portion, then the rent for the entire Premises shall be abated. Tenant's abatement period shall continue until Tenant has been given sufficient time, and sufficient access to the Premises, the parking facilities and/or the Building, to rebuild such portion it is required to rebuild, to install its property, furniture, fixtures, and equipment to the extent the same shall have been removed and/or damaged as a result of such damage or destruction. Tenant shall not be entitled to any compensation or damages for loss of the use of the whole or any part of the Premises and/or any inconvenience or annoyance occasioned by such damage, repair, reconstruction or restoration, nor shall Tenant be entitled to any insurance proceeds, including those in excess of the amount required by Landlord for such repair, reconstruction or restoration. Tenant shall not be released from any of its obligations under this Lease due to damage or destruction of the Building and/or the Premises except to the extent and upon the conditions expressly stated in this Section 16.

(f) *Extent of Repair Obligation*. If Landlord is obligated to or elects to repair or restore as herein provided, Landlord shall be obligated to make repair or restoration only of those portions of the Building and the Premises which were originally provided at Landlord's expense, and the repair and restoration of items not provided at Landlord's expense shall be the obligation of Tenant, except that Tenant shall be responsible for the repair of all Tenant Improvements performed by Tenant under Section 30 below. Tenant shall be entitled to all insurance proceeds payable to or received by Tenant in connection with the Tenant Improvements or any other improvements insured by the Tenant pursuant to Section 14 hereof.

(g) *Waiver*. The provisions of California Civil Code § 1932(2) and § 1933(4), which permit termination of a lease upon destruction of the Premises, are hereby waived by Tenant; and the provisions of this Section 16 shall govern in case of such destruction.

17. CONDEMNATION

(a) *Complete Taking*. If the whole of the Project, the Building or the Premises or so much thereof shall be taken by condemnation or in any other manner for any public or quasi-public use or purpose so that the Premises will no longer be reasonably suitable for Tenant's continued occupancy (as reasonably determined by Tenant), this Lease and the term and estate hereby granted shall terminate as of the date that possession of the Project, the Building or the Premises is so taken (herein called "**Date of the Taking**"), and the Basic Rent and other sums payable hereunder shall be prorated and adjusted as of such termination date.

(b) *Partial Taking*. If only a part of the Building, the Project or the Premises shall be so taken and the remaining part thereof after reconstruction is reasonably suited for Tenant's continued occupancy (as reasonably determined by Tenant), this Lease shall be unaffected by such taking, except that Landlord may, at its option, terminate this Lease by giving Tenant written notice to that effect within sixty (60) days after the Date of the Taking provided that in such event, Landlord also terminates the leases of all other Building tenants. In such event, this Lease shall terminate on the date that such notice from the Landlord to Tenant shall be given, and the Basic Rent and other sums payable hereunder shall be prorated and adjusted as of such termination date. Upon a partial taking after which this Lease continues in force as to any part of the Premises, the Basic Rent and other sums payable hereunder shall be adjusted according to the rentable area remaining.

(c) *Award*. Landlord shall be entitled to receive the entire award or payment in connection with any taking without deduction therefrom for any estate vested in Tenant by this Lease, and Tenant shall receive no part of such award, including any award for the "leasehold bonus value" of this Lease, provided that Tenant shall be entitled to make a separate claim for its relocation expenses, the value of its personal property and fixtures belonging to Tenant actually taken, the value of the Tenant Improvements and other improvements to the extent paid for by Tenant and for the interruption of or damage to Tenant's business (not attributable to the "leasehold bonus value" of this Lease). Tenant hereby expressly assigns to Landlord all of its right, title and interest in and to any award or payment attributable to the "leasehold bonus value" of this Lease.

(d) *Waiver*. Except as may be otherwise provided herein, Tenant hereby waives and releases any right to terminate this Lease under Sections 1265.120 and 1265.130 of the California Code of Civil Procedure or under any similar law, statute or ordinance now or hereafter in effect relative to eminent domain, condemnation or takings.

18. ASSIGNMENT OR SUBLETTING.

(a) *Landlord's Consent*. Without the express prior written consent of Landlord, which consent shall not be unreasonably withheld, conditioned or delayed, Tenant shall not directly or indirectly, voluntarily or by operation of law, sell, assign, encumber, pledge, or otherwise transfer or hypothecate all of its interest in or rights with respect to the Premises (collectively, "**Assignment**"), or permit all or any portion of the Premises to be occupied by anyone other than Tenant or sublet all or any portion of the Premises or transfer a portion of its interest in or rights with respect to the Premises (collectively, "**Sublease**").

(b) *Notice to Landlord*. If Tenant desires to enter into an Assignment or a Sublease, Tenant shall give written notice to Landlord of its intention to do so (the "**Transfer Notice**"), containing (i) the name of the proposed assignee or subtenant (collectively, "**Transferee**"), (ii) the nature of the proposed Transferee's business to be carried on in the Premises, (iii) the material terms of the proposed Assignment or Sublease, including, without limitation, the commencement and expiration dates thereof and the rent payable thereunder, (iv) the portion of the Premises proposed to be assigned or subleased (the "**Transfer Space**"), (v) and the most recent financial statement or other equivalent financial information reasonably available to Tenant concerning the proposed Transferee. Within fifteen (15) days after Landlord's receipt of the Transfer Notice, Landlord shall, by written notice to Tenant, elect to (1) consent to the Sublease or Assignment, or (2) disapprove the Sublease or Assignment; provided, however, that Landlord agrees not to unreasonably withhold its consent to the Sublease or Assignment. Landlord's consent shall not be deemed to have been unreasonably withheld if the Transferee is a new concern with no previous business history or if the Transferee intends to use the Premises (x) for executive suites or any other use inconsistent with Section 6 or the operation of a first-class office building or (y) in a manner which would increase the use of, or the possibility of disturbance of, Hazardous Substances on the Property. Landlord's failure to make such election within fifteen (15) days after Landlord's receipt of the Transfer Notice shall be deemed to be Landlord's approval of the proposed Sublease or Assignment.

(c) *Permitted Transfers*. If Landlord consents to any Sublease or Assignment as set forth inSection 18(b):

(1) Tenant may thereafter, within one hundred eighty (180) days after Landlord's consent, enter into such Assignment or Sublease, but only with the party and upon substantially the same terms as set forth in the Transfer Notice, provided, however, that the financial terms contained in the Assignment or Sublease shall be no less favorable to Tenant than those set forth in the Transfer Notice.

(2) In the case of a Sublease, Tenant shall pay to Landlord fifty percent (50%) of the difference between (x) any and all sums actually received by Tenant in connection with such Sublease (including key money, bonus money and any payment in excess of fair market value for (A) services rendered by Tenant in connection with such Sublease or (B) assets, fixtures, inventory, equipment or furniture transferred by Tenant in connection with such Sublease, but expressly excluding any payment up to the fair market value for the items referenced in the foregoing clauses (A) and/or (B)), minus (y) the sum of the proportionate amount (on a rentable square footage basis) of rent (including Basic Rent and Tenant's Proportionate Share of Operating Expenses) payable by Tenant under this Lease for the Transfer Space plus any actual and reasonable out-of-pocket costs incurred by the Tenant in connection with such Sublease (including brokerage commissions, legal fees, improvement costs for work for the benefit of the subtenant, improvement allowances or other monetary concessions or inducements provided to the subtenant, the gross revenue as to the Transfer Space paid to Landlord by Tenant for all days the Transfer Space was vacated from the date that Tenant first vacated the Transfer Space until the date the subtenant was to pay rent, costs of advertising the space for sublease and unamortized cost of initial and subsequent improvements to the Premises by Tenant [collectively, the "**Transfer Costs**"]), which amounts shall not be paid by Tenant to Landlord until Tenant has recovered its Transfer Costs. Once Tenant has recouped its Transfer Costs, Tenant shall pay Landlord its share of the amounts due hereunder on a monthly basis.

(3) In the case of an Assignment, Tenant shall pay to Landlord fifty percent (50%) of any transfer or assignment fee, purchase price or other consideration received by Tenant in connection with the Assignment attributable to the value of this Lease (but Landlord shall not be entitled to any proceeds paid for the sale of Tenant's business which are not related to the value of this Lease or for the fair market value of any assets, fixtures, inventory, equipment or furniture transferred by Tenant in connection with such Assignment) less the Transfer Costs, which amounts shall be paid by Tenant to Landlord as provided in Section 18(c)(2) above.

(4) Any Sublease or Assignment shall be subject to all of the provisions of this Lease, and Landlord's consent to any Sublease or Assignment shall not be construed as a consent to any terms thereof which conflict with any of the provisions of this Lease except to the extent that Landlord specifically agrees in writing to be bound by such conflicting terms.

(d) Continuing Liability. Tenant shall not be relieved of any obligation to be performed by Tenant under this Lease, including the obligation to obtain Landlord's consent to any other Assignment or Sublease, regardless of whether Landlord consented to any Assignment or Sublease. Any Assignment or Sublease that fails to comply with this Section 18 shall be void. The acceptance of Basic Rent or other sums by Landlord from a proposed Transferee shall not constitute Landlord's consent to such Assignment or Sublease.

(e) *Assumption by Transferee*. Each Transferee under an Assignment shall assume all obligations of Tenant under this Lease and shall be and remain liable jointly and severally with Tenant for the payment of Basic Rent, additional rent and other charges, and for the performance of all other provisions of this Lease. Each Transferee under a Sublease shall be subject to this Lease. No Assignment shall be binding on Landlord unless Landlord shall receive a counterpart of the Assignment and an instrument that contains a covenant of assumption by the Transferee reasonably satisfactory in substance and form to Landlord and consistent with the requirements of this Section 18 but the failure of the Transferee to execute such instrument shall not release the Transferee from its liability as set forth above. Tenant shall reimburse Landlord, within thirty (30) days after Tenant's receipt of an invoice therefore, for any reasonable costs (not to exceed $1,000) that Landlord may incur in connection with any proposed Assignment or Sublease, including Landlord's reasonable attorneys' fees and the costs of investigating the acceptability of any proposed Transferee.

(f) *Default; Waiver*. Any Assignment or Sublease in violation of this Section 18 shall be void. The acceptance of rent or additional charges by Landlord from a purported assignee or sublessee shall not constitute a waiver by Landlord of the provisions of this Section 18.

(g) Intentionally Omitted.

(h) Use by Affiliates. Tenant shall have the right, without consent of Landlord, to assign this Lease or to sublease all or any portion of the Premises, to (i) any person or entity which, directly or indirectly, controls Tenant or is controlled by Tenant or is under common control with Tenant, (ii) any successor to Tenant by merger, consolidation or other operation of law, (iii) any person or entity to whom all or substantially all of the assets of Tenant are conveyed or (iv) any person or entity purchasing the business which the Tenant conducts at the Premises so long as the Premises are used in a manner consistent with the requirements of this Lease. The term "**control**" shall mean ownership, directly or indirectly, of more than fifty percent (50%) of the equity and voting interests of Tenant or such entity, as the case may be.

(i) Recognition Agreement. To the extent that Tenant enters into a Sublease for all of the Premises, Landlord, if it grants its consent to such Sublease, shall also simultaneously execute and deliver a recognition agreement pursuant to which Landlord shall agree that in the event Tenant defaults under this Lease and this Lease is terminated, the Sublease shall be recognized as a direct lease between Landlord and the subtenant on the terms and conditions of the sublease to the extent same are not inconsistent with, or contrary to, the provisions of this Lease and at a rental rate which is the higher of the rental rate under this Lease or the rental rate under the sublease.

(j) Occupancy By Others. Tenant may allow any person or company which is a client or customer of Tenant or which is providing service to Tenant or one of Tenant's clients to occupy certain portions of the Premises without such occupancy being deemed an assignment or subleasing as long as no new demising walls are constructed to accomplish such occupancy and as long as such relationship was not created as a subterfuge to avoid the obligations set forth in this Section 18.

19. SUBORDINATION AND NON-DISTURBANCE. Subject to the last sentence of this Section 19, Tenant agrees that this Lease is and shall be subordinate to any mortgage, deed of trust, ground lease, underlying lease or other prior lien (hereinafter "**Prior Lien**") that may heretofore or hereafter be placed upon the Project or the Building, and all renewals, replacements and extensions thereof. If any Prior Lien holder wishes to have this Lease prior to its Prior Lien, then and in such event, upon such Prior Lien holder's notifying Tenant to that effect, this Lease shall be deemed prior to the Prior Lien. If any ground lease or underlying lease terminates for any reason or any mortgage or deed of trust is foreclosed or a conveyance in lieu of foreclosure is made for any reason, Tenant shall, notwithstanding any subordination, attorn to and become the tenant of the successor in interest to Landlord, provided that such successor in interest recognizes the interest of Tenant under this Lease if no default under this Lease then exists beyond all applicable notice and cure periods. Within fifteen (15) days of presentation, Tenant shall execute any documents which any such Prior Lien holder may require to effectuate the provisions of this Section 19. Notwithstanding anything to the contrary contained herein, Tenant's obligation to subordinate this Lease to the holder of any Prior Lien hereafter placed upon the Project or the Building shall be conditioned upon such Prior Lien holder's executing and delivering to Tenant an agreement of subordination, non-disturbance and adornment with Tenant in commercially reasonable form reasonably designated by such Prior Lien holder and reasonably acceptable to Tenant in which the Prior Lien holder agrees not to disturb Tenant in its possession of the Premises. Landlord represents and warrants to Tenant that as of the date hereof, the Building and Project are not subject to any ground lease, mortgage or lien.

20. ESTOPPEL CERTIFICATE. Tenant will, upon ten (10) business days prior request by Landlord, execute, acknowledge and deliver to Landlord a statement in writing executed by Tenant, substantially in the form of Exhibit D attached hereto, certifying, among other things, the date of this Lease, that this Lease is unmodified and in full force and effect (or, if there have been modifications, that this Lease is in full force and effect as modified, and setting forth such modifications) and the date to which the Basic Rent and additional rent and other sums payable hereunder have been paid, and either stating that to the knowledge of Tenant no default exists hereunder on the part of Landlord or Tenant or specifying each such default of which Tenant may have knowledge and such other matters as may be reasonably requested by Landlord. The parties agree and intend that any such statement by Tenant may be relied upon by any prospective purchaser or mortgagee of the Building or the Project. Tenant's failure to timely deliver such a statement shall be deemed to be an acknowledgment by Tenant that this Lease is in full force and effect without modification (except as set forth by Landlord), there are no uncured defaults under this Lease by Landlord and no more than one monthly installment of Basic Rent and additional rent and other sums payable hereunder have been paid in advance. Landlord will, upon ten (10) business days prior request by Tenant, execute, acknowledge and deliver to Tenant a statement in writing executed by Landlord substantially in the form of Exhibit D attached hereto with such changes as may be required when Tenant is the requesting party.

21. SERVICES.

(a) *Standard Services*. Landlord shall maintain the public and common areas of the Project and the Building, such as lobbies, stairs, corridors and restrooms, in first-class condition and state of repair consistent with Comparable Buildings, except for damage occasioned by the acts or omissions of the Tenant Parties, which shall be repaired at Tenant's sole cost and expense except to the extent the cost of such repair is covered by insurance carried by Landlord (or would have been covered had Landlord carried the insurance required to be carried hereunder). Landlord shall be solely responsible for providing janitorial services to the Premises comparable to janitorial services provided in Comparable Buildings. Notwithstanding the foregoing, Tenant may elect, from time to time with respect to any calendar month(s), by delivery of written notice to Landlord not less than forty-five (45) calendar days prior to the commencement of such month(s), to be responsible for providing janitorial services to the Premises, or to a portion thereof as specified in such notice, which janitorial services shall be consistent with those janitorial services provided by Landlord to other tenants in the Building, in which event Tenant shall be responsible to perform such janitorial services in such month(s) and Tenant shall receive a monthly credit to the Basic Rent due hereunder for such respective month(s), on a month-by-month basis, in an amount equal to $.07 per rentable square foot of space for that portion of the Premises as specified in such notice for which Tenant so elects to provide such janitorial services. Tenant shall have access to the Premises and Project parking garage at all times. Landlord shall furnish the Premises with a minimum of seven (7) watts consumed load per rentable square foot within the Premises of electric power (in addition to the electrical power required for lighting and base Building HVAC) for operation of typical general office machines, hot and cold running water to restrooms, hot and cold water to the kitchen facility within the Premises (through piping to be installed as a part of the Tenant Improvements) and elevator service (including the use of one elevator as a freight elevator for deliveries and construction purposes, but subject to availability based upon common use of such elevator with other Building occupants) at all times during the Term. Landlord shall furnish the Premises with heating or normal office air conditioning comparable to the amounts being provided by comparable landlords of Comparable Buildings between the hours of 6:00 a.m. and 6:00 p.m., Monday through Friday, except for New York Stock Exchange-recognized holidays, and between the hours of 9:00 a.m. and 12:00 p.m. on Saturday. Supplemental air conditioning units and electricity therefore or special air conditioning requirements, such as for any computer centers, and after-hours heating and air conditioning shall be at Tenant's expense at an hourly rate established by the Landlord as its Actual Cost (as hereinafter defined). For purposes hereof, "**Actual Cost**" shall mean the actual out-of-pocket incremental extra cost to Landlord to provide additional services without markup for profit, overhead, depreciation or administration (to the extent Landlord's administration costs are duplicative of amounts being paid by Tenant as part of Operating Expenses). After hours heating and air conditioning shall be charged by the Landlord to the Tenant at the rate of $125.00/hour and shall be payable by the Tenant as Additional Rent within thirty (30) days after receipt of an invoice therefore. Tenant shall be solely responsible for the repair and maintenance of any separate heating, ventilating, air conditioning or other equipment installed in the Premises by the Tenant (with the Landlord's consent). Landlord shall also provide lighting replacement for Landlord-furnished lighting, toilet room supplies, window washing with reasonable frequency as is provided in other Comparable Buildings and janitorial service to all common areas and garages of the Property comparable to that provided in Comparable Buildings. Landlord shall not be liable to Tenant for any loss or damage caused by or resulting from any variation, interruption or failure of said services due to any cause whatsoever; and no temporary interruption or failure of such services incident to the making of repairs, Alterations or improvements due to accident or strike or conditions or events not under Landlord's control shall be deemed an eviction of Tenant or relieve Tenant from any of Tenant's obligations hereunder unless otherwise provided in this Lease.

(b) *Overstandard Use*. Tenant shall not, without the Landlord's prior written consent, use heat-generating machines, machines other than normal office machines, or equipment or lighting located in the Premises, which may materially affect the temperature otherwise maintained by the air conditioning system or increase the water normally furnished for the Premises by Landlord. If such consent is given, Landlord shall have the right to install supplementary air conditioning units or other facilities in the Premises, including supplementary or additional metering devices, and the Actual Cost thereof, including the Actual Cost of installation, operation and maintenance shall be paid by Tenant to Landlord within thirty (30) days of billing by Landlord. If Tenant uses water or electricity in excess of that supplied by Landlord pursuant to subsection (a) above, Tenant shall pay to Landlord, within thirty (30) days of billing, the Actual Cost of such excess consumption, the cost of the installation, operation and maintenance of equipment which is installed in order to supply such excess consumption; and Landlord may install devices to separately meter any increased use and in such event Tenant shall pay the increased cost directly to Landlord, within thirty (30) days of demand, including the Actual Cost of such additional metering devices (including installment costs).

(c) *Abatement of Rent*. Notwithstanding the foregoing or anything in this Lease to the contrary, in the event that Tenant is prevented from using, and does not use, the Premises or any portion thereof, for three (3) consecutive business days or ten (10) business days in any twelve (12) month period (the "**Eligibility Period**") as a result of (i) any repair, maintenance or alteration performed by Landlord after the Commencement Date that substantially interferes with Tenant's use of the Premises, the parking facility and/or the Building, or (ii) any failure by Landlord to provide Tenant with services or access to the Premises, the Parking Facility and/or the Building, then Tenant's Rent shall be abated or reduced, as the case may be, after expiration of the Eligibility Period for such time that Tenant continues to be so prevented from using, and does not use, the Premises or a portion thereof, in the proportion that the rentable area of the portion of the Premises that Tenant is prevented from using, and does not use, bears to the total rentable area of the Premises. However, in the event that Tenant is prevented from conducting, and does not conduct, its business in any portion of the Premises for a period of time in excess of the Eligibility Period, and the remaining portion of the Premises is not sufficient to allow Tenant to effectively conduct its business therein, and if Tenant does not conduct its business from such remaining portion, then for such time after expiration of the Eligibility Period during which Tenant is so prevented from effectively conducting its business therein, the Rent for the entire Premises shall be abated; provided, however, if Tenant reoccupies and conducts its business from any portion of the Premises during such period, the Rent allocable to such reoccupied portion, based on the proportion that the rentable area of such reoccupied portion of the Premises bears to the total rentable area of the Premises, shall be payable by Tenant from the date such business operations commence.

22. SIGNS AND ADVERTISING. Landlord shall provide Tenant, at Landlord's sole cost and expense, with Building standard signage (as such standard is established from time to time by Landlord) on the Building directory in the lobby of the Building and at the entry to the Premises for Tenant. In addition, Tenant shall have the right to install, at Tenant's sole cost and expense, signage on or adjacent to the entry to the Premises, in the lobby and corridor of any floor in which any part of the Premises are located and on the exterior monument sign for the Building in the top tenant location ("**Additional Tenant Signage**"); provided, however, that Tenant must present the desired signage to Landlord for its review and approval, which shall not be unreasonably withheld. Any Additional Tenant Signage shall comply with Landlord's signage program for the Building; provided, however, that Tenant shall be permitted to use its standard font and logo in connection with the Additional Tenant Signage. Tenant shall not erect or install or otherwise utilize signs, lights, symbols, canopies, awnings, window coverings or other advertising or decorative matter (collectively, "**Signs**") on the windows, walls or exterior doors or otherwise visible from the exterior of the Premises without first (a) submitting its plans to Landlord and obtaining Landlord's written approval thereof, which approval shall not be unreasonably withheld, conditioned or delayed, and (b) obtaining any required approval of any applicable governmental authority with jurisdiction at Tenant's sole cost and expense. All Signs approved by Landlord shall be professionally designed and constructed in a first-class workmanlike manner. Subject to Tenant's right to use its standard font and logo, Landlord shall have the right to promulgate from time to time additional reasonable and non-discriminatory rules, regulations and policies relating to the style and type of said advertising and decorative matter which may be used by any occupant, including Tenant, in the Building, and may change or amend such rules and regulations from time to time as in its discretion it deems advisable. Tenant agrees to abide by such rules, regulations and policies. At the expiration or earlier termination of this Lease, all such signs, lights, symbols, canopies, awnings or other advertising or decorative matter attached to or painted by Tenant upon the Premises, whether on the exterior or interior thereof, shall be removed by Tenant at its own expense, and Tenant shall repair any damage or injury to the Premises or the Building, and correct any unsightly condition, caused by the maintenance and removal thereof.

23. PARKING. Subject to the rules and regulations of the Town of Mill Valley and the County of Marin, Tenant shall have the right to use, without payment of additional rent for such parking (provided that nothing contained in this Section 23 shall be deemed to limit Landlord's right to include costs relating to the Project parking areas in Operating Expenses to the extent permitted under the provisions of Section 4 above), four (4) parking spaces for every 1,000 rentable square feet in the Premises in the parking facilities for the Project in common with other tenants, guests and invitees of the Project during the Term of this Lease and otherwise subject to the reasonable rules and regulations applicable to the parking facilities, including, without limitation, hours of operation. The Project shall contain approximately four (4) parking spaces for each 1,000 square feet of usable office space. Access to and from the parking facilities shall be available twenty-four (24) hours per day, seven (7) days per week in accordance with the Landlord's reasonable and nondiscriminatory rules and regulations established therefore from time to time. Tenant has no right to any "reserved" or "designated" parking space(s).

24. RULES AND REGULATIONS. Tenant agrees to observe and be bound by the Rules and Regulations applicable to the Project, a copy of which is attached hereto as Exhibit E. Landlord reserves the right to amend said Rules and Regulations in a reasonable and nondiscriminatory manner, as Landlord in its reasonable judgment may from time to time deem to be necessary or desirable for the safety, care and cleanliness of the Project and the preservation of good order therein, and Tenant agrees to comply therewith provided that no amendments to the Rules and Regulations shall interfere with Tenant's use of the Premises. Landlord may make concessions requested by a tenant without granting the same concessions to any other tenant. To the extent the Rules and Regulations conflict with this Lease, this Lease shall control.

25. TIME. Time is of the essence of this Lease.

26. QUIET ENJOYMENT. Landlord covenants to control its activities and personnel such that if and so long as no Event of Default by Tenant is in existence under this Lease, Tenant shall hold and enjoy the Premises peaceably and quietly, subject to the provisions of this Lease.

27. DEFAULTS AND REMEDIES.

(a) *Defaults*, The occurrence of any one or more of the following events shall constitute a default hereunder by Tenant (each an '**Event of Default**"):

(1) The failure by Tenant to make any payment of Basic Rent, additional rent, other charges or any other payment required to be made by Tenant hereunder, as and when due, where such failure shall continue for a period of five (5) days after written notice thereof from Landlord to Tenant; provided, however, that any such notice shall be in lieu of, and not in addition to, any notice required under California Code of Civil Procedure § 1161 regarding unlawful detainer actions.

(2) The failure by Tenant to observe or perform any of the express or implied covenants or provisions of this Lease to be observed or performed by Tenant, other than as specified in Section 27(a) above, where such failure shall continue for a period of thirty (30) days after written notice thereof from Landlord to Tenant. Any such notice shall be in lieu of, and not in addition to, any notice required under California Code of Civil Procedure § 1161 regarding unlawful detainer actions. If the nature of Tenant's default (other than a default specified in Section 27(a)(1) above) is such that more than thirty (30) days are reasonably required for its cure, then Tenant shall not be deemed to be in default if Tenant shall promptly commence such cure within said thirty (30) day period and thereafter diligently prosecute such cure to completion.

(b) *Remedies*. If an Event of Default exists, in addition to any other remedies available to Landlord at law or in equity, Landlord shall have the following rights and remedies:

(1) The right to terminate the Lease and pursue its rights and remedies provided by California Civil Code Section 1951 .2, in which event Landlord may recover

(A) The worth at the time of award of any unpaid rent which had been earned at the time of such termination; plus

(B) The worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that Tenant proves could have been reasonably avoided; plus

(C) The worth at the time of award of the amount by which the unpaid rent for the balance of the Term after the time of award exceeds the amount of such rental loss that Tenant proves could have been reasonably avoided; plus

(D) Any other amount necessary to compensate Landlord for all the detriment proximately caused by Tenant's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom, specifically including, but not limited to, brokerage commissions and advertising expenses incurred, expenses of remodeling the Premises or any portion thereof for a new tenant, whether for the same or a different use, and any special concessions made to obtain a new tenant; plus

(E) At Landlord's election, such other amounts in addition to or in lieu of the foregoing as may be permitted from time to time by applicable law so long as not duplicative of other amounts paid or payable by Tenant.

The term "rent" as used hereinabove shall be deemed to be and to mean all sums of every nature required to be paid by Tenant pursuant to the terms of this Lease, whether to Landlord or to others. As used herein, the "worth at the time of award" for (A) and (B) above shall be computed by allowing interest at the Interest Rate. As used herein, the "worth at the time of award" for (C) above shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of San Francisco at the time of award plus one percent (1%).

(2) The rights and remedies provided by California Civil Code Section 1951.4, that allow Landlord to continue this Lease in effect and to enforce all of its rights and remedies under this Lease, including the right to recover Basic Rent, additional rent and other charges as they become due, for so long as Landlord does not terminate Tenant's right to possession. Acts of maintenance or preservation, efforts to relet the Premises or the appointment of a receiver upon Landlord's initiative to protect its interest under this Lease shall not constitute a termination of Tenant's right to possession;

(3) The right to enter the Premises and remove therefrom all persons and property, store such property in a public warehouse or elsewhere at the cost of and for the account of Tenant, and sell such property and apply the proceeds therefrom pursuant to applicable California law; and

(4) The right to take steps necessary or appropriate to have a receiver appointed for Tenant in order to take possession of the Premises and apply any rental collected and exercise all other rights and remedies granted to Landlord.

(c) *Reentry*. If an Event of Default exists, Landlord shall also have the right, with or without terminating this Lease, to re-enter the Premises and remove all persons and property from the Premises; such property may be removed and stored in a public warehouse or elsewhere at the cost of and for the account of Tenant. No re-entry or taking possession of the Premises by Landlord pursuant to this Section 27(c) shall be construed as an election to terminate this Lease unless a written notice of such intention is given to Tenant or unless the termination thereof is decreed by a court of competent jurisdiction.

(d) *Remedies Cumulative; Waiver*. All rights, options and remedies of Landlord contained in this Lease or provided by law or in equity shall be construed and held to be cumulative, and no one of them shall be exclusive of the other. No waiver of any default hereunder shall be implied from any acceptance by Landlord of any Basic Rent, additional rent or other charges due hereunder or any omission by Landlord to take any action on account of such default, and no express waiver shall affect any default other than as specified in said waiver. The consent or approval of Landlord to or of any act by Tenant requiring Landlord's consent or approval shall not be deemed to waive or render unnecessary Landlord's consent or approval to or of any subsequent similar acts by Tenant.

28. TRANSFER OF LANDLORD'S INTEREST. In the event of any transfer or transfers of Landlord's interest in the Project or the Building, other than a transfer for security purposes only, and the assumption in writing by the transferee of the obligations of Landlord under this Lease accruing with respect to the period from and after the date of such transfer, Tenant agrees that Landlord shall be automatically relieved of any and all obligations and liabilities on the part of Landlord accruing with respect to the period from and after the date of such transfer and Tenant agrees to attorn to the transferee.

29. RIGHT TO PERFORM. If Tenant shall fail to pay any sum of money, other than Basic Rent required to be paid by it hereunder, or shall fail to perform any other act on its part to be performed hereunder, and such failure shall continue for thirty (30) days after written notice thereof by Landlord (or such shorter period as may be reasonably appropriate in an emergency situation of imminent risk of injury to persons or property damage), Landlord may, but shall not be obligated so to do, and without waiving or releasing Tenant from any obligations of Tenant, make any such payment or perform any such other act on Tenant's part to be made or performed as provided in this Lease. Tenant shall reimburse Landlord for all costs incurred in connection with such payment or performance within thirty (30) days of demand.

30. RIGHT OF FIRST REFUSAL. During the initial and option term herein, Tenant shall have a right of first refusal to lease any available space on the second floor of the Building which becomes vacant and available ("ROFR Space"). This right of first refusal shall be exercised in the following manner: Upon recapture by landlord, Landlord may market the vacant and available space. Landlord shall notify Tenant, in writing and pursuant to the provisions herein, of all material terms and conditions of bona fide offers received during the marketing period ("Marketing Period"). In the event Landlord is ready to accept a bona fide proposed offer ("ROFR Offer") to lease space all or a portion of the ROFR Space, landlord shall present Tenant with the terms of the ROFR Offer ("ROFR Notice"). The terms of the ROFR Notice if applicable, the lease term in the ROFR Notice shall be revised so that it is coterminous with Tenant's remaining Lease Term, and all tenant improvements, abated rent, and or other lease concessions shall be prorated accordingly to reflect the term. Tenant shall have fifteen days from receipt of the ROFR Notice to exercise its right of first refusal, and must do so in writing pursuant to Paragraph 31 of this Lease. Any exercise thereof shall become binding, and the newly demised space shall be let pursuant to all terms and conditions of this Lease, provided that the term of the tenancy shall be coterminous with any term hereunder, and, Additional Rent, and other obligations of Tenant under this Lease shall be adjusted to include the newly demised space. The Basic Rent for the newly acquired space shall be in accordance with the Basic Rent schedule set forth in Paragraph 3(b) above. This right of first refusal may be exercised multiple times as second floor space becomes vacant and available.

31. NOTICES. All notices under this Lease shall be in writing and sent to the parties at the following addresses or at such other address as any party hereto may designate to the other by notice delivered as provided herein:

To Landlord:

Bently Holdings CA LP
240 Stockton Street, Eighth Floor
San Francisco, California 94108
Telephone No.: (415) 288-0202
Facsimile No.: (415) 288-0203

To Tenant:

Redwood Trust, Inc.
One Belvedere Place. Suite 300
Mill Valley, California 94941

Any such notices shall be sent by (i) U.S. certified mail, postage prepaid, return receipt requested, in which case notice shall be deemed delivered three business days after timely deposit in the mail, (ii) a nationally recognized overnight courier, in which case notice shall be deemed delivered one business day after timely deposit with such courier; (iii) personally delivered, in which case notice shall be deemed delivered upon receipt or refusal of receipt, or (iv) electronic communication, whether by telex, telegram or telecopying, in which case notice shall be deemed delivered on the date of confirmed dispatch provided such electronic communication is followed up with a notice sent by mail.

32. ATTORNEYS' FEES. If either party places the enforcement of this Lease or any part hereof, or the collection of any Basic Rent, additional rent or other charges due or to become due hereunder, or recovery of the possession of the Premises, in the hands of an attorney, or files suit or brings an arbitration upon the same, the non-prevailing (or defaulting) party shall pay the other party's reasonable legal and attorneys' fees, costs and expenses, including legal and attorneys' fees, costs and expenses incurred in connection with any appeals and any bankruptcy or insolvency proceedings involving Tenant or this Lease. If Landlord is named as a defendant in any suit brought against Tenant in connection with or arising out of Tenant's occupancy hereunder, Tenant shall pay to Landlord its reasonable costs and expenses in such suit, including its reasonable attorneys' fees. Any such attorneys' fees and other expenses incurred by either party in enforcing a judgment in its favor under this Lease shall be recoverable separately from and in addition to any other amount included in such judgment, and such attorneys' fees obligation is intended to be severable from the other provisions of this Lease and to survive and not be merged into any such judgment. The terms "attorneys' fees" and "attorneys' fees, costs and expenses" shall mean the fees, costs and expenses of counsel to the parties hereto, which may include printing, photostating, duplicating and other expenses, air freight charges, and fees billed for law clerks, paralegals and other persons not admitted to the bar but performing services under the supervision of an attorney, and the costs and fees incurred in connection with the enforcement or collection of any judgment obtained in any such proceeding, and shall include, specifically, all fees, costs and expenses of-expert witnesses. For purposes of this Section 32, the term "prevailing party" shall include a prevailing party as defined in California Code of Civil Procedure Section 998.

33. HOLDING OVER. If Tenant holds over after the expiration or earlier termination of the Term without the express prior written consent of Landlord, Tenant shall become a tenant from month to month only, at a rental rate equal to one hundred twenty-five percent (125%) of the Basic Rent, additional rent and other charges in effect upon the date of such expiration (subject to adjustment as provided in Section 4 hereof and prorated on a daily basis), and otherwise subject to the terms, covenants and conditions herein specified, so far as applicable; provided, however, that such percentage shall increase from one hundred twenty-five percent (125%) to one hundred fifty percent (150%) following the first ninety (90) days of any such holding over. Acceptance by Landlord of rent after such expiration or earlier termination shall not result in a renewal of this Lease and shall not waive Landlord's right to bring an unlawful detainer action against Tenant or otherwise remove Tenant from the Premises. If Tenant fails to surrender the Premises upon the expiration of this Lease despite demand to do so by Landlord, Tenant shall indemnify, defend and hold Landlord harmless from all loss or liability, including without limitation, any claim made by any succeeding tenant founded on or resulting from such failure to surrender.

34. SURRENDER OF PREMISES. Subject to Section 18(i), the voluntary or other surrender of this Lease by Tenant, or a mutual cancellation hereof, shall not work a merger, and shall, at the option of Landlord, operate as an assignment to it of any subleases or subtenancies.

35. NON-WAIVER. Neither the acceptance of rent nor any other act or omission of Landlord or Tenant at any time or times after the happening of any event authorizing the cancellation or forfeiture of this Lease shall operate as a waiver of any past or future violation, breach or failure to keep or perform any covenant, agreement, term or condition hereof, or deprive the other party of its rights and remedies under this Lease, or be construed so as to at any future time stop Landlord or Tenant from promptly exercising any other option, right or remedy that it may have under any term or provision of this Lease.

36. MORTGAGEE PROTECTION. In the event of any default on the part of Landlord, Tenant will give written notice by registered or certified mail to any beneficiary of a deed of trust or mortgagee under a mortgage covering the Project or the Building whose address shall have been furnished to Tenant, and shall offer such beneficiary or mortgagee a reasonable opportunity to cure the default (if such beneficiary or mortgagee is acting in good faith to cure the Landlord's default (if curable)), including time to obtain possession of the Project or the Building by power of sale or a judicial foreclosure, if such should prove necessary to effect a cure. For purposes hereof, a reasonable opportunity shall mean thirty (30) days after receipt of Tenant's notice or such longer period as may be necessary so long as the cure is commenced within said thirty (30) day period and is being diligently pursued to completion.

37. EXPEDITED DISPUTE RESOLUTION. With the exception of the arbitration provisions which shall specifically apply to the determination of the Fair Market Rental Value and Landlord's exercise of unlawful detainer remedies, the provisions of this Section 37 contain the sole and exclusive method, means and procedure to resolve any and all disputes or disagreements, including whether any particular matter constitutes, or with the passage of time would constitute, an Event of Default. The parties hereby irrevocably waive any and all rights to the contrary and shall at all times conduct themselves in strict, full, complete and timely accordance with the provisions of this Section 37. Any and all attempts to circumvent the provisions of this Section 37 shall be absolutely null and void and of no force or effect whatsoever. As to any matter submitted to arbitration to determine whether it would, with the passage of time, constitute an Event of Default, such passage of time shall not commence to run until any such affirmative determination, so long as it is simultaneously determined that the challenge of such matter as a potential Event of Default was made in good faith, except with respect to the payment of money. With respect to the payment of money, such passage of time shall not commence to run only if the party which is obligated to make the payment does in fact make the payment to the other party. Such payment can be made "under protest," which shall occur when such payment is accompanied by a good faith notice stating why the party has elected to make a payment under protest. Such protest will be deemed waived unless the subject matter identified in the protest is submitted to arbitration as set forth in the following:

(a) *Arbitration Panel*. Within ten (10) days after delivery of written notice ("**Notice of Dispute**") of the existence and nature of any dispute given by any party to the other party, and unless otherwise provided herein in any specific instance, the parties shall each: (i) appoint one (1) lawyer actively engaged in the licensed and full time practice of law, specializing in real estate, in the County of Marin for a continuous period immediately preceding the date of delivery ("**Dispute Date**") of the Notice of Dispute of not less than ten (10) years, but who has at no time ever represented or acted on behalf of any of the parties, and (ii) deliver written notice of the identity of such lawyer and a copy of his or her written acceptance of such appointment and acknowledgment of and agreement to be bound by the time constraints and other provisions of this Section 37 ("**Acceptance**") to the other parties hereto. The party who selects the lawyer may not consult with such lawyer, directly or indirectly, to determine the lawyer's position on the issue which is the subject of the dispute. In the event that any party fails to so act, such arbitrator shall be appointed pursuant to the same procedure that is followed when agreement cannot be reached as to the third arbitrator. Within ten (10) days after such appointment and notice, such lawyers shall appoint a third lawyer (together with the first two (2) lawyers, "**Arbitration Panel**") of the same qualification and background and shall deliver written notice of the identity of such lawyer and a copy of his or her written Acceptance of such appointment to each of the parties. In the event that agreement cannot be reached on the appointment of a third lawyer within such period, such appointment and notification shall be made as quickly as possible by any court of competent jurisdiction, by any licensing authority, agency or organization having jurisdiction over such lawyers, by any professional association of lawyers in existence for not less than ten (10) years at the time of such dispute or disagreement and the geographical membership boundaries of which extend to the County of Marin or by any arbitration association or organization in existence for not less than ten (10) years at the time of such dispute or disagreement and the geographical boundaries of which extend to the County of Marin, as determined by the party giving such Notice of Dispute and simultaneously confirmed in writing delivered by such party to the other party. Any such court, authority, agency, association or organization shall be entitled either to directly select such third lawyer or to designate in writing, delivered to each of the parties, an individual who shall do so. In the event of any subsequent vacancies or inabilities to perform among the Arbitration Panel, the lawyer or lawyers involved shall be replaced in accordance with the provisions of this Section 37 as if such replacement was an initial appointment to be made under this Section 37 within the time constraints set forth in this Section 37, measured from the date of notice of such vacancy or inability, to the person or persons required to make such appointment, with all the attendant consequences of failure to act timely if such appointed person is a party hereto.

(b) *Duty*. Consistent with the provisions of this Section 37, the members of the Arbitration Panel shall utilize their utmost skill and shall apply themselves diligently so as to hear and decide, by majority vote, the outcome and resolution of any dispute or disagreement submitted to the Arbitration Panel as promptly as possible, but in any event on or before the expiration of thirty (30) days after the appointment of the members of the Arbitration Panel. None of the members of the Arbitration Panel shall have any liability whatsoever for any acts or omissions performed or omitted in good faith pursuant to the provisions of this Section 37.

(c) *Authority*. The Arbitration Panel shall (i) enforce and interpret the rights and obligations set forth in the Lease to the extent not prohibited by law, (ii) fix and establish any and all rules as it shall consider appropriate in its sole and absolute discretion to govern the proceedings before it, including any and all rules of discovery, procedure and/or evidence, and (iii) make and issue any and all orders, final or otherwise, and any and all awards, as a court of competent jurisdiction sitting at law or in equity could make and issue, and as it shall consider appropriate in its sole and absolute discretion, including the awarding of monetary damages (but shall not award consequential damages to either party and shall not award punitive damages except in situations involving knowing fraud or egregious conduct condoned by, or performed by, the person who, in essence, occupies the position which is the equivalent of the chief executive officer of the party against whom damages are to be awarded), the awarding of reasonable attorneys' fees and costs to the prevailing party as determined by the Arbitration Panel and the issuance of injunctive relief. If the party against whom the award is issued complies with the award, within the time period established by the Arbitration Panel, then no Event of Default will be deemed to have occurred, unless the Event of Default pertained to the non payment of money by Tenant or Landlord, and Tenant or Landlord failed to make such payment under protest.

(d) *Appeal*. The decision of the Arbitration Panel shall be final and binding, may be confirmed and entered by any court of competent jurisdiction at the request of any party and may not be appealed to any court of competent jurisdiction or otherwise except upon a claim of fraud on the part of the Arbitration Panel, or on the basis of a mistake as to the applicable law. The Arbitration Panel shall retain jurisdiction over any dispute until its award has been implemented, and judgment on any such award may be entered in any court having appropriate jurisdiction.

38. CHANGES TO THE PROJECT. Landlord reserves the right at any time to make changes, alterations, reductions and additions to the Project, including the construction of other buildings or improvements in the Project, the leasing of space to restaurant uses, the building of additional stories on any building, without any liability or responsibility to Tenant. Landlord will not block ingress and egress to the Premises. No rights to any view or to light or air over any property, whether belonging to Landlord or any other person, are granted to Tenant by this Lease. If at any time any windows of the Premises are temporarily darkened or the light or view therefrom is obstructed by reason of any repairs, improvements, maintenance or cleaning in or about the Project, the same shall be without liability to the Landlord and without any reduction or diminution of Tenant's obligations under this Lease. Notwithstanding the foregoing, Landlord agrees that it shall not make or permit any permanent modification to the Building (as built substantially in accordance with the Building Plans), on any changes, alterations, reductions and additions to the Project, which change the nature of the Building to something other than a first class office building, materially obstructs the natural light to the Premises or which materially adversely affects (a) use or occupancy of the Premises, (b) parking serving the Building, or (c) ingress, egress or access to or from the Building and the Premises.

39. WAIVER OF JURY TRIAL. EACH PARTY HEREBY WAIVES ANY RIGHT TO A TRIAL BY JURY IN ANY ACTION TO ENFORCE THE SPECIFIC PERFORMANCE OF THIS LEASE, FOR DAMAGES FOR THE BREACH HEREOF, OR OTHERWISE FOR ENFORCEMENT OF ANY REMEDY HEREUNDER. If either party commences litigation against the other for the specific performance of this Lease, for damages for the breach hereof or otherwise for enforcement of any remedy hereunder, the prevailing party shall be entitled to recover from the other party such costs and reasonable attorneys' fees as may have been incurred, including any and all costs incurred in enforcing, perfecting and executing such judgment.

40. OPTIONS TO EXTEND THE TERM

Tenant shall have one five-year option to extend the term of this Lease. This option ("Option") must be exercised upon delivery to Landlord, no later than 180 days prior to the expiration of the Initial Term, written notice pursuant to Paragraph 31 of the Lease. Basic Rent for the Option shall adjust to 100% of Fair Market Value as defined in the term page of the Lease. In the event that Landlord and Tenant are unable to agree upon Fair Market Value, the dispute resolution procedures set forth in Paragraph 37 of this Lease shall be used to resolve the matter. There shall be no increases in Basic Rent during the Option period. There are no other options to extend the Lease Term beside the Option.

(a) In the event that the parties have not agreed upon the Fair Market Value prior to the date four (4) months before the commencement of the extension term, such value shall be determined by binding arbitration in Marin County, California before a single arbitrator as follows:

(i) Landlord and Tenant shall have ten (10) days within which to select one (1) mutually agreeable arbitrator. If Landlord and Tenant fail to agree on one (1) arbitrator within the ten (10) day period, either party may promptly request JAMS to appoint an arbitrator for the matter, and JAMS' selection shall be binding upon Landlord and Tenant. JAMS shall appoint as arbitrator an individual with the following qualifications: (i) not less than ten (10) years' experience in the valuation of commercial rental properties in Marin County, California; and (ii) has never been a direct or indirect employee or agent of either Landlord or Tenant

(ii) Landlord and Tenant shall each submit to the arbitrator, in writing, a good faith determination of the Fair Market Value.

(iii) The arbitrator selected must make a determination of the Fair Market Value by choosing either the Landlord's or Tenant's determination of the Fair Market Value, and the arbitrator's choice shall be final and binding upon the parties. In determining the Fair Market Value, the arbitrator shall consider all relevant factors such as market conditions and comparables. From the date of appointment, the arbitrator shall have 30 days within which to render a decision as to the Fair Market Value. Landlord and Tenant agree to cooperate with the arbitrator and with each other in this regard.

(iv) Judgment upon the award rendered by the arbitrator shall be binding upon the parties and may be entered in any court of competent jurisdiction only if necessary. Each of the parties shall pay their own counsel and arbitration fees and costs.

41. GENERAL PROVISIONS

(a) *Entire Agreement*. This Lease contains all of the agreements of the parties, and there are no verbal or other agreements which modify or affect this Lease. This Lease supersedes any and all prior agreements made or executed by or on behalf of the parties hereto regarding the Premises.

(b) *Terms and Headings*. The words "**Landlord**" and "**Tenant**" include the plural as well as the singular, and words used in any gender include all genders. The titles to sections of this Lease are not a part of this Lease and shall have no effect upon the construction or interpretation of any part hereof.

(c) *Successors and Assigns*. All of the covenants, agreements, terms and conditions contained in this Lease shall inure to and be binding upon Landlord and Tenant and their respective permitted successors in interest and assigns.

(d) *Brokers*. Landlord did not retain a broker. Studley, Inc. was retained to exclusively represent Tenant. Landlord, at its sole cost and expense, shall pay a commission to Studley, Inc. equal to $2.00 per rentable square foot of the Premises per year of the Term only (and not the Option or any holdover period/renewal period). 100% of this commission shall be due and payable upon full execution and delivery of the Lease to Landlord.

(e) *Liability of Landlord*. Landlord's obligations and liability to Tenant under this Lease shall be limited solely to Landlord's interest in the Project, all post-judgment rents, issues and profits arising therefrom and the proceeds from the sale thereof, and any available insurance proceeds and neither Landlord nor any of the members in Landlord, nor any officer, director, shareholder or partner of or in Landlord or any members in Landlord shall have or incur any personal liability whatsoever with respect to this Lease.

(f) *Independent Covenants*. Subject to the provisions of Section 7(a) above, this Lease shall be construed as though the covenants herein between Landlord and Tenant are independent and not dependent and Tenant agrees that if Landlord fails to perform its obligations set forth herein, Tenant shall not be entitled to make any repairs or perform any acts hereunder at Landlord's expense or to any setoff of amounts owing hereunder against Landlord except as otherwise provided in this Lease; provided, however, that the foregoing shall in no way impair the right of Tenant to commence a separate action against Landlord for any violation by Landlord of the provisions hereof so long as notice is first given to Landlord and any holder of a mortgage or deed of trust covering the Building or the Project or any portion thereof, and an opportunity is granted to Landlord and such mortgage holder to correct such violations as provided above.

(g) *Waiver of Redemption by Tenant*. Tenant herby waives, for Tenant and for all those claiming under Tenant, any and all rights now or hereafter existing to redeem by order or judgment of any court or by any legal process or writ, Tenant's right of occupancy of the Premises after any termination of this Lease.

(h) *Severability*. Any provision of this Lease which shall prove to be invalid, void or illegal shall in no way affect, impair or invalidate any other provision hereof, and the remaining provisions hereof shall nevertheless remain in full force and effect.

(i) *Force Majeure*. Except as may be otherwise specifically provided herein, time periods for Landlord's or Tenant's performance under any provisions of this Lease not involving the payment of money shall be extended for periods of time during which the nonperforming party's performance is prevented due to circumstances beyond the party's control, including, without limitation, strikes, embargoes, governmental regulations, acts of God, weather, war or other strife. Tenant hereby waives and releases its right to terminate this Lease under Section 1932(1) of the California Civil Code or under any similar law, statute or ordinance now or hereafter in effect.

(j) *Prior Leases/Rental Agreements.* The parties acknowledge that Tenant was/is a tenant of Landlord in the Building pursuant to two rental and lease agreements. These rental and lease agreements shall become null and void as of the Commencement Date. No party may rely upon these agreements after the Commencement Date.

(k) *Examination of Lease*. Submission of this instrument for examination or signature by Tenant does not constitute a reservation of or option to lease, and it is not effective as a lease or otherwise until execution by and delivery to both Landlord and Tenant.

(l) *No Warranty*. In executing and delivering this Lease, Tenant has not relied on any representations, including, but not limited to, any representation as to the amount of any item comprising additional rent or the amount of the additional rent in the aggregate or that Landlord is furnishing the same services to other tenants, at all, on the same level or on the same basis, or any warranty or any statement of Landlord which is not set forth herein or in one or more of the exhibits attached hereto.

(m) *Right to Lease*. Landlord reserves the absolute right to effect such other tenancies in the Project as Landlord in the exercise of its sole business judgment shall determine to best promote the interests of the Building and the Belvedere Place office center so long as the Building remains a first-class office building comparable to Comparable Buildings. Tenant does not rely on the fact, nor does Landlord represent, that any specific tenant or type or number of tenants shall, during the Term, occupy any space in the Building or the Belvedere Place office center.

(n) *Transportation Management*. Tenant shall exercise commercially reasonable efforts to comply with all present or future programs intended to manage parking, transportation or traffic in and around the Project, and in connection therewith, Tenant shall take reasonable and responsible action for the transportation planning and management of all employees located at the Project by working directly with Landlord, any governmental transportation management organization or any other transportation-related committees or entities. Such programs may include, without limitation (i) restrictions on the number of peak-hour vehicle trips generated by Tenant; (ii) increased vehicle occupancy; (iii) implementation of an in-house ridesharing program and an employee transportation coordinator; (iv) working with employees and any Project, Building or area-wide ridesharing program manager; and (v) utilizing flexible work shifts for employees.

(o) *Modification for Lender*. If, in connection with Landlord's obtaining construction, interim or permanent financing for the Building or Project, the lender shall request reasonable modifications in this Lease as a condition to such financing, Tenant will not unreasonably withhold, delay or defer its consent thereto, provided that such modifications do not increase the obligations of Tenant hereunder, decrease Tenant's rights or adversely affect the leasehold interest hereby created or Tenant's rights hereunder.

(p) *Requirements of Law*. Landlord shall comply with all laws, rules and regulations (including, without limitation, the Americans with Disabilities Act) applicable to the common areas of the Building, other than such laws, rules and regulations with which Tenant is obligated to comply under the terms of this Lease.

(q) *Recording*. Neither Landlord nor Tenant shall record this Lease nor a short form memorandum hereof.

(r) *Applicable Laws*. This Lease shall be governed by and construed pursuant to the laws of the State of California.

(s) *Relationship of Parties*. Nothing contained in this Lease shall be deemed or construed by the parties hereto or by any third party to create the relationship of principal and agent, partnership, joint venture or any association between Landlord and Tenant, it being expressly understood and agreed that neither the method of computation of rent nor any act or omission of the parties hereto shall be deemed to create any relationship between Landlord and Tenant other than the relationship of landlord and tenant.

(t) *Landlord's Title*. Landlord's title is and always shall be paramount to the title of Tenant. Nothing herein contained shall empower Tenant to do any act which can, shall or may encumber the title of Landlord.

(u) *Project or Building Name and Storage*. Landlord shall have the right at any time to change the name of the Building or Project and to install, affix and maintain any and all signs on the exterior and on the interior of the Project or Building as Landlord may, in Landlord's sole discretion, desire. Tenant shall not use the name of the Project or the Building (including the name Belvedere Place) or use pictures or illustrations of the Project or the Building in advertising or other publicity, without the prior written consent of the Landlord (which consent shall not be unreasonably withheld).

(v) *Survival of Obligations*. All provisions of this Lease which require the payment of money or the delivery of property after the termination of this Lease or require either party to indemnify, defend or hold the other harmless shall survive the termination of this Lease.

(w) *Authority*. Each individual executing this Lease represents that it has all requisite power and authority to execute and deliver this Lease on behalf of the entity for which it is signing, and by his or her signature, will bind such party to the terms of this Lease.

(x) *Execution in Counterparts*. This Agreement may be executed in any number of counterparts and by different parties hereto in separate counterparts, each of which when so executed shall be deemed to be an original and all of which taken together shall constitute one and the same agreement.

(y) *Consent/Duty to Act Reasonably*. Any time the consent of Landlord or Tenant is required, such consent shall not be unreasonably withheld, conditioned or delayed. Whenever this Lease grants Landlord or Tenant the right to take action, exercise discretion, establish rules and regulations or make allocations or other determinations (other than decisions to exercise expansion, contraction, cancellation, termination or renewal options), Landlord and Tenant shall act reasonably and in good faith and take no action which might result in the frustration of the reasonable expectations of a sophisticated tenant or landlord concerning the benefits to be enjoyed under this Lease.

(z) *Landlord Bankruptcy Proceeding*. In the event that the obligations of Landlord under this Lease are not performed during the pendency of a bankruptcy or insolvency proceeding involving the Landlord as the debtor, or following the rejection of this Lease in accordance with Section 365 of the United States Bankruptcy Code, then notwithstanding any provision of this Lease to the contrary, and in addition to any and all other remedies permitted by this Lease and/or by applicable laws Tenant shall have the right to set off against Rents next due and owing under this Lease (a) any and all damages caused by such non-performance of Landlord's obligations under this Lease by Landlord, debtor-in-possession, or the bankruptcy trustee, and (b) any and all damages caused by the non-performance of Landlord's obligations under this Lease following any rejection of this Lease in accordance with Section 365 of the United States Bankruptcy Code.

(aa) *Access*. Tenant shall be granted access to the Building, the Premises and the parking provided to the Building twenty-four (24) hours per day, seven (7) days per week, every day of the year.

(bb) *Prohibited Persons and Transactions*. Tenant and Landlord (each, a "**Representing Party**") each represents and warrants to the other (i) that neither the Representing Party nor any person or entity that directly owns a 10% or greater equity interest in it nor any of its officers, directors or managing members is a person or entity (each, a "**Prohibited Person**") with whom U.S. persons or entities are restricted from doing business under regulations of the Office of Foreign Asset Control ("**OFAC**") of the Department of the Treasury (including those named on OFAC's Specially Designated and Blocked Persons List) or under any statute, executive order (including Executive Order 13224 (the "**Executive Order**") signed on September 24, 2001 and entitled "Blocking Property and Prohibiting Transactions with Persons Who Commit, Threaten to Commit, or Support Terrorism), or other governmental action, (ii) that the Representing Party's activities do not violate the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 or the regulations or orders promulgated thereunder (as amended from time to time, the "**Money Laundering Act**"), and (iii) that throughout the Term the Representing Party shall comply with the Executive Order and with the Money Laundering Act.

(cc) *When Payment Is Due*. Whenever in this Lease a payment is required to be made by one party to the other, but a specific date for payment is not set forth or a specific number of days within which payment is to be made is not set forth, or the words "immediately", "promptly" and/or "on demand", or the equivalent, are used to specify when such payment is due, then such payment shall be due thirty (30) days after the party which is entitled to such payment sends written notice to the other party demanding payment.

IN WITNESS WHEREOF, the parties hereto have executed this Lease as of the date first above written.

LANDLORD:

BENTLY HOLDINGS CALIFORNIA LP,
a California limited partnership

By: /s/ Amber Marie Bently
Name: Amber Marie Bently
Its: President

By: /s/ Chris Bently
Name: Chris Bently
Its: Chief Executive Officer

TENANT:

REDWOOD TRUST, INC.

By: /s/ Brett D. Nicholas
Name: Brett F. Nicholas
Its: Executive Vice President &
Chief Operating Officer

EXHIBIT A

Legal Description of the Property

[Intentionally Omitted]

EXHIBIT B

Description of the Premises

[Intentionally Omitted]

EXHIBIT C

notice Of Lease Term dates

To: ____________________________________

Re: Office Lease dated June 1, 2012, between Bently Holdings California LP, a California limited partnership (**"Landlord"**), and Redwood trust, Inc. (**"Tenant"**), concerning the third floor and designated portions of the second floor at One Belvedere Place, Mill Valley, California

Ladies and Gentlemen:

In accordance with the referenced Office Lease (the**"Lease"**), we wish to advise you and/or confirm as follows:

1. The Term shall commence on or has commenced on June 1, 2012 for a term of six years ending on May 31, 2018.

2. Rent commenced to accrue on June 1, 2012, in the amount of $121,381.17 per month.

Initially capitalized terms used herein without definition shall have the respective meanings given such terms in the Lease.

LANDLORD: **Bently Holdings California LP,**
a California limited partnership

By: ____________________________________
Name: Christopher Bently
Title: CEO

By: ____________________________________
Name: Amber Marie Bently
Title: President

EXHIBIT D

Form of Tenant Estoppel Certificate

TENANT ESTOPPEL CERTIFICATE

To: ______________________
____
____
____

Ladies and Gentlemen:

Redwood Trust, Inc. (**"Tenant"**) hereby certifies as follows:

1. The undersigned is the Tenant under that certain Office Lease dated June 1, 2012 (the**"Lease"**), executed by BENTLY HODLINGS CALIFORNIA LP, a California limited partnership (**"Landlord"**), as Landlord, and the undersigned, as Tenant, covering a portion of the building located at One Belvedere Place, Mill Valley, California designated as the entire third floor and designated portions of the second floor (the **"Premises"**). Initially capitalized terms used herein without definition shall have the respective meanings given such terms in the Lease.

2. The Premises initially consists of approximately 27,292 rentable square feet of space. Tenant has paid to Landlord a security deposit of $364,143.51. The Term of the Lease commenced on June 1, 2012 and the expiration of the Lease is May 31, 2018.

3. The Lease provides for one five-year option to extend the initial term of the Lease.

4. To Tenant's actual knowledge, Landlord is not in any respect in default in the performance of the terms and provisions of the Lease. Tenant is not in any respect in default under the Lease beyond all applicable notice and cure periods and has not assigned, transferred or hypothecated the Lease or any interest therein or subleased all or any portion of the Premises.

5. There are no offsets or credits against rentals payable under the Lease and no free rent periods or rental concessions have been granted to Tenant.

Tenant hereby expressly acknowledges and agrees that _____________________ is relying upon this Certificate.

"Tenant"

Redwood Trust, Inc.

By: ______________________
Name:

EXHIBIT E

Rules and Regulations

1. Tenant shall have access to the Building and the Premises at all times during the Term, except to the extent otherwise necessary for emergencies, maintenance or repairs, which maintenance and repairs shall be accomplished with as little interference to Tenant as commercially reasonable. On all hours other than normal business hours for the Project (as defined in Paragraph 19(iii) of these Rules and Regulations below), or such other hours as Landlord shall determine from time to time, access to the Project and/or to the passageways, entrances, exits, shipping areas, halls, corridors, elevators or stairways and other areas in the Project may be restricted and access gained by use of a key/card key to the outside doors of the Project, or pursuant to such security procedures as Landlord may from time to time impose. All such areas, and all roofs, are not for use of the general public, and Landlord shall in all cases retain the right to control and prevent access thereto by all persons whose presence in the judgment of Landlord shall be prejudicial to the safety, character, reputation and interests of the Project and its tenants, provided, however, that nothing herein contained shall be construed to prevent such access to persons with whom Tenant deals in the normal course of Tenant's business unless such persons are engaged in activities which are illegal or violate these Rules. No Tenant Parties shall enter into areas reserved for the exclusive use of Landlord Parties. Tenant shall keep doors to corridors and lobbies closed except when persons are entering or leaving.

2. Tenant shall not paint, display, inscribe, maintain or affix any sign, placard, picture, advertisement, name, notice, lettering or direction on any part of the outside or inside of the Project, or on any part of the inside of the Premises which can be seen from the outside of the Premises, without the prior consent of Landlord, and then only such name or names or matter and in such color, size, style, character and material as may be first approved by Landlord in writing. Landlord shall prescribe the suite number and identification sign for the Premises (which shall be prepared and installed by Landlord at Tenant's expense). Landlord reserves the right to remove at Tenant's expense all matter not so installed or approved without notice to Tenant.

3. Tenant shall not in any manner use the name of the Project for any purpose other than that of the business address of the Tenant, or use any picture or likeness of the Project, in any letterheads, envelopes, circulars, notices, advertisements, containers or wrapping material without Landlord's express written consent.

4. Tenant shall not place anything or allow anything to be placed in the Premises near the glass of any door, partition, wall or window which may be unsightly from outside the Premises, and Tenant shall not place or permit to be placed any article of any kind on any window ledge or on the exterior walls. Blinds, shades, awnings or other forms of inside or outside window ventilators or similar devices, shall not be placed in or about the outside windows in the Premises except to the extent, if any, that the character, shape, color, material and make thereof are first approved by Landlord in writing.

5. Furniture, freight and other large or heavy articles, and all other deliveries may be brought into the Project only at times and in the manner designated by Landlord, and always at Tenant's sole responsibility and risk. Landlord may impose reasonable charges for use of freight elevators after or before normal business hours. All damage done to the Project by moving or maintaining such furniture, freight or articles shall be repaired by Landlord at Tenant's expense. Landlord may inspect items brought into the Project or Premises with respect to weight or dangerous nature. Landlord may require that all furniture, equipment, cartons and similar articles removed from the Premises or the Project be listed and a removal permit therefor first be obtained from Landlord. Tenant shall not take or permit to be taken in or out of other entrances or elevators of the Project any item normally taken, or which Landlord otherwise reasonably requires to be taken, in or out through service doors or on freight elevators. Tenant shall not allow anything to remain in or obstruct in any way, any lobby, corridor, sidewalk, passageway, entrance, exit, hall, stairway, shipping area, or other such area. Tenant shall move all supplies, furniture and equipment as soon as received directly to the Premises, and shall move all such items and waste (other than waste customarily removed by Project employees) that are at any time being taken from the Premises directly to the areas designated for disposal. Any handcarts used at the Project shall have rubber wheels.

6. Tenant shall not overload any floor or part thereof in the Premises, or Project, including any public corridors or elevators therein bringing in or removing any large or heavy articles, and Landlord may direct and control the location of safes and all other heavy articles and require supplementary supports at Tenant's expense of such material and dimensions as Landlord may deem necessary to properly distribute the weight.

7. Tenant shall not attach or permit to be attached additional locks or similar devices to any door or window, change existing locks or the mechanism thereof, or make or permit to be made any keys for any door other than those provided by Landlord. If more than two keys for one lock are desired, Landlord will provide them upon payment therefor by Tenant. Tenant, upon termination of its tenancy, shall deliver to Landlord all keys of offices, rooms and toilet rooms which have been furnished Tenant or which Tenant shall have had made, and in the event of loss of any keys so furnished shall pay Landlord therefor.

8. If Tenant desires signal, communication, alarm or other utility or similar service connections installed or changed, Tenant shall not install or change the same without the prior approval of Landlord, and then only under Landlord's direction at Tenant's expense. Tenant shall not install in the Premises any equipment which requires more electric current than Landlord is required to provide under this Lease, without Landlord's prior written approval, and Tenant shall ascertain from Landlord the maximum amount of load or demand for or use of electrical current which can safely be permitted in the Premises, taking into account the capacity of electric wiring in the Building and the Premises and the needs of tenants of the Building, and shall not in any event connect a greater load than such safe capacity.

9. Tenant shall not obtain for use upon the Premises ice, drinking water, towel, janitorial and other similar services, except from Persons approved by Landlord in writing. Any Person engaged by Tenant to provide janitor or other services shall be subject to direction by the manager or security personnel of the Project.

10. The toilet rooms, urinals, washbowls and other such apparatus shall not be used for any purpose other than that for which they were constructed, and no foreign substance of any kind whatsoever shall be thrown therein, and the expense of any breakage, stoppage or damage resulting from the violation of this Rule shall be borne by Tenant who, or whose employees or invitees, shall have caused it. Tenant shall not cause any unnecessary labor by reason of Tenant's carelessness or indifference in the preservation of good order and cleanliness in and around the Project.

11. The janitorial closets, utility closets, telephone closets, broom closets, electrical closets, storage closets, and other such closets, rooms and areas shall be used only for the purposes and in the manner designated by Landlord, and may not be used by tenants, or their contractors, agents, employees, or other parties, without Landlord's prior written consent.

12. Landlord reserves the right to exclude or expel from the Project any person who, in the judgment of Landlord, is intoxicated or under the influence of liquor or drugs, or who shall in any manner do any act in violation of any of these Rules. Tenant shall not at any time manufacture, sell, use or give away, any spirituous, fermented, intoxicating or alcoholic liquors on the Premises, nor permit any of the same to occur (except in connection with occasional social or business events conducted in the Premises which do not violate any laws nor bother or annoy any other tenants). Tenant shall not at any time sell, purchase or give away food in any form by or to any of the other Tenant Parties or any other parties on the Premises, nor permit any of the same to occur (other than in lunchrooms or kitchens for employees).

13. Tenant shall not make any room-to-room canvass to solicit business or information or to distribute any article or material to or from other tenants or occupants of the Project and shall not exhibit, sell or offer to sell, use, rent or exchange any products or services in or from the Premises unless ordinarily embraced within the Tenant's use of the Premises specified in the Lease.

14. Tenant shall not waste electricity, water, heat or air conditioning or other utilities or services, and agrees to cooperate fully with Landlord to ensure the most effective and energy-efficient operation of the Project and shall not allow the adjustment (except by Landlord's authorized Project personnel) of any controls. Tenant shall keep corridor doors closed and shall not open any windows, except that if the air circulation shall not be in operation, windows which are openable may be opened with Landlord's consent. As a condition to claiming any deficiency in the air-conditioning or ventilation services provided by Landlord, Tenant shall close any blinds or drapes in the Premises to prevent or minimize direct sunlight.

15. Tenant shall conduct no auction, fire or "going out of business" sale or bankruptcy sale in or from the Premises, and such prohibition shall apply to Tenant's creditors.

16. Tenant shall cooperate and comply with any reasonable safety or security programs, including fire drills and air raid drills, and the appointment of "fire wardens" developed by Landlord for the Project, or required by law. Before leaving the Premises unattended, Tenant shall close and securely lock all doors or other means of entry to the Premises and shut off all lights and water faucets in the Premises (except heat to the extent necessary to prevent the freezing or bursting of pipes).

17. Tenant will comply with all municipal, county, state, federal or other governmental laws, statutes, codes, regulations and other requirements, including without limitation, environmental health, safety and police requirements and regulations respecting the Premises, now or hereinafter in force, at its sole cost, and will not use the Premises for any immoral purposes.

18. Tenant shall not (i) carry on any business, activity or service except those ordinarily embraced within the permitted use of the Premises specified in the Lease and more particularly, but without limiting the generality of the foregoing, shall not (ii) install or operate any internal combustion engine, boiler, machinery, refrigerating, heating or air conditioning equipment in or about the Premises except as permitted by the Lease, (iii) use the Premises for housing, lodging or sleeping purposes or for the washing of clothes, (iv) place any radio or television antennae other than inside of the Premises except as permitted by the Lease, (v) operate or permit to be operated any musical or sound producing instrument or device which may be heard outside the Premises, (vi) use any source of power other than electricity, (vii) operate any electrical or other device from which may emanate electrical or other waves which may interfere with or impair radio, television, microwave, or other broadcasting or reception from or in the Project or elsewhere, (viii) bring or permit any bicycle or other vehicle, or dog (except in the company of a blind person or except where specifically permitted) or other animal or bird in the Project, (ix) make or permit objectionable noise or odor to emanate from the Premises, (x) do anything in or about the Premises tending to create or maintain a nuisance or do any act tending to injure the reputation of the Project, (xi) throw or permit to be thrown or dropped any article from any window or other opening in the Building, (xii) use or permit upon the Premises anything that will invalidate or increase the rate of insurance on any policies of insurance now or hereafter carried on the Project or violate the certificates of occupancy issued for the Premises or the Project, (xiii) use the Premises for any purpose, or permit upon the Premises anything, that may be dangerous to persons or property (including but not limited to flammable oils, fluids, paints, chemicals, firearms or any explosive articles or materials), (xiv) do or permit anything to be done upon the Premises in any way tending to disturb any other tenant at the Project or the occupants of neighboring property, or (xv) at any time go upon the roof of the Building without prior approval from Landlord.

19. The following Rules shall apply regarding the parking area:

(i) Parking shall be available in areas designated generally for tenant parking. Tenant shall have card-key access to the parking facilities 24 hours a day, seven day a week. In all cases, parking for Tenant and the other Tenant Parties shall be on a "first come, first served," unassigned basis, with Landlord and other tenants at the Project, and their employees and visitors, and other Persons to whom Landlord shall grant the right or who shall otherwise have the right to use the same, all subject to these Rules, as the same may be amended or supplemented, and applied on a non-discriminatory basis. Notwithstanding the foregoing to the contrary, Landlord reserves the right to assign specific spaces, and to reserve spaces for visitors, small cars, handicapped individuals, and other tenants, visitors of tenants or other Persons, and Tenant Parties shall not park in any such assigned or reserved spaces. Landlord may restrict or prohibit full size vans and other large vehicles.

(ii) In case of any violation of these provisions, Landlord may refuse to permit the violator to park, and may remove the vehicle owned or driven by the violator from the Project without liability whatsoever, at such violator's risk and expense. Landlord reserves the right to temporarily close all or a portion of the parking areas or facilities in order to make repairs or perform maintenance services, or to alter, modify, re-stripe or renovate the same, or if required by casualty, strike, condemnation, act of God, law or governmental requirement, or any other reason beyond Landlord's reasonable control. In the event access is denied for any reason, any monthly parking charges shall be abated to the extent access is denied, as Tenant's sole recourse. Tenant acknowledges that such parking areas or facilities may be operated by an independent contractor not affiliated with Landlord, and Tenant acknowledges that in such event, Landlord shall have no liability for claims arising through acts or omissions of such independent contractor.

(iii) Normal business hours for the Project shall be 7 A.M. to 6 P.M., Monday through Friday, and 9:00 A.M. to 12:00 P.M. on Saturdays, or such other hours as may be reasonably established by Landlord or its parking operator from time to time. During such normal business hours, cars must be parked entirely within the stall lines, and only small cars may be parked in areas reserved for small or compact cars; all directional signs and arrows must be observed; the speed limit shall be 5 miles per hour; spaces reserved for handicapped parking must be used only by vehicles properly designated; every parker is required to park and lock his own car; washing, waxing, cleaning or servicing of any vehicle is prohibited; parking spaces may be used only for parking automobiles; parking is prohibited in areas: (a) not striped or designated for parking, (b) aisles, (c) where "no parking" signs are posted, (d) on ramps, and (e) loading areas and other specially designated areas. Delivery trucks and vehicles shall use only those areas designated therefor.

20. The directory of the Building will be provided for the display of the name and location of tenants only, and Landlord reserves the right to exclude any other names therefrom. Any additional name that Tenant shall desire to be placed upon the directory must first be approved by Landlord, and if so approved, a charge will be made therefore.

21. There is no storage of any kind permitted in the parking facilities. **No storage of any kind is permitted in the parking garage. The garage area shall be used for the parking of operable motor vehicles and bicycles (in designated bike areas) only.**

22. Landlord may waive any one or more of these Rules for the benefit of a particular tenant, but no such waiver by Landlord shall be construed as a waiver of these Rules in favor of any other tenant nor prevent Landlord from thereafter enforcing any such Rules against any or all of the tenants of the building.

23. Landlord reserves the right to make such other and reasonable rules as in its sole and absolute discretion may from time to time be needed for the safety, care, efficiency, cleanliness, management and operation of the building, and for the preservation of good order therein; provided, however, that no such changes shall interfere with Tenant's permitted use of the Premises. In the event of a conflict between these Rules and Regulations and the Lease, the Lease shall control.

EXHIBIT F

SECOND FLOOR BUILD OUT PLANS

[Intentionally Omitted]

EXHIBIT 31.1

CHIEF EXECUTIVE OFFICER CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Martin S. Hughes, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Redwood Trust, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over the financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 3, 2011

/s/ Martin S. Hughes

Martin S. Hughes
President and Chief Executive Officer

EXHIBIT 31.2

CHIEF FINANCIAL OFFICER CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Diane L. Merdian, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Redwood Trust, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over the financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 3, 2011

/s/ Diane L. Merdian

Diane L. Merdian
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION

Pursuant to 18 U.S.C. §1350, the undersigned officer of Redwood Trust, Inc. (the "Registrant") hereby certifies that the Registrant's Quarterly Report on Form 10-Q for the three months ended September 30, 2011 (the "Quarterly Report") fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Date: November 3, 2011

/s/ Martin S. Hughes
____
Martin S. Hughes
President and Chief Executive Officer

The foregoing certification is being furnished solely pursuant to 18 U.S.C. §1350 and is not being filed as part of the Quarterly Report or as a separate disclosure document.

EXHIBIT 32.2

CERTIFICATION

Pursuant to 18 U.S.C. §1350, the undersigned officer of Redwood Trust, Inc. (the “Registrant”) hereby certifies that the Registrant’s Quarterly Report on Form 10-Q for the three months ended September 30, 2011 (the “Quarterly Report”) fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Date: November 3, 2011

/s/ Diane L. Merdian

Diane L. Merdian
Chief Financial Officer

The foregoing certification is being furnished solely pursuant to 18 U.S.C. §1350 and is not being filed as part of the Quarterly Report or as a separate disclosure document.