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

FORM 10-K

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

FOR THE FISCAL YEAR ENDED: DECEMBER 31, 1997

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.)

591 REDWOOD HIGHWAY, SUITE 3100

MILL VALLEY, CALIFORNIA	94941
(Address of principal executive offices)	(Zip Code)

(415) 389-7373
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:	Name of Exchange on Which Registered:
CLASS B 9.74 % CUMULATIVE CONVERTIBLE PREFERRED STOCK, PAR VALUE $0.01 PER SHARE (Title of Class)	NEW YORK STOCK EXCHANGE
COMMON STOCK, PAR VALUE $0.01 PER SHARE (Title of Class)	NEW YORK STOCK EXCHANGE

Securities registered pursuant to Section 12(g) of the Act:
NONE

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 [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

At March 11, 1998 the aggregate market value of the voting stock held by non-affiliates of the Registrant was $224,761,545.

The number of shares of the Registrant's Common Stock outstanding on March 11, 1998 was 14,070,557.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement issued in connection with the 1998 Annual Meeting of Stockholders are incorporated by reference into Part III.

REDWOOD TRUST, INC.
1997 FORM 10-K ANNUAL REPORT

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PART I

ITEM 1. BUSINESS

THE COMPANY

Redwood Trust, Inc. (the "Company") was incorporated in the State of Maryland on April 11, 1994 and commenced operations on August 19, 1994. It invests in mortgage loans and securities (together "Mortgage Assets") financed by the proceeds of equity offerings and by borrowings. The Company produces net interest income on Mortgage Assets qualifying as Qualified Real Estate Investment Trust ("REIT") Real Estate Assets while maintaining strict cost controls in order to generate net income for distribution to its stockholders. The Company intends to continue operating in a manner that will permit it to maintain its qualification as a REIT for Federal and State income tax purposes. As a result of its REIT status, the Company is permitted to deduct dividend distributions to stockholders, thereby effectively eliminating the "double taxation" that generally results when a corporation earns income and distributes that income to stockholders in the form of dividends. See "Certain Federal Income Tax Considerations" commencing on page 20 of this Form 10-K. The principal executive offices of the Company are located at 591 Redwood Highway, Suite 3100, Mill Valley, California 94941, telephone (415) 389-7373. The address of the Company's Web site is http://www.redwoodtrust.com. The Company is self-advised and self-managed.

Statements in this report regarding the Company's business which are not historical facts are "forward-looking statements" as contemplated in the Private Securities Litigation Reform Act of 1995. Such statements should be read in light of the risks and uncertainties attendant to the business of the Company, including, without limitation, risks of substantial leverage and potential net interest and operating losses in connection with borrowings, risk of decrease in net interest income due to interest rate fluctuations, prepayment risks of Mortgage Assets, risk of failing to hedge against interest rate changes effectively, risk of loss associated with hedging, counterparty risks, risk of loss due to default on Mortgage Assets and risk of failure to maintain REIT status and being subject to tax as a regular corporation. For a complete description of these and other risks associated with the business of the Company, see "Risk Factors" commencing on page 27 of this Form 10-K.

Reference is made to the Glossary commencing on page 83 of this report

for definitions of terms used in the following description of the Company's business and elsewhere in this report.

BUSINESS AND STRATEGY

The Company's principal business objective is to produce net interest income on its Mortgage Assets while maintaining strict cost controls in order to generate net income for distribution to stockholders. The Company seeks to distribute dividends to stockholders at levels that generally adjust in the same direction, following a lag period, with changes in short-term market interest rates and that may increase over time in the event of improvements in the real estate markets or in operating efficiencies. To achieve its business objective and generate dividend yields that provide a relatively attractive rate of return for stockholders, the Company's strategy is:

- to purchase Single-Family Mortgage Assets, the majority of which have had adjustable interest rates based on changes in short-term market interest rates;
- to manage the credit risk of its Mortgage Assets through, among other activities, (i) carefully selecting Mortgage Assets to be acquired, including an underwriting review of Mortgage Loans and lower-rated Mortgage Securities, (ii) following the Company's policies with respect to credit risk concentration which, among other things, require the Company to maintain a Mortgage Asset portfolio with a weighted average credit rating level of A- or better, (iii) actively monitoring the ongoing credit quality and servicing of its Mortgage Assets, and (iv) maintaining appropriate capital levels and reserves for possible credit losses;

- to finance such purchases with the proceeds of equity offerings and, to the extent permitted by the Company's capital and liquidity policies, to utilize leverage to increase potential returns to stockholders through borrowings;
- to attempt to structure its borrowings to have interest rate adjustment indices and interest rate adjustment periods that, on an aggregate basis, generally correspond to the interest rate adjustment indices and interest rate adjustment periods of the adjustable-rate Mortgage Assets purchased by the Company;
- to utilize interest rate caps, swaps, futures and similar instruments to mitigate the risk of the cost of its liabilities increasing relative to the earnings on Mortgage Assets;
- to seek to minimize prepayment risk by structuring a diversified portfolio with a variety of prepayment characteristics, through hedging, and through other means;
- to apply securitization techniques designed to enhance the value and liquidity of the Company's Mortgage Assets acquired in the form of Mortgage Loans by securitizing them into Mortgage Securities that are tailored to the Company's objectives;
- to re-securitize portions of its Mortgage Securities portfolio when the underlying Mortgage Loans have improved in credit quality through seasoning or rising underlying property values, or when the credit quality of a junior class of security improves due to the prepayment of more senior classes, as such re-securitization transactions may result in improved credit ratings, higher market values and lowered borrowing costs;
- to use Mortgage Assets to collateralize the issuance of long term collateralized mortgage bonds and other forms of long-term financing;
- to add staff to seek to increase the Company's ability to source Mortgage Assets in a value-added manner;
- to broaden the scope of its mortgage acquisitions over time to include hybrid ARM and fixed rate single-family mortgages, multifamily mortgages and commercial mortgages when management deems such purchases to be in the best interests of shareholders;
- to strive to become more cost-efficient and capital-efficient over time; and
- to pursue other opportunities in mortgage finance when management deems such activities to be in the best interest of shareholders.

The Company believes that its principal competition in the business of

acquiring and managing Mortgage Assets are financial institutions such as banks, savings and loans, life insurance companies, government-sponsored entities ("GSE's"), institutional investors such as mutual funds and pension funds, and certain other mortgage REITs. While many of these entities have significantly greater resources than the Company, the Company anticipates that it will be able to compete effectively due to its relatively low level of operating costs, relative freedom to securitize its assets, ability to utilize prudent amounts of leverage through accessing the wholesale market for collateralized borrowings, freedom from certain forms of regulation and the tax advantages of its REIT status.

The Company believes it is and plans to continue to be a "low cost producer" compared to most of its competitors in the business of holding Mortgage Assets. Accordingly, the Company plans to generate relatively attractive earnings and dividends while holding Mortgage Assets of higher credit quality and maintaining a lower interest rate risk profile as compared to its principal competitors. The Company will attempt to be increasingly cost-efficient by: (i) seeking to raise additional capital from time to time in order to increase its ability to invest in Mortgage Assets, as operating costs are not anticipated to increase as quickly as Mortgage Assets and because growth will increase the Company's purchasing influence with suppliers of Mortgage Assets; (ii) striving to

lower its effective borrowing costs over time through direct funding with collateralized lenders rather than using Wall Street intermediaries or by using commercial paper and medium term note programs; (iii) improving the efficiency of its balance sheet structure by investigating the issuance of various forms of debt and capital; and (iv) utilizing information technology to the fullest extent possible in its business, which technology the Company believes can be developed to improve the Company's ability to monitor the performance of its Mortgage Assets, improve its ability to assess credit risk, improve hedge efficiency and lower operating costs.

MORTGAGE ASSETS

General

The Mortgage Assets purchased by the Company may consist of Single-Family, Multifamily and Commercial Mortgage Assets. Although all of the Company's Mortgage Assets purchased through December 31, 1997 were Single-Family Mortgage Assets, the Company may acquire Multifamily Mortgage Assets and Commercial Mortgage Assets from time to time in the future when consistent with its Asset Acquisition/Capital Allocation Policies. Through the end of 1997, all Mortgage Assets acquired by the Company bore adjustable interest rates. Hybrid ARMS, with an initial period to the first rate adjustment greater than one year, made up 1.6% of Mortgage Assets. Fixed-rate Mortgage Assets may be acquired in the future, when they satisfy the Company's Asset Acquisition/Capital Allocation and asset/liability management Policies and management believes they will contribute to the Company's business objectives with respect to desired levels of income and dividend distributions. From time to time, the Company may also acquire common stock in other REITs that invest primarily in Mortgage Assets if the Company believes the potential returns on such common stock are good and such opportunities are as favorable or more favorable than investing in Mortgage Assets directly. The Company may also acquire its own stock, when permitted by applicable securities and state corporation laws.

The Company expects that a majority of its Mortgage Assets will continue to have investment grade ratings (the four highest rating levels) from one or more nationally recognized mortgage security rating agencies or be deemed by the Company to be of comparable credit quality. Based upon the Company's investment strategy and the guidelines under the Company's Asset Acquisition/Capital Allocation Policies, the Company expects that the weighted average rating of its Mortgage Assets (including the Company's deemed equivalent ratings for unrated Mortgage Assets) will be at the "A-" rating level or better under Standard and Poor's Corporation ("S&P") rating system and at the comparable level under other rating systems.

The Company has not acquired residuals, interest-only strips, principal-only strips, inverse floaters, companion bonds, first loss Subordinated Bonds rated below BBB or mortgage securities rated below B, except on a limited basis. The Company expects that the Company's focus will continue to be on the acquisition of Mortgage Loans and Mortgage Securities of a pass-thru nature rather than on the acquisition of these types of assets. The Company may seek to acquire additional mortgage securities rated below AA, including securities rated below B. The Company may create a variety of different types of assets, including the types mentioned in this paragraph, through the normal process of securitization of the Company's own Mortgage Assets.

The Company does not plan to create taxable mortgage pools or acquire or retain any Real Estate Mortgage Investment Conduit ("REMIC") residual interest that may give rise to the distribution to shareholders of "excess inclusion" income as defined under Section 860E of the Code. See "Certain Federal Income Tax Considerations - Taxation of Tax-Exempt Entities."

The Company's Asset Acquisition/Capital Allocation Policies utilize a return on equity calculation that includes adjustments for credit risk, borrowing costs, the cost of associated interest rate agreements (e.g., caps, swaps and futures) and the Risk-Adjusted Capital Policy requirements. The relative attractiveness of various asset types will vary over time. The Company may acquire its Mortgage Assets in the secondary mortgage market or upon origination pursuant to arrangements with loan originators. Purchases of Mortgage Assets in the secondary market generally are from national broker/dealer firms or other large financial institutions. The Company may issue Commitments to originators and other sellers of Mortgage Loans who it believes follow prudent origination policies and procedures and comply with all applicable federal and state laws and regulations for origination of Mortgage Loans. In addition, the Company may issue Commitments for Mortgage Securities. These Commitments will obligate the Company to purchase Mortgage Assets from the holders of the Commitment for a specific period of time, in a specific aggregate principal amount and at a specified price and margin over an

index. Following the issuance of Commitments, the Company will be exposed to risks of interest rate fluctuations similar to those risks on the Company's adjustable-rate Mortgage Assets. As described below under "Management Policies and Programs - Mortgage Loan Securitization Techniques," the Company works with loan originators, conduits and other issuers of Mortgage Securities and their investment bankers to acquire and securitize Mortgage Loans in a manner that best meets the needs of the Company. Such activity may involve the issuance of Commitments by the Company.

The "face value" of Mortgage Assets represents the outstanding principal balance of the Mortgage Loans or Mortgage Securities comprising the Mortgage Assets, and "amortized cost" means the purchase prices paid for the Mortgage Assets adjusted to reflect (i) amortization of discounts or premiums and (ii) principal repayments. Mortgage Assets are carried on the balance sheet at what is referred to by the Company as "carrying value." "Carrying value" for the Mortgage Securities is management's estimate of the bid side of the market value for such assets. "Carrying value" for Mortgage Loans is amortized cost net of any specific credit reserves on such Mortgage Loans. Management usually bases its estimates on the lowest of third-party bid-side indications of market value for Mortgage Securities obtained from firms making a market in or lending against Mortgage Securities. Generally, such indications are solicited by the Company on a monthly basis and from time to time in connection with the Company's borrowing activities and the lowest of such indications with respect to a Mortgage Security generally comes from the secured lender on that asset. To the extent that such bid-side indications typically are below the amortized cost of Mortgage Securities (net of any specific credit reserves on such Mortgage Securities), the difference is referred to as unrealized losses, and, to the extent that such indications exceed the amortized cost (net of any specific credit reserves), the difference is referred to as unrealized gains. The net amount of such unrealized gains and losses is reflected on the balance sheet as a valuation adjustment to Stockholders' Equity under the caption "Net Unrealized Gain or Loss on Assets Available for Sale." To determine the fair market value of the Company's Mortgage Loans as reported in "Note 9: Fair Value of Financial Instruments", management uses the same process as described above for Mortgage Securities.

All of the Mortgage Loans underlying the Company's Mortgage Assets at December 31, 1997 were being serviced by third-party servicers unrelated to the Company. The Company's Mortgage Securities are held by either Mellon Bank, N.A., pursuant to a Custody Agreement dated August 22, 1994 or by Bankers Trust, pursuant to a Clearance Agreement dated December 1, 1996.

TYPES OF MORTGAGE ASSETS

The various types of Mortgage Assets the Company may purchase are summarized below.

Single-Family and Multifamily Mortgage Assets

Single-Family Mortgage Loans. The Company may acquire both Conforming Mortgage Loans and Non-conforming Mortgage Loans. Conventional Conforming Mortgage Loans will comply with the requirements for inclusion in a loan guarantee program sponsored by either the Federal Home Loan Mortgage Corporation ("FHLMC") or the Federal National

Mortgage Association ("FNMA"). The Company also may acquire United States Federal Housing Administration ("FHA") Loans or United States Department of Veteran Affairs ("VA") Loans, which qualify for inclusion in a pool of Mortgage Loans guaranteed by GNMA. As of January 1, 1998, the maximum principal balance allowed on Conforming Mortgage Loans ranges from $227,150 ($340,725 for Mortgage Loans secured by Mortgaged Properties located in either Alaska or Hawaii) for one-unit to $436,600 ($654,900 for Mortgage Loans secured by mortgaged properties located in either Alaska or Hawaii) for four-unit residential loans. Non-conforming Single-Family Mortgage Loans are Single-Family Mortgage Loans that do not qualify in one or more respects for purchase by FNMA or FHLMC. The Company expects that a majority of the Non-conforming Mortgage Loans it purchases will be non-conforming because they have original principal balances which exceed the requirements for FHLMC or FNMA programs or generally because they vary in certain other respects from the requirements of such programs other than the requirement relating to creditworthiness of the mortgagors. A substantial portion of the Company's Non-conforming Mortgage Loans are expected to meet the requirements for sale to national private mortgage conduit programs in the secondary mortgage market.

The Company currently expects that substantial amount of the Single-Family Mortgage Loans acquired by it will be adjustable-rate mortgages ("ARMs"). The interest rate on an ARM is typically tied to an index (such as the London Interbank Offered Rate ("LIBOR") or the interest rate on United States Treasury Bills), and is adjustable periodically at various intervals. Such Mortgage Loans are typically subject to lifetime interest rate caps and periodic interest rate and/or payment caps. Some ARMs have relatively long first periods during which the mortgage coupon rate is fixed, after which the mortgage coupon will change in an adjustable fashion ("Hybrid ARMS"). Initial fixed periods for Hybrid ARMS typically range from three to ten years. The Company expects it will also acquire hybrid and fixed-rate Single-Family Mortgage Loans.

Multifamily Mortgage Loans. Multifamily Mortgage Loans generally involve larger principal amounts per loan than Single-Family Mortgage Loans and require more complex credit and property evaluation analyses. Multifamily Mortgage Loans share many of the characteristics and risks associated with Commercial Mortgage Loans and are often categorized as commercial loans rather than residential loans. For example, the credit quality of a Multifamily Mortgage Loan typically depends upon the existence and terms of underlying leases, tenant credit quality and the historical and anticipated level of vacancies and rents on the mortgaged property and on the competitive market condition of the mortgaged property relative to other competitive properties in the same region, among other factors. Multifamily Mortgage Loans, however, constitute 'qualified mortgages" for purposes of the REMIC regulations and the favorable tax treatment associated therewith and, when securitized, certain of the resulting rated classes of Multifamily Mortgage Securities qualify as "mortgage-related securities" and for the favorable treatment awarded such securities under the Secondary Mortgage Market Enhancement Act of 1984 ("SMMEA").

Single-Family and Multifamily Mortgage Securities. The Mortgage Assets purchased by the Company are expected to include Single-Family and Multi-Family Mortgage Securities. In addition, the Company expects to pool and exchange a substantial portion of its Single-Family and Multifamily Mortgage Loans for Single- Family and Multifamily Mortgage Securities, respectively, which it may then hold for investment, sell or pledge to secure borrowings. The types of Single-Family and Multifamily Mortgage Securities that the Company may purchase or receive in exchange for its Single-Family and Multifamily Mortgage Loans are described below.

Single-Family and Multifamily Privately-Issued Certificates. Single-Family and Multifamily Privately-Issued Certificates are Pass-Through Certificates that are not issued by one of the Agencies and that are backed by a pool of conventional Single-Family or Multifamily Mortgage Loans, respectively. Single-Family and Multifamily Privately-Issued Certificates are issued by originators of, investors in, and other owners of Mortgage Loans, including savings and loan associations, savings banks, commercial banks, mortgage banks, investment banks and special purpose "conduit" subsidiaries of such institutions.

While Agency Certificates are backed by the express obligation of guarantee of one of the Agencies, as described below, Single-Family and Multifamily Privately-Issued Certificates are generally covered by one or more forms of private (i.e.,. non-governmental) credit enhancements. Such credit enhancements provide an extra layer of loss coverage in the event that losses are incurred upon foreclosure sales or other liquidations of underlying mortgaged properties in amounts that exceed the holder's equity interest in the property and result in Realized

Losses. Forms of credit enhancements include, but are not limited to, limited issuer guarantees, reserve funds, private mortgage guaranty pool insurance, over-collateralization and subordination.

Subordination is a form of credit enhancement frequently used and involves the issuance of multiple classes of Senior-Subordinated Mortgage Securities. Such classes are structured into a hierarchy of levels for purposes of allocating Realized Losses and also for defining priority of rights to payment of principal and interest. Typically, one or more classes of Senior Securities are created which are rated in one of the two highest rating levels by one or more nationally recognized rating agencies and which are supported by one or more classes of Mezzanine Securities and Subordinated Securities that bear Realized Losses prior to the classes of Senior Securities. Mezzanine Securities refer to any classes that are rated below the two highest levels but no lower than a single "B" level under the S&P rating system (or comparable level under other rating systems) and are supported by one or more classes of Subordinated Securities which bear Realized Losses prior to the classes of Mezzanine Securities. As used herein, Subordinated Securities will refer to any class that bears the "first loss" from Realized Losses or that is rated below a single "B" level (or, if unrated, is deemed by the Company to be below such level based on a comparison of characteristics of such class with other rated Subordinated Securities

with like characteristics). In some cases, only classes of Senior Securities and Subordinated Securities are issued. By adjusting the priority of interest and principal payments on each class of a given series of Senior-Subordinated Securities, issuers are able to create classes of Mortgage Securities with varying degrees of credit exposure, prepayment exposure and potential total return, tailored to meet the needs of sophisticated institutional investors.

The Company may purchase Single-Family and Multifamily Privately-Issued Certificates in the secondary market. The Company may also acquire Single-Family and Multifamily Privately-Issued Certificates by pooling and exchanging some of its Single-Family and Multifamily Mortgage Loans, respectively, for such securities. In connection with exchanging its Single-Family and Multifamily Mortgage Loans for Single-Family and Multifamily Privately-Issued Certificates, the Company may retain some or all classes resulting therefrom, including Mezzanine Securities and Subordinated Securities. In cases where the Company retains such junior classes, the Company will continue to be exposed to the various risks of loss associated with the entire pool of underlying Mortgage Loans.

GNMA Certificates. The Government National Mortgage Association ("GNMA") is a wholly-owned corporate instrumentality of the United States within the Department of Housing and Urban Development ("HUD"). Section 306(g) of Title III of the National Housing Act of 1934, as amended (the "Housing Act"), authorizes GNMA to guarantee the timely payment of the principal and interest on certificates which represent an interest in a pool of mortgages insured by the VA under the Servicemen's Readjustment Act of 1944, as amended, or Chapter 37 of Title 38, United States Code and other loans eligible for inclusion in mortgage pools underlying GNMA Certificates. Section 306(g) of the Housing Act provides that "the full faith and credit of the United States is pledged to the payment of all amounts which may be required to be paid under any guaranty under this subsection." An opinion, dated December 12, 1969, of an Assistant Attorney General of the United States provides that such guarantees under section 306(g) of GNMA Certificates of the type which may be purchased or received in exchange by the Company are authorized to be made by GNMA and "would constitute general obligations of the United States backed by its full faith and credit."

At present, all GNMA Certificates are backed by Single-Family Mortgage Loans. The interest rate paid on GNMA Certificates may be fixed rate or adjustable rate. The interest rate on GNMA Certificates issued under GNMA's standard ARM program adjusts annually in relation to the Treasury Index. Interest rates paid on GNMA ARM Certificates typically equal the index rate plus 150 basis points. Adjustments in the interest rate are generally limited to an annual increase or decrease of 1% and to a lifetime cap of 5% over the initial interest rate.

FNMA Certificates. FNMA is a privately-owned, GSE organized and existing under the Federal National Mortgage Association Charter Act (12 U.S.C. 1716 et seq.). FNMA provides funds to the mortgage market primarily by purchasing residential Mortgage Loans from local lenders, thereby replenishing their funds for additional lending. FNMA guarantees to the registered holder of a FNMA Certificate that it will distribute amounts representing scheduled principal and interest (at the rate provided by the FNMA Certificate) on the Mortgage Loans in the pool underlying the FNMA Certificate, whether or not received, and the

full principal amount of any such mortgaged loan foreclosed or otherwise finally liquidated, whether or not the principal amount is actually received. The obligations of FNMA under its guarantees are solely those of FNMA and are not backed by the full faith and credit of the United States. If FNMA were unable to satisfy such obligations, distributions to holders of FNMA Certificates would consist solely of payments and other recoveries on the underlying Mortgage Loans and, accordingly, monthly distributions to holders of FNMA Certificates would be affected by delinquent payments and defaults on such Mortgage Loans.

FNMA Certificates may be backed by pools of Single-Family or Multifamily Mortgage Loans. The original terms to maturities of the Mortgage Loans generally do not exceed 40 years. FNMA Certificates may pay interest at a fixed rate or adjustable rate. Each series of FNMA ARM Certificates bears an initial interest rate and margin tied to an index based on all loans in the related pool, less a fixed percentage representing servicing compensation and FNMA's guarantee fee. The specified index used in each such series has included the Treasury Index, the 11th District Cost of Funds Index published by the Federal Home Loan Bank of San Francisco ("COFI"), LIBOR and other indices. In addition, the majority of series of FNMA ARM Certificates issued to date have evidenced pools of Mortgage Loans with monthly, semi-annual or annual interest rate

adjustments. Certain FNMA programs include Mortgage Loans which allow the borrower to convert the adjustable mortgage interest rate to a fixed rate. ARMs which are converted into fixed rate Mortgage Loans are repurchased by FNMA or by the seller of such loans to FNMA at the unpaid principal balance thereof plus accrued interest to the due date of the last adjustable rate interest payment. Adjustments to the interest rates on FNMA ARM Certificates are typically subject to lifetime interest rate caps and periodic interest rate and/or payment caps.

FHLMC Certificates. FHLMC is a privately-owned, GSE created pursuant to an Act of Congress (Title III of the Emergency Home Finance Act of 1970, as amended, 12 U.S.C. 1451-1459), on July 24, 1970. The principal activity of FHLMC currently consists of the purchase of conventional Conforming Mortgage Loans or participation interests therein and the resale of the loans and participations so purchased in the form of guaranteed mortgage securities. FHLMC guarantees to each holder of FHLMC Certificates the timely payment of interest at the applicable pass-through rate and ultimate collection of all principal on the holder's pro rata share of the unpaid principal balance of the related Mortgage Loans, but does not guarantee the timely payment of scheduled principal of the underlying Mortgage Loans. The obligations of FHLMC under its guarantees are solely those of FHLMC and are not backed by the full faith and credit of the United States. If FHLMC were unable to satisfy such obligations, distributions to holders of FHLMC Certificates would consist solely of payments and other recoveries on the underlying Mortgage Loans and, accordingly, monthly distributions to holders of FHLMC Certificates would be affected by delinquent payments and defaults on such Mortgage Loans.

FHLMC Certificates may be backed by pools of Single-Family or Multifamily Mortgage Loans. Such underlying Mortgage Loans may have original terms to maturity of up to 40 years. FHLMC Certificates may be issued under cash programs (composed of Mortgage Loans purchased from a number of sellers) or guarantor programs (composed of Mortgage Loans purchased from one seller in exchange for participation certificates representing interests in the Mortgage Loans purchased). FHLMC Certificates may pay interest at a fixed rate or adjustable rate. The interest rate paid on FHLMC ARM Certificates adjusts periodically within 60 days prior to the month in which the interest rates on the underlying Mortgage Loans adjust. The interest rates paid on FHLMC ARM Certificates issued under FHLMC's standard ARM programs adjust in relation to the Treasury Index. Other specified indices used in FHLMC ARM Programs include COFI, LIBOR and other indices. Interest rates paid on fully-indexed FHLMC ARM Certificates equal the applicable index rate plus a specified number of basis points ranging typically from 125 to 250 basis points. In addition, the majority of series of FHLMC ARM Certificates issued to date have evidenced pools of Mortgage Loans with monthly, semi-annual or annual interest adjustments. Adjustments in the interest rates paid are generally limited to an annual increase or decrease of either 1% or 2% and to a lifetime cap of 5% or 6% over the initial interest rate. Certain FHLMC programs include Mortgage Loans which allow the borrower to convert the adjustable mortgage interest rate to a fixed rate. ARMs which are converted into fixed rate Mortgage Loans are repurchased by FHLMC or by the seller of such loans to FHLMC at the unpaid principal balance thereof plus accrued interest to the due date of the last adjustable rate interest payment.

Single-Family and Multifamily Collateralized Mortgage Obligations ("CMOs"). The Company may, from time to time, invest in adjustable- or

fixed-rate Single-Family and Multifamily CMOs. Single-Family and Multifamily CMOs ordinarily are issued in series, each of which consists of several serially maturing classes ratably secured by a single pool of Single-Family or Multifamily Mortgage Loans or Single-Family or Multifamily Privately-Issued Certificates. Generally, principal payments received on the mortgage-related assets securing a series of CMOs, including prepayments on such mortgage-related assets, are applied to principal payments on one or more classes of the CMOs of such series on each principal payment date for such CMOs. Scheduled payments of principal and interest on the mortgage-related assets and other collateral securing a series of CMOs are intended to be sufficient to make timely payments of interest on such CMOs and to retire each class of such CMOs by its stated maturity. By allocating the principal and interest cash flows from the underlying collateral among the separate CMO classes, different classes (referred to as "tranches") of bonds are created, each with its own stated maturity, estimated average life, coupon rate and prepayment characteristics.

Principal prepayments on the mortgage-related assets underlying a CMO issue may cause different tranches of a CMO issue to be retired substantially earlier than their stated maturities or final distribution dates. Interest

generally is paid or accrues on interest-bearing classes of CMOs on a monthly, quarterly or semi-annual basis. The principal of and interest on the underlying mortgage-related assets may be allocated among the several classes of a CMO issue in a variety of ways. One type of CMO issue is one in which payments of principal, including any principal prepayments, on the mortgage-related asset are applied to the classes of CMOs in order of their respective stated maturities or final distribution dates, so that no payment of principal will be made on any class of the series until all other classes having an earlier stated maturity or final distribution date have been paid in full.

Other types of CMO issues include classes such as parallel pay CMOs some of which, such as Planned Amortization Class CMOs ("PAC Bonds"), provide protection against prepayment uncertainty. Parallel pay CMOs are structured to provide payments of principal on certain payment dates to more than one class. These simultaneous payments are taken into account in calculating the stated maturity date or final distribution date of each class which, as with other CMO structures, must be retired by its stated maturity date or final distribution date but may be retired earlier. PAC Bonds generally require payment of a specified amount of principal on each payment date so long as prepayment speeds on the underlying collateral fall within a specified range. PAC Bonds are always parallel pay CMOs with the required principal payment on such securities having the highest priority after interest has been paid to all classes.

Other types of CMO issues include Targeted Amortization Class CMOs ("TAC Bonds"), which are similar to PAC Bonds. While PAC Bonds maintain their amortization schedule within a specified range of prepayment speeds, TAC Bonds are generally targeted to a narrow range of prepayment speeds or a specified pricing speed. TAC Bonds can provide protection against prepayment uncertainty since cash flows generated from higher prepayments of the underlying mortgage-related assets are applied to the various other pass-through tranches so as to allow the TAC Bonds to maintain their amortization schedule.

CMOs may be subject to certain rights of issuers thereof to redeem such CMOs prior to their stated maturity dates, which may have the effect of diminishing the Company's anticipated return on its investment. Privately-Issued Single-Family and Multifamily CMOs are supported by private credit enhancements similar to those used for Privately-Issued Certificates and are often issued as Senior-Subordinated Mortgage Securities. The Company will only acquire CMOs that constitute beneficial ownership in grantor trusts holding Mortgage Loans, or regular interests in REMICs, or that otherwise constitute Qualified REIT Real Estate Assets (provided that the Company has obtained a favorable opinion of counsel or a ruling from the Internal Revenue Service ("IRS") to that effect).

Commercial Mortgage Assets

Commercial Mortgage Loans. Commercial Mortgage Loans are secured by commercial properties, such as industrial and warehouse properties, office buildings, retail space and shopping malls, hotels and motels, hospitals, nursing homes and senior living centers. Commercial Mortgage Loans have certain distinct risk characteristics: existing Commercial Mortgage Loans generally lack standardized terms, which may complicate their structure (although certain of the new conduits are introducing standard form documents for use in their programs); Commercial Mortgage Loans tend to have shorter maturities than Single-Family Mortgage Loans; they may not be fully amortizing, meaning that they may have a significant principal balance or "balloon" due on maturity; and

commercial properties, particularly industrial and warehouse properties, are generally subject to relatively greater environmental risks than non-commercial properties and the corresponding burdens and costs of compliance with environmental laws and regulations.

Unlike most Single-Family Mortgage Loans, Commercial Mortgage Loans generally utilize yield maintenance agreements to impose penalties on prepayments of principal that compensate mortgagees, in part or in full, for the possibility of lower interest lending rates that may be applicable at the time of prepayment. Commercial Mortgage Loans may also contain prohibitions, at least for a period of time following origination, on principal prepayments. Such prepayment penalties and prohibitions tend to reduce the likelihood of prepayments on Commercial Mortgage Loans as compared to Single-Family Mortgage Loans.

The credit quality of a Commercial Mortgage Loan may depend on, among other factors, the existence and structure of underlying leases, deferred maintenance on the property or physical condition of the property, the creditworthiness of tenants, the historical and anticipated level of vacancies and rents on the property and on

other comparable properties located in the same region, potential or existing environmental risks and the local and regional economic climate in general. Primary indicators of credit quality on a Commercial Mortgage Loan are the debt service coverage, i.e., the ratio of current net operating income on a commercial property to the current debt service obligation on the same property, and the loan-to-value ratio, both of which generally are examined by the rating agencies from the perspective of a variety of worst-case scenarios. Loan-to-value analysis is particularly important in the case of Commercial Mortgage Loans because many are non-recourse to the borrower and therefore the value of the property will determine the amount of loss in the event of default. Foreclosures of defaulted Commercial Mortgage Loans are generally subject to a number of complicating factors not present in foreclosures of Single-Family Mortgage Loans.

The Company may buy or originate Commercial Loans. The Company will only acquire Commercial Mortgage Loans when it believes it has the necessary expertise to evaluate and manage them and only if they are consistent with the Company's Asset Acquisition/Capital Allocation Policies.

Commercial Mortgage Securities. Commercial Mortgage Securities are securities that represent an interest in, or are secured by, Commercial Mortgage Loans. Commercial Mortgage Securities generally have been structured as Pass-Through Certificates with private (i.e., non-governmental) credit enhancements ("Commercial Privately-Issued Certificates") or as CMOs ("Commercial CMOs"). Commercial Mortgage Securities may pay adjustable rates of interest. Because of the great diversity in characteristics of the Commercial Mortgage Loans that secure or underlie Commercial Mortgage Securities, however, such securities will also have diverse characteristics. Although many Commercial Mortgage Securities are backed by large pools of Commercial Mortgage Loans with relatively small individual principal balances, Commercial Mortgage Securities may be backed by Commercial Mortgage Loans collateralized by only a few commercial properties or a single commercial property. Because the risk involved in single commercial property financings is highly concentrated, single-property Commercial Mortgage Securities to date have tended to be limited to extremely desirable commercial properties with excellent values and/or lease agreements with extremely creditworthy and reliable tenants, such as major corporations.

Commercial Mortgage Securities generally are structured with some form of private credit enhancement to protect against potential Realized Losses on the underlying Mortgage Assets. As with Single-Family Mortgage Securities, such credit enhancements provide an extra layer of loss coverage in cases where the equityholder's equity interest in the underlying mortgaged property has been completely extinguished. Because of the particular risks that accompany Commercial Mortgage Securities, the required amount and corresponding cost of such credit support may be significant. Credit supports used in the Commercial Mortgage Securities market have included, but have not been limited to, limited issuer guarantees, reserve funds, Subordinated Securities (which bear the risks of default before more senior classes of securities of the same issuer), cross-collateralization, over-collateralization, cross-default provisions, subordination and letters of credit. The Company expects that multiple-class structures, featuring Senior-Subordinated Mortgage Securities, will continue to be the most common form of credit enhancement used in the Commercial Mortgage Securities markets. In addition to credit support, Commercial Mortgage Securities may be structured with liquidity protections intended to provide assurance of timely payment of principal and interest. Such protections may include surety bonds, letters of credit and payment advance agreements. The process used to rate Commercial Mortgage

Securities may focus on, among other factors, the structure of the security, the quality and adequacy of collateral and insurance, and the creditworthiness of the originators, servicing companies and providers of credit support.

Commercial Mortgage Securities have been issued in public and private transactions by a variety of public and private issuers. Non-governmental entities that have issued or sponsored Commercial Mortgage Securities include owners of commercial properties, originators of and investors in Commercial Mortgage Loans, savings and loan associations, mortgage banks, commercial banks, insurance companies, investment banks and special purpose subsidiaries of the foregoing.

The Commercial Mortgage Securities market is newer and in terms of total outstanding principal amount of issues is relatively small compared to the total size of the market for Single-Family Mortgage Securities. Securitization of the commercial mortgage market has accelerated in recent years, however, in part as a result of new risk-based capital rules imposed on insurance companies, banks and thrift institutions that have required

many such institutions to reduce positions in Commercial Mortgage Loans in their investment portfolios. The establishment by the rating agencies of rating criteria for Commercial Mortgage Securities and the resulting assignment of ratings by the rating agencies to such securities has made such securities more attractive to potential investors and has increased their potential investor base. As Commercial Mortgage Loans with balloon payments become due, such loans will have to be re-financed or the underlying commercial properties will have to be sold. In either case, there will be a significant need for new Commercial Mortgage Loans. In addition, to the extent financial institutions continue to seek to reduce their portfolio holdings of Commercial Mortgage Loans, the supply of Commercial Mortgage Loans available for securitization will increase. Demand for new commercial real estate financings and the reluctance of financial institutions to assume long-term portfolio risk with respect to such financings also should encourage securitization. The Company believes that an increased supply of Commercial Mortgage Securities may present attractive investment opportunities for the Company.

MANAGEMENT POLICIES AND PROGRAMS

ASSET ACQUISITION POLICIES

The Company only acquires those Mortgage Assets the Company believes it has the necessary expertise to evaluate and manage and which are consistent with the Company's balance sheet guidelines and risk management objectives. Since the intention of the Company is generally to hold its Mortgage Assets until maturity, the Company generally does not seek to acquire assets whose investment returns are only attractive in a limited range of scenarios. The Company believes that future interest rates and mortgage prepayment rates are very difficult to predict. Therefore, the Company seeks to acquire Mortgage Assets which the Company believes will provide acceptable returns over a broad range of interest rate and prepayment scenarios.

Among the asset choices available to the Company, the Company acquires those Mortgage Assets which the Company believes will generate the highest returns on capital invested, after considering (i) the amount and nature of anticipated cash flows from the asset, (ii) the Company's ability to pledge the asset to secure collateralized borrowings, (iii) the increase in the Company's risk-adjusted capital requirement determined by the Company's Risk-Adjusted Capital Policy resulting from the purchase and financing of the asset, and (iv) the costs of financing, hedging, managing, securitizing, and reserving for the asset. Prior to acquisition, potential returns on capital employed are assessed over the life of the asset and in a variety of interest rate, yield spread, financing cost, credit loss and prepayment scenarios.

Management also gives consideration to balance sheet management and risk diversification issues. A specific asset which is being evaluated for potential acquisition is deemed more (or less) valuable to the Company to the extent it serves to decrease (or increase) certain interest rate or prepayment risks which may exist in the balance sheet, to diversify (or concentrate) credit risk, and to meet (or not meet) the cash flow and liquidity objectives management may establish for the balance sheet from time to time. Accordingly, an important part of the evaluation process is a simulation, using the Company's risk management model, of the addition of a potential asset and its associated borrowings and hedges to the balance sheet and an assessment of the impact this potential asset acquisition would have on the risks in and returns generated by the Company's balance sheet as a whole over a variety of scenarios.

The Company has focused primarily on the acquisition of floating-rate, adjustable-rate and, beginning in 1997, hybrid ARM assets, but intends to acquire fixed-rate assets in the future. The Company generally intends to acquire fixed-rate loans when such loans can meet its return and other standards when funded on a long-term basis, financed with equity only, or funded on a short-term basis with a comprehensive hedging program. Generally it is anticipated that any such long-term financing or comprehensive hedging program will serve to reduce the risk that could arise from the funding of term fixed-rate assets with variable-rate debt.

The Company may also purchase the stock of other mortgage REITs or similar companies when the Company believes that such purchases will yield attractive returns on capital employed. When the stock market valuations of such companies are low in relation to the market value of their assets, such stock purchases can be a way for the Company to acquire an interest in a pool of Mortgage Assets at an attractive price. The Company does not, however, presently intend to invest in the securities of other issuers for the purpose of exercising control or to underwrite securities of other issuers.

The Company may seek to acquire other mortgage finance businesses when management deems such activities to be in the best interest of the Company's shareholders.

The Company intends to acquire new Mortgage Assets, and will also seek to expand its capital base in order to further increase the Company's ability to acquire new assets, when the potential returns from new investments appear attractive relative to the return expectations of stockholders. The Company may in the future acquire Mortgage Assets by offering its debt or equity securities in exchange for such Mortgage Assets.

The Company generally intends to hold Mortgage Assets to maturity. In addition, the REIT provisions of the Code limit in certain respects the ability of the Company to sell Mortgage Assets. See "Certain Federal Income Tax Considerations - General - Gross Income Tests" and " - Taxation of the Company." However, management may decide to sell assets from time to time for a number of reasons including, without limitation, to dispose of an asset as to which credit risk concerns have risen beyond levels the Company wishes to manage, to reduce interest rate risk, to substitute one type of Mortgage Asset for another, to improve yield, to maintain compliance with the 55% requirement under the Investment Company Act, to effect a change in strategy, or generally to re-structure the balance sheet when management deems such action advisable. Management will select any Mortgage Asset to be sold according to the particular purpose such sale will serve. The Board of Directors has not adopted a policy that would restrict management's authority to determine the timing of sales or the selection of Mortgage Assets to be sold.

As a requirement for maintaining REIT status, the Company, will distribute to stockholders aggregate dividends equaling at least 95% of its taxable income. See "Certain Federal Income Tax Considerations - General - Distribution Requirement." The Company's current policy is to seek to distribute 100% of its taxable income as dividends over time. The Company may also make distributions constituting returns of capital should the return expectations of the stockholders appear to exceed returns potentially available to the Company through making new investments in Mortgage Assets. Subject to the limitations of applicable securities and state corporation laws, the Company can distribute capital by making purchases of its own Capital Stock, through paying down or repurchasing any outstanding uncollateralized debt obligations, or through increasing the Company's dividend to include a return of capital.

CREDIT RISK MANAGEMENT POLICIES

The Company reviews credit risk, interest rate risk and other risk of loss associated with each investment and determines the appropriate allocation of capital to apply to such investment under its Risk-Adjusted Capital Policy. In addition, the Company attempts to diversify its investment portfolio to avoid undue geographic and other types of concentrations. Management monitors the overall portfolio risk and determines appropriate levels of provision for credit loss and provides such information to the Board of Directors.

With respect to its Mortgage Securities, the Company is exposed to various levels of credit and special hazard risk, depending on the nature of the underlying mortgages and the nature and level of credit enhancements supporting such securities. Most of the Mortgage Securities acquired by the Company have some degree of protection from normal credit losses. At December 31, 1997 and December 31, 1996, 29% and 45%, respectively, of the Company's Mortgage Assets were Mortgage

Securities covered by credit protection in the form of a 100% guarantee from a GSE ("Agency Certificates").

An additional 25% and 31% of the Company's Mortgage Assets at December 31, 1997 and December 31, 1996, respectively, were Privately-Issued Certificates and represented interests in pools of residential mortgage loans with partial credit enhancement; of these amounts, 99% and 96% were rated investment grade, respectively. Credit loss protection for Privately-Issued Certificates is achieved through the subordination of other interests in the pool to the interest held by the Company, through pool insurance or through other means. The degree of credit protection varies substantially among the Privately-Issued Certificates held by the Company. While the Privately-Issued Certificates held by the Company have some degree of credit enhancement, some Mortgage Securities are, in turn, subordinated to other interests. Thus, should such a Privately-Issued Certificate experience credit losses, such losses could be greater than the Company's pro rata share of the remaining mortgage pool, but in no event could exceed the Company's investment in such Privately-Issued Certificate. The Company has undertaken an independent underwriting review of a sample of the loans underlying the

Privately-Issued Certificates that are rated below BBB which represent 1% and 4% of the Company's Privately-Issued Certificates as of December 31, 1997 and 1996, respectively.

Beginning in the fourth quarter of 1995, the Company began purchasing Mortgage Assets in the form of unsecuritized Mortgage Loans. The Company has developed a quality control program to monitor the quality of loan underwriting at the time of acquisition and on an ongoing basis. The Company may conduct, or cause to be conducted, a legal document review of each Mortgage Loan acquired to verify the accuracy and completeness of the information contained in the mortgage notes, security instruments and other pertinent documents in the file. As a condition of purchase, the Company will generally select a sample of Mortgage Loans targeted to be acquired, focusing on those Mortgage Loans with higher risk characteristics, and submit them to a third party, nationally recognized underwriting review firm for a compliance check of underwriting and review of income, asset and appraisal information. In addition, the Company or its agents will generally underwrite all Multifamily and Commercial Mortgage Loans that the Company acquires. During the time it holds Mortgage Loans, the Company will be subject to risks of borrower defaults and bankruptcies and special hazard losses (such as those occurring from earthquakes or floods) that are not covered by standard hazard insurance. The Company will generally not obtain credit enhancements such as mortgage pool or special hazard insurance for its Mortgage Loans, although individual loans may be covered by FHA insurance, VA guarantees or private mortgage insurance and, to the extent securitized into Agency Certificates, by such GSE obligations or guarantees.

CAPITAL AND LEVERAGE POLICIES

The Company's goal is to strike a balance between the under-utilization of leverage, which reduces potential returns to stockholders, and the over-utilization of leverage, which could reduce the Company's ability to meet its obligations during adverse market conditions and/or cause adverse tax consequences for the Company. The Company has established a Risk-Adjusted Capital Policy which limits management's ability to acquire additional assets during times when the actual capital base of the Company is less than a required amount defined in the policy. In this way, the use of balance sheet leverage is controlled. The actual capital base as defined for the purpose of the Risk Adjusted Capital Policy is equal to the market value of total assets funded short-term less the book value of total collateralized short-term borrowings plus the actual investment on a historical amortized cost basis in subsidiary trusts ("mortgage equity interests") wherein Mortgage Assets are funded with non-recourse, long-term debt less the book value of any parent-level debt associated with these mortgage equity interests, less any unsecured debt.

Prior to the fourth quarter of 1996, under its Risk-Adjusted Capital Policy, management was prohibited from acquiring additional Mortgage Assets during periods when the actual capital base of the Company was less than the minimum amount required under the Risk-Adjusted Capital Policy (except when such Mortgage Asset acquisitions may have been necessary to maintain REIT status or the Company's exemption from the Investment Company Act of 1940). As a result, the Company had generally grown in the past by issuing equity and then seeking to acquire Mortgage Assets over time in order to fully employ the capital raised. In order to employ new capital more efficiently, the Board of Directors approved a permanent modification to the Company's Risk-Adjusted Capital Policy on October 31, 1996. Management is now able to acquire Mortgage Assets when attractive opportunities present themselves in excess of the level at which the Company's capital base would have been

fully employed under the pre-modified Risk-Adjusted Capital Policy within certain limitations and in certain circumstances. As a result, when additional equity is raised, some or all of the assets necessary to fully employ this capital will have been pre-acquired. Such excess asset acquisitions are subject to a variety of limitations, including (i) that additional asset growth not increase the balance sheet size by more than 10% beyond the point at which capital would have been fully employed under the pre-modified Risk-Adjusted Capital Policy guidelines, and (ii) that the Company seek to issue additional equity to bring the Company into compliance with the pre-modified Risk-Adjusted Capital Policy guidelines.

The first component of the Company's capital requirements with respect to short-term funded assets is the current aggregate over-collateralization amount or "haircut" that lenders require the Company to hold as capital. The haircut for each such Mortgage Asset is determined by the lender based on the risk characteristics and liquidity of that asset. Haircut levels on individual borrowings range from 2% for Agency Certificates and Mortgage Loans to 25% for certain Privately-Issued Certificates, and currently average 3% to 5% for the

Company as a whole. Should the market value of the pledged assets decline, the Company will be required to deliver additional collateral to the lenders in order to maintain a constant over-collateralization level on its short-term borrowings.

The second component of the Company's capital requirement with respect to short-term funded assets is the "liquidity capital cushion." The liquidity capital cushion is an additional amount of capital in excess of the haircut maintained by the Company in order to help the Company meet the demands of the short-term lenders for additional collateral should the market value of the Company's short-term funded Mortgage Assets decline. The aggregate liquidity capital cushion equals the sum of liquidity cushion amounts assigned under the Risk-Adjusted Capital Policy to each of the Company's short-term funded Mortgage Assets. Liquidity capital cushions are assigned to each short-term funded Mortgage Asset based on management's assessment of that Mortgage Asset's market price volatility, credit risk, liquidity and attractiveness for use as collateral by short-term lenders. The process of assigning liquidity capital cushions relies on management's ability to identify and weigh the relative importance of these and other factors. Consideration is also given to hedges associated with the short-term funded Mortgage Asset and any effect such hedges may have on reducing net market price volatility, concentration or diversification of credit and other risks in the balance sheet as a whole and the net cash flows that can be expected to arise from the interaction of the various components of the Company's balance sheet. The Board of Directors thus reviews on a periodic basis various analyses prepared by management of the risks inherent in the Company's balance sheet, including an analysis of the effects of various scenarios on the Company's net cash flow, earnings, dividends, liquidity and net market value. Should the Board of Directors determine that the minimum required capital base set by the Company's Risk- Adjusted Capital Policy is either too low or too high, the Board of Directors may raise or lower the capital requirement accordingly.

The Company expects that its aggregate minimum capital requirement under the Risk-Adjusted Capital Policy will approximate 3% to 15% of the sum of the market value of the Company's short-term funded Mortgage Assets and the book value of its long-term funded Mortgage Assets. This percentage will fluctuate over time, and may fluctuate out of the expected range, as the composition of the balance sheet changes, haircut levels required by lenders change, the market value of short-term funded Mortgage Assets changes, as liquidity capital cushions set by the Board of Directors are adjusted over time, and as the balance of funding between short-term and long-term changes. As of December 31, 1997, the aggregate Risk-Adjusted Capital Requirement was 7.51% of total assets. The Company's actual capital base was 9.73% of total assets at December 31, 1997, thus the Company was not utilizing, at that time, all of the leverage potential available to the Company under its Risk- Adjusted Capital policies.

Over 50% of the Company's borrowings were short-term at December 31, 1997. The Company's short-term borrowings have consisted of collateralized borrowing arrangements of various types (reverse repurchase agreements, notes payable, and revolving lines of credit). As of December 31, 1997, the Company had no outstanding notes payable or revolving lines of credit. The Company's long-term borrowings at December 31, 1997 consisted of non-recourse, floating-rate with life caps, collateralized mortgage bonds. In the future, however, the Company's borrowings may also be obtained through loan agreements, Dollar-Roll Agreements (an agreement to sell a security for delivery on a specified future date and a simultaneous agreement to repurchase the same or a substantially similar security on a specified future date) and other credit facilities with institutional lenders, the issuance of

long-term collateralized debt or similar instruments in the form of collateralized mortgage bonds, collateralized bond obligations, REMICs, FASITs, or other forms, and the issuance of secured and unsecured debt securities such as commercial paper, medium-term notes and senior or subordinated notes.

At December 31, 1997, the Company had not entered into commitment agreements under which the lender would be required to enter into new reverse repurchase agreements during a specified period of time, nor did the Company have liquidity facilities with commercial banks. The Company, however, may enter into such commitment agreements in the future if deemed favorable to the Company. The Company enters into reverse repurchase agreements primarily with national broker/dealers, commercial banks and other lenders which typically offer such financing. The Company enters into short-term collateralized borrowings only with financial institutions meeting credit standards approved by the Company's Board of Directors, including

approval by a majority of Independent Directors, and monitors the financial condition of such institutions on a regular basis.

A reverse repurchase agreement, although structured as a sale and repurchase obligation, acts as a financing vehicle under which the Company effectively pledges its Mortgage Assets as collateral to secure a short-term loan. Generally, the other party to the agreement will make the loan in the amount equal to a percentage of the market value of the pledged collateral. At the maturity of the reverse repurchase agreement, the Company is required to repay the loan and correspondingly receives back its collateral. While used as collateral, Mortgage Assets continue to pay principal and interest which inure to the benefit of the Company. In the event of the insolvency or bankruptcy of the Company, certain reverse repurchase agreements may qualify for special treatment under the Bankruptcy Code, the effect of which is, among other things, to allow the creditor under such agreements to avoid the automatic stay provisions of the Bankruptcy Code and to foreclose on the collateral agreements without delay. In the event of the insolvency or bankruptcy of a lender during the term of a reverse repurchase agreement, the lender may be permitted, under applicable insolvency laws, to repudiate the contract, and the Company's claim against the lender for damages therefrom may be treated simply as one of unsecured creditor. In addition, if the lender is a broker or dealer subject to the Securities Investor Protection Act of 1970, or an insured depository institution subject to the Federal Deposit Insurance Act, the Company's ability to exercise its rights to recover its securities under a reverse repurchase agreement or to be compensated for any damages resulting from the lender's insolvency may be further limited by those statutes. These claims would be subject to significant delay and, if and when received, may be substantially less than the damages actually suffered by the Company.

The Company expects that some of its borrowing agreements will continue to require the Company to deposit additional collateral in the event the market value of existing collateral declines, which may require the Company to sell assets to reduce the borrowings. The Company's liquidity management policy is designed to maintain a cushion of equity sufficient to provide required liquidity to respond to the effects under its borrowing arrangements of interest rate movements and changes in market value of its Mortgage Assets, as described above. However, a major disruption of the reverse repurchase or other markets relied on by the Company for short-term borrowings would have a material adverse effect on the Company unless the Company were able to arrange alternative sources of financing on comparable terms. The Company's Bylaws do not limit its ability to incur borrowings, whether secured or unsecured.

ASSET/LIABILITY MANAGEMENT

To the extent consistent with its election to qualify as a REIT, the Company follows an interest rate risk management program intended to protect principally against the effects of substantial increases in interest rates. Specifically, the Company's interest rate risk management program is formulated with the intent to offset the potential adverse effects resulting from rate adjustment limitations on its Mortgage Assets and the differences between interest rate adjustment indices and interest rate adjustment frequency of its adjustable-rate Mortgage Assets and related borrowings. The Company's interest rate risk management program encompasses a number of procedures. The Company attempts to structure its borrowings to have interest rate adjustment indices and interest rate adjustment periods that, on an aggregate basis, generally correspond to the interest rate adjustment indices and interest rate adjustment periods of the adjustable-rate, hybrid and fixed-rate Mortgage Assets purchased by the Company. The Company expects to be able to adjust the average maturity/adjustment period of such borrowings on an ongoing basis by changing the mix of maturities and interest rate adjustment periods as

borrowings come due and are renewed and by modifying the effective characteristics of borrowing through the use of interest rate agreements. Through use of these procedures, the Company intends to minimize differences between interest rate adjustment periods of Mortgage Assets and related borrowings that may occur.

The Company purchases and sells, from time to time, interest rate caps, interest rate floors, interest rate swaps, interest rate futures, options on interest rate futures and similar instruments to attempt to mitigate the risk of the cost of its variable rate liabilities increasing at a faster rate than the earnings on its Mortgage Assets during a period of rising rates. The Company also may use such instruments to modify the characteristics of any fixed-rate loan issuance or to hedge the anticipated issuance of future liabilities or the market value of certain assets. In this way, the Company intends generally to hedge as much of the interest rate risk as management determines is in the best interest of the stockholders of the Company, given the cost of such hedging transactions and the

need to maintain the Company's status as a REIT. See "Certain Federal Income Tax Considerations - General - Gross Income Tests." This determination may result in management electing to have the Company bear a level of interest rate risk that could otherwise be hedged when management believes, based on all relevant facts, that bearing such risk is prudent in light of competing tax and market risks. The Company also, to the extent consistent with its compliance with the REIT Gross Income Tests, Maryland law and the no-action relief discussed below, utilizes financial futures contracts, options and forward contracts as a hedge against future interest rate changes. The Company obtained no-action relief from the Commodities Futures Trading Commission permitting the Company to invest a small percentage of the Company's total assets in certain financial futures contracts and options thereon without registering as a commodity pool operator under the Commodity Exchange Act, provided that the Company uses such instruments solely for bona fide hedging purposes.

The Company seeks to build a balance sheet and undertake an interest rate risk management program which is likely, in management's view, to enable the Company to generate positive earnings and maintain an equity liquidation value sufficient to maintain operations given a variety of potentially adverse circumstances. Accordingly, the hedging program address both income preservation, as discussed in the first part of this section, and capital preservation concerns. With regard to the latter, the Company monitors its "equity duration." This is the expected percentage change in the Company's equity (measured as the carrying value of total assets less the book value of total liabilities) that would be caused by a 1% change in short and long term interest rates. To date, the Company believes that it has met its goal of maintaining an equity duration of less than 15%. To monitor its equity duration and the related risks of fluctuations in the liquidation value of the Company's equity, the Company models the impact of various economic scenarios on the market value of the Company's Mortgage Assets, liabilities and interest rate agreements. The Company believes that the existing hedging programs will allow the Company to maintain operations throughout a wide variety of potentially adverse circumstances without further management action. Nevertheless, in order to further preserve the Company's capital base (and lower its equity duration) during periods when management believes a trend of rapidly rising interest rates has been established, management may decide to increase hedging activities and/or sell assets. Each of these types of actions may lower the earnings and dividends of the Company in the short term in order to further the objective of maintaining attractive levels of earnings and dividends over the long term.

Each interest rate cap and floor agreement is a legal contract between the Company and a third party firm (the "counter-party"). When the Company purchases a cap or floor contract, the Company makes an up-front cash payment to the counter-party and the counter-party agrees to make payments to the Company in the future should the reference rate (typically one- or three-month LIBOR) rise above (cap agreements) or fall below (floor agreements) the "strike" rate specified in the contract. Each contract has a "notional face" amount. Should the reference rate rise above the contractual strike rate in a cap, the Company will earn cap income. Should the reference rate fall below the contractual strike rate in a floor, the Company will earn floor income. Payments on an annualized basis will equal the contractual notional face amount times the difference between actual reference rates and the contracted strike rate. When the Company sells a cap or floor agreement, the Company receives a premium payment but may be liable for future payments based on movements in the reference rate.

Interest rate swaps are agreements in which a series of interest rate flows are exchanged over a prescribed period. The notional amount on which the interest payments are based is not exchanged. Most of the Company's swaps involve the exchange of either fixed interest payments

for floating interest payments or the exchange of one floating interest payment for another floating interest payment based on a different index. Most of the interest rate swaps require that the Company provide collateral in the form of Mortgage Assets to the counterparty.

Interest Rate Futures ("Futures") are contracts for the delivery of securities or cash in which the seller agrees to deliver on a specified future date, a specified instrument (or the cash equivalent), at a specified price or yield. Under these agreements, if the Company has sold (bought) the futures, the Company will generally receive additional cash flows if interest rates rise (fall). Conversely, the Company will generally pay additional cash flows if interest rates fall (rise).

In all of its interest rate risk management transactions, the Company follows certain procedures designed to limit credit exposure to counterparties, including dealing only with counterparties whose financial strength meets the Company's requirements.

The Company may elect to conduct a portion of its hedging operations through one or more subsidiary corporations which would not be a Qualified REIT Subsidiary and would be subject to Federal and state income taxes. In order to comply with the nature of asset tests applicable to the Company as a REIT, the value of the securities of any such subsidiary held by the Company must be limited to less than 5% of the value of the Company's total assets as of the end of each calendar quarter and no more than 10% of the voting securities of any such subsidiary may be owned by the Company. See "Certain Federal Income Tax Considerations - General - Asset Tests." A taxable subsidiary would not elect REIT status and would distribute any net profit after taxes to the Company and its other stockholders. Any dividend income received by the Company from any such taxable subsidiary (combined with all other income generated from the Company's assets, other than Qualified REIT Real Estate Assets) must not exceed 25% of the gross income of the Company. See "Certain Federal Income Tax Considerations - General - Gross Income Tests." Before the Company forms any such taxable subsidiary corporation for its hedging activities, the Company will obtain an opinion of counsel to the effect that the formation and contemplated method of operation of such corporation will not cause the Company to fail to satisfy the nature of assets and sources of income tests applicable to it as a REIT.

At December 31, 1997, the Company's weighted average assets and liabilities were matched within a twelve-month period in terms of adjustment frequency and speed of adjustment to market conditions assuming stable interest rates. Looking at these two factors only (and thus ignoring periodic and life caps and other risks such as basis risk and prepayment risk), the Company's net interest spread should be stable over time periods greater than twelve months. Substantially all of the Company's Mortgage Assets at December 31, 1997 had coupon rates that adjust to market levels at least every twelve months, with a weighted average term to reset of approximately four months. The majority of the Company's borrowings at December 31, 1997 will either mature or adjust to a market interest rate level within six months of such date. The short-term borrowings had a weighted average term to rate reset of 31 days at December 31, 1997. Both changes in coupon rates earned on assets and in the rates paid on borrowings are expected to be highly correlated with changes in LIBOR and/or Treasury rates (subject to the effects of periodic and lifetime caps).

Although the Company believes it has developed a cost-effective asset/liability management program to provide a level of protection against interest rate, basis and prepayment risks, no strategy can completely insulate the Company from the effect of interest rate changes, prepayment risks, mortgage credit losses, defaults by counterparties, or liquidity risk. Further, certain of the Federal income tax requirements that the Company must satisfy to qualify as a REIT limit the Company's ability to fully hedge its interest rate and prepayment risks. The Company monitors carefully, and may have to limit, its asset/liability management program to assure that it does not realize excessive hedging income, or hold hedging assets having excess value in relation to total assets, which would result in the Company's disqualification as a REIT or, in case of excess hedging income, the payment of a penalty tax for failure to satisfy certain REIT income tests under the Code, provided such failure was for reasonable cause. See "Certain Federal Income Tax Considerations - General." In addition, asset/liability management involves transaction costs which increase dramatically as the period covered by the hedging protection increases. Therefore, the Company may be prevented from effectively hedging its interest rate and prepayment risks over the long-term.

PREPAYMENT RISK MANAGEMENT

The Company seeks to minimize the effects of faster or slower than anticipated prepayment rates through structuring a diversified

portfolio with a variety of prepayment characteristics, investing in Mortgage Assets with prepayment prohibitions and penalties, investing in certain Mortgage Securities structures which have prepayment protections, and, when possible, balancing Mortgage Assets purchased at a premium with Mortgage Assets purchased at a discount when such types of assets are available in the marketplace. In certain operating environments, including most of 1997, however, it has not been possible for the Company to acquire assets with a zero net balance of discount and premium. In such circumstances, the risk of earnings variability resulting from changes in prepayment rates rises. In addition, the Company may purchase interest-only strips, principal-only strips and/or other financial assets such as floors, calls, swaptions and futures, as a hedge against

prepayment risks. The Company may also seek to create and sell interest-only and principal-only strips from existing assets to help manage prepayment risk. Prepayment risk is monitored by management and the Board of Directors through periodic review of the impact of a variety of prepayment scenarios on the Company's revenues, net earnings, dividends, cash flow and net balance sheet market value.

The Company owns a variety of non-agency Mortgage Securities which are structured so that for several years they receive either less than or more than a pro rata share of principal repayments experienced in the underlying mortgage pool as a whole. In such Mortgage Securities, one or more classes of Senior Securities are ordinarily entitled to receive all principal prepayments on the underlying pool of loans until such Senior Securities have been paid down to a specified amount determined by formula. To illustrate, a Mortgage Security totaling $100 million of aggregate principal balance may be structured so that there is (i) $92 million face value of Senior Securities, (ii) Mezzanine Securities with a face value of $2 million providing credit support for the Senior Securities, (iii) Subordinated Securities with a face value of $6 million providing credit support for the Mezzanine Securities and the Senior Securities, and (iv) the $100 million face value of Senior Securities, Mezzanine Securities and Subordinated Securities had been issued in this format, the Mezzanine Securities or the Subordinated Securities would receive no principal prepayments on the underlying loans until the $92 million face value of Senior Securities had been paid down to a formula-determined amount, which would normally be expected to occur within a range of three to ten years depending on the rate of prepayments and other factors. The Company owns interests which are similar to the Senior Securities, Mezzanine Securities and Subordinated Securities in this example.

During 1997, the Company received $973.1 million in principal payments on its Mortgage Assets. One commonly used measure of the average annual rate of prepayment of mortgage principal is the conditional prepayment rate ("CPR"). The CPR for the Company's Mortgage Assets was 25% for 1997. In addition to prepayments, the Company also receives scheduled mortgage principal payments (payments representing the normal principal amortization of a 30-year mortgage loan). Thus, the total amount of repayments of mortgage principal received each month exceeds the level of prepayments. The annualized rate of principal repayment (total principal received as a percent of average face value of Mortgage Assets) the Company experienced was 34%. The amortized cost of the Company's Mortgage Assets at December 31, 1997 was equal to 102.20% of the face value of the assets; the net premium was 2.20%. The smaller the level of net discount or premium, the less risk there is that fluctuations in prepayment rates will affect earnings. The Company may use interest rate agreements and other means to seek to mitigate the risk that premium amortization expenses may rise as mortgage prepayments increase in falling interest rate environments.

MORTGAGE LOAN SECURITIZATION TECHNIQUES

The Company expects to contract with conduits, financial institutions, mortgage bankers, investment banks and others to purchase Mortgage Loans which they are originating or holding in their portfolio. The Company anticipates that it will have sufficient purchasing power in some circumstances to induce origination firms to originate Mortgage Loans to the Company's specifications. The Company intends to enhance the value and liquidity of most of the Mortgage Loans it acquires by securitizing the loans into Mortgage Securities or pledging the loans to secure the issuance of long-term debt in the manner which will best meet its own needs.

In addition to creating Mortgage Securities and issuing long-term debt with the Mortgage Loans in its portfolio, the Company also plans from time to time to "re-securitize" portions of its Mortgage Securities portfolio. In a re-securitization transaction, Mortgage Securities rather than Mortgage Loans are used as collateral to create new Mortgage Securities. This would typically be done as the Mortgage Loans underlying the Mortgage Securities improve in credit quality through seasoning, as values rise on the underlying properties or when the

credit quality of junior classes of Mortgage Securities improve due to prepayment of more senior classes. Such transactions can result in improved credit ratings, higher market values and lowered borrowing costs. The Company believes that this built-in tendency of securitized mortgage bonds to improve in credit quality even if real estate prices remain level could be one of the most attractive aspects of the markets in which the Company will invest. In December 1997, the Company completed its first re-securitization.

The Company may conduct its securitization activities through one or more taxable or REIT-qualifying subsidiaries formed for such purpose. In 1997, the Company formed Sequoia Mortgage Funding Corporation ("Sequoia"), a REIT-qualifying subsidiary, to carry out securitizations. During 1997, Sequoia completed three

securitizations. The Company issued $1.3 billion of non-recourse debt, which appears on the balance sheet, and $0.05 billion of securities through a re-REMIC as a result of these securitizations.

CERTAIN FEDERAL INCOME TAX CONSIDERATIONS

The following discussion summarizes certain Federal income tax considerations to the Company and its stockholders. This discussion is based on existing Federal income tax law, which is subject to change, possibly retroactively. This discussion does not address all aspects of Federal income taxation that may be relevant to a particular stockholder in light of its personal investment circumstances or to certain types of investors subject to special treatment under the Federal income tax laws (including financial institutions, insurance companies, broker-dealers and, except to the extent discussed below, tax-exempt entities and foreign taxpayers) and it does not discuss any aspects of state, local or foreign tax law. This discussion assumes that stockholders will hold their Common Stock as a "capital asset" (generally, property held for investment) under the Internal Revenue Code of 1986, as amended (the "Code"). Stockholders are advised to consult their tax advisors as to the specific tax consequences to them of purchasing, holding and disposing of the Common Stock, including the application and effect of Federal, state, local and foreign income and other tax laws.

GENERAL

The Company has elected to become subject to tax as a REIT, for Federal income tax purposes, commencing with the taxable year ending December 31, 1994. Management currently expects that the Company will continue to operate in a manner that will permit the Company to maintain its qualifications as a REIT. This treatment will permit the Company to deduct dividend distributions to its stockholders for Federal income tax purposes, thus effectively eliminating the "double taxation" that generally results when a corporation earns income and distributes that income to its stockholders.

There can be no assurance that the Company will continue to qualify as a REIT in any particular taxable year, given the highly complex nature of the rules governing REITs, the ongoing importance of factual determinations and the possibility of future changes in the circumstances of the Company. If the Company failed to qualify as a REIT in any particular year, it would be subject to Federal income tax as a regular, domestic corporation, and its stockholders would be subject to tax in the same manner as stockholders of such corporation. In this event, the Company could be subject to potentially substantial income tax liability in respect of each taxable year that it fails to qualify as a REIT, and the amount of earnings and cash available for distribution to its stockholders could be significantly reduced or eliminated.

The following is a brief summary of certain technical requirements that the Company must meet on an ongoing basis in order to qualify, and remain qualified, as a REIT under the Code.

STOCK OWNERSHIP TESTS

The capital stock of the Company must be held by at least 100 persons and no more than 50% of the value of such capital stock may be owned, directly or indirectly, by five or fewer individuals at all times during the last half of the taxable year. Under the Code, most tax-exempt entities including employee benefit trusts and charitable trusts (but excluding trusts described in 401(a) and exempt under 501(a)) are generally treated as individuals for these purposes. These stock ownership requirements must be satisfied by the Company each taxable year. The Company must solicit information from certain of its shareholders to verify ownership levels and its Articles of Incorporation provide restrictions regarding the transfer of the

Company's shares in order to aid in meeting the stock ownership requirements. If the Company were to fail either of the stock ownership tests, it would generally be disqualified from REIT status, unless, in the case of the "five or fewer" requirement, the recently enacted "good faith" exemption is available.

ASSET TESTS

The Company must generally meet the following asset tests (the "REIT Asset Tests") at the close of each quarter of each taxable year:

(a) at least 75% of the value of the Company's total assets must consist of Qualified REIT Real Estate Assets, government securities, cash, and cash items (the "75% Asset Test"); and

(b) the value of securities held by the Company but not taken into account for purposes of the 75% Asset Test must not exceed (i) 5% of the value of the Company's total assets in the case of securities of any one non-government issuer, and (ii) 10% of the outstanding voting securities of any such issuer.

The Company expects that substantially all of its assets will be Qualified REIT Real Estate Assets. In addition, the Company does not expect that the value of any non-qualifying security of any one entity would ever exceed 5% of the Company's total assets, and the Company does not expect to own more than 10% of any one issuer's voting securities.

The Company intends to monitor closely the purchase, holding and disposition of its assets in order to comply with the REIT Asset Tests. In particular, the Company intends to limit and diversify its ownership of any assets not qualifying as Qualified REIT Real Estate Assets to less than 25% of the value of the Company's assets and to less than 5%, by value, of any single issuer. If it is anticipated that these limits would be exceeded, the Company intends to take appropriate measures, including the disposition of non-qualifying assets, to avoid exceeding such limits.

GROSS INCOME TESTS

The Company must generally meet the following gross income tests (the "REIT Gross Income Tests") for each taxable year:

(a) at least 75% of the Company's gross income must be derived from certain specified real estate sources including interest income and gain from the disposition of Qualified REIT Real Estate Assets or "qualified temporary investment income" (i.e., income derived from "new capital" within one year of the receipt of such capital) (the "75% Gross Income Test");

(b) at least 95% of the Company's gross income for each taxable year must be derived from sources of income qualifying for the 75% Gross Income Test, or from dividends, interest, and gains from the sale of stock or other securities (including certain interest rate swap and cap agreements, options, futures and forward contracts entered into to hedge variable rate debt incurred to acquire Qualified REIT Real Estate Assets) not held for sale in the ordinary course of business (the "95% Gross Income Test"); and

(c) for four years prior to 1998, less than 30% of the Company's gross income must have been derived from the sale of Qualified REIT Real Estate Assets held for less than four years, stock or securities held for less than one year (including certain interest rate swaps and cap agreements entered into to hedge variable rate debt incurred to acquire Qualified REIT Real Estate Assets) and certain "dealer" property (the "30% Gross Income Test").

The Company intends to maintain its REIT status by carefully monitoring its income, including income from hedging transactions and sales of Mortgage Assets, to comply with the REIT Gross Income Tests. In particular, the Company will treat income generated by its interest rate caps and other hedging instruments as non-qualifying income for purposes of the 95% Gross Income Tests unless it receives advice from counsel that such income constitutes qualifying income for purposes of such test. Under certain circumstances, for example, (i) the sale of a substantial amount of Mortgage Assets to repay borrowings in the event that other credit is unavailable or (ii) unanticipated decrease in the qualifying income of the Company which may result in the non-qualifying income exceeding 5% of gross income, the Company may be unable to comply with certain of the REIT Gross Income Tests. See " - Taxation of the Company" below for a discussion of the tax consequences of failure to comply with the REIT Provisions of the Code.

DISTRIBUTION REQUIREMENT

The Company must generally distribute to its stockholders an amount equal to at least 95% of the Company's REIT taxable income before deductions of dividends paid and excluding net capital gain.

The IRS has ruled that if a REIT's dividend reinvestment plan allows stockholders of the REIT to elect to have cash distributions reinvested in shares of the REIT at a purchase price equal to at least 95% of the fair market value of such shares on the distribution date, then such distributions qualify under the 95% distribution requirement. The Company maintains a Dividend Reinvestment and Stock Purchase Plan ("DRP") and intends that the terms of its DRP will comply with this ruling.

QUALIFIED REIT SUBSIDIARIES

The Company currently holds some of its assets through Sequoia Mortgage Funding Corporation, a wholly-owned subsidiary, which it believes is a "Qualified REIT Subsidiary". As such its assets, liabilities and income are generally treated as assets, liabilities and income of the Company for purposes of each of the above REIT qualification tests.

TAXATION OF THE COMPANY

In any year in which the Company qualifies as a REIT, the Company will generally not be subject to Federal income tax on that portion of its REIT taxable income or capital gain which is distributed to its stockholders. The Company will, however, be subject to Federal income tax at normal corporate income tax rates upon any undistributed taxable income or capital gain.

Notwithstanding its qualification as a REIT, the Company may also be subject to tax in certain other circumstances. If the Company fails to satisfy either the 75% or the 95% Gross Income Test, but nonetheless maintains its qualification as a REIT because certain other requirements are met, it will generally be subject to a 100% tax on the greater of the amount by which the Company fails either the 75% or the 95% Gross Income Test. The Company will also be subject to a tax of 100% on net income derived from any "prohibited transaction," and if the Company has (i) net income from the sale or other disposition of "foreclosure property" which is held primarily for sale to customers in the ordinary course of business or (ii) other non-qualifying income from foreclosure property, it will be subject to Federal income tax on such income at the highest corporate income tax rate. In addition, if the Company fails to distribute during each calendar year at least the sum of (i) 85% of its REIT ordinary income for such year and (ii) 95% of its REIT capital gain net income for such year, the Company would be subject to a 4% Federal excise tax on the excess of such required distribution over the amounts actually distributed during the taxable year, plus any undistributed amount of ordinary and capital gain net income from the preceding taxable year. The Company may also be subject to the corporate alternative minimum tax, as well as other taxes in certain situations not presently contemplated.

If the Company fails to qualify as a REIT in any taxable year and certain relief provisions of the Code do not apply, the Company would be subject to Federal income tax (including any applicable alternative minimum tax) on its taxable income at the regular corporate income tax rates. Distributions to stockholders in any year in which the Company fails to qualify as a REIT would not be deductible by the company, nor would they generally be required to be made under the Code. Further, unless entitled to relief under certain other provisions of the Code, the Company would also be disqualified from re-electing REIT status for the four taxable years following the year in which it became disqualified.

The Company intends to monitor on an ongoing basis its compliance with the REIT requirements described above. In order to maintain its REIT status, the Company will be required to limit the types of assets that the Company might otherwise acquire, or hold certain assets at times when the Company might otherwise have determined that the sale or other disposition of such assets would have been more prudent.

TAXABLE SUBSIDIARIES

Hedging activities and the creation of Mortgage Securities through securitization may be done through a taxable subsidiary of the Company. The Company and one or more other entities may form and capitalize one or more taxable subsidiaries. In order to ensure that the Company would not violate the more than 10% voting stock of a single issuer limitation described above, the Company would own only nonvoting preferred and nonvoting common stock or 10% or less of the voting common stock and the other entities would own all of the remaining

voting common stock. The value of the Company's investment in such a subsidiary must also be limited to less than 5% of the value of the Company's total assets at the end of each calendar quarter so that the Company can also comply with the 5% of value, single issuer asset limitation described above under " - General - Asset Tests." The taxable subsidiary would not elect REIT status and would distribute only net after-tax profits to its stockholders, including the Company. Before the Company engages in any hedging or securitization activities or uses any such taxable subsidiary corporation, the Company will obtain an opinion of counsel to the effect that such activities or the formation and contemplated method of operation of such corporation will not cause the Company to fail to satisfy the REIT Asset and REIT Gross Income Tests.

The Company recently formed, but is not yet operating, a taxable REIT subsidiary. There is currently proposed legislation in Congress (described below) which could, if passed, restrict or eliminate the Company's ability to use such taxable subsidiary.

TAXATION OF STOCKHOLDERS

COMMON STOCK

Distributions (including constructive distributions) made to holders of Common Stock other than tax-exempt entities (and not designated as capital gain dividends) will generally be subject to tax as ordinary income to the extent of the Company's current and accumulated earnings and profits as determined for Federal income tax purposes. If the amount distributed exceeds a stockholder's allocable share of such earnings and profits, the excess will be treated as a return of capital to the extent of the stockholder's adjusted basis in the Common Stock, which will not be subject to tax, and thereafter as a taxable gain from the sale or exchange of a capital asset.

Distributions designated by the Company as capital gain dividends will generally be subject to tax as long-term capital gain to stockholders, to the extent that the distribution does not exceed the Company's actual net capital gain for the taxable year. Distributions by the Company, whether characterized as ordinary income or as capital gain, are not eligible for the corporate dividends received deduction. In the event that the Company realizes a loss for the taxable year, stockholders will not be permitted to deduct any share of that loss. Further, if the Company (or a portion of its assets) were to be treated as a taxable mortgage pool, any "excess inclusion income" that is allocated to a stockholder would not be allowed to be offset by a net operating loss of such stockholder. Future Treasury Department regulations may require that the stockholders take into account, for purposes of computing their individual alternative minimum tax liability, certain tax preference items of the Company.

Dividends declared during the last quarter of a taxable year and actually paid during January of the following taxable year are generally treated as if received by the stockholder on the record date of the dividend payment and not on the date actually received. In addition, the Company may elect to treat certain other dividends distributed after the close of the taxable year as having been paid during such taxable year, but stockholders will be treated as having received such dividend in the taxable year in which the distribution is made.

Upon a sale or other disposition of the Common Stock, a stockholder will generally recognize a capital gain or loss in an amount equal to the difference between the amount realized and the stockholder's adjusted basis in such stock, which gain or loss will be mid-term if the stock was held for more than twelve months and long-term if the stock was held for more than eighteen months. Any loss on the sale or exchange of Common Stock held by a stockholder for six months or less will generally be treated as a long-term capital loss to the extent of designated capital gain dividends received by such stockholder.

DRP participants will generally be treated as having received a dividend distribution, subject to tax as ordinary income, in an amount equal to the fair value of the Common Stock purchased with the reinvested dividends generally on the date the Company credits such Common Stock to the DRP participant's account.

The Company is required under Treasury Department regulations to demand annual written statements from the record holders of designated percentages of its Capital Stock disclosing the actual and constructive ownership of such stock and to maintain permanent records showing the information it has received as to the actual and constructive ownership of such stock and a list of those persons failing or refusing to comply with such demand.

In any year in which the Company does not qualify as a REIT,

distributions made to its stockholders would be taxable in the same manner discussed above, except that no distributions could be designated as capital gain dividends, distributions would be eligible for the corporate dividends received deduction, the excess inclusion income rules would not apply, and stockholders would not receive any share of the Company's tax preference items. In such event, however, the Company would be subject to potentially substantial Federal income tax liability, and the amount of earnings and cash available for distribution to its stockholders could be significantly reduced or eliminated.

TAXATION OF TAX-EXEMPT ENTITIES

Subject to the discussion below regarding a "pension-held REIT," a tax-exempt stockholder is generally not subject to tax on distributions from the Company or gain realized on the sale of the Securities, provided that such stockholder has not incurred indebtedness to purchase or hold its Securities, that its shares are not otherwise used in an unrelated trade or business of such stockholder, and that the Company, consistent with its present intent, does not hold a residual interest in a REMIC that gives rise to "excess inclusion" income as defined under section 860E of the Code. However, if the Company were to hold residual interests in a REMIC, or if a pool of its assets were to be treated as a "taxable mortgage pool," a portion of the dividends paid to a tax-exempt stockholder may be subject to tax as unrelated business taxable income ("UBTI"). Although the Company does not believe that the Company, or any portion of its assets, will be treated as a taxable mortgage pool, no assurance can be given that the IRS might not successfully maintain that such a taxable mortgage pool exists.

If a qualified pension trust (i.e., any pension or other retirement trust that qualifies under Section 401 (a) of the Code) holds more than 10% by value of the interests in a "pension-held REIT" at any time during a taxable year, a substantial portion of the dividends paid to the qualified pension trust by such REIT may constitute UBTI. For these purposes, a "pension-held REIT" is a REIT (i) that would not have qualified as a REIT but for the provisions of the Code which look through qualified pension trust stockholders in determining ownership of stock of the REIT and (ii) in which at least one qualified pension trust holds more than 25% by value of the interest of such REIT or one or more qualified pension trusts (each owning more than a 10% interest by value in the REIT) hold in the aggregate more than 50% by value of the interests in such REIT. Assuming compliance with the Ownership Limit provisions in the Company's Articles of Incorporation it is unlikely that pension plans will accumulate sufficient stock to cause the Company to be treated as a pension-held REIT.

Distributions to certain types of tax-exempt stockholders exempt from Federal income taxation under Sections 501 (c)(7), (c)(9), (c)(17), and (c)(20) of the Code may also constitute UBTI, and such prospective investors should consult their tax advisors concerning the applicable "set aside" and reserve requirements.

STATE AND LOCAL TAXES

The Company and its stockholders may be subject to state or local taxation in various jurisdictions, including those in which it or they transact business or reside. The state and local tax treatment of the Company and its stockholders may not conform to the Federal income tax consequences discussed above. Consequently, prospective stockholders should consult their own tax advisors regarding the effect of state and local tax laws on an investment in the Common Stock.

CERTAIN UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS APPLICABLE TO FOREIGN HOLDERS

The following discussion summarizes certain United States Federal tax consequences of the acquisition, ownership and disposition of Common Stock or Preferred Stock by an initial purchaser that, for United States Federal income tax purposes, is a "Non-United States Holder". Non- United States Holder means: not a citizen or resident of the United States; not a corporation, partnership, or other entity created or organized in the United States or under the laws of the United States or of any political subdivision thereof; or not an estate or trust whose income is includible in gross income for United States Federal income tax purposes regardless of its source. This discussion does not consider any specific facts or circumstances that may apply to particular non-United States Federal tax consequences of acquiring, holding and disposing of Common Stock or Preferred Stock, as well as any tax consequences that may arise under the laws of any foreign, state, local or other taxing jurisdiction.

DIVIDENDS

Dividends paid by the Company out of earnings and profits, as

determined for United States Federal income tax purposes, to a Non-United States Holder will generally be subject to withholding of United States Federal income tax at the rate of 30%, unless reduced or eliminated by an applicable tax treaty or unless such dividends are treated as effectively connected with a United States trade or business. Distributions paid by the Company in excess of its earnings and profits will be treated as a tax-free return of capital to the extent of the holder's adjusted basis in his shares, and thereafter as gain from the sale or exchange of a capital asset as described

below. If it cannot be determined at the time a distribution is made whether such distribution will exceed the earnings and profits of the Company, the distribution will be subject to withholding at the same rate as dividends. Amounts so withheld, however, will be refundable or creditable against the Non-United States Holder's United States Federal tax liability if it is subsequently determined that such distribution was, in fact, in excess of the earnings and profits of the Company. If the receipt of the dividend is treated as being effectively connected with the conduct of a trade or business within the United States by a Non-United States Holder, the dividend received by such holder will be subject to the United States Federal income tax on net income that applies to United States persons generally (and, with respect to corporate holders and under certain circumstances, the branch profits tax).

For any year in which the Company qualifies as a REIT, distributions to a Non-United States Holder that are attributable to gain from the sales or exchanges by the Company of "United States real property interests" will be treated as if such gain were effectively connected with a United States business and will thus be subject to tax at the normal capital gain rates applicable to United States stockholders (subject to applicable alternative minimum tax) under the provisions of the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"). Also, distributions subject to FIRPTA may be subject to a 30% branch profits tax in the hands of a foreign corporate stockholder not entitled to a treaty exemption. The Company is required to withhold 35% of any distribution that could be designated by the Company as a capital gains dividend. This amount may be credited against the Non-United States Holder's FIRPTA tax liability. It should be noted that Mortgage Loans without substantial equity or shared appreciation features generally would not be classified as "United States real property interests."

GAIN ON DISPOSITION

A Non-United States Holder will generally not be subject to United States Federal income tax on gain recognized on a sale or other disposition of its shares of either Common or Preferred Stock unless (i) the gain is effectively connected with the conduct of a trade or business within the United States by the Non-United States Holder, (ii) in the case of a Non-United Stated Holder who is a nonresident alien individual and holds such shares as a capital asset, such holder is present in the United States for 183 or more days in the taxable year and certain other requirements are met, or (iii) the Non-United States Holder is subject to tax under the FIRPTA rules discussed below. Gain that is effectively connected with the conduct of a United States Holder will be subject to the United States Federal income tax on net income that applies to United States persons generally (and, with respect to corporate holders and under certain circumstances, the branch profits tax) but will not be subject to withholding. Non-United States Holders should consult applicable treaties, which may provide for different rules.

Gain recognized by a Non-United States Holder upon a sale of either Common Stock or Preferred Stock will generally not be subject to tax under FIRPTA if the Company is a "domestically-controlled REIT," which is defined generally as a REIT in which at all times during a specified testing period less than 50% in value of its shares were held directly or indirectly by non-United States persons. Because only a minority of the Company's stockholders are expected to be Non-United States Holders, the Company anticipates that it will qualify as a "domestically- controlled REIT." Accordingly, a Non-United States Holder should not be subject to United States Federal income tax from gains recognized upon disposition of its shares.

INFORMATION REPORTING AND BACKUP WITHHOLDING

The Company will report to its U.S. shareholders and the Internal Revenue Service the amount of distributions paid during each calendar year, and the amount of tax withheld, if any. Under the backup withholding rules, a shareholder may be subject to backup withholding at the rate of 31% with respect to distributions paid unless such holder (a) is a corporation or comes within certain other exempt categories and, when required, demonstrates that fact; or (b) provides a taxpayer identification number, certifies as to no loss of exemption from backup withholding, and otherwise complies with applicable

requirements of the backup withholding rules. A shareholders that does not provide the Company with its correct taxpayer identification number may also be subject to penalties imposed by the Internal Revenue Service. Any amount paid as backup withholding will be creditable against the shareholder's income tax liability. In addition, the Company may be required to withhold a portion of dividends and capital gain distributions to any shareholders who do not certify under penalties of perjury their non-foreign status to the Company.

PROPOSED TAX LEGISLATION

The President's 1999 Budget Plan (released on February 2, 1998) includes certain tax proposals applicable to REITs that may be relevant to the Company. In particular, one proposal would prohibit a REIT from owning more than 10% of the voting power or value of the stock of any corporation other than a "Qualified REIT Subsidiary". (The current 10% ownership limit described previously relates only to voting power.) This proposal is intended to limit the ability of REITs to form taxable subsidiaries to undertake activities that would otherwise give rise to non-qualifying income or assets if earned or held by a REIT directly. It is proposed to be effective with respect to stock acquired on or after the date of "first committee action" (by the House Ways & Means Committee or the Senate Finance Committee) and any grandfathering with respect to stock acquired prior to the date of "first committee action" would be terminated if the applicable corporation engages in a new trade or business or acquires substantial new assets after such date. To date no such committee action has occurred .

Another proposal would generally expand the "five or fewer" stock ownership test to also limit entities from owning or controlling 50% of a REITs stock.

It is unclear whether these or any of the President's other tax proposals will be enacted, and if so, in what form. It is therefore unclear whether (i) the Company will in fact be able to utilize its recently formed taxable subsidiary to achieve its intended benefits or (ii) will otherwise be adversely effected by the President's tax proposals.

COMPETITION

The Company believes that its principal competition in the business of acquiring and holding Mortgage Assets are financial institutions such as banks, savings and loans, life insurance companies, GSEs, institutional investors such as mutual funds and pension funds, and certain other mortgage REITs. While most of these entities have significantly greater resources than the Company, the Company anticipates that it will be able to compete effectively and generate relatively attractive rates of return for stockholders due to its relatively low level of operating costs, relative freedom to securitize its assets, ability to utilize prudent amounts of leverage through accessing the wholesale market for collateralized borrowings, freedom from certain forms of regulation and the tax advantages of its REIT status. The existence of these competitive entities, as well as the possibility of additional entities forming in the future, may increase the competition for the acquisition of Mortgage Assets resulting in higher prices and lower yields on such Mortgage Assets.

POLICIES AND STRATEGIES

The Board of Directors has established the investment policies and strategies summarized in this report. The Board of Directors has the power to modify or waive such policies and strategies without the consent of the stockholders to the extent that the Board of Directors determines that such modification or waiver is in the best interests of stockholders. Among other factors, developments in the market which affect the policies and strategies mentioned herein or which change the Company's assessment of the market may cause the Board of Directors to revise the Company's policies and strategies.

The Company at all times intends to conduct its business so as not to become regulated as an investment company under the Investment Company Act. Accordingly, the Company does not expect to be subject to the restrictive provisions of the Investment Company Act. The Investment Company Act exempts entities that are "primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate" ("Qualifying Interests"). Under the current interpretation of the staff of the Securities and Exchange Commission, in order to qualify for this exemption, the Company must maintain at least 55% of its assets directly in Mortgage Loans, qualifying pass-though Certificates and certain other qualifying

interests in real estate. In addition, unless certain Mortgage Securities represent all the Certificates issued with respect to an underlying pool of mortgages, such Mortgage Securities may be treated as securities separate from the underlying Mortgage Loans and, thus, may not qualify as Qualifying Interests for purposes of the 55% requirement. Therefore, the Company's ownership of certain Mortgage Assets may be limited by the provisions of the Investment Company Act.

EMPLOYEES

As of March 11, 1998, the Company had nineteen employees.

RISK FACTORS

In addition to the other information contained in this Form 10-K, the following risk factors should be carefully considered in evaluating the Company and its business.

OPERATIONS RISKS

GENERAL

The results of the Company's operations are affected by various factors, many of which are beyond the control of the Company. The results of the Company's operations depend on, among other things, the level of net interest income generated by the Company's Mortgage Assets, the market value of such Mortgage Assets, the supply of and demand for such Mortgage Assets and conditions in debt markets. The Company's net interest income varies primarily as a result of changes in short-term interest rates, borrowing costs and prepayment rates, the behavior of which involve various risks and uncertainties as set forth below. Prepayment rates, interest rates, borrowing costs and credit losses depend upon the nature and terms of the Mortgage Assets, the geographic location of the properties securing the Mortgage Loans included in or underlying the Mortgage Assets, conditions in financial markets, the fiscal and monetary policies of the United States government and the Board of Governors of the Federal Reserve System, international economic and financial conditions, competition and other factors, none of which can be predicted with any certainty. Because changes in interest and prepayment rates may significantly affect the Company's activities, the operating results of the Company depend, in large part, upon the ability of the Company to effectively manage its interest rate and prepayment risks while maintaining its status as a REIT.

RISKS OF SUBSTANTIAL LEVERAGE AND POTENTIAL NET INTEREST AND OPERATING LOSSES IN CONNECTION WITH BORROWINGS

General

The Company intends to continue to employ its financing strategy to increase the size of its Mortgage Asset investment portfolio by borrowing a substantial portion (which may vary depending upon the mix of the Mortgage Assets in the Company's portfolio and the application of the Risk-Adjusted Capital Policy requirements to such mix of Mortgage Assets) of the market value or, in the case of certain forms of long-term debt, face value of its Mortgage Assets. The Company expects generally to maintain a ratio of its total book capital base (book value of capital accounts, retained earnings and subordinated debt deemed by management to qualify as capital for this purpose, taking into account valuation adjustments) to book value of total Mortgage Assets of between 3% and 15%, although the percentage may vary from time to time depending upon market conditions and other factors deemed relevant by management. However, the Company is not limited under its Bylaws in respect of the amount of its borrowings, whether secured or unsecured, and the aggregate percentage of total equity capital could at times be outside of this range. If the returns on the Mortgage Assets purchased with borrowed funds fail to cover the cost of the borrowings, the Company may experience net income losses. In addition, through increases in haircuts, decreases in the market value of the Company's Mortgage Assets, increases in interest rate volatility, availability of financing in the market, rating agency and bond insurer requirements for long-term financing circumstances then applicable in the lending market and other factors, the Company may not be able to achieve the degree of leverage it believes to be optimal, which may cause the Company to be less profitable than it would be otherwise.

Risk of Failure to Refinance Outstanding Borrowings

Additionally, the ability of the Company to achieve its investment objectives depends not only on its ability to borrow money in sufficient amounts and on favorable terms but also on the Company's ability to renew or replace on a continuous basis its maturing short-term borrowings. At December 31, 1997, the Company relied

on short-term borrowings to fund over 50% of its Mortgage Assets that have adjustable-rate coupons and long-term maturities. The Company may, in the future, utilize short-term borrowings to fund hybrid and fixed-rate Mortgage Assets. The Company has not, at the present time, entered into any long-term commitment agreements under which a lender would be required to enter into new borrowing agreements during a specified period of time; however, the Company may enter into one or more of such commitment agreements in the future if deemed favorable to the Company. In the event the Company is not able to renew or replace maturing borrowings, the Company could be required to sell Mortgage Assets under adverse market conditions and could incur losses as a result. In addition, in such event, the Company may be required to terminate Interest Rate Agreements, which could result in further costs to the Company. An event or development such as a sharp rise in interest rates or increasing market concern about the value or liquidity of a type or types of Mortgage Loans or Mortgage Securities which are short-term funded will reduce the market value of the Mortgage Assets, which would likely cause lenders to require additional collateral. At the same time, the market value of the short-term funded Mortgage Assets in which the Company's liquidity capital is invested may have decreased. A number of such factors in combination may cause difficulties for the Company, including a possible liquidation of a major portion of the Company's Mortgage Assets at disadvantageous prices with consequent losses, which could have a materially adverse effect on the Company and its solvency.

Risk of Decline in Market Value of Mortgage Assets; Margin Calls

Certain of the Company's Mortgage Assets may be cross-collateralized to secure multiple short-term borrowing obligations of the Company from a single lender. A decline in the market value of such Mortgage Assets may limit the Company's ability to borrow or result in lenders initiating margin calls on the Company's short-term debt (i.e., requiring a pledge of cash or additional Mortgage Assets to re-establish the ratio of the amount of the borrowing to the value of the collateral). In the event that the Company acquires fixed-rate or hybrid Mortgage Assets pursuant to its Asset Acquisition/Capital Allocation Policies, such fixed-rate Mortgage Assets, if funded with short-term debt, may be more susceptible to margin calls as increases in interest rates tend to more negatively affect the market value of fixed-rate or hybrid Mortgage Assets than adjustable-rate Mortgage Assets. This remains true despite effective hedging against such fluctuations as the hedging instruments may not be part of the collateral securing the collateralized borrowings. Additionally, it may be difficult to realize the full value of the hedging instrument when desired for liquidity purposes due to the applicable REIT Provisions of the Code. The Company could be required to sell Mortgage Assets under adverse market conditions in order to maintain liquidity. Such sales may be effected by management when deemed necessary in order to preserve the capital base of the Company. If these sales were made at prices lower than the amortized cost of the Mortgage Assets, the Company would experience losses. A default by the Company under its short-term or long-term collateralized borrowings could also result in a liquidation of the collateral, including any cross-collateralized assets, and a resulting loss of the difference between the value of the collateral and the amount borrowed. Additionally, in the event of a bankruptcy of the Company, certain reverse repurchase agreements may qualify for special treatment under the Bankruptcy code, the effect of which is, among other things, to allow the creditors under such agreements to avoid the automatic stay provisions of the Bankruptcy Code and to liquidate the collateral under such agreements without delay.

To the extent the Company is compelled to liquidate Mortgage Assets qualifying as Qualified REIT Real Estate Assets to repay borrowings, the Company may be unable to comply with the REIT provisions of the Code regarding assets and sources of income requirements, ultimately jeopardizing the Company's status as a REIT.

RISK OF DECREASE IN NET INTEREST INCOME DUE TO INTEREST RATE FLUCTUATIONS; PREPAYMENT RISKS OF MORTGAGE ASSETS

The Company's Mortgage Assets bear, and the Company expects that some of the Company's Mortgage Assets in the future will continue to bear, adjustable interest or pass-through rates based on short-term interest rates, and substantially all of the Company's borrowings connected with

adjustable-rate assets will bear interest at short-term rates. Such borrowings, if short-term, will typically have maturities or resets of less than one year. Consequently, changes in short-term interest rates may significantly influence the Company's net interest income. While increases in short-term interest rates will generally increase the yields on the Company's adjustable-rate Mortgage Assets, rising short-term rates will also increase the costs of borrowings by the

Company which will be utilized to fund the Mortgage Assets and, to the extent such costs rise more rapidly than the yields on such Mortgage Assets, the Company's net interest income, in the short-term, may be reduced or a net loss may result. Conversely, decreases in short-term interest rates may decrease the interest cost on the Company's borrowings more rapidly than the yields on the Mortgage Assets and, hence, may increase the Company's net interest income in the short-term. In some circumstances, however, the yield on the Company's Mortgage Assets may fall faster than the Company's cost of funds, thus decreasing net interest income. In the longer-term, lower short-term interest rates are expected to be more likely to lead to lower net income and higher short-term interest rates are expected to be more likely to lead to higher net income, all other factors being equal. No assurance can be given as to the amount or timing of changes in interest rates or their effect on the Company's Mortgage Assets, borrowings or net interest income.

Mortgage Asset prepayment rates vary from time to time and may cause changes in the amount of the Company's net interest income. Prepayments of adjustable-rate, fixed-rate and hybrid Mortgage Loans and Mortgage Securities backed by adjustable-rate, fixed-rate and hybrid Mortgage Loans usually can be expected to increase when mortgage interest rates fall below the then-current interest rates on such assets and decrease when mortgage interest rates exceed the then-current interest rates on the assets, although such effects are not predictable. Prepayment experience also may be affected by the geographic location of the property securing the Mortgage Loans, the assumability of the Mortgage Loans, conditions in the housing and financial markets, general economic conditions and other factors. In addition, prepayments on ARMs are affected by the ability of the borrower to convert an ARM to a fixed-rate loan and by conditions in the fixed-rate mortgage market. If the interest rates on ARMs increase at a rate greater than the interest rates on fixed-rate Mortgage Loans, prepayments on ARMs may tend to increase. In periods of fluctuating interest rates, interest rates on ARMs may exceed interest rates on fixed-rate Mortgage Loans, which may tend to cause prepayments on ARMs to increase at a rate greater than anticipated. The Company seeks to minimize prepayment risk through a variety of means, including structuring a diversified portfolio with a variety of prepayment characteristics, investing in Mortgage Assets with prepayment prohibitions and penalties, investing in certain Mortgage Securities structures which have prepayment protection, balancing Mortgage Assets purchased at a premium with Mortgage Assets purchased at a discount and prepayment hedging. In certain operating environments, however, it may not be possible for the Company to acquire assets with a zero net balance of discount and premium. The Company may choose not to hedge prepayment risk, and any such hedges may not be effective. In such circumstances, the risk of earning variability resulting from changes in prepayment rates may rise. In addition, the Company has purchased interest-only strips and may in the future purchase interest-only and principal-only strips to a limited extent. No strategy can completely insulate the Company from prepayment risks arising from the effects of interest rate changes while simultaneously meeting returns acceptable to shareholders.

Changes in anticipated prepayment rates of Mortgage Assets could affect the Company in several adverse ways. The faster than anticipated prepayment of any adjustable-, hybrid- or fixed-rate Mortgage Asset with a premium balance that is owned by the Company would generally result in a faster than anticipated write-off any remaining unamortized premium amount and consequent reduction of the Company's net interest income by such amount. In addition, increased prepayments may disadvantage the Company in environments where the Company can only acquire assets with lower returns than its existing assets. In addition, a, portion of the adjustable-rate Single-Family Mortgage Loans acquired or to be acquired by the Company (either directly as Mortgage Loans or through Mortgage Securities backed by Mortgage Loans) have or will have been recently originated and may still bear initial interest rates which are lower than their "fully-indexed" rates (the applicable index plus margin). In the event that such an ARM is prepaid faster than anticipated prior to or soon after the time of adjustment to a fully-indexed rate, the Company will have experienced an adverse effect on its net interest income during the time it held such ARM compared with holding a fully-indexed ARM and will have lost the opportunity to receive interest at the fully-indexed rate over the expected life of the ARM. These effects may be mitigated to the extent such ARMs were acquired at a discount to face value.

RISK OF FAILING TO HEDGE AGAINST INTEREST RATE CHANGES EFFECTIVELY; RISK OF LOSSES ASSOCIATED WITH HEDGING; COUNTERPARTY RISKS

The Company's operating strategy subjects it to interest and prepayment rate risks as described above. The Company follows an asset/liability management program intended to partially protect against interest rate

changes and prepayments. Nevertheless, developing an effective asset/liability management strategy is complex and no strategy can completely insulate the Company from risks associated with interest rate changes and prepayments and the Company does not attempt to hedge away all such risks. In addition, there can be no assurance that the Company's hedging activities will have the desired beneficial impact on the Company's results of operations or financial condition. Hedging typically involves costs, including transaction costs, which increase dramatically as the period covered by the hedge increases and which also increase during periods of rising and volatile interest rates. The Company may increase its hedging activity, and thus increase its hedging costs, during such periods when interest rates are volatile or rising and/or when hedging costs have increased. Moreover, Federal tax laws applicable to REITs may substantially limit the Company's ability to engage in asset/liability management transactions. Such Federal tax laws may prevent the Company from effectively implementing hedging strategies that the Company determines, absent such restrictions, would best insulate the Company from the risks associated with changing interest rates and prepayments.

The Company purchases and sells from time to time interest rate caps, interest rate swaps, interest rate futures and similar instruments to attempt to mitigate the risk of the cost of its variable-rate liabilities increasing at a faster rate than the earnings on its assets during a period of rising rates to modify the characteristics of any fixed-rate loan issuance or to hedge the anticipated issuance of future liabilities or the market value of certain assets. In this way, the Company intends generally to hedge as much of the interest rate risk and prepayment risk as management determines is in the best interests of the stockholders of the Company given the cost of such hedging transactions and the need to maintain the Company's status as a REIT. In this regard, the amount of income the Company may earn from its interest rate caps and other hedging instruments is subject to substantial limitations under the REIT Provisions of the Code. In particular, when the Company earns income under such instruments, it will seek advice from tax counsel as the whether such income constitutes qualifying income for purposes of the 95% Gross Income Test and as to the proper characterization of such arrangements for purposes of the REIT Asset Tests. This determination may result in management electing to have the Company bear a level of interest rate risk that could otherwise be hedged when management believes, based on all relevant facts, that bearing such risk is prudent.

In the event that the Company purchases interest rate caps or floors or enters into other contractual interest rate agreements, and the provider of interest rate agreements becomes financially unsound or insolvent, the Company may be forced to unwind its interest rate agreements with such provider and may take a loss on such interest rate agreements. Although the Company intends to purchase interest rate agreements only from financially sound institutions and to monitor the financial strength of such institutions on an on-going basis, no assurance can be given that the Company can avoid such third party risks.

RISK OF LOSS ON SINGLE-FAMILY MORTGAGE ASSETS

At December 31, 1997, 54% of the Mortgage Assets owned by the Company were Mortgage Securities. The Company bears the risk of loss on any Mortgage Securities it purchases in the secondary mortgage market or otherwise. However, 99% of Mortgage Securities at December 31, 1997, are either Agency Certificates or are generally structured with one or more types of credit enhancement. To the extent third parties have been contracted to provide the credit enhancement, the Company is dependent in part upon the creditworthiness and claims-paying ability of the insurer and the timeliness of reimbursement in the event of a default on the underlying obligations. Further, the insurance coverage for various types of losses is limited in amount and losses in excess of the limitation may be borne by the Company. The Company generally does not intend to obtain credit enhancements such as mortgage pool or special hazard insurance for its Single-Family Mortgage Loans, other than FHA insurance, VA guarantees and private mortgage insurance, in each case relating only to individual Mortgage Loans. Accordingly, during the time it holds such Mortgage Loans for which third party insurance is not obtained, the Company will be subject to risks of borrower defaults and bankruptcies and special hazard losses that are not covered by standard hazard insurance (such as those occurring from

earthquakes or floods). In the event of a default on any Single-Family Mortgage Loan held by the Company, including, without limitation, any event of default resulting from higher default levels as a result of declining property values and worsening economic conditions, among other factors, the Company would bear the risk of loss of principal to the extent of any deficiency between the value of the related mortgage property, plus any payments from an insurer or guarantor, and the amount owing on the Mortgage Loan. Defaulted Mortgage

Loans may also cease to be eligible collateral for short-term borrowings and, to the extent not funded with long-term, non-recourse debt, would have to be financed by the Company out of other funds or funded with equity until ultimately liquidated, resulting in increased financing costs, reduced net income or a net loss.

RISK OF FUTURE REVISIONS IN POLICIES AND STRATEGIES BY BOARD OF DIRECTORS

The Board of Directors has established the investment policies and operation policies and strategies set forth in this Form 10-K as the investment policies and operating policies and strategies of the Company. However, these policies and strategies may be modified or waived by the Board of Directors, subject in certain cases to approval by a majority of the Independent Directors, without stockholder consent. The ultimate effect of changes in these policies and strategies may be positive or negative.

The Company is building a credit reserve for potential future credit losses through its credit provisions. To the extent credit losses experienced in the future exceed anticipated levels, the amount of credit provisions may be increased, negatively impacting the Company's income under Generally Accepted Accounting Principles ("GAAP"). Moreover, for tax purposes, credit losses are not covered by the GAAP credit provisions; rather, credit losses reduce the Company's taxable income in the period in which they are realized and hence would reduce the dividends payable for such period.

OTHER RISKS

DEPENDENCE ON KEY PERSONNEL

The Company's operations depend significantly upon the contributions of its executive officers, many of whom may be difficult to replace. Although all executive officers currently have employment agreements with the Company, there can be no assurance of the continued employment of all such officers. The loss of any key person could have a material adverse effect on the Company's business and results of operations.

CAPITAL STOCK PRICE VOLATILITY RISK

With respect to the public market for the Common Stock, it is likely that the market price of the Common Stock will be influenced by any variation between the net yield on the Company's Mortgage Assets and prevailing market interest rates and by the market's perception of the Company's ability to achieve earnings growth. The Company's earnings will be derived primarily from any positive spread between and yield on the Company's Mortgage Assets and the cost of the Company's borrowings. The positive spread between the yield on the Company's Mortgage Assets and the cost of borrowings will not necessarily be stable regardless of the Company's business strategy to achieve such result over longer periods of time. If the anticipated or actual net yield on the Company's Mortgage Assets declines or if prevailing short-term market interest rates rise, thereby decreasing the positive spread between the net yield on the Mortgage Assets and the cost of the Company's borrowings, the market price of the Common Stock may be adversely affected. The market price of the Company's Common Stock may also be influenced by real or perceived future earnings variability caused by changes in prepayment rates. In addition, if the market price of other REIT stocks decline for any reason, or there is a broad-based decline in real estate values or in the value of the Company's Mortgage Assets and the market price of the Common Stock has been adversely affected due to any of the foregoing reasons, the liquidity of the Common Stock may be negatively impacted and investors who may desire or be required to sell shares of Common Stock may experience losses.

RECENT PROPOSED TAX LEGISLATION

The President's recently released 1999 Budget Plan includes certain proposed legislative changes which, if enacted, could adversely affect the Company and its ability to engage in certain activities. Under the

President's proposals, among other things, a REIT would be prohibited from owning more than 10 percent of the stock of a corporation (other than a "Qualified REIT Subsidiary") measured either by vote or by value, rather than more than 10 percent of the voting stock of such a corporation as under current law. If this proposal is adopted, the Company will be unable to establish taxable subsidiaries through which to engage in non-qualifying activities, such as the holding of property primarily for sale in the ordinary course of business or certain hedging activities. It is impossible to predict at this time whether one or more of the President's proposals, or other proposals

which would similarly affect the Company, will ultimately be adopted. See "Certain Federal Income Tax Considerations - Proposed Tax Legislation".

ITEM 2. PROPERTIES

The Company's executive and administrative offices are located at 591 Redwood Highway, Suite 3100, Mill Valley, California 94941, telephone (415) 389-7373. Such offices are leased under a lease expiring on May 5, 2001.

ITEM 3. LEGAL PROCEEDINGS

At December 31, 1997, there were no pending legal proceedings to which the Company was a party or of which any of its property was subject.

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

No matters were submitted to a vote of the Company's shareholders during the fourth quarter of 1997.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

As of January 28, 1998, the Company's Common Stock is listed and traded on the New York Stock Exchange under the symbol RWT. Prior to that date, the Company's Common Stock was traded on the over-the-counter market and was quoted on the Nasdaq National Market under the symbol RWTI. The Company's Common Stock was held by approximately 400 holders of record on March 11, 1998 and the total number of beneficial shareholders holding stock through depository companies was approximately 4,000. The high and low closing sales prices of shares of the Common Stock as reported on the New York Stock Exchange or the Nasdaq National Market composite tape and the cash dividends declared on the Common Stock for the periods indicated below were as follows:

<TABLE>
<CAPTION>

	Stock Prices		Dividends
	High	Low	Declared
<S>	<C>	<C>	<C>
Year Ended December 31, 1998			
First Quarter (through March 11, 1998)	$22 1/2	$18 5/8	N/A
Year Ended December 31, 1997			
First Quarter	$56 3/4	$36 1/2	$0.60
Second Quarter	$57 1/8	$39 1/4	$0.60
Third Quarter	$50	$27 7/8	$0.60

Fourth Quarter	$31 3/4	$19 9/16	$0.35
Year Ended December 31, 1996			
First Quarter	$21 3/4	$18 3/4	$0.46
Second Quarter	$28	$19 3/8	$0.40
Third Quarter	$32 1/4	$23 1/4	$0.40
Fourth Quarter	$37 1/2	$31 1/4	$0.41

The Company intends to pay quarterly dividends. The Company intends to make distributions to its stockholders of all or substantially all of its taxable income each year (subject to certain adjustments) so as to qualify for the tax benefits accorded to a REIT under the Code. All distributions will be made by the Company at the discretion of the Board of Directors and will depend on the taxable earnings of the Company, financial condition of the Company, maintenance of REIT status and such other factors as the Board of Directors may deem relevant from time to time. No dividends may be paid on the Common Stock unless full cumulative dividends have been paid on the Preferred Stock. As of December 31, 1997, the full cumulative dividends have been paid on the Preferred Stock.

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data is for the years ended December 31, 1997, 1996 and 1995 and for the period from commencement of operations on August 19, 1994 to December 31, 1994. It is qualified in its entirety by, and should be read in conjunction with the more detailed information contained in the Consolidated Financial Statements and Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this Form 10-K.

(IN THOUSANDS, EXCEPT PER SHARE DATA)	YEARS ENDED DECEMBER 31, 1997	1996	1995	PERIOD FROM AUGUST 19, 1994 TO DECEMBER 31, 1994
STATEMENT OF OPERATIONS DATA:				
Interest income	$ 198,604	$ 67,284	$ 15,726	$ 1,296
Interest expense	160,277	49,191	10,608	760
Interest rate agreement expense	3,741	1,158	339	8
Net interest income	34,586	16,935	4,779	528
Net income	27,561	12,685	3,155	382
Net income available to common stockholders	$ 24,746	$ 11,537	$ 3,155	$ 382
Net taxable income	$ 29,964	$ 15,168	$ 3,832	$ 354
Net taxable income available to common stockholders	$ 27,149	$ 14,020	$ 3,832	$ 354
Weighted average shares of common stock and common stock equivalents - "diluted"	13,680,410	8,744,184	3,703,803	1,916,846
Diluted earnings per share	$ 1.81	$ 1.32	$ 0.85	$ 0.20
Dividends declared per Class A preferred share	N/A	N/A	$ 0.500	$ 0.250
Dividends declared per Class B preferred share	$ 3.020	$ 1.141	N/A	N/A
Dividends declared per common share	$ 2.150	$ 1.670	$ 0.460	N/A
BALANCE SHEET DATA:				
Mortgage assets	$ 3,366,622	$ 2,153,428	$ 432,244	$ 117,477
Total assets	$ 3,444,197	$ 2,184,197	$ 441,557	$ 121,528
Short-term debt	$ 1,914,525	$ 1,953,103	$ 370,316	$ 100,376
Long-term debt	$ 1,172,801	--	--	--
Total liabilities	$ 3,109,660	$ 1,973,192	$ 373,267	$ 101,248
Total stockholders' equity	$ 334,537	$ 211,005	$ 68,290	$ 20,280
Number of Class A preferred shares outstanding	--	--	--	1,666,063
Number of Class B preferred shares outstanding	909,518	1,006,250	--	--
Number of common shares outstanding	14,284,657	10,996,572	5,517,299	208,332
OTHER DATA:				
Average assets (amortized cost)	$ 3,036,725	$ 999,762	$ 220,616	$ 58,414
Average borrowings	$ 2,709,208	$ 861,316	$ 174,926	$ 37,910
Average equity	$ 307,029	$ 131,315	$ 43,349	$ 20,137

Interest rate spread	0.68%	1.09%	1.11%	0.72%
Net interest margin	1.14%	1.69%	2.17%	2.50%
Operating expenses as a percent of net interest income	13.47%	15.08%	23.66%	27.73%
Operating expenses as a percent of average assets	0.15%	0.26%	0.51%	0.69%
Operating expenses as a percent of average equity	1.52%	1.94%	2.61%	2.01%
Return on average assets	0.91%	1.27%	1.43%	1.81%
Average assets/average equity	9.89x	7.61x	5.09x	2.93x
Return on average equity	8.98%	9.66%	7.28%	5.25%
Credit reserves	$ 4,931	$ 2,180	$ 490	--
Actual credit losses	$ 179	$ 7	$ 4	--

</TABLE>

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

SAFE HARBOR STATEMENT

"Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995: Statements in this discussion regarding Redwood Trust, Inc. (the "Company") and its business which are not historical facts are "forward-looking statements" that involve risks and uncertainties. For a discussion of such risks and uncertainties, which could cause actual results to differ from those contained in the forward-looking statements, see "Risk Factors" commencing on Page 27 of this Form 10-K.

OVERVIEW

Redwood Trust, Inc. is a financial institution specializing in the single-family residential mortgage spread lending business. The Company earns net income to the extent that the interest income it earns from its mortgage loans and securities exceeds the cost of borrowed funds, hedging, credit loss expenses and operating expenses.

The Company seeks to earn net interest income from first-lien single-family residential mortgage loans and securities underwritten to "A" or "prime" quality standards. The Company believes its primary competitors in the "A" quality mortgage spread lending business are banks, savings and loans, insurance companies, the two government-sponsored mortgage entities ("GSEs": Fannie Mae and Freddie Mac) and other mortgage Real Estate Investment Trusts ("REITs").

The Company has chosen to pursue a wholesale strategy (such as is employed by the GSEs) rather than a retail strategy (such as is employed by most banks and savings and loans). Like the GSEs, the Company does not originate loans directly but rather acquires loans from mortgage origination companies and from the secondary mortgage market. Like the GSEs, the Company out-sources the servicing of its mortgage loans and sources its borrowings on a wholesale basis in the capital markets rather than seeking retail deposits through a branch banking system. The Company believes that its wholesale strategy allows the Company to operate in a highly efficient manner while remaining focused on its core spread lending business.

Over the past year, the Company has moved a long way towards transforming itself from a spread lending company managing mortgage securities funded with short-term debt to a spread lending company managing high-quality single-family mortgage loans funded with long-term debt. The impact of this transition on the Company's results is discussed below.

The Company has elected to be considered a REIT with respect to Federal and state income taxes. This election generally allows the Company to avoid paying corporate income tax so long as it distributes at least 95% of its taxable income as dividends and meets the other REIT requirements.

RESULTS OF OPERATIONS

Mortgage Asset Acquisitions, Principal Repayments and Net Asset Growth

In the fourth quarter of 1997, the Company acquired $342 million in mortgage assets, including $275 million in mortgage loans and $67 million in mortgage securities. The Company received mortgage principal repayments of $347 million and sold mortgage securities for $46 million during this period. The net decline in total assets was $81 million, or 2%, in the fourth quarter of 1997.

In 1997, the Company acquired $1.3 billion in mortgage loans and $1.0 billion in mortgage securities. The Company received mortgage principal repayments of $973 million and sold mortgage securities for $88

million. Total assets grew by $1.3 billion, or 58%, to $3.4 billion.

In 1996, the Company acquired $0.5 billion in mortgage loans and $1.5 billion in mortgage securities. The Company received mortgage principal repayments of $258 million. Total assets grew by $1.7 billion, or 395%, to $2.2 billion.

Through December 31, 1997, all mortgage loans acquired have been high-quality, adjustable-rate, first-lien mortgages on single-family residential properties. All mortgage securities acquired have represented securitized interests in pools of adjustable rate, single-family mortgage loans.

One commonly used measure of the average annual rate of prepayment of mortgage principal is the conditional prepayment rate ("CPR"). The CPR for the Company's mortgage loans and the mortgages contained in the pools underlying its mortgage securities increased from 19% in 1995 to 25% in both 1996 and 1997. The CPR rate of the Company's mortgage asset portfolio in the fourth quarter of 1997 was 27%. The CPR rate of the Company's mortgage asset portfolio has ranged between 23% and 29% since the fourth quarter of 1995.

In addition to prepayments, the Company also receives scheduled mortgage principal payments (payments representing the normal principal amortization of a 30-year mortgage loan). Some mortgage securities owned by the Company are subject to call provisions and some receive accelerated payments, i.e., a greater than pro-rata share of principal repayments generated by the underlying mortgage pool. Thus the total amount of repayment of mortgage principal received each month exceeds the level of prepayments. The average annualized rate of mortgage principal repayment from all of these sources as a percent of the average principal balance of mortgage assets increased from 18% in 1995 to 27% in 1996 to 34% in 1997. Principal repayments from all sources accelerated to 43% in the fourth quarter of 1997. The annualized rate of mortgage principal repayment of the Company's mortgage assets has ranged between 26% and 32% from the fourth quarter of 1995 through the third quarter of 1997.

Creation of Mortgage Equity Interests, Issuance of Long-Term Debt, REMICs

Over the past year, the Company has concentrated on reducing liquidity risk and other risks on its balance sheet by replacing short-term debt with long-term debt. It has done this through the creation of "mortgage equity interests." The Company defines a mortgage equity interest as the ownership of the equity portion of a mortgage spread lending "subsidiary trust" wherein the assets of the trust are funded with long-term debt or similar instruments, the debt and other liabilities of the trust are non-recourse to the Company, and liquidity risk is essentially eliminated. Mortgage equity interests can be created through transactions structured as collateralized mortgage bonds, collateralized bond obligations, REMICs, FASITs and other means.

Through its special-purpose finance subsidiary, Sequoia Mortgage Funding Corporation ("Sequoia"), the Company issued $1.3 billion of non-recourse, floating-rate, long-term debt in 1997 in the form of collateralized mortgage bonds. The Company used the proceeds to reduce short-term debt. All of the long-term debt is rated AAA, amortizes at approximately the same rate as the collateral and has a 10% lifetime interest rate cap. On a consolidated basis, long-term debt at year end was $1.2 billion and represented 38% of total debt. At year end, the investment in the mortgage equity interests created through the Sequoia program totaled $49 million. Liquidity and market value fluctuation risk for that portion of the Company's equity base has been substantially eliminated. Recognizing this risk reduction, the Company requires significantly lowered Risk-Adjusted Capital guideline amounts for Sequoia assets as opposed to assets held in the Redwood Trust parent corporation funded with short-term debt. As a result, the Company's overall weighted average Risk-Adjusted Capital guideline equity-to-assets ratio declined from 9.97% at the end of 1996 to 7.51% at the end of 1997.

In 1994 and 1995, the Company acquired a $55 million portfolio of mortgage equity interests which had been created by others in the form of subordinated tranches of REMIC transactions. The Company was able to effectively re-finance this portfolio of mortgage equity interests in December 1997 through a non-recourse re-REMIC transaction with an insurance company as the counter-party. Through this transaction, the Company was able to reduce its net equity capital investment in this portfolio from $20 million to $9 million. This transaction significantly reduced the Company's credit risk and liquidity risk from this portfolio, while at the same time enhanced the Company's return on equity from these assets and freed up a substantial portion of the Company's original capital investment in this portfolio for reallocation to fund future growth opportunities.

Although this re-REMIC transaction is most easily understood as a financing, it qualified as a sale for accounting purposes. As a result, the company recognized a gain on sale from the re-REMIC of $0.54 million for GAAP income and $0.35 million for taxable income and the net amount of $46.4 million of assets in the REMIC which were refinanced through the issuance of re-REMIC securities do not appear on the Company's consolidated balance sheet.

Mortgage equity interests created and retained by the Company through the re-REMIC and Sequoia transactions totaled $58 million at year end. The Company generally intends to fund ownership of mortgage equity interests with equity capital rather than through the use of debt. Over 17% of the Company's equity base was allocated to mortgage equity interests at year end 1997. The Company intends to seek to increase this allocation over time through the creation of additional mortgage equity interests and through the acquisition of mortgage equity interests created by others.

Interest Income

From the third quarter of 1997 to the fourth quarter of 1997, interest income declined by 5%. This decrease was the result of lower coupon rates and higher prepayments. In the fourth quarter of 1997, average earning assets of $3.30 billion generated interest income of $54.0 million. In the third quarter of 1997, average earning assets of $3.33 billion generated interest income of $56.5 million.

In the fourth quarter of 1997, the Company's earning asset yield (interest income annualized and divided by the average daily amortized cost of earning assets) of 6.54% was below the yield of 6.80% achieved in the third quarter of 1997. The average mortgage coupon rate (mortgage interest payments annualized and divided by the average daily principal value of mortgages) fell from 7.77% to 7.70%. The coupon yield on the Company's average amortized cost of 102.2% for the Company's mortgages also fell 0.07%, from 7.60% to 7.53%. Net mortgage premium and discount amortization expenses increased from $6.9 million to $8.2 million from the third to the fourth quarter of 1997. These expenses reduced the yield on earning assets by 0.98% in the fourth quarter of 1997 and 0.79% in the third quarter of 1997. This 0.19% reduction in yield due to prepayments and the 0.07% drop in coupon rates resulted in the yield on earning assets falling by 0.26% in the fourth quarter of 1997 from the previous quarter.

From 1996 to 1997, interest income increased by 195%. From 1995 to 1996, interest income increased by 328%. These increases were driven primarily by a 203% increase in average earning assets (mortgage assets plus cash) from 1996 to 1997 and a 355% increase in average earning assets from 1995 to 1996. In 1997, the Company's average earning assets of $2.95 billion generated interest income of $198.6 million. In 1996, average earning assets of $0.97 billion generated interest income of $67.3 million. In 1995, average earning assets of $0.21 billion generated interest income of $15.7 million.

In 1997, the Company's earning asset yield was 6.74%. The average mortgage coupon rate was 7.72%. Since the Company's average amortized cost was 102.1% of mortgage principal value during the year, the coupon yield on amortized cost for the Company's mortgages was 7.56%. Net mortgage premium amortization expenses of $23.4 million reduced the coupon yield by 0.81% for a net mortgage yield of 6.75%. The yield earned on the Company's cash balances during the year was 5.53%; the blended earning asset yield was 6.74%.

The Company's earning asset yield was 6.93% in 1996. The average mortgage coupon rate was 7.55%. Since the Company's average amortized cost for mortgage assets was 100.7% of mortgage principal value during the year, the coupon yield on amortized cost for the Company's mortgages was 7.50%. Net mortgage premium amortization expenses of $5.2 million reduced the coupon yield by 0.55% for a net mortgage yield of 6.95%. The yield earned on the Company's cash balances during the quarter was 5.51%, bringing the overall 1996 blended earning asset yield to 6.93%.

The Company's earning asset yield was 7.36% in 1995. The average mortgage coupon rate was 7.16%. Since the Company's average amortized cost for mortgage assets was 99.0% of mortgage principal value during the year, the coupon yield on amortized cost for the Company's mortgages was 7.23%. Net mortgage discount amortization income of $0.36 million increased the coupon yield by 0.17% for a net mortgage yield of 7.40%. The yield

earned on the Company's cash balances during the quarter was 5.43%, bringing the overall 1995 blended earning asset yield to 7.36%.

The 6.74% earning asset yield for 1997 was lower than the 6.93% for 1996. The actual coupon yield on the mortgage assets was slightly higher in 1997 than in 1996 (7.56% versus 7.50%). The Company's average amortized cost for mortgage assets, however, was higher in 1997 than in 1996 (102.1% versus 100.7%) as was the total mortgage principal repayment rate (34% versus 27%). The reduction in mortgage yield due to net premium amortization expense increased from 0.55% in 1996 to 0.81% in 1997.

The 6.93% earning asset yield for 1996 was lower than the 7.36% for 1995. The actual coupon yield on the mortgage assets was higher in 1996 than in 1995 (7.50% versus 7.23%). The Company's average amortized cost for mortgage assets, however, was higher in 1996 than in 1995 (100.7% versus 99.0%) as was the total mortgage principal repayment rate (27% versus 18%). The negative impact to mortgage yield due to net premium amortization expense was 0.55% in the 1996, whereas net discount amortization income contributed 0.17% to mortgage yield in 1995.

During 1996 and 1997, the Company generally acquired mortgage assets with lower risk characteristics than those assets previously acquired. As a result, average credit quality improved, with the percentage of the balance sheet consisting of subordinated mortgage securities rated below AA falling from 12.4% at the end of 1995 to 2.5% at the end of 1996 to 0.3% at the end of 1997. This change in asset mix was one of the factors allowing significant decreases in the equity-to-assets capital adequacy guideline as determined by the Company's Risk-Adjusted Capital Policy.

The lower risk assets acquired by the Company generally had higher acquisition prices reflecting their lower risk. As a result, the Company earned a lower yield on these mortgages. This is part of the Company's current strategy of seeking to earn higher returns on equity over time by utilizing lower-risk, reduced spread assets in conjunction with greater leverage. To some degree, the slight decrease in the earning asset yield in 1997 also reflects the high pricing levels (relative to the risk) for mortgages that have prevailed in the mortgage market for several quarters.

Interest Expense

From the third quarter of 1997 to the fourth quarter of 1997, interest expense increased by 1%. Total average borrowings remained relatively stable. In the third quarter of 1997, average borrowings were $3.05 million of which 12% were long-term borrowings. In the fourth quarter of 1997, average borrowings were $3.06 million of which 20% were long-term borrowings. This increase in higher cost long-term borrowings, combined with a slight increase in short-term interest rates, resulted in an increase in the Company's cost of funds from 6.02% to 6.09% from the third to the fourth quarter of 1997.

From 1996 to 1997, interest expense increased by 226%. This increase was driven primarily by a 215% increase in average borrowings from 1996 to 1997. Average borrowings were $0.86 billion in 1996 and $2.71 billion in 1997. Borrowings increased at a slightly faster rate during 1997 than did earning assets (215% versus 203%) as the Company utilized a greater percentage of debt rather than equity to fund its growing mortgage operations. The average equity-to-assets ratio for the Company was 10.1% in 1997 as compared to 13.1% in 1996.

An additional factor driving the increase in interest expense from 1996 to 1997 was a 0.21% increase in the Company's cost of funds from 5.71% in 1996 to 5.92% in 1997. This increase reflects higher levels of short-term interest rates; the average daily one month LIBOR rate was 0.19% higher in 1997 than in 1996. The increase in cost of funds also reflects the issuance of long-term debt during the third and fourth quarters of 1997 and a change in the mix of assets towards mortgage loans rather than mortgage securities.

From 1995 to 1996, interest expense increased by 364%. This increase was driven primarily by a 392% increase in average borrowings from 1995 to 1996. Average borrowings were $0.17 billion in 1995. Borrowings increased at a faster rate during 1996 than did earning assets (392% versus 355%) as the Company utilized a greater percentage of debt rather than equity to fund its growing mortgage operations. The average equity-to-assets ratio for the Company was 13.1% in 1996 as compared to 19.6% in 1995. The Company's cost of funds

decreased by 0.35% from 6.06% in 1995 to 5.71% in 1996. The decrease in cost of funds primarily reflects the decrease in short-term interest rates during this period; the average daily one month LIBOR rate was 0.52% lower in 1996 than in 1995. The Company's cost of funds did not

fall by the full 0.52% decline in short-term rates due to a change in the mix of assets towards mortgage loans rather than mortgage securities and because the average term-to-next-rate-adjustment of the Company's liabilities exceeded one month so the cost of funds did not drop as quickly as the one month LIBOR rate did.

Interest Rate Agreements Expense

Interest rate agreements are a form of interest rate insurance, or hedging, which the Company utilizes to reduce the effects that large changes in interest rates could have on its balance sheet and earnings. The Company seeks to hedge, in part, the market value and earnings risks arising from the life caps, periodic caps and the fixed coupon period to the next adjustment date for its adjustable-rate mortgage assets. The Company also, in part, may hedge the market value of acquired mortgage loans prior to securitization into a mortgage equity interest, hedge the anticipated issuances of liabilities, hedge premium amortization risk that may arise from falling interest rates, and hedge the risk arising from any hybrid or fixed rate mortgages which are funded short-term or on a non-matched basis. The Company may use interest rate agreements for other hedging purposes as well.

Interest rate agreements expense increased from $1.03 million in the third quarter of 1997 to $1.27 million in the fourth quarter of 1997. This net expense increased as a percent of average assets from 0.12% to 0.15%, and as a percent of average borrowings from 0.14% to 0.17%. This increase was due to an increase in the number of interest rate agreements which were effective during the fourth quarter.

From 1996 to 1997, net interest rate agreement expense grew by 222%, from $1.16 million to $3.74 million. The net interest rate agreement expenses grew during this period as total assets and borrowings grew. In 1996, interest rate agreement expenses represented 0.12% of average assets and 0.13% of average borrowings. In 1997, net interest rate agreement expense represented 0.12% of average assets and 0.14% of average borrowings.

From 1995 to 1996, net interest rate agreement expense grew by 241%, from $0.34 million to $1.16 million. Net interest rate agreement expenses grew during this period as total assets and borrowings grew. In 1995, net interest rate agreement expenses represented 0.15% of average assets and 0.19% of average borrowings.

Net Interest Income

Net interest income is interest income less interest expense and net interest rate agreement expenses. Net interest income decreased from $9.6 million in the third quarter of 1997 to $6.2 million in the fourth quarter of 1997. The Company's interest rate spread narrowed due to a decline in the yield on earning assets and an increase in the cost of funds during these periods as discussed above.

Net interest income increased from $16.9 million in 1996 to $34.6 million in 1997, an increase of 104%. This increase was driven by balance sheet growth. Growth in net interest income was less than the growth in average equity of 133%. Net interest income as a percentage of average equity decreased from 12.90% to 11.26%.

Net interest income grew more slowly than the growth in net average equity primarily due to a narrowing in the spread between the Company's yield on earning assets and the cost of its borrowed funds and net hedging expenses (its interest rate spread). The Company's interest rate spread was 1.09% in 1996 as compared to 0.68% in 1997. As discussed above, the Company's yield on earning assets fell by 0.19% from 1996 to 1997 while the cost of funds rose by 0.21% and the cost of hedging rose by 0.01%. The Company has generally been seeking to maintain or improve its return on equity by offsetting the narrower spread it earns from lower risk assets through the greater use of leverage. Because the Company was not able to employ all of its capital, particularly in the second half of 1997, this strategy was not yet fully effective.

Net interest income increased from $4.8 million in 1995 to $16.9 million in 1996, an increase of 254%. This increase was driven by the growth in average total equity of 203%. Net interest income as a percentage of average equity increased from 11.03% to 12.90%.

Net interest income grew faster in 1996 than the growth in net average equity, despite a narrowing in the Company's interest rate spread. The Company's interest rate spread was 1.11% in 1995 as compared to 1.09% in 1996. The Company's yield on earning assets fell by 0.43% from 1995 to 1996 while the cost of funds declined by 0.35% and the cost of hedging fell by 0.06%. Net interest income grew faster than the Company's average total equity due to the Company's increased use of leverage during the period. The Company's average equity-to-assets ratio decreased from 19.6% in 1995 to 13.1% in 1996.

Please see "Interest Income" and "Interest Expense" above for a discussion of the factors that resulted in a trend towards a more narrow interest rate spread over time.

Credit Provision Expense and Actual Credit Losses

The Company establishes credit provisions in order build a reserve for potential future credit losses. Total credit provisions decreased from $0.94 million in the third quarter of 1997 to $0.52 million in the fourth quarter of 1997. This decrease was primarily the result of the re-REMIC transaction discussed above which allowed the Company to stop building up its credit reserves on its mortgage securities portfolio.

Total credit provisions of $2.93 million in 1997 equaled 0.10% of average assets and 0.95% of average equity in 1997. Total credit provisions of $1.70 million in 1996 equaled 0.17% of average total assets and 1.29% of average equity. Total credit provisions of $0.49 million in 1995 equaled 0.22% of average total assets and 1.14% of average equity.

The Company takes credit provisions for risk of credit loss from its portfolio of below-BBB rated subordinated mortgage securities as a function of projections of potential future losses. The Company reviews its loss projections based on trends in serious delinquencies and loan loss severities (actual losses realized as a percent of defaulted loan balances) in the underlying mortgage pools. Credit provisions for these assets were $0.43 million in 1997, $1.35 million in 1996 and $0.41 million in 1995. As a result of the re-REMIC transaction discussed above, the Company was able to significantly reduce its basis, and thus its credit risk, on this portfolio. This decline in credit risk resulted in a decline in the amount of credit provision required on these assets in 1997 as compared to 1996.

The Company takes credit provisions for its mortgage loan portfolio to provide for expected credit losses over the life of the portfolio. The Company took mortgage loan provisions of $2.50 million in 1997, $0.35 million in 1996 and $0.08 million in 1995. The Company's current policy is to set aside annual credit provisions for mortgage loans on an on-going basis equaling 0.10% to 0.20% of its mortgage loan portfolio. Though 1997, the annual provisions taken were greater than 0.20% of the loan portfolio as the Company sought to establish a higher base level of credit reserves. The increase in mortgage loans provisions from 1995 to 1996 was the result of average mortgage loans increasing from $0.01 billion in 1995 to $0.08 billion 1996. The increase in mortgage loans provisions from 1996 to 1997 was a result of average mortgage loans increasing from $0.08 billion in 1996 to $0.96 billion in 1997.

The Company realized actual credit losses of $179,000 in 1997, $7,000 in 1996 and $3,000 in 1995. Total cumulative actual credit losses from the inception of the Company through December 31, 1997 have been $189,000.

Credit provisions reduce net income and earnings per share but only actual credit losses are deducted when calculating taxable income. Dividends from a REIT are based on taxable income, so future dividends levels will be influenced by the rate of actual realized credit loss rather than the rate of credit provisioning. Thus, the Company's current credit reserve will not serve to insulate the Company's dividends from the effects of future actual realized credit losses.

Gain or Loss on Sale Transactions

The Company sold $88.0 million of mortgage securities in 1997. The gain on the sale of $42 million of mortgage securities sold in the third quarter was $0.17 million. In conjunction with the sale of these mortgage securities, the Company wrote down related interest rate agreements in the amount of $0.15 million, thereby reducing the net gain to $0.02 million. The net gain from this sale, combined with the $0.54 million gain in the fourth quarter of 1997 from the sale of $46 million of mortgage securities through the re-REMIC transaction discussed above, resulted in total 1997 gains on sales transactions of $0.56 million. These gains increased diluted earnings per share by $0.03 in 1997. There were no gains or losses on sales in 1995 or 1996.

Operating Expenses

Total operating expenses decreased from $1.15 million in the third quarter of 1997 to $1.13 million in fourth quarter of 1997. Operating expenses as a percentage of average assets remained at 0.13%, operating expenses as a percentage of average equity improved slightly from 1.33% to 1.29%, the efficiency ratio (operating expenses as a percentage of net interest income) worsened from 11.93% to 18.25% (due to a decrease in net interest income), and average assets per employee decreased slightly from $244 million to $242 million.

From 1996 to 1997, total operating expenses increased by 82%, from $2.55 million to $4.66 million. From 1995 to 1996, total operating expenses increased by 126%, from $1.13 million to $2.55 million. Compensation and other operating expenses increased as the scope of Company's operations expanded. The Company had 7 employees at the end of 1995, 10 employees at the end of 1996 and 15 employees at the end of 1997. In addition, a portion of the stock options granted to management, employees, and directors have dividend equivalent rights ("DERs") attached; the DER expense increased as the dividend per common share rose and the number of outstanding stock options with DERs attached increased. DER expense decreased from the third to the fourth quarter of 1997 as the dividend declined.

Operating expense ratios have improved as the Company realized economies of scale through growth. From 1996 to 1997, operating expenses as a percentage of assets improved from 0.26% to 0.15%, operating expenses as a percentage of average equity improved from 1.94% to 1.52%, the efficiency ratio improved from 15.08% to 13.47%, and average assets per employee increased from $109 million to $242 million. From 1995 to 1996, operating expenses as a percentage of assets improved from 0.51% to 0.26%, operating expenses as a percentage of average equity improved from 2.61% to 1.94%, the efficiency ratio improved from 23.66% to 15.08%, and average assets per employee improved from $39 million to $109 million.

The Company has adopted a Stock Option Plan for executive officers, employees and non-employee directors. At December 31, 1997 there were 840,644 stock options outstanding, 591,729 of which had current pay DERs attached and 206,832 of which had stock DERs attached. A portion of these DERs are subject to minimum dividend and/or vesting requirements. Holders of DERs are generally eligible to receive all types of distributions made to common shareholders, including any non-cash or return of capital distributions. To the extent options have been granted with current pay DERs attached, GAAP and taxable income will recognize the expense as cash payments accrue to the holders of the underlying option. To the extent options have been granted with stock DERs, there will be a non-cash charge to operating expenses for GAAP for the value of the DERs which accrue. There is no expense recognized for taxable income for stock DERs until the underlying option is exercised. In addition, for taxable income purposes only, when non-qualified stock options ("NQSO") are exercised, the Company will recognize an expense equal to the difference between the fair market value of the stock and the exercise price paid. Although this is a non-operating, non-cash expense, such expenses arising from the future exercise of options will the lower the Company's taxable income, and thus its dividend, in the quarters when NQSOs are exercised. For additional detail, see "Note 10. Stockholders Equity - Stock Option Plan" in the Notes to Consolidated Financial Statements.

Net Income Before Preferred Dividends

From the third quarter of 1997 to the fourth quarter of 1997, total net income available to common and preferred shareholders decreased by 33%, from $7.55 million to $5.08 million. Return on average assets dropped from

0.88% to 0.59% due to the interest spread narrowing and the decreased level of utilization of capital. The return on total average equity (common plus preferred) decreased from 8.60% to 5.43%. The return on total average equity in the first half of 1997 was 11.43%.

Total net income available to common and preferred shareholders increased from $12.69 million in 1996 to $27.56 million in 1997, an increase of 117%. Return on average assets dropped from 1.27% to 0.91% while return on total average equity (common plus preferred) decreased from 9.66% to 8.98%. As discussed above, the positive effect of strong asset growth, increased use of leverage and improved operational efficiencies partially offset the negative effects of interest spread narrowing.

Total net income available to common and preferred shareholders increased from $3.16 million in 1995 to $12.69 million in 1996, an increase of 302%. Return on assets dropped from 1.43% to 1.27% due interest spread narrowing. Due to increased use of debt funding and improved operating efficiencies, however, the return on total average equity (common plus preferred) increased from 7.28% to 9.66%.

Preferred Dividends

The Company's Class B 9.74% Cumulative Convertible Preferred Stock ("preferred stock") was issued in the third quarter of 1996. Total 1997 preferred dividends were $2.82 million; total 1996 preferred dividends were $1.15 million. The preferred dividend was greater in 1997 than in 1996 as preferred stock was outstanding 365 days in 1997 as compared to 138 days in 1996. The quarterly preferred dividend equals the greater

of the common stock dividend or $0.755 per share. Each share of preferred stock is convertible at the option of the holder at any time into one share of common stock. There were 1,006,250 preferred shares outstanding at December 31, 1996 as compared to 909,518 shares outstanding at December 31, 1997. In 1997, preferred shareholders converted 96,732 shares into common stock. After September 1999, the Company has the right to force the conversion of each share of preferred stock into one share of common stock, providing the price of the common stock exceeds $31.00, or to redeem the preferred stock at $31.00 per share.

Net Income Available to Common Shareholders

From the third quarter of 1997 to the fourth quarter of 1997, net income available to common shareholders decreased by 36%, from $6.86 million to $4.40 million. Over the same period, average common equity increased by 1%, from $319.0 million to $323.6 million. Return on average common equity decreased from 8.73% to 5.80%.

From 1996 to 1997, net income available to common shareholders increased by 114%, from $11.5 million to $24.7 million. Over the same period, average common equity increased by 132%, from 120.0 million to $279.1 million. Return on average common equity decreased from 9.61% to 8.87%.

From 1995 to 1996, net income available to common shareholders increased by 266%, from $3.16 million to $11.5 million. Over the same period, average common equity increased by 177%, from $43.3 million to $120.0 million. Return on average common equity increased from 7.28% to 9.61%.

Diluted Earnings Per Share

From the third quarter of 1997 to the fourth quarter of 1997, diluted earnings per share fell by 36%, from $0.47 to $0.30. The average number of diluted common shares outstanding decreased by 1% and net income available to common shareholders decreased by 36%. This decrease in diluted earnings per share was the result of a 37% decrease in return on equity while average book value per common share increased 1%.

From 1996 to 1997, diluted earnings per share rose by 37%, from $1.32 to $1.81. The average number of diluted common shares outstanding increased by 56% and net income available to common shareholders increased by 114% during the same period. The primary factor driving the increase in diluted earnings per share was a 39% increase in average book value (equity) per common share from 1996 to 1997. Book value per share increased as the Company issued new common stock at prices in excess of book value.

From 1995 to 1996, diluted earnings per share rose by 55%, from $0.85 to $1.32. The average number of diluted common shares outstanding increased by 136% and net income available to common shareholders increased by 266%. This increase in diluted earnings per share was made possible by a 32% increase in return on common equity and a 15% increase in average book value (equity) per common share.

Taxable Income after Preferred Dividend

As a REIT, the Company is required to distribute as dividends over time at least 95% of its taxable income. Taxable income can vary from GAAP income due to a variety of reasons, such as differences in credit expenses (actual credit losses are deducted from taxable income rather than credit provisions), premium and discount amortization, accounting for stock options as well as other differences.

From the third quarter of 1997 to the fourth quarter of 1997, taxable income after preferred dividends fell 34%, from $7.46 million to $4.90 million. The taxable return on average common equity dropped from 9.36% to 6.06% during this period.

Taxable income after preferred dividend in 1997 of $27.15 million was greater than 1997 GAAP income available to common shareholders of $24.75 million due to differences in credit expenses of $2.75 million, premium and discount amortization differences of negative $0.18 million, gain on sale differences of negative $0.19 million and operating expense differences of $0.02 million.

Taxable income after preferred dividend in 1996 of $14.02 million was greater than 1996 GAAP income available to common shareholders of $11.54 million due to differences in credit expenses of $1.69 million, premium and discount amortization differences of $0.45 million and operating expense differences of $0.34 million.

Taxable income before preferred dividend in 1995 of $3.83 million was greater than 1995 GAAP income of $3.16 million due to differences in

credit expenses of $0.49 million, premium and discount amortization differences of $0.17 million and operating expense differences of $0.28 million.

On a taxable income basis, return on average common equity was 9.73% for 1997 as compared to 11.68% for 1996 and 8.84% for 1995. Taxable return on average common equity was generally influenced by the same factors that reduced GAAP return on average common equity.

Common Share Dividends

In accordance with REIT rules, over time the Company's dividends will reflect the Company's level of taxable income earned. Dividends per common share have exceeded GAAP earnings per common share primarily because taxable income has exceeded GAAP income in each year. Effective with the fourth quarter 1997 dividend, the Company's policy is to declare a common dividend each quarter equal to that quarter's taxable income per common share entitled to a dividend. In order to assist the Company with this goal, starting in 1998, the first three quarter dividends will be declared after taxable income has been determined for the quarter. The dividend declaration for the first, second and third quarter dividends is expected occur in the fourth week of April, July and October, respectively. The record and payable dates will be announced at the time the dividend is declared. In order to comply with REIT dividend distribution rules, the Company's fourth quarter dividend will be declared in December based on estimated fourth quarter taxable income. The Company's common dividend is expected to vary from quarter to quarter, both due to fluctuations in the Company's operating results and due to changes in other operating and non-operating items that impact taxable income.

In the fourth quarter of 1997, the Company declared common dividends of $0.35 per share, a decrease from the dividends declared in the third quarter of 1997 of $0.60 per share. Total common dividends declared were $8.75 million in the third quarter of 1997 and $5.00 million in the fourth quarter of 1997.

The Company declared common dividends of $2.15 per share in 1997, resulting in a distribution of $28.84 million. Including preferred dividends, the Company distributed $31.65 million, or 105.6% of the taxable income earned in

1997. Through December 31, 1997, the Company had cumulatively declared dividends equaling 102.6% of cumulative taxable income earned through that date. At December 31, 1997, cumulative dividends declared in excess of cumulative taxable income were $1.29 million.

The Company declared common dividends of $1.67 per share in 1996, resulting in the distribution of $14.08 million. Including preferred dividends, the Company distributed $15.23 million, or 100.4% of the taxable income earned in 1996.

In 1995, the Company declared common dividends of $0.96 per share, resulting in the distribution of $3.37 million. The Company had no preferred shares outstanding. The Company distributed 88.0% of the taxable income earned in 1995.

FINANCIAL CONDITION

Mortgage Loans

From December 31, 1996 to December 31, 1997, the Company's mortgage loan portfolio grew in size by 195% and increased as a percentage of the Company's mortgage assets from 24.5% to 46.1%. Over this period, the percentage of the Company's mortgage loan properties located in California dropped, the average seasoning declined, the average loan size increased and the effective average loan-to-value ratio decreased. The percentage of the loan portfolio in non-performing status increased slightly from 0.24% to 0.25% during this period.

At December 31, 1997, the Company owned 5,041 adjustable-rate, first-lien mortgage loans on single-family residential properties with a principal value of $1.52 billion and an amortized cost of $1.55 billion. The Company estimates that the bid-side market value of the Company's mortgage loan portfolio at December 31, 1997 was approximately $1.55 billion. Hybrid loans, with first adjustment periods longer than one year, were 3.6% of mortgage loans.

As verified by its re-underwriting process, the Company believes that all mortgage loans owned as of December 31, 1997 were generally originated to "A" quality, or "Prime" quality, underwriting standards. The average loan size was $301,000. Loans with current balances less than $214,600 (the 1997 Fannie Mae/Freddie Mac limit for most loans) made up 18% of the dollar balance of the Company's mortgage loan portfolio, while loans with current balances in excess of $500,000 made

up 37%. Loans on owner-occupied houses made up 89% of the loan portfolio; second homes represented 8% and investment properties 3%. As of December 31, 1997, the average seasoning of the loan portfolio was 18 months.

At December 31, 1997, 38% of loans had original loan-to-value ratios ("OLTV") in excess of 80%. Of these, 95% had either primary mortgage insurance ("PMI") or additional collateral in the form of pledged accounts. The average original LTV for the Company's loan portfolio was 78% as of December 31, 1997; after giving effect to PMI and additional collateral, the average effective LTV was 66%.

At December 31, 1997, 29% of the mortgage loans owned by the Company were on properties located in California (11% in Northern California and 18% in Southern California). Loans in Florida were 9%, loans in New York were 7% and loans in Georgia were 5% of the total. All other states were less than 5%.

At December 31, 1997, 17 mortgage loans were non-performing assets ("NPAs"), as they were over 90 days delinquent, in bankruptcy, in foreclosure, or had become Real Estate Owned ("REO"). The loan balance of these NPAs totaled $3.90 million, or 0.25% of the mortgage loan portfolio and 0.11% of total assets. Included in this NPA balance was REO of $0.71 million resulting from the default of 4 loans.

If all of the NPAs as of December 31, 1997 were to default rather than cure, and the loss severity experienced on these loans was 10%, 20%, 30%, or 40%, the Company estimates its realized credit losses from these assets would be $396,000, $793,000, $1,189,000 or $1,586,000, respectively. The mortgage loan credit reserve as of December 31, 1997 was $2.85 million. Cumulatively through December 31, 1997, the Company has achieved resolution or liquidation on six defaulted mortgage loans: the average loss severity on those loans was 7%. The

analysis in this paragraph reviews the risk of loss from NPAs as of December 31, 1997 only; it does not purport to analyze or measure credit losses from additional NPAs that may arise after December 31, 1997.

At December 31, 1996, the Company owned 2,172 adjustable-rate, first-lien mortgage loans on single-family residential properties with a principal value of $0.52 billion and an amortized cost of $0.53 billion. The Company estimates that the bid-side market value of these mortgage loans at December 31, 1996 was approximately $0.53 billion. None of these mortgage loans were hybrid loans with first adjustment periods longer than one year.

The average loan size at December 31, 1996 was $237,000. Loans with current balances less than $207,000 (the 1996 FNMA/FHLMC limit for most loans) made up 23% of the Company's mortgage loan portfolio, while loans with current balances in excess of $500,000 made up 8%. Loans on owner-occupied houses made up 94% of the loan portfolio; second homes represented 4% and investment properties 2%. As of December 31, 1996, the average seasoning of the loan portfolio was 37 months.

At December 31, 1996, 25% of the loans had a loan-to-value ratio (LTV) at origination in excess of 80%. Of these, 97% of these loans had primary mortgage insurance (PMI). The average original LTV for the Company's mortgage loan portfolio was 77% as of December 31, 1996; after giving effect to PMI, the average effective original LTV was 73%.

At December 31, 1996, 44% of the mortgage loans owned by the Company were on properties located in California (18% in Northern California and 26% in Southern California). Loans in Maryland were 8% of the total. All other states were less than 5%.

At December 31, 1996, 7 loans were non-performing assets. The loan balance of these NPAs totaled $1.25 million, or 0.24% of the mortgage loan portfolio and 0.06% of total assets. Included in this total was one REO of $0.2 million.

If all the NPAs as of December 31, 1996 were to default rather than cure, and the loss severity experienced on these loans was 10%, 20%, 30%, or 40%, the Company estimated its realized credit losses from these assets would have been $127,000, $253,000, $380,000 or $506,000, respectively. The mortgage loan credit reserve as of December 31, 1996 was $428,000.

Mortgage Securities

From December 31, 1996 to December 31, 1997, the Company's portfolio of mortgage securities increased by 12%. Mortgage securities declined as a percentage of total mortgage assets from 75.5% to 53.9%. All of the Company's mortgage securities represent interests in pools of adjustable rate, first lien mortgages on single-family residential properties. None of the loans underlying these mortgage securities were

hybrid loans with first adjustment periods longer than one year.

At December 31, 1997, the principal value of the Company's mortgage securities was $1.78 billion and the amortized cost was $1.82 billion. The Company estimates that the bid-side market value of the Company's mortgage securities portfolio at December 31, 1997 was approximately $1.81 billion.

At December 31, 1997, 99.5% of the Company's mortgage securities had a credit rating equivalent of AAA or AA. The remaining 0.5% represent the retained mortgage equity interests in the re-REMIC discussed above. Securities guaranteed by Fannie Mae or Freddie Mac made up 54.3% of the mortgage securities portfolio. Non-agency mortgage securities structured with large amounts of subordination or other forms of third-party credit enhancement and rated AAA or AA made up 45.2% of the mortgage securities portfolio. Based on information available as of December 31, 1997, the Company had no reason to suspect that it would be likely to incur credit losses in the foreseeable future from its mortgage securities rated AAA or AA.

The Company has taken and expects to continue to take credit losses on the mortgage equity interests in the re-REMIC. Although the loans in the mortgage pools underlying these securities were, for the most part, originated to "A" quality standards, these interests are subordinated to other securities issued from the same pools and

therefore are subject to leveraged credit risk with respect to the underlying mortgages. At December 31, 1997, the re-REMIC mortgage equity interests had a principal value of $21.0 million, an amortized cost before credit reserve of $9.1 million and an estimated market value of $9.3 million. If all the underlying loans were to default, the maximum loss the Company could incur would be $9.1 million and the maximum impact to reported earnings, after taking into account the credit reserve of $2.1 million, would be $7.0 million.

The Company estimates that if all the loans underlying mortgage equity interests in the re-REMIC which were over 90 days delinquent, in foreclosure, in bankruptcy, or REO as of December 31, 1997 were to default and have a loss severity of 10%, 20%, 30%, or 40%, realized credit losses for the Company would be $0.39 million, $0.89 million, $1.16 million or $1.83 million, respectively. The Company's credit reserve for these assets at December 31, 1997 was $2.1 million. Cumulatively, from the acquisition dates of mortgage securities rated below investment grade through December 31, 1997, 254 defaulted mortgage loans in the underlying pools had been liquidated and the average loss severity on these loans was 21%. The analysis in this paragraph reviews the risk of loss from seriously delinquent loans underlying the Company's mortgage securities as of December 31, 1997 only; it does not purport to analyze or measure credit losses from additional serious delinquencies that may arise after December 31, 1997.

At December 31, 1996, the principal value of the Company's mortgage securities was $1.60 billion and the amortized cost was $1.63 billion. The Company estimates that the bid-side market value of the Company's mortgage securities portfolio at December 31, 1996 was approximately $1.63 billion.

At December 31, 1996, 96.6% of the Company's mortgage securities had a credit rating equivalent of AAA or AA, 1.6% had a credit rating equivalent of A or BBB and 1.8% had a credit rating equivalent less than BBB. Securities guaranteed by Fannie Mae or Freddie Mac made up 59.4% of total mortgage securities. Other AAA and AA securities made up 37.2% of the mortgage securities portfolio.

At December 31, 1996, below-BBB rated securities had a principal value of $40.8 million, an amortized cost before credit reserve of $28.9 million and a market value of $25.6 million. The Company's credit reserve for these assets at December 31, 1996 was $1.75 million. The Company estimates that if all the loans in the underlying mortgage pools which were over 90 days delinquent, in foreclosure, in bankruptcy, or REO as of December 31, 1996 were to default and have a loss severity of 10%, 20%, 30%, or 40%, realized credit losses for the Company would be $0.06 million, $0.61 million, $2.04 million, or $3.65 million, respectively.

Total Mortgage Asset Portfolio Characteristics

At December 31, 1997, the average credit rating equivalent of all of the Company's mortgage assets (loans plus securities) was AA+, with mortgage loans (the bulk of the value which would be rated AAA if securitized and rated) representing 46.1% of the total mortgage asset portfolio and AAA and AA mortgage securities representing 53.6%.

At December 31, 1997, all mortgage assets consisted of adjustable-rate mortgages. Hybrid mortgages, with first adjustment periods longer than

one year, made up 1.6% of mortgage assets. The average coupon rate accruing on mortgage assets was 7.71%. The average level of the short-term interest rate indices which determine coupon adjustments was 5.68%. Since the average net margin was 2.06%, the highest potential average mortgage coupon rate (the fully-indexed rate) at that time was 7.74%. The actual coupon rate was lower than the fully-indexed rate by 0.03%.

At December 31, 1997, 34.9% of the Company's mortgage assets had coupon rate adjustments every six months based on the six-month LIBOR or CD index and 20.1% had monthly adjustments based on the one-month LIBOR index. Mortgage assets with annual coupon adjustments based on the six-month or one-year U.S. Treasury index were 41.9% of the portfolio. Hybrid mortgages, that will have annual coupon adjustments based on the one-year Treasury index after the initial fixed period, represented 1.6%. Mortgage assets with other indices made up 1.5% of the total. At December 31, 1997, the average term-to-next-coupon-adjustment for all mortgage assets was 4 months. For most mortgage assets, coupon rate adjustments are based on the index level 30 to 75 days prior to the start of a new coupon accrual period.

Potential coupon rate changes can be limited by periodic and life caps. At December 31, 1997, all of the Company's assets had a life cap and the average mortgage asset life time maximum cap rate was 12.08%. At December 31, 1997, periodic caps limited coupon changes to 2% annually for 67.2% of mortgage assets and there were no periodic caps on 32.8% of mortgage assets.

At December 31, 1996, the average mortgage asset credit rating equivalent was AA+, with mortgage loans representing 24.5% of the total mortgage asset portfolio, AAA and AA mortgage securities representing 73.0%, A and BBB rated mortgage securities representing 1.2% and below-BBB rated mortgage securities representing 1.3%.

At December 31, 1996, all mortgage assets consisted of adjustable-rate mortgages. The average coupon rate accruing on these assets was 7.75%. The average level of the short-term interest rate indices which determine coupon adjustments was 5.58%. Since the average net margin was 2.24%, the highest potential average mortgage coupon rate (the fully-indexed rate) at that time was 7.82%. The actual coupon rate was lower than the fully-indexed rate by 0.07%.

At December 31, 1996, 38.7% of the Company's mortgage assets had coupon rate adjustments every six months based on the six month LIBOR or CD index and 1.4% had monthly adjustments based on the one month LIBOR index. Six month or one year U.S. Treasury index mortgage assets made up 57.7% of the total. Mortgage assets with other indices made up 2.2% of the total. At December 31, 1996, the average term-to-next-coupon-adjustment for all mortgage assets was 5 months.

At December 31, 1996, the Company's average mortgage asset life time maximum cap rate was 11.73%. At December 31, 1996, periodic caps limited coupon changes to 2% annually for 95.5% of the mortgage assets and there were no periodic caps on 4.5% of the mortgage assets.

Allocation of Equity to Mortgage Assets

The Company assigns a capital requirement to each mortgage asset through its Risk-Adjusted Capital Policy process. Allocations are based on the perceived risk characteristics of each asset and its associated borrowings and hedges. At December 31, 1997, 51.7% of the Company's $335 million of capital was allocated to AAA and AA-rated mortgage securities funded short-term, 17.4% was allocated to mortgage equity interests (the equity portion of the two Sequoia Trusts and the re-REMIC) and 8.2% was allocated to mortgage loans which will most likely be used to create mortgage equity interests in the future but which were funded short-term at that time. The remainder of the Company's equity capital -- 22.7% of the total -- was not being utilized.

At December 31, 1996, 71.5% of the Company's $211 million of capital was allocated to AAA and AA-rated mortgage securities funded short-term, 8.9% was allocated to short-funded securities rated less than AA, and 22.8% was allocated to short-funded mortgage loans. The total capital allocated at that time equaled 103.2% of the Company's actual capital base, as the Company at year end 1996 had acquired additional assets in excess of its normal balance sheet capacity pursuant to its expanded capital guidelines which are in effect in certain circumstances prior to a planned equity offering.

Interest Rate Agreements

At December 31, 1997, the Company owned $5.3 billion notional face of interest rate agreements, principally caps and swaps. These interest rate agreements had various start dates, maturity dates, and interest

rate protection features; See "Note 6. Interest Rate Agreements" and "Note 9. Fair Value of Financial Instruments" in the Notes to Consolidated Financial Statements for additional detail.

These agreements are designed to reduce the Company's interest rate and market value fluctuation risk. They had a historical amortized cost basis of $10.78 million and an estimated bid-side market value of $1.52 million as of December 31, 1997. Market values were lower than amortized cost due to a drop in interest rate volatility assumptions in the marketplace for interest rate agreements, a drop in interest rates, the effect of taking bid-ask

spread mark-downs on new agreements and due to the mis-matched timing of GAAP amortization methods for premiums paid for interest rate caps and the rate of actual economic decay in their market values. Interest rate agreements hedging mortgage loans are carried on the balance sheet at historical amortized cost, as a result changes in market values of these interest rate agreements are not shown in the valuation account. Market value fluctuations for interest rate agreements hedging mortgage securities are reflected in the Company's interest rate agreement market valuation account.

At December 31, 1996, the Company owned $2.6 billion notional face of interest rate agreements with a historical amortized cost basis of $6.2 million and an estimated bid-side market value of $2.6 million.

There is a risk that the counter-parties to the Company's interest rate agreements will not be able to perform to the terms of these contracts. If this were to happen, the Company's total accounting credit loss exposure would be limited to its historical amortized cost basis in these assets, although the true economic opportunity cost to the Company could be higher. Through December 31, 1997, each of the counter-parties to the Company's interest rate agreements had a credit rating of at least "A".

Borrowings, Cash Balances and Liquidity

At December 31, 1997, the Company's borrowings consisted of $1.9 billion short-term collateralized borrowing arrangements such as reverse repurchase agreements, notes payable, and revolving lines of credit ("short-term debt"), and $1.2 billion non-recourse, floating rate, amortizing long-term debt ("long-term debt"). The long-term debt was issued in the second half of 1997 in the form of collateralized mortgage bonds through the Company's Sequoia program. The funds raised in the long-term debt offerings were used to reduce short-term debt. Long-term debt at year end represented 38% of total debt.

At December 31, 1997, the Company's short-term debt totaled $1.9 billion with a weighted average debt rate of 6.00% as compared to $2.0 billion with a weighted average debt rate of 5.83% at December 31, 1996. Long-term debt totaled $1.2 billion at December 31, 1997 with a weighted average all-in-cost of 6.38%. The Company had no long-term debt at December 31, 1996.

As the Company reduces risks on its balance sheet, it is able to use a greater amount of leverage under its Risk-Adjusted Capital Policy. However, the Company's debt-to-equity ratio declined from 9.11x at December 31, 1996 to 8.96x at December 31, 1997 because the Company was not taking advantage of its increased ability to leverage its balance sheet. See "Stockholders' Equity, Capital Efficiency and Capital Adequacy." The average debt-to-equity ratio increased from 6.56x during 1996 to 8.82x during 1997.

At December 31, 1997, $1.2 billion of the mortgage assets served as collateral for the Company's long term debt. The remaining mortgage assets, which had a market value of $2.2 billion, were available to collateralize the Company's short-term debt. The Company estimates it had additional borrowing capacity in excess of its current requirements of $183 million at year end. In addition, the Company had $25 million of unrestricted cash. The monthly principal and interest payments received on the mortgages which serve as collateral to the long-term debt are held in trust until the bond payment date and are included in the Company's cash balances as "restricted cash."

At December 31, 1996, the Company had borrowings equaling 90.7% of the $2.15 billion market value of its mortgage assets available to collateralize such borrowings. The Company estimates it had additional borrowing capacity at that time of $124 million, as well as $11 million of unrestricted cash.

The Company's liquidity status, borrowing capacity, and ability to roll over its short-term debt as it matures depend on the market value, liquidity and credit quality of its assets, the soundness and capitalization of the Company's balance sheet, the state of the

collateralized lending market and other factors. If the Company's liquidity or borrowing capacity were to become seriously diminished, the Company would most likely seek to sell its mortgage assets (the sale of which, in such circumstances, might be difficult and most likely would be at a loss). In order to avoid such an occurrence, the Company seeks to maintain what it believes to be a prudent level of capital, i.e., the Company restricts its asset growth according to its Risk-Adjusted Capital Policy and thereby seeks to maintain adequate unused borrowing capacity.

At December 31, 1997 and December 31, 1996, the average term-to-maturity of the Company's short-term debt was 64 days and 98 days and the average term-to-next-rate-adjustment was 31 days and 52 days, respectively; the term-to-next-rate-adjustment was shorter than the term-to-maturity as some of the Company's debt had a cost of funds that adjusted to market levels on a monthly or daily basis during the term of the debt. In general, the cost of short-term borrowings has been able to reset more quickly to interest rate conditions than coupon rates on the Company's mortgages could adjust to those same changes. Through its hedging program, the Company seeks to mitigate the short-term impact that a large increase in interest rates could have on its cost of funds and spread earnings

At December 31, 1997, the stated maturity on the Company's long-term debt ranged from 26 to 32 years. The expected life of the debt was three to six years, as the debt generally pays down as the underlying mortgages pay down. The debt is callable by the Company before its stated maturity date. The interest rate on the long-term debt resets monthly. At December 31, 1997, 14% of the long-term debt had an interest rate tied to the daily average Fed Funds rate, 50% had an interest rate tied to a moving average of the one-year Treasury rate and 36% had an interest rate tied to one-month LIBOR. The debt is AAA rated, adjustable-rate, amortizes at approximately the same rate as the collateral and has a lifetime interest rate cap of 10%.

Stockholders' Equity, Capital Efficiency and Capital Adequacy

From December 31, 1996 to December 31, 1997, the Company's equity (exclusive of the market valuation account) grew from $214.5 million to $344.6 million. This equity growth was the result of the Company issuing $157.3 million in common stock through stock offerings, the exercise of warrants and from stock issuance pursuant to the Company's Dividend Reinvestment and Stock Purchase Plan. Equity was reduced in the second half of 1997 by $23.1 million through the Company's Stock Repurchase Program. Dividends, which are based on taxable income, exceeded GAAP earnings by $4.1 million in 1997, reducing stockholders' equity.

Book value, or equity, per common share (excluding the market valuation account) increased by 32% from $16.81 on December 31, 1996 to $22.25 on December 31, 1997. The primary driver of this book value growth was accretive stock offerings at prices in excess of book value.

For balance sheet purposes, the Company carries its mortgage securities and associated interest rate agreements at their estimated bid-side market value (historical amortized cost less market valuation account). The total market valuation account for the Company was a negative $3.5 million on December 31, 1996 and negative $10.1 million on December 31, 1997. As a result of this accounting treatment, the Company's reported equity base and book value per share fluctuates due to market conditions and other factors. Mortgage loans, associated interest rate agreements and all other assets and liabilities were carried on the Company's balance sheet at December 31, 1997 at amortized cost.

The Company estimated that the bid-side market value (or realizable value) of all its assets less the cost of paying off all of its obligations was approximately $211.2 million at December 31, 1996 and $334.9 million at December 31, 1997. The net total "mark-to-market" value for the Company's assets and liabilities was $3.3 million lower than amortized cost at December 31, 1996 and $9.7 million lower than amortized cost at December 31, 1997. Between December 31, 1996 and December 31, 1997, the liquidation value of the Company's mortgage assets increased while the liquidation value of its interest rate agreements dropped. The Company expects that the net total "mark-to-market" value of the Company may fluctuate significantly over time.

Through its Risk-Adjusted Capital Policy, the Company assigns a guideline capital adequacy amount (expressed in the form of a guideline equity-to-assets ratio) to each of its mortgage assets. For short-term funded assets, this ratio will fluctuate over time, based on changes in that asset's credit quality, liquidity characteristics, potential for market value fluctuation, interest rate risk, prepayment risk, and the over-collateralization requirements for that asset set by the Company's collateralized short-term lenders. Capital requirements for

mortgage equity interests generally equal the Company's net investment. The sum of the capital adequacy amounts for all of the Company's mortgage assets is the Company's aggregate guideline capital adequacy amount.

Since management believes that the bulk of the capital currently necessary to manage the Company prudently is needed due to the liquidity and market value fluctuation risks that arise from the utilization of short-term debt, the guideline capital amount has declined as the Company has eliminated some of these risks through the creation of mortgage equity interests.

The Company does not expect that its actual capital levels will always, exceed the guideline amount. The Company measures all of its mortgage assets funded with short-term debt at estimated market value for the purpose of making Risk-Adjusted Capital calculations. If interest rates were to rise in a significant manner, the Company's capital guideline amount would rise (as the potential interest rate risk of its mortgages would increase, at least on a temporary basis, due to periodic and life caps) while its actual capital levels as determined for the Risk-Adjusted Capital Policy would likely fall as the market values of its mortgages, net of mark-to-market gains on hedges, fell (market value declines may be temporary as well, as future coupon adjustments may help to restore some of the lost market value). In this circumstance, or any other circumstance in which the Company's actual capital levels fell below the Company's capital adequacy guideline amount, the Company would cease the acquisition of new mortgage assets until capital balance was restored. In defined circumstances prior to a planned equity offering, management is authorized by the Board of Directors to acquire mortgage assets in a limited amount beyond the usual constraints of the Company's Risk-Adjusted Capital Policy.

As expressed as an equity-to-assets ratio, the Company's average Risk-Adjusted Capital Policy guideline capital amount declined from 10.9% of assets in 1996 to 9.1% in 1997. The average guideline capital amount was 8.1% in the fourth quarter of 1997. Since 1995, the Company has adjusted its asset and funding mix in a manner that it believes presents the Company with lower levels of anticipated risk. The capital guideline has continued to drop as a result of this adjustment.

The actual average equity-to-asset ratio for the Company declined from 13.1% in 1996 to 10.1% in 1997. The actual average equity-to-asset ratio was 10.2% in the fourth quarter of 1997. Since actual equity-to-asset ratios have been higher in all these periods than the capital guideline ratios, the Company could have owned more mortgage assets during those periods and still met its capital guidelines. Balance sheet capacity utilization (the percentage of the Company's capital employed in the mortgage spread lending business as opposed to being un-utilized) is a key measure of capital efficiency for the Company. Even though average balance sheet capacity utilization increased from 83% in 1996 to 90% in 1997, it has been declining throughout 1997 due to the decline in capital requirements. It was 79% in the fourth quarter of 1997.

From June 12, 1997 through the common stock equity offering of July 25, 1997, the Company was at its approximate maximum asset size as determined by its Risk-Adjusted Capital Policy. Accordingly, the Company ceased making firm commitments to new asset acquisitions during that period. Approximately $29.4 million of the proceeds from the July offering was necessary to bring the Company into compliance with its normal capital guidelines. As a result of this constraint on acquisitions during the early part of the quarter, the level of total asset acquisitions for the third quarter of 1997 may have been less than otherwise would have been the case.

Beginning in September 1997, strong demand for mortgage assets in an environment of reduced supply led to increasing prices for mortgage loans and mortgage securities. These rising prices together with the potential for increased mortgage prepayment rates led the Company to reduce the rate at which it sought to acquire new mortgage assets. Although this decision resulted in the Company's balance sheet having excess capital in the latter part of 1997, management believed that long-term shareholder value would be maximized by refraining from committing significant capital to the new mortgage acquisitions until mortgage prices adjusted downwards. Although mortgage prices did fall somewhat in the fourth quarter of 1997, as of year end 1997 the Company had still not resumed its prior rate of growth. Mortgage prices continued to fall in the first quarter of 1998. In order to utilize excess capital and increase long-term shareholder value, a common stock repurchase program was announced in September. The Company repurchased a total of 840,000 shares for $23.1 million as of December 31, 1997. The Company continued to repurchase stock in the first quarter of 1998.

Risk Management

The Company seeks to manage the potential credit, interest rate, liquidity and other risks inherent in all financial institutions in a prudent manner designed to insure the longevity of the Company while, at the same time, seeking to provide an opportunity for shareholders to realize attractive total rates of return through long-term stock ownership in the Company. While the Company does not seek to avoid risk, it does seek, to the best of its ability, to assume risks that can be quantified from historical experience, to actively manage such risk, to earn sufficient compensation to justify the taking of such risks and to maintain capital levels consistent with the risks it does undertake.

The Company seeks to limit credit risk by maintaining what it believes to be high quality mortgage loan underwriting standards. The Company is a nationwide "A" (or "prime") quality lending company: it acquires and owns first mortgages on single-family residential properties which have been underwritten to the highest levels of underwriting standards generally in use for these types of loans. Credit losses from such mortgages tend to be cyclical. Historically, however, the magnitude of credit loss incurred from high quality single-family mortgages during historical credit cycles has been contained relative to credit losses arising from other forms of commercial, consumer and residential mortgage lending.

The Company seeks to manage liquidity risk and short-term borrowing roll-over risk (which could be caused by market value fluctuations of assets pledged as collateral for short-term borrowings or by changes in lending markets) through: (1) maintaining what it believes to be a high quality and liquid portfolio of mortgage assets, (2) maintaining a hedging program utilizing interest rate agreements designed to partially mitigate net changes in the market values of its assets, (3) maintaining what it believes to be a prudent level of capitalization (and therefore a prudent level of unused borrowing capacity), and (4) replacing a portion of its short-term borrowings with long-term borrowings. Liquidity risks and short-term borrowing roll-over risks cannot be completely eliminated unless the Company can replace all of its short-term borrowings with long-term borrowings. At December 31, 1997, the Company remained exposed to such risk, particularly in general market environments of rapidly rising interest rates, market dislocation or illiquidity.

The Company seeks to manage some of its interest rate risk through matching the interest rate characteristics of its mortgages and its borrowings to the degree that management believes is likely to be in the best interests of the shareholders in the long-term.

The Company does not seek to be perfectly matched or to entirely eliminate interest rate risk. Through December 31, 1997, the Company has paired adjustable-rate mortgages with variable-rate liabilities. The Company has generally maintained borrowings which adjust to market conditions several months faster than its assets. This short-term mis-match was lower on the Company's balance sheet at the end of 1997 than in prior periods. For larger interest rate increases, the potential short-term negative earnings impact resulting from this short-term mis-match should be partially mitigated by the Company's interest rate agreements. In addition, since the Company's adjustable-rate earning assets have exceeded its liabilities through December 31, 1997, the longer term impact of an increase in short-term interest rates may be positive after a lag period (once the coupon rate on the assets has fully adjusted to the rate increase). Conversely, while the short-term earnings effect of a decline in short-term interest rates may be positive, the longer-run effect after a lag period may be a decline in earnings relative to what they otherwise would have been after the coupon rates on the assets have adjusted downwards.

Through December 31, 1997, the Company generally has assumed some other types of asset/liability mis-matches as well, including some yield curve flattening risk (the risk of six and twelve month interest rates falling relative to one and three month interest rates) and some "TED" spread risk (the risk of U.S. Treasury rates falling relative to LIBOR rates, as the percentage of the Company's assets which adjust off of Treasury rates exceeds the percent of the Company's liabilities which adjust off of Treasury rates). Certain other types of interest rate risks remain partially unhedged as well. Management believes that the assumption of these risks, to the extent undertaken by the Company, is more likely than not to result in higher earnings for the Company in the long-term but also, from time to time, may cause earnings

volatility and opportunity cost from foregone growth potential. Management believes that retained interest rate risks (to the extent they are separate from liquidity and market value fluctuation risk) are

unlikely to cause a safety and soundness issue for the Company except in relatively extreme and unexpected scenarios.

If the rate of mortgage principal repayment of the Company's mortgage assets is faster than expected, the rate at which the Company amortizes its net premium balances as an expense will increase and earnings will be reduced relative to what they would have been otherwise. Changes in principal repayment rates may be a source of earnings volatility for the Company. In addition, faster principal repayments may reduce the Company's net asset growth rate; net asset growth is generally an important component of future earnings growth. Prospects for the Company may also be reduced by higher than expected mortgage principal repayments if the potential return characteristics of assets then available for acquisition are less attractive than those of the existing assets held in portfolio. Prepayment rates for adjustable-rate mortgages increased during the third and fourth quarters of 1997 and such prepayment rates may further increase in the first half of 1998. Slowing rates of mortgage principal repayment could exacerbate certain liquidity, market value fluctuation, and interest rate risks in a rising interest rate environment.

While adjustable-rate mortgage principal repayment rates are not highly predictable, management believes the strongest influencing factor in the past has been the absolute level of longer-term interest rates. As longer-term rates drop, adjustable-rate mortgage principal repayments have tended to increase, particularly if longer-term rates drop relative to shorter-term interest rates. In addition, management believes adjustable-rate mortgage principal repayments have been increasing on a secular trend basis due to structural and behavioral changes in the mortgage origination market. Through December 31, 1997, the Company has not sought to hedge mortgage principal repayment risk but rather has sought to analyze, based on individual mortgage characteristics, the propensity of each acquired mortgage or mortgage pool to experience accelerated principal repayment rates and to adjust its acquisition price bid accordingly based on the level of perceived downside (and upside) earnings risk. The Company has been able to effectively reduce the prepayment risk on some of its assets though the issuance of long-term debt with certain characteristics.

The pricing of mortgage assets relative to the underlying risk in the assets, and relative to levels at which the Company can issue long-term debt, has a large effect on the Company's net asset growth and equity utilization, and therefore on the Company's earnings growth. Higher mortgage prices on an absolute basis or on a relative basis as compared to debt markets will slow growth. The Company cannot hedge earnings volatility that may arise from this source.

Virtually all of the Company's assets and liabilities are financial in nature. As a result, interest rates, changes in interest rates and other factors drive the Company's performance far more than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. The Company's financial statements are prepared in accordance with Generally Accepted Accounting Principles and the Company's dividends are generally determined based on the Company's net income as calculated for tax purposes; in each case, the Company's activities and balance sheet are measured with reference to historical cost or fair market value without considering inflation.

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 1
<TABLE>
<CAPTION>

INCOME STATEMENT (ALL DOLLARS IN THOUSANDS)	FOR THREE MONTHS ENDING DEC. 31, 1997	SEP. 30, 1997	JUN. 30, 1997	MAR. 31, 1997
<S>	<C>	<C>	<C>	<C>
Mortgage Loans:				
Coupon Income	$ 24,911	$ 21,432	$ 14,474	$ 10,784
Amortization of Discount Balances	0	1	8	11
Amortization of Premium Balances	(2,088)	(1,803)	(1,462)	(940)
Interest Income: Mortgage Loans	22,823	19,630	13,020	9,855

Mortgage Securities:				
Coupon Income	36,595	41,124	39,879	31,440
Amortization of Discount Balances	258	375	409	261
Amortization of Premium Balances	(6,091)	(5,085)	(4,065)	(3,150)
Interest Income: Mortgage Securities	30,762	36,414	36,223	28,551
Total Interest Income From Mortgage Assets	53,585	56,044	49,243	38,406
Interest Income: Cash Balances	399	499	266	162
Total Interest Income	53,984	56,543	49,509	38,568
Interest Expense on Short-Term Debt	(31,964)	(40,318)	(38,958)	(28,900)
Interest Expense on Long-Term Debt	(14,567)	(5,570)	0	0
Total Interest Expense	(46,531)	(45,888)	(38,958)	(28,900)
Interest Rate Agreement Expense	(1,281)	(1,064)	(912)	(602)
Interest Rate Agreement Income	12	26	73	7
Net Interest Rate Agreement Expense	(1,269)	(1,038)	(839)	(595)
Net Interest Income	6,184	9,617	9,712	9,073
Provision for Potential Credit Losses				
Mortgage Loans	(1,516)	(473)	(299)	(215)
Mortgage Securities	1,000	(470)	(477)	(480)
Total Credit Provision	(516)	(943)	(776)	(695)
Gain (Loss) on Sale Transactions	543	20	0	0
Operating Expenses				
Compensation and Benefits Expense	(422)	(441)	(516)	(529)
Dividend Equivalent Rights Expense	(145)	(361)	(358)	(203)
Other Operating Expenses	(561)	(346)	(341)	(435)
Total Operating Expenses	(1,128)	(1,148)	(1,215)	(1,167)
Other Income (Expenses)	0	0	0	0
Corporate Income Tax Expense	0	0	0	0
Net Income Before Preferred Dividends	$ 5,083	$ 7,546	$ 7,721	$ 7,211
Preferred Dividends	(686)	(687)	(687)	(755)
Net Income to Common Shareholders	$ 4,397	$ 6,859	$ 7,034	$ 6,456
Calculation of Taxable REIT Income				
GAAP Net Income Before Preferred Dividends	$ 5,083	$ 7,546	$ 7,721	$ 7,211
Mortgage Amortization Differences	105	(95)	(103)	(87)
Credit Provisions less Actual Losses	475	875	747	653
Gain (Loss) on Sale Differences	(190)	0	0	0
Operating Expense Differences	113	(175)	(50)	135
Taxable Income Before Preferred Dividend	$ 5,586	$ 8,151	$ 8,315	$ 7,912

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 1 (CONTINUED)

<TABLE>
<CAPTION>

INCOME STATEMENT	FOR THREE MONTHS ENDING			
(ALL DOLLARS IN THOUSANDS)	DEC. 31, 1996	SEP. 30, 1996	JUN. 30, 1996	MAR. 31, 1996
<S>	<C>	<C>	<C>	<C>
Mortgage Loans:				
Coupon Income	$ 2,582	$ 1,656	$ 749	$ 479
Amortization of Discount Balances	11	7	11	2
Amortization of Premium Balances	(189)	(62)	(43)	(19)
Interest Income: Mortgage Loans	2,404	1,601	717	462
Mortgage Securities:				
Coupon Income	25,292	18,901	12,973	8,965
Amortization of Discount Balances	206	264	234	175
Amortization of Premium Balances	(2,236)	(1,645)	(1,225)	(688)
Interest Income: Mortgage Securities	23,262	17,520	11,982	8,452
Total Interest Income From Mortgage Assets	25,666	19,121	12,699	8,914

Interest Income: Cash Balances	215	250	202	217
Total Interest Income	25,881	19,371	12,901	9,131
Interest Expense on Short-Term Debt	(19,467)	(14,447)	(9,075)	(6,202)
Interest Expense on Long-Term Debt	0	0	0	0
Total Interest Expense	(19,467)	(14,447)	(9,075)	(6,202)
Interest Rate Agreement Expense	(403)	(350)	(255)	(151)
Interest Rate Agreement Income	1	0	0	0
Net Interest Rate Agreement Expense	(402)	(350)	(255)	(151)
Net Interest Income	6,012	4,574	3,571	2,778
Provision for Potential Credit Losses				
Mortgage Loans	(35)	(178)	(140)	5
Mortgage Securities	(337)	(338)	(337)	(336)
Total Credit Provision	(372)	(516)	(477)	(331)
Gain (Loss) on Sale Transactions	0	0	0	0
Operating Expenses				
Compensation and Benefits Expense	(343)	(309)	(305)	(234)
Dividend Equivalent Rights Expense	(137)	(81)	(79)	(85)
Other Operating Expenses	(316)	(281)	(210)	(174)
Total Operating Expenses	(796)	(671)	(594)	(493)
Other Income (Expenses)	0	0	0	0
Corporate Income Tax Expense	0	0	0	0
Net Income Before Preferred Dividends	$ 4,844	$ 3,387	$ 2,500	$ 1,954
Preferred Dividends	(760)	(388)	--	--
Net Income to Common Shareholders	$ 4,084	$ 2,999	$ 2,500	$ 1,954
Calculation of Taxable REIT Income				
GAAP Net Income Before Preferred Dividends	$ 4,844	$ 3,387	$ 2,500	$ 1,954
Mortgage Amortization Differences	131	61	82	175
Credit Provisions less Actual Losses	365	516	477	331
Gain (Loss) on Sale Differences	0	0	0	0
Operating Expense Differences	89	84	83	89
Taxable Income Before Preferred Dividend	$ 5,429	$ 4,048	$ 3,142	$ 2,549

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 1 (CONTINUED)

<TABLE>
<CAPTION>

INCOME STATEMENT	FOR YEAR ENDING			
(ALL DOLLARS IN THOUSANDS)	DEC. 31, 1997	DEC. 31, 1996	DEC. 31, 1995	DEC. 31, 1994
<S>	<C>	<C>	<C>	<C>
Mortgage Loans:				
Coupon Income	$ 71,601	$ 5,466	$ 379	$ 0
Amortization of Discount Balances	20	31	4	0
Amortization of Premium Balances	(6,293)	(313)	(4)	0
Interest Income: Mortgage Loans	65,328	5,184	379	0
Mortgage Securities:				
Coupon Income	149,038	66,131	14,759	1,102
Amortization of Discount Balances	1,303	879	915	101
Amortization of Premium Balances	(18,391)	(5,794)	(559)	(19)
Interest Income: Mortgage Securities	131,949	61,216	15,115	1,184
Total Interest Income From Mortgage Assets	197,277	66,400	15,494	1,184
Interest Income: Cash Balances	1,326	884	232	112
Total Interest Income	198,604	67,284	15,726	1,296
Interest Expense on Short-Term Debt	(140,140)	(49,191)	(10,608)	(760)
Interest Expense on Long-Term Debt	(20,137)	0	0	0

Total Interest Expense	(160,277)	(49,191)	(10,608)	(760)
Interest Rate Agreement Expense	(3,859)	(1,159)	(339)	(8)
Interest Rate Agreement Income	118	1	0	0
Net Interest Rate Agreement Expense	(3,741)	(1,158)	(339)	(8)
Net Interest Income	34,586	16,935	4,779	528
Provision for Potential Credit Losses				
Mortgage Loans	(2,503)	(348)	(79)	0
Mortgage Securities	(427)	(1,348)	(414)	0
Total Credit Provision	(2,930)	(1,696)	(493)	0
Gain (Loss) on Sale Transactions	563	0	0	0
Operating Expenses				
Compensation and Benefits Expense	(1,819)	(1,191)	(463)	(63)
Dividend Equivalent Rights Expense	(1,067)	(382)	(54)	--
Other Operating Expenses	(1,772)	(981)	(614)	(83)
Total Operating Expenses	(4,658)	(2,554)	(1,131)	(146)
Other Income (Expenses)	0	0	0	0
Corporate Income Tax Expense	0	0	0	0
Net Income Before Preferred Dividends	$ 27,561	$ 12,685	$ 3,155	$ 382
Preferred Dividends	(2,815)	(1,148)	--	--
Net Income to Common Shareholders	$ 24,746	$ 11,537	$ 3,155	$ 382
Calculation of Taxable REIT Income				
GAAP Net Income Before Preferred Dividends	$ 27,561	$ 12,685	$ 3,155	$ 382
Mortgage Amortization Differences	(180)	449	175	(28)
Credit Provisions less Actual Losses	2,750	1,689	490	0
Gain (Loss) on Sale Differences	(190)	0	(0)	0
Operating Expense Differences	23	345	12	0
Taxable Income Before Preferred Dividend	$ 29,964	$ 15,168	$ 3,832	$ 354

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 2

<TABLE>
<CAPTION>

	AT			
BALANCE SHEETS (ALL DOLLARS IN THOUSANDS)	DEC. 31, 1997	SEP. 30, 1997	JUN. 30, 1997	MAR. 31, 1997
<S>	<C>	<C>	<C>	<C>
Cash and Cash Equivalents	$ 49,549	$ 57,696	$ 29,425	$ 12,985
Mortgage Loans:				
Principal Value	1,519,124	1,348,619	1,111,029	716,009
Unamortized Premium	34,844	30,852	25,442	15,951
Unamortized Discount	0	0	(123)	(131)
Real Estate Owned	713	220	346	128
Reserve For Credit Losses	(2,855)	(1,363)	(929)	(630)
Market Valuation Account	0	0	0	(1,291)
Total Mortgage Loans	1,551,826	1,378,328	1,135,765	730,035
Mortgage Securities:				
Principal Value	1,779,375	2,010,374	2,179,186	1,839,720
Unamortized Premium	51,329	56,082	62,219	49,156
Unamortized Discount	(12,442)	(14,387)	(14,968)	(15,510)
Reserve For Credit Losses	(2,076)	(3,093)	(2,651)	(2,203)
Market Valuation Account	(1,390)	10,619	3,603	3,516
Total Mortgage Securities	1,814,796	2,059,595	2,227,389	1,874,679
Total Mortgage Assets	3,366,622	3,437,923	3,363,154	2,604,714
Interest Rate Agreements	10,781	11,708	12,233	7,879
Market Valuation Account	(8,681)	(8,782)	(7,366)	(2,106)
Total Interest Rate Agreements	2,100	2,926	4,867	5,773

Accrued Interest Receivable	23,119	23,859	24,065	17,722
Fixed Assets, Leasehold, Org. Costs	539	358	257	259
Prepaid Expenses and Other Receivables	2,268	2,490	2,738	1,611
Other Assets	25,926	26,707	27,060	19,592
Total Assets	$ 3,444,197	$ 3,525,252	$ 3,424,506	$ 2,643,064
Short-Term Borrowings	$ 1,914,525	$ 2,639,773	$ 3,102,784	$ 2,373,279
Long-Term Borrowings	1,172,801	497,367	0	0
Accrued Interest Payable	14,476	20,216	18,153	14,962
Accrued Expenses and Other Payables	2,172	2,129	1,743	1,262
Dividends Payable	5,686	9,433	8,638	7,899
Total Liabilities	$ 3,109,660	$ 3,168,918	$ 3,131,318	$ 2,397,402
Preferred Stock	$ 26,736	$ 26,733	$ 26,733	$ 29,383
Common Stock	143	146	133	119
Additional Paid-in Capital	324,555	333,841	274,420	219,461
Net Market Valuation Account	(10,071)	1,837	(3,762)	118
Retained Earnings after Dividends	(6,826)	(6,223)	(4,336)	(3,419)
Total Stockholders' Equity	334,537	356,334	293,188	245,662
Total Liabilities plus Stockholders' Equity	$ 3,444,197	$ 3,525,252	$ 3,424,506	$ 2,643,064

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 2 (CONTINUED)

<TABLE>
<CAPTION>

	AT			
BALANCE SHEETS (ALL DOLLARS IN THOUSANDS)	DEC. 31, 1996	SEP. 30, 1996	JUN. 30, 1996	MAR. 31, 1996
<S>	<C>	<C>	<C>	<C>
Cash and Cash Equivalents	$ 11,068	$ 14,599	$ 10,407	$ 9,705
Mortgage Loans:				
Principal Value	514,837	126,426	69,154	24,831
Unamortized Premium	12,389	1,535	686	191
Unamortized Discount	(142)	(153)	(160)	(171)
Real Estate Owned	196	0	0	0
Reserve For Credit Losses	(428)	(393)	(214)	(74)
Market Valuation Account	(1,377)	279	200	84
Total Mortgage Loans	525,475	127,694	69,666	24,861
Mortgage Securities:				
Principal Value	1,602,212	1,234,636	936,611	548,976
Unamortized Premium	41,928	31,072	22,004	12,599
Unamortized Discount	(15,951)	(16,185)	(16,448)	(16,683)
Reserve For Credit Losses	(1,752)	(1,421)	(1,084)	(747)
Market Valuation Account	1,516	74	(3,269)	(3,847)
Total Mortgage Securities	1,627,953	1,248,176	937,814	540,298
Total Mortgage Assets	2,153,428	1,375,870	1,007,480	565,159
Interest Rate Agreements	6,200	3,286	2,835	2,534
Market Valuation Account	(3,599)	(2,413)	(1,484)	(1,301)
Total Interest Rate Agreements	2,601	873	1,351	1,233
Accrued Interest Receivable	14,134	10,781	7,292	4,496
Fixed Assets, Leasehold, Org. Costs	257	265	233	198
Prepaid Expenses and Other Receivables	2,709	1,090	1,567	522
Other Assets	17,100	12,136	9,092	5,216
Total Assets	$ 2,184,197	$ 1,403,478	$ 1,028,330	$ 581,313
Short-Term Borrowings	$ 1,953,103	$ 1,225,094	$ 896,214	$ 508,721
Long-Term Borrowings	0	0	0	0
Accrued Interest Payable	14,060	10,379	4,052	1,616
Accrued Expenses and Other Payables	761	472	361	290
Dividends Payable	5,268	4,016	3,408	2,540

Total Liabilities	$ 1,973,192	$ 1,239,961	$ 904,035	$ 513,167
Preferred Stock	$ 29,579	$ 29,712	$ 0	$ 0
Common Stock	110	91	85	55
Additional Paid-in Capital	187,507	138,081	130,441	73,926
Net Market Valuation Account	(3,460)	(2,060)	(4,553)	(5,065)
Retained Earnings after Dividends	(2,731)	(2,307)	(1,678)	(770)
Total Stockholders' Equity	211,005	163,517	124,295	68,146
Total Liabilities plus Stockholders' Equity	$ 2,184,197	$ 1,403,478	$ 1,028,330	$ 581,313

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 2 (CONTINUED)

<TABLE>
<CAPTION>

	AT			
BALANCE SHEETS (ALL DOLLARS IN THOUSANDS)	DEC. 31, 1997	DEC. 31, 1996	DEC. 31, 1995	DEC. 31, 1994
<S>	<C>	<C>	<C>	<C>
Cash and Cash Equivalents	$ 49,549	$ 11,068	$ 4,825	$ 1,027
Mortgage Loans:				
Principal Value	1,519,124	514,837	26,411	0
Unamortized Premium	34,844	12,389	210	0
Unamortized Discount	0	(142)	(172)	0
Real Estate Owned	713	196	0	0
Reserve For Credit Losses	(2,855)	(428)	(79)	0
Market Valuation Account	0	(1,377)	80	0
Total Mortgage Loans	1,551,826	525,475	26,450	0
Mortgage Securities:				
Principal Value	1,779,375	1,602,212	417,214	120,627
Unamortized Premium	51,329	41,928	9,433	828
Unamortized Discount	(12,442)	(15,951)	(16,860)	(1,320)
Reserve For Credit Losses	(2,076)	(1,752)	(411)	0
Market Valuation Account	(1,390)	1,516	(3,582)	(2,658)
Total Mortgage Securities	1,814,796	1,627,953	405,794	117,477
Total Mortgage Assets	3,366,622	2,153,428	432,244	117,477
Interest Rate Agreements	10,781	6,200	2,521	1,791
Market Valuation Account	(8,681)	(3,599)	(1,974)	101
Total Interest Rate Agreements	2,100	2,601	547	1,892
Accrued Interest Receivable	23,119	14,134	3,270	743
Fixed Assets, Leasehold, Org. Costs	539	257	206	201
Prepaid Expenses and Other Receivables	2,268	2,709	465	188
Other Assets	25,926	17,100	3,941	1,132
Total Assets	$ 3,444,197	$ 2,184,197	$ 441,557	$ 121,529
Short-Term Borrowings	$ 1,914,525	$ 1,953,103	$ 370,316	$ 100,376
Long-Term Borrowings	1,172,801	0	0	0
Accrued Interest Payable	14,476	14,060	1,290	676
Accrued Expenses and Other Payables	2,172	761	227	29
Dividends Payable	5,686	5,268	1,434	167
Total Liabilities	$ 3,109,660	$ 1,973,192	$ 373,267	$ 101,248
Preferred Stock	$ 26,736	$ 29,579	$ 0	$ 22,785
Common Stock	143	110	55	2
Additional Paid-in Capital	324,555	187,507	73,895	19
Net Market Valuation Account	(10,071)	(3,460)	(5,476)	(2,557)
Retained Earnings after Dividends	(6,826)	(2,731)	(184)	31
Total Stockholders' Equity	334,537	211,005	68,290	20,280
Total Liabilities plus Stockholders' Equity	$ 3,444,197	$ 2,184,197	$ 441,557	$ 121,528

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 3

<TABLE>
<CAPTION>

MORTGAGE ASSET CHARACTERISTICS (ALL DOLLARS IN THOUSANDS)	AT OR FOR THREE MONTHS ENDING			
	DEC. 31, 1997	SEP. 30, 1997	JUN. 30, 1997	MAR. 31, 1997
Average Characteristics of Loans and Securities (Mortgage Assets) at End of Period				
Single-Family Properties	100%	100%	100%	100%
Adjustable Rate	100%	100%	100%	100%
First Lien	100%	100%	100%	100%
Average Credit Rating Equivalent	AA+	AA+	AA+	AA+
Amortized Cost as % of Principal Value	102.23%	102.16%	102.21%	101.94%
Coupon Rate	7.71%	7.75%	7.73%	7.70%
Months to Next Coupon Adjustment	4	4	5	5
Level of Index	5.68%	5.65%	5.77%	5.98%
Net Margin	2.06%	2.11%	2.15%	2.21%
Fully Indexed Coupon Rate	7.74%	7.76%	7.92%	8.19%
Coupon Versus Fully-Indexed Rate	-0.03%	-0.01%	-0.19%	-0.49%
Net Life Cap	12.08%	12.03%	12.01%	11.91%
Percentage of Mortgage Assets by Credit Type, by Amortized Cost				
Mortgage Loans	46.1%	40.2%	33.8%	28.1%
Mortgage Securities: AAA/AA	53.6%	58.2%	64.5%	69.8%
Mortgage Securities: A/BBB	0.0%	0.7%	0.8%	1.0%
Mortgage Securities: Below BBB	0.3%	0.9%	0.9%	1.1%
Total Mortgage Assets (%)	100.0%	100.0%	100.0%	100.0%
Total Mortgage Assets (Amortized Cost)	$ 3,372,943	$3,431,760	$3,363,131	$2,605,323
Percentage of Mortgage Assets by Index, Adjustment Frequency, and Annualized Periodic Cap, By Principal Value				
1 Month LIBOR, adjusts monthly, no periodic cap	20.1%	12.4%	8.9%	2.6%
6 Month LIBOR, adjusts every 6 months, 2% periodic cap	22.5%	26.2%	27.5%	32.4%
6 Month LIBOR, adjusts every 6 months, no periodic cap	11.2%	11.4%	7.4%	1.9%
6 Month CD, adjusts every 6 months, 2% periodic cap	1.2%	1.3%	1.5%	1.9%
6 Month Treasury, adjusts every 6 months, 2% periodic cap	0.6%	0.6%	0.6%	0.8%
6 Month Treasury, adjusts every 6 months, no periodic cap	0.5%	0.5%	0.5%	0.7%
3/1 Hybrid: 12 Month Treasury with 3 year initial coupon	1.6%	1.7%	1.8%	2.4%
12 Month Treasury, adjusts annually, 2% periodic cap	40.7%	44.5%	50.3%	55.4%
12 Month Treasury, adjusts annually, no periodic cap	0.1%	0.1%	0.1%	0.1%
Other	1.5%	1.3%	1.4%	

				1.8%
Total Mortgage Assets (%)	100.0%	100.0%	100.0%	100.0%
Total Mortgage Assets (Principal Value)	$ 3,299,212	$3,359,213	$3,290,562	$ 2,555,857
Net Mortgage Asset Growth				
Mortgage Acquisitions	$ 342,283	$ 369,463	$ 962,890	$ 627,075
Mortgage Principal Repayments	(347,427)	(252,398)	(199,945)	(173,362)
Amortization	(7,921)	(6,512)	(5,109)	(3,818)
Credit Losses	(40)	(68)	(28)	(41)
Sales	(45,712)	(41,856)	0	0
Change in Mortgage Assets (Amortized Cost)	(58,817)	68,629	757,808	449,854

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 3 (CONTINUED)

<TABLE>
<CAPTION>

MORTGAGE ASSET CHARACTERISTICS	AT OR FOR THREE MONTHS ENDING			
(ALL DOLLARS IN THOUSANDS)	DEC. 31, 1996	SEP. 30, 1996	JUN. 30, 1996	MAR. 31, 1996
<S>	<C>	<C>	<C>	<C>
Average Characteristics of Loans and Securities (Mortgage Assets) at End of Period				
Single-Family Properties	100%	100%	100%	100%
Adjustable Rate	100%	100%	100%	100%
First Lien	100%	100%	100%	100%
Average Credit Rating Equivalent	AA+	AA+	AA+	AA+
Amortized Cost as % of Principal Value	101.81%	101.20%	100.60%	99.29%
Coupon Rate	7.75%	7.55%	7.42%	7.59%
Months to Next Coupon Adjustment	5	4	4	3
Level of Index	5.58%	5.70%	5.72%	5.47%
Net Margin	2.24%	2.21%	2.21%	2.11%
Fully Indexed Coupon Rate	7.82%	7.91%	7.93%	7.58%
Coupon Versus Fully-Indexed Rate	-0.07%	-0.36%	-0.51%	0.01%
Net Life Cap	11.73%	11.69%	11.71%	11.53%
Percentage of Mortgage Assets by Credit Type, by Amortized Cost				
Mortgage Loans	24.5%	9.3%	6.9%	4.4%
Mortgage Securities: AAA/AA	73.0%	86.8%	87.7%	86.1%
Mortgage Securities: A/BBB	1.2%	1.8%	2.5%	4.6%
Mortgage Securities: Below BBB	1.3%	2.1%	2.9%	4.9%
Total Mortgage Assets (%)	100.0%	100.0%	100.0%	100.0%
Total Mortgage Assets (Amortized Cost)	$2,155,469	$1,377,331	$1,011,847	$569,743
Percentage of Mortgage Assets by Index, Adjustment Frequency, and Annualized Periodic Cap, By Principal Value				

1 Month LIBOR, adjusts monthly, no periodic cap	1.4%	2.3%	3.3%	6.6%
6 Month LIBOR, adjusts every 6 months, 2% periodic cap	36.2%	45.9%	54.4%	63.2%
6 Month LIBOR, adjusts every 6 months, no periodic cap	0.0%	0.0%	0.0%	0.0%
6 Month CD, adjusts every 6 months, 2% periodic cap	2.5%	2.4%	3.3%	8.7%
6 Month Treasury, adjusts every 6 months, 2% periodic cap	1.1%	1.7%	2.4%	0.0%
6 Month Treasury, adjusts every 6 months, no periodic cap	0.9%	1.3%	1.9%	3.6%
3/1 Hybrid: 12 Month Treasury with 3 year initial coupon	0.0%	0.0%	0.0%	0.0%
12 Month Treasury, adjusts annually, 2% periodic cap	55.7%	45.0%	32.8%	14.6%
12 Month Treasury, adjusts annually, no periodic cap	0.0%	0.0%	0.0%	0.0%
Other	2.2%	1.4%	1.9%	3.3%
	----------	----------	----------	--------
Total Mortgage Assets (%)	100.0%	100.0%	100.0%	100.0%
Total Mortgage Assets (Principal Value)	$2,117,244	$1,361,062	$1,005,764	$573,807
Net Mortgage Asset Growth				
Mortgage Acquisitions	$875,968	$443,860	$496,184	$166,852
Mortgage Principal Repayments	(95,610)	(76,942)	(53,058)	(32,814)
Amortization	(2,213)	(1,434)	(1,022)	(531)
Credit Losses	(7)	0	0	0
Sales	0	0	0	0
	----------	----------	----------	--------
Change in Mortgage Assets (Amortized Cost)	778,138	365,484	442,104	133,507

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

<TABLE>
<CAPTION>

TABLE 3 (CONTINUED)
MORTGAGE ASSET CHARACTERISTICS

(ALL DOLLARS IN THOUSANDS)	AT OR FOR YEAR ENDING			
	DEC. 31, 1997	DEC. 31, 1996	DEC. 31, 1995	DEC. 31, 1994
<S>	<C>	<C>	<C>	<C>
Average Characteristics of Loans and Securities (Mortgage Assets) at End of Period				
Single-Family Properties	100%	100%	100%	100%
Adjustable Rate	100%	100%	100%	100%
First Lien	100%	100%	100%	100%
Average Credit Rating Equivalent	AA+	AA+	AA+	AA+
Amortized Cost as % of Principal Value	102.23%	101.81%	98.33%	99.59%
Coupon Rate	7.71%	7.75%	7.50%	6.00%
Months to Next Coupon Adjustment	4	5	3	3
Level of Index	5.68%	5.58%	5.44%	6.94%
Net Margin	2.06%	2.24%	2.08%	2.25%
Fully Indexed Coupon Rate	7.74%	7.82%	7.52%	9.19%
Coupon Versus Fully-Indexed Rate	-0.03%	-0.07%	-0.02%	-3.19%
Net Life Cap	12.08%	11.73%	11.54%	11.48%
Percentage of Mortgage Assets by Credit Type, by Amortized Cost				
Mortgage Loans	46.1%	24.5%	6.1%	

Mortgage Securities: AAA/AA	53.6%	73.0%	81.5%	92.9%
Mortgage Securities: A/BBB	0.0%	1.2%	5.8%	4.3%
Mortgage Securities: Below BBB	0.3%	1.3%	6.6%	2.8%
Total Mortgage Assets (%)	100.0%	100.0%	100.0%	100.0%
Total Mortgage Assets (Amortized Cost)	$3,372,943	$2,155,469	$436,236	$120,135
Percentage of Mortgage Assets by Index, Adjustment Frequency, and Annualized Periodic Cap, By Principal Value				
1 Month LIBOR, adjusts monthly, no periodic cap	20.1%	1.4%	7.6%	3.9%
6 Month LIBOR, adjusts every 6 months, 2% periodic cap	22.5%	36.2%	60.3%	78.3%
6 Month LIBOR, adjusts every 6 months, no periodic cap	11.2%	0.0%	0.0%	0.0%
6 Month CD, adjusts every 6 months, 2% periodic cap	1.2%	2.5%	12.2%	17.8%
6 Month Treasury, adjusts every 6 months, 2% periodic cap	0.6%	1.1%	0.0%	0.0%
6 Month Treasury, adjusts every 6 months, no periodic cap	0.5%	0.9%	4.9%	0.0%
3/1 Hybrid: 12 Month Treasury with 3 year initial coupon	1.6%	0.0%	0.0%	0.0%
12 Month Treasury, adjusts annually, 2% periodic cap	40.7%	55.7%	12.3%	0.0%
12 Month Treasury, adjusts annually, no periodic cap	0.1%	0.0%	0.0%	0.0%
Other	1.5%	2.2%	2.7%	0.0%
Total Mortgage Assets (%)	100.0%	100.0%	100.0%	100.0%
Total Mortgage Assets (Principal Value)	$3,299,212	$2,117,244	$443,625	$120,627
Net Mortgage Asset Growth				
Mortgage Acquisitions	$2,301,711	$1,982,864	$354,572	$121,297
Mortgage Principal Repayments	(973,132)	(258,424)	(38,824)	(1,244)
Amortization	(23,361)	(5,200)	357	82
Credit Losses	(179)	(7)	(4)	(0)
Sales	(87,565)	0	0	0
Change in Mortgage Assets (Amortized Cost)	1,217,474	1,719,233	316,101	120,135

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 4

<TABLE>
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MORTGAGE LOAN SUMMARY (ALL DOLLARS IN THOUSANDS)	AT DEC. 31, 1997	SEP. 30, 1997	JUN. 30, 1997	MAR. 31, 1997
<S>	<C>	<C>	<C>	<C>
Number of Loans	5,041	4,651	3,983	2,795
Principal Value	$1,519,837	$1,348,839	$1,111,376	$ 716,137
Amortized Cost	1,554,681	1,379,691	1,136,694	731,957
Reported Value (Net of Credit Reserve)	1,551,826	1,378,328	1,135,765	730,035
Estimated Bid-Side Market Value	1,552,586	1,379,166	1,136,004	729,561
Adjustable-Rate	100%	100%	100%	100%
Single-Family	100%	100%	100%	100%
"A" Quality Underwriting	100%	100%	100%	100%
First Lien	100%	100%	100%	100%
Primary Residence (Owner-Occupied)	89%	91%	92%	94%
Second Home	8%	7%	6%	4%

Investor Property	3%	2%	2%	2%
Average Loan Size	$ 301	$ 290	$ 279	$ 256
Loan Balance (Less than) Conventional Loan Balance Limit ($214,600 in 1997)	18%	19%	20%	20%
Loan Balance (Greater than) $500,000	37%	33%	27%	14%
Original Loan-To-Value Ratio (LTV)	78%	77%	78%	74%
Original LTV (Greater than) 80%	38%	35%	33%	24%
% of Original LTV (Greater than) 80% with Primary Mortgage Insurance or Pledged Account Collateral	95%	96%	94%	94%
Effective Average Original LTV Including Primary Mortgage Insurance or Pledged Account Collateral	66%	66%	69%	68%
1990 and Prior Years' Origination	4%	4%	6%	9%
1991 Origination	*	*	1%	1%
1992	1%	1%	2%	3%
1993	4%	4%	6%	9%
1994	13%	17%	23%	41%
1995	1%	2%	2%	4%
1996	11%	14%	18%	30%
1997	66%	58%	42%	2%
Average Seasoning in Months	18	19	22	33
Northern California	11%	13%	13%	17%
Southern California	18%	19%	21%	24%
Florida	9%	9%	8%	5%
New York	7%	6%	5%	4%
Georgia	5%	4%	3%	2%
New Jersey	4%	4%	4%	3%
Connecticut	4%	4%	4%	3%
Texas	4%	4%	4%	3%
Colorado	4%	3%	3%	2%
Maryland	3%	3%	4%	6%
Illinois	3%	3%	3%	4%
Arizona	2%	3%	3%	1%
Other States	26%	25%	25%	26%

</TABLE>

*: less than 0.5%

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 4 (CONTINUED)

<TABLE>
<CAPTION>

	AT			
MORTGAGE LOAN SUMMARY (ALL DOLLARS IN THOUSANDS)	DEC. 31, 1996	SEP. 30, 1996	JUN. 30, 1996	MAR. 31, 1996
<S>	<C>	<C>	<C>	<C>
Number of Loans	2,172	478	257	101
Principal Value	$515,033	$126,426	$ 69,154	$ 24,831
Amortized Cost	527,280	127,808	69,680	24,851
Reported Value (Net of Credit Reserve)	525,475	127,694	69,666	24,861
Estimated Bid-Side Market Value	525,475	127,694	69,666	24,861
Adjustable-Rate	100%	100%	100%	100%
Single-Family	100%	100%	100%	100%
"A" Quality Underwriting	100%	100%	100%	100%
First Lien	100%	100%	100%	100%
Primary Residence (Owner-Occupied)	94%	99%	99%	100%
Second Home	4%	1%	1%	0%
Investor Property	2%	0%	0%	0%
Average Loan Size	$ 237	$ 264	$ 269	$ 246

Loan Balance [Less Than] Conventional Loan Balance Limit ($214,600 in 1997)	22%	15%	13%	27%
Loan Balance [Greater Than] $500,000	8%	12%	13%	25%
Original Loan-To-Value Ratio (LTV)	77%	78%	76%	77%
Original LTV [Greater Than] 80%	25%	32%	23%	27%
% of Original LTV [Greater Than] 80% with Primary Mortgage Insurance or Pledged Account Collateral	97%	100%	100%	100%
Effective Average Original LTV Including Primary Mortgage Insurance or Pledged Account Collateral	73%	73%	73%	73%
1990 and Prior Years' Origination	13%	0%	0%	0%
1991 Origination	2%	0%	0%	0%
1992	4%	0%	0%	0%
1993	14%	7%	1%	0%
1994	52%	43%	2%	2%
1995	7%	32%	63%	98%
1996	8%	18%	34%	0%
1997	0%	0%	0%	0%
Average Seasoning in Months	37	9	4	7
Northern California	18%	34%	30%	30%
Southern California	26%	51%	43%	46%
Florida	4%	*	1%	1%
New York	3%	*	*	0%
Georgia	2%	*	1%	1%
New Jersey	3%	*	*	1%
Connecticut	3%	1%	1%	1%
Texas	2%	1%	1%	4%
Colorado	1%	2%	3%	3%
Maryland	8%	*	1%	2%
Illinois	4%	*	1%	0%
Arizona	2%	0%	0%	0%
Other States	24%	11%	18%	11%

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*: less than 0.5%

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 4 (CONTINUED)

AT

<TABLE>
<CAPTION>

MORTGAGE LOAN SUMMARY (ALL DOLLARS IN THOUSANDS)	DEC. 31, 1997	DEC. 31, 1996	DEC. 31, 1995	DEC. 31, 1994
<S>	<C>	<C>	<C>	<C>
Number of Loans	5,041	2,172	109	0
Principal Value	$1,519,837	$ 515,033	$ 26,411	$ 0
Amortized Cost	1,554,681	527,280	26,449	0
Reported Value (Net of Credit Reserve)	1,551,826	525,475	26,450	0
Estimated Bid-Side Market Value	1,552,586	525,475	26,450	0
Adjustable-Rate	100%	100%	100%	n/a
Single-Family	100%	100%	100%	n/a
"A" Quality Underwriting	100%	100%	100%	n/a
First Lien	100%	100%	100%	n/a
Primary Residence (Owner-Occupied)	89%	94%	100%	n/a
Second Home	8%	4%	0%	n/a
Investor Property	3%	2%	0%	n/a
Average Loan Size	$ 301	$ 237	$ 242	n/a
Loan Balance Less than Conventional Loan Balance Limit ($214,600 in 1997)	18%	23%	11%	n/a
Loan Balance Greater Than $500,000	37%	8%	13%	n/a
Original Loan-To-Value Ratio (LTV)	78%	77%	76%	n/a
Original LTV Greater than 80%	38%	25%	26%	n/a
% of Original LTV Greater than 80% with Primary Mortgage Insurance or Pledged Account Collateral	95%	97%	100%	n/a
Effective Average Original LTV Including Primary Mortgage Insurance or Pledged Account Collateral	66%	73%	72%	n/a
1990 and Prior Years' Origination	4%	13%	0%	n/a
1991 Origination	*	2%	0%	n/a
1992	1%	4%	0%	n/a
1993	4%	14%	0%	n/a
1994	13%	52%	2%	n/a
1995	1%	7%	98%	n/a
1996	11%	8%	0%	n/a
1997	66%	0%	0%	n/a
Average Seasoning in Months	18	37	4	n/a
Northern California	11%	18%	30%	n/a
Southern California	18%	26%	44%	n/a
Florida	9%	4%	1%	n/a
New York	7%	3%	0%	n/a
Georgia	5%	2%	1%	n/a
New Jersey	4%	3%	1%	n/a

Connecticut	4%	3%	1%	n/a
Texas	4%	2%	4%	n/a
Colorado	4%	1%	3%	n/a
Maryland	3%	8%	2%	n/a
Illinois	3%	4%	0%	n/a
Arizona	2%	2%	2%	n/a
Other States	26%	24%	11%	n/a

</TABLE>

*: less than 0.5%

TABLE 5

<TABLE>
<CAPTION>

EARNING ASSET YIELD, INTEREST RATE SPREAD AND INTEREST RATE MARGIN	FOR THREE MONTHS ENDING			
	DEC. 31, 1997	SEP. 30, 1997	JUN. 30, 1997	MAR. 31, 1997
<S>	<C>	<C>	<C>	<C>
Mortgage Coupon Rate (All Mortgage Assets)	7.70	7.77	7.74	7.70%
Amortized Cost as % of Principal Value	102.20	102.22	102.15	101.84%
Coupon Yield on Amortized Cost	7.53	7.60	7.57	7.56%
Effect of Premium/Discount Amortization	-0.98%	-0.79%	-0.71%	-0.68%
Mortgage Yield	6.55	6.81	6.86	6.88%
Cash Yield	5.59	5.60	5.52	5.33%
Earning Asset Yield (Mortgages plus Cash)	6.54	6.80	6.86	6.87%
Cost of Funds of Short-Term Borrowings	5.96	5.98	5.86	5.62%
Cost of Funds of Long-Term Borrowings	6.40	6.28	n/a	n/a
Total Cost of Funds	6.09	6.02	5.86	5.62%
Cost of Hedging (as % of Borrowings)	0.17	0.14	0.13	0.12%
Interest Rate Spread	0.28	0.64	0.87	1.13%
Net Interest Margin (Net Interest Income/Assets)	0.72	1.12	1.31	1.57%
Net Interest Income/Average Equity	7.06	11.13	13.25	15.30%
SELECTED OPERATING RATIOS AND RETURN ON EQUITY				
Credit Provisions as a % of Assets	0.06	0.11	0.10	0.12%
Credit Provisions as a % of Equity	0.59	1.09	1.06	1.17%
Operating Expenses to Average Assets	0.13	0.13	0.16	0.20%
Operating Expenses to Average Equity	1.29	1.33	1.66	1.97%
Efficiency Ratio (Op. Exp./Net Int. Income)	18.25	11.93	12.51	12.86%
Average Assets Per Employee ($MM)	$ 242	$ 244	$ 257	$ 221
GAAP Return on Total Equity	5.80	8.73	10.53	12.16%
GAAP Return on Common Equity	5.43	8.60	10.65	12.44%
Taxable Income Return on Total Equity	6.38	9.43	11.34	13.34%
Taxable Income Return on Common Equity	6.06	9.36	11.55	13.79%
GAAP Return on Average Assets	0.59	0.88	1.04	1.25%
PRINCIPAL PAYDOWN AND PREPAYMENT RATES				
Average Annual Conditional Prepayment Rate (CPR) of Underlying Mortgages in Mortgage Securities and Mortgage Loan Pools	27%	24%	23%	24%
Annualized Principal Payment as % of Average Principal Balance of Mortgage Securities and Mortgage Loans	43%	31%	28%	32%
Average Annual Conditional Prepayment Rate (CPR) of Underlying Mortgages in Mortgage Loan Pools	24%	23%	28%	24%
Annualized Principal Payment as % of Average Principal Balance of Mortgage Loans	29%	29%	35%	32%
Average Annual Conditional Prepayment Rate (CPR) of Underlying Mortgages in Mortgage Securities Pools	30%	25%	22%	23%
Annualized Principal Payment as % of Average Principal Balance of Mortgage Securities	53%	33%	26%	31%

</TABLE>

TABLE 5 (CONTINUED)

<TABLE>
<CAPTION>

EARNING ASSET YIELD, INTEREST RATE SPREAD AND INTEREST RATE MARGIN	FOR THREE MONTHS ENDING			
	DEC. 31, 1996	SEP. 30, 1996	JUN. 30, 1996	MAR. 31, 1996
<S>	<C>	<C>	<C>	<C>
Mortgage Coupon Rate (All Mortgage Assets)	7.58%	7.52%	7.47%	7.73%
Amortized Cost as % of Principal Value	101.41%	100.98%	99.95%	98.85%
Coupon Yield on Amortized Cost	7.48%	7.44%	7.48%	7.82%
Effect of Premium/Discount Amortization	-0.59%	-0.52%	-0.56%	-0.44%
Mortgage Yield	6.89%	6.92%	6.92%	7.38%
Cash Yield	5.31%	5.30%	5.61%	5.93%
Earning Asset Yield (Mortgages plus Cash)	6.87%	6.90%	6.90%	7.34%
Cost of Funds of Short-Term Borrowings	5.76%	5.78%	5.57%	5.69%
Cost of Funds of Long-Term Borrowings	n/a	n/a	n/a	n/a
Total Cost of Funds	5.76%	5.78%	5.57%	5.69%
Cost of Hedging (as % of Borrowings)	0.12%	0.14%	0.16%	0.14%
Interest Rate Spread	0.99%	0.98%	1.17%	1.51%
Net Interest Margin (Net Interest Income/Assets)	1.55%	1.58%	1.85%	2.17%
Net Interest Income/Average Equity	13.01%	12.40%	12.14%	14.92%
SELECTED OPERATING RATIOS AND RETURN ON EQUITY				
Credit Provisions as a % of Assets	0.10%	0.18%	0.25%	0.26%
Credit Provisions as a % of Equity	0.81%	1.40%	1.62%	1.78%
Operating Expenses to Average Assets	0.21%	0.23%	0.31%	0.38%
Operating Expenses to Average Equity	1.72%	1.82%	2.02%	2.64%
Efficiency Ratio (Op. Exp./Net Int. Income)	13.23%	14.69%	16.63%	17.71%
Average Assets Per Employee ($MM)	$ 155	$ 115	$ 84	$ 70
GAAP Return on Total Equity	10.48%	9.18%	8.50%	10.50%
GAAP Return on Common Equity	10.53%	9.06%	8.50%	10.50%
Taxable Income Return on Total Equity	11.75%	10.97%	10.69%	13.69%
Taxable Income Return on Common Equity	12.03%	11.06%	10.69%	13.69%
GAAP Return on Average Assets	1.25%	1.17%	1.30%	1.52%
PRINCIPAL PAYDOWN AND PREPAYMENT RATES				
Average Annual Conditional Prepayment Rate (CPR) of Underlying Mortgages in Mortgage Securities and Mortgage Loan Pools	23%	24%	29%	26%
Annualized Principal Payment as % of Average Principal Balance of Mortgage Securities and Mortgage Loans	26%	28%	29%	27%
Average Annual Conditional Prepayment Rate (CPR) of Underlying Mortgages in Mortgage Loan Pools	32%	19%	28%	19%
Annualized Principal Payment as % of Average Principal Balance of Mortgage Loans	42%	25%	37%	25%
Average Annual Conditional Prepayment Rate (CPR) of Underlying Mortgages in Mortgage Securities Pools	22%	24%	29%	26%
Annualized Principal Payment as % of Average Principal Balance of Mortgage Securities	24%	28%	28%	27%

</TABLE>

TABLE 5 (CONTINUED)

<TABLE>
<CAPTION>

EARNING ASSET YIELD, INTEREST RATE SPREAD AND INTEREST RATE MARGIN	FOR YEAR ENDING			
	DEC. 31, 1997	DEC. 31, 1996	DEC. 31, 1995	DEC. 31, 1994
<S>	<C>	<C>	<C>	<C>
Mortgage Coupon Rate (All Mortgage Assets)	7.72%	7.55%	7.16%	6.09%
Amortized Cost as % of Principal Value	102.13%	100.68%	99.02%	100.02%
Coupon Yield on Amortized Cost	7.56%	7.50%	7.23%	6.09%
Effect of Premium/Discount Amortization	-0.81%	-0.55%	0.17%	0.45%
Mortgage Yield	6.75%	6.95%	7.40%	6.54%

Cash Yield	5.53%	5.51%	5.43%	4.73%
Earning Asset Yield (Mortgages plus Cash)	6.74%	6.93%	7.36%	6.33%
Cost of Funds of Short-Term Borrowings	5.86%	5.71%	6.06%	5.55%
Cost of Funds of Long-Term Borrowings	6.31%	n/a	n/a	n/a
Total Cost of Funds	5.92%	5.71%	6.06%	5.55%
Cost of Hedging (as % of Borrowings)	0.14%	0.13%	0.19%	0.06%
Interest Rate Spread	0.68%	1.09%	1.11%	0.72%
Net Interest Margin (Net Interest Income/Assets)	1.14%	1.69%	2.17%	2.50%
Net Interest Income/Average Equity	11.27%	12.90%	11.03%	7.27%
SELECTED OPERATING RATIOS AND RETURN ON EQUITY				
Credit Provisions as a % of Assets	0.10%	0.17%	0.22%	0.00%
Credit Provisions as a % of Equity	0.95%	1.29%	1.14%	0.00%
Operating Expenses to Average Assets	0.15%	0.26%	0.51%	0.69%
Operating Expenses to Average Equity	1.52%	1.94%	2.61%	2.01%
Efficiency Ratio (Op. Exp./Net Int. Income)	13.47%	15.08%	23.66%	27.73%
Average Assets Per Employee ($MM)	$ 242	$ 109	$ 39	$ 12
GAAP Return on Total Equity	8.98%	9.66%	7.28%	5.25%
GAAP Return on Common Equity	8.87%	9.61%	7.28%	5.25%
Taxable Income Return on Total Equity	9.76%	11.55%	8.84%	4.86%
Taxable Income Return on Common Equity	9.73%	11.68%	8.84%	4.86%
GAAP Return on Average Assets	0.91%	1.27%	1.43%	1.81%
PRINCIPAL PAYDOWN AND PREPAYMENT RATES				
Average Annual Conditional Prepayment Rate (CPR) of Underlying Mortgages in Mortgage Securities and Mortgage Loan Pools	25%	25%	19%	9%
Annualized Principal Payment as % of Average Principal Balance of Mortgage Securities and Mortgage Loans	34%	27%	18%	7%
Average Annual Conditional Prepayment Rate (CPR) of Underlying Mortgages in Mortgage Loan Pools	24%	26%	5%	n/a
Annualized Principal Payment as % of Average Principal Balance of Mortgage Loans	31%	35%	6%	n/a
Average Annual Conditional Prepayment Rate (CPR) of Underlying Mortgages in Mortgage Securities Pools	25%	24%	19%	9%
Annualized Principal Payment as % of Average Principal Balance of Mortgage Securities	36%	27%	19%	2%

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 6

<TABLE>
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AVERAGE DAILY BALANCE SHEET	AT OR FOR THREE MONTHS ENDING			
(ALL DOLLARS IN THOUSANDS)	DEC. 31, 1997	SEP. 30, 1997	JUN. 30, 1997	MAR. 31, 1997
<S>	<C>	<C>	<C>	<C>
Cash	$ 28,592	$ 35,647	$ 19,307	$ 12,147
Mortgage Loans	1,360,029	1,155,099	758,445	574,781
Mortgage Securities	1,914,118	2,136,442	2,111,832	1,658,629
Credit Reserve	(4,679)	(3,873)	(3,083)	(2,394)
Market Valuation Adjustment, Mortgage Assets	$ 5,937	$ 6,072	$ 1,913	$ 1,022
Interest Rate Agreements	11,207	11,943	11,185	6,899
Market Valuation Adjustment, Interest Rate Agreements	(8,792)	(8,640)	(4,576)	(4,004)
Other Assets	117,643	85,689	75,928	58,856
Total Assets	3,424,055	3,418,379	2,970,951	2,305,936
Short-Term Borrowings	1,233,924	2,695,438	2,659,914	2,056,051
Long-Term Borrowings	910,870	355,028	0	0
Other Liabilities	20,912	24,714	20,530	15,691

Total Liabilities	2,165,706	3,075,181	2,680,444	2,071,742
Preferred Stock	26,733	26,733	28,946	29,545
Common Stock	328,384	321,492	265,561	208,426
Market Valuation Adjustment	$ (2,855)	$ (2,568)	$ (2,663)	$ (2,982)
Retained Earnings, after Dividend	(4,783)	(2,458)	(1,337)	(795)
Stockholders' Equity	347,479	343,199	290,507	234,194
Amortized Cost of Total Assets	3,426,910	3,420,947	2,973,614	2,308,918
Equity, before Market Valuation Adjustments	350,334	345,767	293,170	237,176
BORROWING COMPOSITIONS (AT END OF PERIOD)				
Short-Term Borrowings: 1 to 6 Month LIBOR, no caps	62.0%	84.1%	100.0%	100.0%
Long-Term Borrowings: 1 Month LIBOR, 10% cap	13.8%	9.9%	0.0%	0.0%
Long-Term Borrowings: Federal Funds, 10% cap	5.3%	6.0%	0.0%	0.0%
Long-Term Borrowings: 1 Year Treasury, 10% cap	18.9%	0.0%	0.0%	0.0%
Total Borrowings %	100.0%	100.0%	100.0%	100.0%
Total Borrowings $	$ 3,087,326	$ 3,137,140	$ 3,102,784	$ 2,373,279
LIQUIDITY (AT END OF PERIOD)				
Unrestricted Cash	$ 24,893	$ 28,758	$ 29,425	$ 12,985
Estimated Borrowing Capacity	182,713	206,442	160,338	140,561
Total Liquidity	$ 207,606	$ 235,200	$ 189,763	$ 153,546
Total Liquidity as Percent of Short-Term Borrowings	11%	9%	6%	6%
NET PREMIUM AS % OF EQUITY AND ASSETS (AT END OF PERIOD)				
Unamortized Premium of Mortgage Assets	$ 86,173	$ 86,934	$ 87,661	$ 65,107
Unamortized Discount of Mortgage Assets	(12,442)	(14,387)	(15,091)	(15,641)
Unamortized Premium of Long-Term Debt	(5,795)	0	0	0
Net Premium	$ 67,937	$ 72,548	$ 72,569	$ 49,466
Net Premium as Percent of Equity (before Market Value Adjustments)	19.7%	20.5%	24.4%	20.1%
Net Premium as Percent of Assets (Amortized Cost)	2.0%	2.1%	2.1%	1.9%

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 6 (CONTINUED)

<TABLE>
<CAPTION>

AVERAGE DAILY BALANCE SHEET	AT OR FOR THREE MONTHS ENDING			
(ALL DOLLARS IN THOUSANDS)	DEC. 31, 1996	SEP. 30, 1996	JUN. 30, 1996	MAR. 31, 1996
<S>	<C>	<C>	<C>	<C>
Cash	$ 16,137	$ 18,854	$ 14,402	$ 14,639
Mortgage Loans	143,368	93,991	45,313	25,279
Mortgage Securities	1,347,617	1,010,853	688,697	457,841
Credit Reserve	(1,952)	(1,491)	(1,002)	(594)
Market Valuation Adjustment, Mortgage Assets	$ 603	$ (2,279)	$ (3,865)	$ (3,880)
Interest Rate Agreements	4,681	3,185	2,737	2,503
Market Valuation Adjustment, Interest Rate Agreements	(3,513)	(1,352)	(1,080)	(1,836)
Other Assets	41,430	30,129	21,566	13,094
Total Assets	1,548,371	1,151,890	766,768	507,046
Short-Term Borrowings	1,351,510	999,229	651,643	435,979
Long-Term Borrowings	0	0	0	0

Other Liabilities	14,898	8,728	2,472	2,324
Total Liabilities	1,366,408	1,007,957	654,115	438,303
Preferred Stock	29,671	15,179	0	0
Common Stock	156,594	132,924	117,695	73,998
Market Valuation Adjustment	$ (2,910)	$ (3,631)	$ (4,945)	$ (5,716)
Retained Earnings, after Dividend	(1,392)	(539)	(97)	461
Stockholders' Equity	181,963	143,933	112,653	68,743
Amortized Cost of Total Assets	1,551,281	1,155,521	771,713	512,762
Equity, before Market Valuation Adjustments	184,873	147,564	117,598	74,459
BORROWING COMPOSITIONS (AT END OF PERIOD)				
Short-Term Borrowings: 1 to 6 Month LIBOR, no caps	100.0%	100.0%	100.0%	100.0%
Long-Term Borrowings: 1 Month LIBOR, 10% cap	0.0%	0.0%	0.0%	0.0%
Long-Term Borrowings: Federal Funds, 10% cap	0.0%	0.0%	0.0%	0.0%
Long-Term Borrowings: 1 Year Treasury, 10% cap	0.0%	0.0%	0.0%	0.0%
Total Borrowings %	100.0%	100.0%	100.0%	100.0%
Total Borrowings $	$ 1,953,103	$ 1,225,094	$ 896,214	$ 508,721
LIQUIDITY (AT END OF PERIOD)				
Unrestricted Cash	$ 11,068	$ 14,599	$ 10,407	$ 9,705
Estimated Borrowing Capacity	123,995	99,126	69,581	29,153
Total Liquidity	$ 135,063	$ 113,725	$ 79,988	$ 38,858
Total Liquidity as Percent of Short-Term Borrowings	7%	9%	9%	8%
NET PREMIUM AS % OF EQUITY AND ASSETS (AT END OF PERIOD)				
Unamortized Premium of Mortgage Assets	$ 54,318	$ 32,607	$ 22,690	$ 12,790
Unamortized Discount of Mortgage Assets	(16,093)	(16,338)	(16,608)	(16,854)
Unamortized Premium of Long-Term Debt	0	0	0	0
Net Premium	$ 38,225	$ 16,270	$ 6,082	$ (4,064)
Net Premium as Percent of Equity (before Market Value Adjustments)	17.8%	9.8%	4.7%	-5.6%
Net Premium as Percent of Assets (Amortized Cost)	1.7%	1.2%	0.6%	-0.7%

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 6 (CONTINUED)

<TABLE>
<CAPTION>

AVERAGE DAILY BALANCE SHEET	AT OR FOR YEAR ENDING			
(ALL DOLLARS IN THOUSANDS)	DEC. 31, 1997	DEC. 31, 1996	DEC. 31, 1995	DEC. 31, 1994
<S>	<C>	<C>	<C>	<C>
Cash	$ 24,001	$ 16,016	$ 4,272	$ 6,627
Mortgage Loans	964,768	77,215	5,006	0
Mortgage Securities	1,956,452	877,907	204,284	50,080
Credit Reserve	(3,514)	(1,262)	(92)	0
Market Valuation Adjustment, Mortgage Assets	$ (1,134)	$ (2,347)	$ (78)	$ (583)
Interest Rate Agreements	10,325	3,280	2,039	759
Market Valuation Adjustment, Interest Rate Agreements	(2,482)	(1,948)	(1,046)	31
Other Assets	84,693	26,606	5,107	948
Total Assets	3,033,108	995,467	219,492	57,862

-				
Short-Term Borrowings	2,390,132	861,316	174,926	37,910
Long-Term Borrowings	319,076	0	0	0
Other Liabilities	20,488	7,131	2,342	367
-				
Total Liabilities	2,729,696	868,447	177,268	38,277
-				
Preferred Stock	27,978	11,274	0	0
Common Stock	281,405	120,436	43,390	20,941
Market Valuation Adjustment	$ (3,617)	$ (4,295)	$ (1,124)	$ (552)
Retained Earnings, after Dividend	(2,354)	(395)	(42)	(804)
-				
Stockholders' Equity	303,412	127,020	42,224	19,585
-				
Amortized Cost of Total Assets	3,036,725	999,762	220,616	58,414
Equity, before Market Valuation Adjustments	307,029	131,315	43,349	20,137
BORROWING COMPOSITIONS (AT END OF PERIOD)				
Short-Term Borrowings: 1 to 6 Month LIBOR, no caps	62.0%	100.0%	100.0%	100.0%
Long-Term Borrowings: 1 Month LIBOR, 10% cap	13.8%	0.0%	0.0%	0.0%
Long-Term Borrowings: Federal Funds, 10% cap	5.3%	0.0%	0.0%	0.0%
Long-Term Borrowings: 1 Year Treasury, 10% cap	18.9%	0.0%	0.0%	0.0%
-				
Total Borrowings %	100.0%	100.0%	100.0%	100.0%
Total Borrowings $	$ 3,087,326	$ 1,953,103	$ 370,316	$ 100,376
LIQUIDITY (AT END OF PERIOD)				
Unrestricted Cash	$ 24,893	$ 11,068	$ 4,825	$ 1,027
Estimated Borrowing Capacity	182,713	123,995	38,698	11,907
-				
Total Liquidity	$ 207,606	$ 135,063	$ 43,523	$ 12,934
Total Liquidity as Percent of Short-Term Borrowings	11%	7%	12%	13%
NET PREMIUM AS % OF EQUITY AND ASSETS (AT END OF PERIOD)				
Unamortized Premium of Mortgage Assets	$ 86,173	$ 54,318	$ 9,644	$ 827
Unamortized Discount of Mortgage Assets	(12,442)	(16,093)	(17,032)	(1,320)
Unamortized Premium of Long-Term Debt	(5,795)	0	0	0
-				
Net Premium	$ 67,937	$ 38,225	$ (7,389)	$ (493)
Net Premium as Percent of Equity (before Market Value Adjustments)	19.7%	17.8%	-10.0%	-2.2%
Net Premium as Percent of Assets (Amortized Cost)	2.0%	1.7%	-1.7%	-0.4%

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SUPPLEMENTAL HISTORICAL INFORMATION

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TABLE 7 ESTIMATED PERIOD-END BID-SIDE MARKET VALUE / REALIZABLE VALUE (ALL DOLLARS IN THOUSANDS)	AT OR FOR THREE MONTHS ENDING DEC. 31, 1997	SEP. 30, 1997	JUN. 30, 1997	MAR. 31, 1997
<S>	<C>	<C>	<C>	<C>
Cash	$ 49,549	$ 57,696	$ 29,425	$ 12,985
Mortgage Loans	1,552,586	1,379,166	1,136,004	729,561
Mortgage Securities	1,814,796	2,059,595	2,227,389	1,874,679
Interest Rate Agreements	1,522	2,169	4,206	5,773
Other Assets	25,156	26,048	25,857	19,291
Short-Term Borrowings	1,914,525	2,639,773	3,102,784	2,373,279
Long-Term Borrowings	1,172,938	497,465	0	0
Other Liabilities	21,201	30,628	27,515	23,411
"Mark-To-Market" of Total Equity	334,945	356,808	292,582	245,598
Liquidation Cost of Preferred Equity	28,195	28,195	28,195	30,989
"Mark-To-Market" of Common Equity	$ 306,750	$ 328,613	$ 264,387	$ 214,610

"Mark-To-Market" of Common Equity Per Common Share Outstanding	$ 21.47	$ 22.54	$ 19.95	$ 18.03
Reported Common Equity Per Common Share Outstanding	$ 21.55	$ 22.61	$ 20.11	$ 18.17
Historical Cost of Common Equity Per Common Share Outstanding	$ 22.25	$ 22.49	$ 20.39	$ 18.16
AVERAGE BALANCE SHEET UTILIZATION DURING PERIOD VERSUS RISK-ADJUSTED CAPITAL GUIDELINES				
Actual Average Equity/Assets	10.2%	10.1%	9.9%	10.3%
Average Risk-Adjusted Capital Guideline	8.1%	9.0%	9.5%	10.1%
Balance Sheet Capacity Utilization	79%	89%	96%	98%
Excess Capital and Asset Growth Potential At Period End				
Ending Actual Equity/Assets	9.71%	10.12%	8.55%	9.28%
Ending Risk-Adjusted Capital Guideline	7.51%	8.59%	9.41%	10.09%
Excess Capital	$ 76,189	$ 54,038	$ (29,417)	$ (21,029)
Estimated Asset Growth Potential (Same Asset Mix and Funding)	$ 1,013,956	$ 629,081	$ (312,637)	$ (208,706)
Estimated Asset Growth Potential Assuming All Assets (existing and future) Use Long-Term Funding	$ 4,748,787	$ 5,373,637	$ 4,005,833	$ 3,589,525
INVESTMENT OF RISK-ADJUSTED CAPITAL				
Assets with Short-Term Funding				
Agencies	24.1%	26.2%	36.0%	37.1%
Mortgage Securities Rated "AAA" or "AA"	27.6%	27.0%	36.6%	37.2%
Mortgage Securities Rated "A" or below	0.0%	6.0%	6.4%	7.6%
Whole Loans	8.2%	18.3%	31.1%	26.7%
Total Assets with Short-Term Funding	59.9%	77.5%	110.1%	108.6%
Assets with Long-Term, Non-Recourse Funding				
Mortgage Securities Rated "A" or below	2.7%	0.0%	0.0%	0.0%
Whole Loans	14.7%	7.4%	0.0%	0.0%
Total Assets with Long-Term, Non-Recourse Funding	17.4%	7.4%	0.0%	0.0%
Excess Capital	22.7%	15.1%	-10.1%	-8.6%
Total Market-Value of Capital %	100.0%	100.0%	100.0%	100.0%
Total Market-Value of Capital $	$ 334,945	$ 356,808	$ 292,582	$ 245,598

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SUPPLEMENTAL HISTORICAL INFORMATION

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TABLE 7 (CONTINUED)
ESTIMATED PERIOD-END BID-SIDE MARKET VALUE/
REALIZABLE VALUE
(ALL DOLLARS IN THOUSANDS)

	AT OR FOR THREE MONTHS ENDING			
	DEC. 31, 1996	SEP. 30, 1996	JUN. 30, 1996	MAR. 31, 1996
<S>	<C>	<C>	<C>	<C>
Cash	$ 11,068	$ 14,599	$ 10,407	$ 9,705
Mortgage Loans	525,475	127,694	69,666	24,861
Mortgage Securities	1,627,953	1,248,176	937,814	540,298
Interest Rate Agreements	2,601	873	1,351	1,233
Other Assets	16,778	11,766	8,864	4,987
Short-Term Borrowings	1,953,103	1,225,094	896,214	508,721
Long-Term Borrowings	0	0	0	0
Other Liabilities	19,531	14,457	7,522	4,240
"Mark-To-Market" of Total Equity	211,241	163,557	124,366	68,123
Liquidation Cost of Preferred Equity	31,194	31,194	0	0
"Mark-To-Market" of Common Equity	$ 180,047	$ 132,363	$ 124,366	$ 68,123
"Mark-To-Market" of Common Equity Per Common Share Outstanding	$ 16.37	$ 14.59	$ 14.60	$ 12.34

Reported Common Equity Per Common Share Outstanding	$ 16.50	$ 14.75	$ 14.59	$ 12.34
Historical Cost of Common Equity Per Common Share Outstanding	$ 16.81	$ 14.98	$ 15.12	$ 13.26
AVERAGE BALANCE SHEET UTILIZATION DURING PERIOD VERSUS RISK-ADJUSTED CAPITAL GUIDELINES				
Actual Average Equity/Assets	11.9%	12.8%	15.2%	14.5%
Average Risk-Adjusted Capital Guideline	10.2%	10.7%	11.4%	12.8%
Balance Sheet Capacity Utilization	86%	84%	75%	88%
Excess Capital and Asset Growth Potential At Period End				
Ending Actual Equity/Assets	9.66%	11.65	12.09	11.72%
Ending Risk-Adjusted Capital Guideline	9.97%	10.32	10.77	11.72%
Excess Capital	$ (6,798)	$ 18,664	$ 13,566	$ 26
Estimated Asset Growth Potential (Same Asset Mix and Funding)	$ (68,169)	$ 180,836	$ 125,972	$ 227
Estimated Asset Growth Potential Assuming All Assets (existing and future) Use Long-Term Funding	$ 3,181,906	$ 2,767,399	$ 2,155,950	$ 1,192,215
INVESTMENT OF RISK-ADJUSTED CAPITAL				
Assets with Short-Term Funding				
Agencies	39.1%	48.0%	44.9%	36.0%
Mortgage Securities Rated "AAA" or "AA"	32.4%	22.2%	24.4%	33.6%
Mortgage Securities Rated "A" or below	8.9%	11.4%	14.8%	27.1%
Whole Loans	22.8%	7.0%	5.0%	3.3%
Total Assets with Short-Term Funding	103.2%	88.6%	89.1%	100.0%
Assets with Long-Term, Non-Recourse Funding				
Mortgage Securities Rated "A" or below	0.0%	0.0%	0.0%	0.0%
Whole Loans	0.0%	0.0%	0.0%	0.0%
Total Assets with Long-Term, Non-Recourse Funding	0.0%	0.0%	0.0%	0.0%
Excess Capital	-3.2%	11.4%	10.9%	0.0%
Total Market-Value of Capital %	100.0%	100.0%	100.0%	100.0%
Total Market-Value of Capital $	$ 211,241	$ 163,557	$ 124,366	$ 68,123

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SUPPLEMENTAL HISTORICAL INFORMATION

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TABLE 7 (CONTINUED) ESTIMATED PERIOD-END BID-SIDE MARKET VALUE/ REALIZABLE VALUE (ALL DOLLARS IN THOUSANDS)	AT OR FOR YEAR ENDING DEC. 31, 1997	DEC. 31, 1996	DEC. 31, 1995	DEC. 31, 1994
<S>	<C>	<C>	<C>	<C>
Cash	$ 49,549	$ 11,068	$ 4,825	$ 1,027
Mortgage Loans	1,552,586	525,475	26,450	0
Mortgage Securities	1,814,796	1,627,953	405,794	117,477
Interest Rate Agreements	1,522	2,601	547	1,892
Other Assets	25,156	16,778	3,671	888
Short-Term Borrowings	1,914,525	1,953,103	370,316	100,376
Long-Term Borrowings	1,172,938	0	0	0
Other Liabilities	21,201	19,531	2,829	872
"Mark-To-Market" of Total Equity	334,945	211,241	68,142	20,036
Liquidation Cost of Preferred Equity	28,195	31,194	0	0
"Mark-To-Market" of Common Equity	$ 306,750	$ 180,047	$ 68,142	$ 20,036
"Mark-To-Market" of Common Equity Per Common Share Outstanding	$ 21.47	$ 16.37	$ 12.35	$ 10.69
Reported Common Equity Per Common Share Outstanding	$ 21.55	$ 16.50	$ 12.38	$ 10.82
Historical Cost of Common Equity Per Common Share Outstanding	$ 22.25	$ 16.81	$ 13.37	$ 12.18
AVERAGE BALANCE SHEET UTILIZATION DURING PERIOD VERSUS RISK-ADJUSTED CAPITAL GUIDELINES				
Actual Average Equity/Assets	10.1%	13.1%	19.6%	34.5%
Average Risk-Adjusted Capital Guideline	9.1%	10.9%	13.4%	10.6%
Balance Sheet Capacity Utilization	90%	83%	68%	31%
Excess Capital and Asset Growth Potential At Period End				

Ending Actual Equity/Assets	9.71%	9.66%	15.47%	16.69%
Ending Risk-Adjusted Capital Guideline	7.51%	9.97%	12.59	10.84%
Excess Capital	$ 76,189	$ (6,798)	$ 12,028	$ 6,716
Estimated Asset Growth Potential (Same Asset Mix and Funding)	$ 1,013,956	$ (68,169)	$ 100,874	$ 65,519
Estimated Asset Growth Potential Assuming All Assets (existing and future) Use Long-Term Funding	$ 4,748,787	$ 3,181,906	$ 1,325,602	$ 392,001
INVESTMENT OF RISK-ADJUSTED CAPITAL				
Assets with Short-Term Funding				
Agencies	24.1%	39.1%	29.3%	33.0%
Mortgage Securities Rated "AAA" or "AA"	27.6%	32.4%	22.7%	18.8%
Mortgage Securities Rated "A" or below	0.0%	8.9%	26.8%	14.7%
Whole Loans	8.2%	22.8%	3.5%	0.0%
Total Assets with Short-Term Funding	59.9%	103.2%	82.3%	66.5%
Assets with Long-Term, Non-Recourse Funding				
Mortgage Securities Rated "A" or below	2.7%	0.0%	0.0%	0.0%
Whole Loans	14.7%	0.0%	0.0%	0.0%
Total Assets with Long-Term, Non-Recourse Funding	17.4%	0.0%	0.0%	0.0%
Excess Capital	22.7%	-3.2%	17.7%	33.5%
Total Market-Value of Capital %	100.0%	100.0%	100.0%	100.0%
Total Market-Value of Capital $	$ 334,945	$ 211,241	$ 68,142	$ 20,036

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 8
<TABLE>
<CAPTION>

CREDIT PROVISIONS AND CREDIT RESERVES	AT OR FOR THREE MONTHS ENDING			
(ALL DOLLARS IN THOUSANDS)	DEC. 31, 1997	SEP. 30, 1997	JUN. 30, 1997	MAR. 31, 1997
<S>	<C>	<C>	<C>	<C>
MORTGAGE LOANS				
Credit Provision During Period	$ 1,516	$ 473	$ 299	$ 215
Actual Losses During Period	23	40	0	13
Cumulative Actual Losses	76	53	13	13
Mortgage Loan Credit Reserve at End of Period	2,855	1,363	929	630
Annualized Mortgage Loan Credit Provision as % of Average Amortized Cost of Mortgage Loans	0.45%	0.16%	0.16%	0.15%
Mortgage Loan Credit Reserve as % of Amortized Cost of Mortgage Loans at Period End	0.18%	0.10%	0.08%	0.09%
Non-Performing Assets: 90+ Days Delinquent, Foreclosures, Bankruptcies, and REO				
Number of Loans	17	13	12	6
Non-Performing Assets Loan Balance	$ 3,903	$ 2,792	$ 2,366	$ 1,220
Non-Performing Assets as % of Amortized Cost of Mortgage Loans	0.25%	0.20%	0.21%	0.17%
Non-Performing Assets as % of Amortized Cost of Total Assets	0.11%	0.08%	0.07%	0.05%
Mortgage Loan Credit Reserve as % of Non-Performing Assets	73%	49%	39%	52%
Credit Experience of Mortgage Loans				
Liquidated Defaulted Loans (Cumulative)	6	4	1	1
Average Loss Severity Experience (Cumulative)	7%	6%	7%	7%
Scenario Analysis of Potential Credit Losses Over Next 12 Months If All Current (But No Future) Non-Performing Mortgage Loans Default:				
At 10% Loss Severity	$ 396	$ 283	$ 241	$ 124
At 20% Loss Severity	793	567	481	248
At 30% Loss Severity	1,189	850	722	372
At 40% Loss Severity	1,586	1,133	962	496
Mortgage Loan Credit Reserve at End of Period	$ 2,855	$ 1,363	$ 929	$ 630
MORTGAGE SECURITIES				
Credit Provision During Period	$(1,000)	$ 470	$ 477	$ 480
Actual Losses During Period	17	28	29	29
Cumulative Actual Losses	113	97	69	40
Mortgage Securities Credit Reserve at End of Period	2,076	3,093	2,651	2,203
Annualized Mortgage Securities Credit Provision as % of Average Amortized Cost of Mortgage Securities Rated (Less than) BBB	-20.9%	6.4%	6.6%	6.6%
Mortgage Securities Credit Reserve as % of Amortized Cost of Mortgage Securities Rated (Less than) BBB at End of Period	22.8%	10.6%	9.1%	7.6%
Amortized Cost of Mortgage Securities Rated (Less than) BBB at End of Period	$ 9,109	$29,189	$29,113	$28,955

Credit Experience of Loans in Pools Underlying Mortgage Securities Rated (Less than) BBB (Since Acquisition)				
Resolved Defaulted Loans (Cumulative)	254	182	137	90
Average Loss Severity Experience (Cumulative)	21%	23%	24%	25%
Scenario Analysis of Potential Credit Losses Over Next 12 Months If All Current (But No Future) Seriously Delinquent Loans in Mortgage Pools Underlying Less than BBB Rated Securities Default:				
At 10% Loss Severity	$ 389	$ 724	$ 109	$ 80
At 20% Loss Severity	894	2,286	1,488	792
At 30% Loss Severity	1,163	3,789	3,702	2,845
At 40% Loss Severity	1,825	6,437	6,410	5,103
Mortgage Securities Credit Reserve at End of Period	$ 2,076	$ 3,093	$ 2,651	$ 2,203

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 8 (CONTINUED)

<TABLE>
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CREDIT PROVISIONS AND CREDIT RESERVES (ALL DOLLARS IN THOUSANDS)	AT OR FOR THREE MONTHS ENDING			
	DEC. 31, 1996	SEP. 30, 1996	JUN. 30, 1996	MAR. 31, 1996
<S>	<C>	<C>	<C>	<C>
MORTGAGE LOANS				
Credit Provision During Period	$ 35	$ 178	$ 140	$ (5)
Actual Losses During Period	0	0	0	0
Cumulative Actual Losses	0	0	0	0
Mortgage Loan Credit Reserve at End of Period	428	393	214	74
Annualized Mortgage Loan Credit Provision as % of Average Amortized Cost of Mortgage Loans	0.10%	0.76%	1.23%	-0.08%
Mortgage Loan Credit Reserve as % of Amortized Cost of Mortgage Loans a Period End	0.08%	0.31%	0.31%	0.30%
Non-Performing Assets: 90+ Days Delinquent, Foreclosures, Bankruptcies, and REO				
Number of Loans	7	3	2	1
Non-Performing Assets Loan Balance	$ 1,249	$ 404	$ 279	$ 190
Non-Performing Assets as % of Amortized Cost of Mortgage Loans	0.24%	0.32%	0.40%	0.77%
Non-Performing Assets as % of Amortized Cost of Total Assets	0.06%	0.03%	0.03%	0.03%
Mortgage Loan Credit Reserve as % of Non-Performing Assets	34%	97%	77%	39%
Credit Experience of Mortgage Loans				
Liquidated Defaulted Loans (Cumulative)	0	0	0	0
Average Loss Severity Experience (Cumulative)	0%	0%	0%	0%
Scenario Analysis of Potential Credit Losses Over Next 12 Months If All Current (But No Future) Non-Performing Mortgage Loans Default:				
At 10% Loss Severity	$ 127	$ 41	$ 28	$ 19
At 20% Loss Severity	253	82	56	39
At 30% Loss Severity	380	123	85	58
At 40% Loss Severity	506	164	113	77
Mortgage Loan Credit Reserve at End of Period	$ 428	$ 393	$ 214	$ 74
MORTGAGE SECURITIES				
Credit Provision During Period	$ 337	$ 338	$ 337	$ 336
Actual Losses During Period	7	--	--	--
Cumulative Actual Losses	11	4	4	4
Mortgage Securities Credit Reserve at End of Period	1,752	1,421	1,084	747
Annualized Mortgage Securities Credit Provision as % of Average Amortized Cost of Mortgage Securities Rated (Less than) BBB	4.7%	4.7%	4.7%	4.7%
Mortgage Securities Credit Reserve as % of Amortized Cost of Mortgage Securities Rated (Less than) BBB at End of Period	6.1%	4.9%	3.8%	2.7%
Amortized Cost of Mortgage Securities Rated (Less than) BBB at End of Period	$ 28,935	$ 28,906	$ 28,858	$ 28,051
Credit Experience of Loans in Pools Underlying Mortgage Securities Rated (Less than) BBB (Since Acquisition)				
Resolved Defaulted Loans (Cumulative)	59	28	15	4
Average Loss Severity Experience (Cumulative)	27%	22%	16%	10%
Scenario Analysis of Potential Credit Losses Over Next 12 Months If All Current (But No Future) Seriously Delinquent Loans in Mortgage Pools Underlying (Less than) BBB Rated Securities Default:				
At 10% Loss Severity	$ 63	$ 61	$ 40	$ 20
At 20% Loss Severity	608	123	91	39
At 30% Loss Severity	2,040	1,131	1,364	597
At 40% Loss Severity	3,647	3,041	3,148	2,162
Mortgage Securities Credit Reserve at End of Period	$ 1,752	$ 1,421	$ 1,084	$ 747

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 8 (CONTINUED)

<TABLE>
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CREDIT PROVISIONS AND CREDIT RESERVES	AT OR FOR YEAR ENDING			
(ALL DOLLARS IN THOUSANDS)	DEC. 31, 1997	DEC. 31, 1996	DEC. 31, 1995	DEC. 31, 1994
<S>	<C>	<C>	<C>	<C>
MORTGAGE LOANS				
Credit Provision During Period	$ 2,503	$ 349	$ 79	$ 0
Actual Losses During Period	76	0	0	0
Cumulative Actual Losses	76	0	0	0
Mortgage Loan Credit Reserve at End of Period	2,855	428	79	0
Annualized Mortgage Loan Credit Provision as % of Average Amortized Cost of Mortgage Loans	0.26%	0.45%	1.58%	n/a
Mortgage Loan Credit Reserve as % of Amortized Cost of Mortgage Loans a Period End	0.18%	0.08%	0.30%	n/a
Non-Performing Assets: 90+ Days Delinquent, Foreclosures, Bankruptcies, and REO				
Number of Loans	17	7	0	0
Non-Performing Assets Loan Balance	$ 3,903	$ 1,249	$ 0	$ 0
Non-Performing Assets as % of Amortized Cost of Mortgage Loans	0.25%	0.24%	0.00%	0.00%
Non-Performing Assets as % of Amortized Cost of Total Assets	0.11%	0.06%	0.00%	0.00%
Mortgage Loan Credit Reserve as % of Non-Performing Assets	73%	34%	n/a	n/a
Credit Experience of Mortgage Loans				
Liquidated Defaulted Loans (Cumulative)	6	0	0	0
Average Loss Severity Experience (Cumulative)	7%	0%	0%	0%
Scenario Analysis of Potential Credit Losses Over Next 12 Months If All Current (But No Future) Non-Performing Mortgage Loans Default:				
At 10% Loss Severity	$ 396	$ 127	$ 0	$ 0
At 20% Loss Severity	793	253	0	0
At 30% Loss Severity	1,189	380	0	0
At 40% Loss Severity	1,586	506	0	0
Mortgage Loan Credit Reserve at End of Period	$ 2,855	$ 428	$ 79	$ 0
MORTGAGE SECURITIES				
Credit Provision During Period	$ 427	$ 1,348	$ 414	$ 0
Actual Losses During Period	104	7	4	--
Cumulative Actual Losses	113	11	4	--
Mortgage Securities Credit Reserve at End of Period	2,076	1,752	411	0
Annualized Mortgage Securities Credit Provision as % of Average Amortized Cost of Mortgage Securities Rated Less than BBB	1.7%	4.7%	2.9%	0.0%
Mortgage Securities Credit Reserve as % of Amortized Cost of Mortgage Securities Rated Less than BBB at End of Period	22.8%	6.1%	1.4%	0.0%
Amortized Cost of Mortgage Securities Rated Less than BBB at End of Period	$ 9,109	$28,935	$28,869	$ 3,376
Credit Experience of Loans in Pools Underlying Mortgage Securities Rated Less than BBB (Since Acquisition)				
Resolved Defaulted Loans (Cumulative)	254	59	2	0
Average Loss Severity Experience (Cumulative)	21%	27%	9%	0%
Scenario Analysis of Potential Credit Losses Over Next 12 Months If All Current (But No Future) Seriously Delinquent Loans in Mortgage Pools Underlying Less than BBB Rated Securities Default:				
At 10% Loss Severity	$ 389	$ 63	$ 15	$ 0
At 20% Loss Severity	894	608	29	0
At 30% Loss Severity	1,163	2,040	103	0
At 40% Loss Severity	1,825	3,647	768	0
Mortgage Securities Credit Reserve at End of Period	$ 2,076	$ 1,752	$ 411	$ 0

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 9

<TABLE>
<CAPTION>

SHARES OUTSTANDING AND PER SHARE DATA	AT OR FOR THREE MONTHS ENDING			
(ALL DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	DEC. 31,	SEP. 30,	JUN. 30,	MAR. 31,

	1997	1997	1997	1997
<S>	<C>	<C>	<C>	<C>
Shares Outstanding and Receiving Dividends at Period End				
Common (RWT)	14,284,657	14,576,477	13,251,847	11,905,957
Class A Preferred (converted 9/95)	0	0	0	0
Class B Preferred (RTW-PB)	909,518	909,518	909,518	999,638
Total	15,194,175	15,485,995	14,161,365	12,905,595
Common Dividend Declared	$ 0.350	$ 0.600	$ 0.600	$ 0.600
Class A Preferred Dividend Declared	n/a	n/a	n/a	n/a
Class B Preferred Dividend Declared	$ 0.755	$ 0.755	$ 0.755	$ 0.755
Common Dividend Total	$ 5,000	$ 8,746	$ 7,951	$ 7,144
Class A Preferred Dividend Total	0	0	0	0
Class B Preferred Dividends Total	686	687	687	755
Total Dividend	$ 5,686	$ 9,433	$ 8,638	$ 7,899
Taxable Income Earned	$ 5,586	$ 8,150	$ 8,315	$ 7,912
Dividend Pay-Out Ratio for Period	101.8%	115.7%	103.9%	99.8%
Cumulative Dividend Pay-Out Ratio	102.6%	102.7%	99.7%	98.5%
Warrants Outstanding at Period End (expired 12/31/97)	0	149,466	236,297	272,304
Average Shares Outstanding During Period				
Common	14,375,992	14,316,678	12,997,566	11,605,171
Class A Preferred	0	0	0	0
Class B Preferred	909,518	909,518	990,725	1,005,515
Total	15,285,510	15,226,196	13,988,291	12,610,686
Calculation of "Diluted" Common Shares				
Average Number of Common Shares Outstanding	14,375,992	14,316,678	12,997,566	11,605,171
Potential Dilution Due to Warrants	57,139	130,489	182,137	258,422
Potential Dilution Due to Options	99,383	177,434	291,227	253,274
Total Average "Diluted" Common Shares	14,532,514	14,624,601	13,470,930	12,116,867
Net Income to Common Shareholders	$ 4,397	$ 6,859	$ 7,034	$ 6,456
Total Average "Diluted" Common Shares	14,532,514	14,624,601	13,470,930	12,116,867
Earnings Per Share ("Diluted")	$ 0.30	$ 0.47	$ 0.52	$ 0.53
Average Number of Common Shares Outstanding ("Basic")	14,375,992	14,316,678	12,997,566	11,605,171
Earnings Per Share ("Basic")	$ 0.31	$ 0.48	$ 0.54	$ 0.56
Per Share Ratios (Average Common and Preferred Shares Outstanding)				
Average Total Assets	$ 224.19	$ 224.68	$ 212.58	$ 183.09
Average Total Equity	$ 22.92	$ 22.71	$ 20.96	$ 18.81
Net Interest Income	$ 0.40	$ 0.63	$ 0.70	$ 0.72
Credit Expenses	$ 0.03	$ 0.06	$ 0.06	$ 0.06
Operating Expenses	$ 0.07	$ 0.07	$ 0.09	$ 0.09
Gain/(Loss) on Sale	$ 0.03	$ 0.00	$ 0.00	$ 0.00
Net Income	$ 0.33	$ 0.50	$ 0.55	$ 0.57

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

TABLE 9 (CONTINUED)

<TABLE>
<CAPTION>

SHARES OUTSTANDING AND PER SHARE DATA	AT OR FOR THREE MONTHS ENDING			
(ALL DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	DEC. 31, 1996	SEP. 30, 1996	JUN. 30, 1996	MAR. 31, 1996
<S>	<C>	<C>	<C>	<C>
Shares Outstanding and Receiving Dividends at Period End				
Common (RWT)	10,996,572	9,069,653	8,520,116	5,521,376
Class A Preferred (converted 9/95)	0	0	0	0
Class B Preferred (RTW-PB)	1,006,250	1,006,250	0	0
Total	12,002,822	10,075,903	8,520,116	5,521,376
Common Dividend Declared	$ 0.410	$ 0.400	$ 0.400	$ 0.460

Class A Preferred Dividend Declared	n/a	n/a	n/a	n/a
Class B Preferred Dividend Declared	$ 0.755	$ 0.386	n/a	n/a
Common Dividend Total	$ 4,508	$ 3,628	$ 3,408	$ 2,540
Class A Preferred Dividend Total	0	0	0	0
Class B Preferred Dividend Total	760	388	0	0
Total Dividend	$ 5,268	$ 4,016	$ 3,408	$ 2,540
Taxable Income Earned	$ 5,429	$ 4,048	$ 3,142	$ 2,549
Dividend Pay-Out Ratio for Period	97.0%	99.2%	108.5%	99.7%
Cumulative Dividend Pay-Out Ratio	97.9%	98.3%	97.9%	93.0%
Warrants Outstanding at Period End (expired 12/31/97)	412,894	1,076,431	1,563,957	1,665,063
Average Shares Outstanding During Period				
Common	9,705,138	8,732,326	7,813,974	5,521,376
Class A Preferred	0	0	0	0
Class B Preferred	1,006,250	514,063	0	0
Total	10,711,388	9,246,389	7,813,974	5,521,376
Calculation of "Diluted" Common Shares				
Average Number of Common Shares Outstanding	9,705,138	8,732,326	7,813,974	5,521,376
Potential Dilution Due to Warrants	570,415	621,455	603,426	443,984
Potential Dilution Due to Options	176,919	162,393	182,832	164,227
Total Average "Diluted" Common Shares	10,452,472	9,516,174	8,600,232	6,129,587
Net Income to Common Shareholders	$ 4,084	$ 2,999	$ 2,500	$ 1,954
Total Average "Diluted" Common Shares	10,452,472	9,516,174	8,600,232	6,129,587
Earnings Per Share ("Diluted")	$ 0.39	$ 0.32	$ 0.29	$ 0.32
Average Number of Common Shares Outstanding ("Basic")	9,705,138	8,732,326	7,813,974	5,521,376
Earnings Per Share ("Basic")	$ 0.42	$ 0.34	$ 0.32	$ 0.35
Per Share Ratios (Average Common and Preferred Shares Outstanding)				
Average Total Assets	$ 144.83	$ 124.97	$ 98.76	$ 92.87
Average Total Equity	$ 17.26	$ 15.96	$ 15.05	$ 13.49
Net Interest Income	$ 0.55	$ 0.50	$ 0.45	$ 0.50
Credit Expenses	$ 0.03	$ 0.06	$ 0.06	$ 0.06
Operating Expenses	$ 0.07	$ 0.07	$ 0.07	$ 0.09
Gain/(Loss) on Sale	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Net Income	$ 0.45	$ 0.37	$ 0.32	$ 0.35

</TABLE>

SUPPLEMENTAL HISTORICAL INFORMATION

<TABLE>
<CAPTION>

TABLE 9 (CONTINUED)
SHARES OUTSTANDING AND PER SHARE DATA

(ALL DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	AT OR FOR YEAR ENDING			
	DEC. 31, 1997	DEC. 31, 1996	DEC. 31, 1995	DEC. 31, 1994
<S>	<C>	<C>	<C>	<C>
Shares Outstanding and Receiving Dividends at Period End				
Common (RWT)	14,284,657	10,996,572	5,517,299	208,332
Class A Preferred (converted 9/95)	0	0	0	1,666,063
Class B Preferred (RTW-PB)	909,518	1,006,250	0	0
Total	15,194,175	12,002,822	5,517,299	1,874,395
Common Dividend Declared	$ 2.150	$ 1.670	$ 0.460	n/a
Class A Preferred Dividend Declared	n/a	n/a	$ 0.500	$ 0.250
Class B Preferred Dividends Declared	$ 3.020	$ 1.141	n/a	n/a
Common Dividend Total	$ 28,840	$ 14,084	$ 2,537	$ 0
Class A Preferred Dividend Total	0	0	833	350
Class B Preferred Dividends Total	2,815	1,148	0	0
Total Dividend	$ 31,655	$ 15,232	$ 3,370	$ 350
Taxable Income Earned	$ 29,963	$ 15,168	$ 3,832	$ 353
Dividend Pay-Out Ratio for Period	105.6%	100.4%	88.0%	99.2%
Cumulative Dividend Pay-Out Ratio	102.6%	97.9%	88.9%	99.2%
Warrants Outstanding at Period End (expired 12/31/97)	0	412,894	1,665,063	1,666,063

Average Shares Outstanding During Period				
Common	13,334,163	7,950,175	2,487,857	208,332
Class A Preferred	--	--	826,185	1,467,748
Class B Preferred	953,435	382,155	--	--
Total	14,287,598	8,332,330	3,314,042	1,676,080
Calculation of "Diluted" Common Shares				
Average Number of Common Shares Outstanding	13,334,163	7,950,175	3,314,042	1,676,080
Potential Dilution Due to Warrants	191,513	618,618	221,112	240,766
Potential Dilution Due to Options	154,734	175,391	168,649	0
Total Average "Diluted" Common Shares	13,680,410	8,744,184	3,703,803	1,916,846
Net Income to Common Shareholders	$ 24,746	$ 11,537	$ 3,155	$ 382
Total Average "Diluted" Common Shares	13,680,410	8,744,184	3,703,803	1,916,846
Earnings Per Share ("Diluted")	$ 1.81	$ 1.32	$ 0.85	$ 0.20
Average Number of Common Shares Outstanding ("Basic")	13,334,163	7,950,175	3,314,042	1,676,080
Earnings Per Share ("Basic")	$ 1.86	$ 1.45	$ 0.95	$ 0.23
Per Share Ratios (Average Common and Preferred Shares Outstanding)				
Average Total Assets	$ 212.54	$ 119.99	$ 66.57	$ 34.85
Average Total Equity	$ 21.49	$ 15.76	$ 13.08	$ 12.01
Net Interest Income	$ 2.42	$ 2.03	$ 1.44	$ 0.32
Credit Expenses	$ 0.21	$ 0.20	$ 0.15	$ 0.00
Operating Expenses	$ 0.32	$ 0.31	$ 0.34	$ 0.09
Gain/(Loss) on Sale	$ 0.04	$ 0.00	$ 0.00	$ 0.00
Net Income	$ 1.93	$ 1.52	$ 0.95	$ 0.23

</TABLE>

ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Consolidated Financial Statements of the Company and the related Notes, together with the Independent Auditors' Report thereon, are set forth on pages F-1 through F-19 of this Form 10-K and incorporated herein by reference.

ITEM 9. CHANGES AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by Item 10 as to directors and executive officers of the Company is incorporated herein by reference to the definitive Proxy Statement to be filed pursuant to Regulation 14A under the headings "Election of Directors" and "Management of the Company."

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is incorporated herein by reference to the definitive Proxy Statement to be filed pursuant to Regulation 14A under the heading "Executive Compensation."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by Item 12 is incorporated herein by reference to the definitive Proxy Statement to be filed pursuant to Regulation 14A under the heading "Security Ownership of Certain Beneficial Owners and Management."

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

None.

ITEM 14. EXHIBITS, CONSOLIDATED FINANCIAL STATEMENTS SCHEDULES AND REPORTS ON FORM 8-K

(a) Documents filed as part of this report:

(1) Consolidated Financial Statements

(2) Schedules to Consolidated Financial Statements:
All Consolidated Financial Statements schedules not included have been omitted because they are either inapplicable or the information required is provided in the Company's Consolidated Financial Statements and Notes thereto, included in Part II, Item 8, of this Annual Report on Form 10-K.

(3) Exhibits:

Exhibit Number	Exhibit
3.1	Articles of Amendment and Restatement of the Registrant (a)
3.2	Articles Supplementary of the Registrant (a)
3.3	Amended and Restated Bylaws of the Registrant (b)
3.3.1	Amended and Restated Bylaws, amended December 13, 1996 (g)
3.4	Articles Supplementary of the Registrant, dated August 14, 1995 (d)
3.4.1	Articles Supplementary of the Registrant relating to the Class B 9.74% Cumulative Convertible Preferred Stock, filed August 9, 1996 (the "Preferred Stock") (f)
4.2	Specimen Common Stock Certificate (a)
4.3	Specimen Class B 9.74% Cumulative Convertible Preferred Stock Certificate (f)
4.4	Indenture dated as of June 1, 1997 between Sequoia Mortgage Trust 1 (a wholly-owned, consolidated subsidiary of the Registrant) and First Union National Bank, as Trustee (i)
4.4.1	Indenture dated as of October 1, 1997 between Sequoia Mortgage Trust 2 (a wholly-owned, consolidated subsidiary of the Registrant) and Norwest Bank Minnesota, N.A., as Trustee (j)
10.1	Purchase Terms Agreement, dated August 18, 1994, between the Registrant and Montgomery Securities (a)
10.2	Registration Rights Agreement, dated August 19, 1994, between the Registrant and Montgomery Securities (a)
10.4	Founders Rights Agreement, dated August 19, 1994, between the Registrant and the original holders of Common Stock of the Registrant (a)
10.5	Form of Reverse Repurchase Agreement for use with Agency Certificates, Privately- Issued Certificates and Privately-Issued CMOs (a)
10.5.1	Form of Reverse Repurchase Agreement for use with Mortgage Loans (d)
10.6.1	Amended and Restated Loan and Security Agreement, dated May 26, 1995, between the Registrant and Paine Webber Real Estate Securities, Inc. (d)
10.7	Pledge and Security Agreement, dated March 29, 1995, between the Registrant and Greenwich Capital Financial Products, Inc. (a)
10.8	Forms of Interest Rate Cap Agreements (a)
10.9	Custody Agreement, dated August 22, 1994, between the Registrant and Mellon Bank N.A. (b)
10.9.2	Clearance Agreement, dated December 1, 1996, between the Registrant and Bankers Trust Company (d)
10.10	Employment Agreement, dated August 19, 1994, between the Registrant and George E. Bull (a)
10.11	Employment Agreement, dated August 19, 1994, between the Registrant and Douglas B. Hansen (a)
10.12	Employment Agreement, dated August 19, 1994, between the Registrant and Frederick H. Borden (a)
10.13	Employment Agreement, dated August 19, 1994, between the Registrant and Vickie L. Rath (a)
10.14	1994 Amended and Restated Executive and Non-Employee Director Stock Option Plan (c)
10.14.1	1994 Amended and Restated Executive and Non-Employee Director Stock Option Plan, amended March 6, 1996 (d)
10.14.2	Amended and Restated 1994 Executive and Non-Employee Director Stock Option Plan, amended December 13, 1996 (h)
10.27	Administrative Services Agreement, dated August 19, 1994, between the Registrant and GB Capital (a)

10.29	Form of Dividend Reinvestment Plan (b)
10.29.1	Form of Dividend Reinvestment and Stock Purchase Plan (g)

10.30	Office Building Lease (d)
10.30.1	Amendment to Office Building Lease
11.1	Statement re: Computation of Per Share Earnings
21	List of Subsidiaries
23	Consent of Accountants
27	Financial Data Schedule

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(a) Incorporated by reference to the correspondingly numbered exhibit to the Registration Statement on Form S-11 (33-92272) filed by the Registrant with the Securities and Exchange Commission on May 19, 1995.

(b) Incorporated by reference to the correspondingly numbered exhibit to the Registration Statement on Form S-11 (33-97946) filed by the Registrant with the Securities and Exchange Commission on October 10, 1995.

(c) Incorporated by reference to the correspondingly numbered exhibit to the Registration Statement on Form S-11 (33-94160) filed by the Registrant with the Securities and Exchange Commission on June 30, 1995.

(d) Incorporated by reference to the correspondingly numbered exhibit to the Registration Statement on Form S-11 (333-02962) filed by the Registrant with the Securities and Exchange Commission on March 26, 1996.

(e) Incorporated by reference to the "Risk Factors" section of the Prospectus included in the Registration Statement on Form S-11 (333-02962) filed by the Registrant with the Securities and Exchange Commission on March 26, 1996.

(f) Incorporated by reference to the correspondingly numbered exhibit to the Registration Statement on Form S-11 (333-08363) filed by the Registrant with the Securities and Exchange Commission on July 18, 1996.

(g) Incorporated by reference to the Registration Statement on Form S-3 (333-18061) filed by the Registrant with the Securities and Exchange Commission on January 2, 1997.

(h) Incorporated by reference to the correspondingly numbered exhibit to Form 8-K (000-26436) filed by the Registrant with the Securities and Exchange Commission on January 7, 1997.

(i) Incorporated by reference to the Form 8-K filed by Sequoia Mortgage Funding Corporation with the Securities and Exchange Commission on August 12, 1997.

(j) Incorporated by reference to the Form 8-K filed by Sequoia Mortgage Funding Corporation with the Securities and Exchange Commission on November 18, 1997.

(b) Reports on Form 8-K:

None.

GLOSSARY

As used in this document, the capitalized and other terms listed below have the meanings indicated.

"Agency" means GNMA, FNMA or FHLMC.

"Agency Certificates" or "Agency ARM Certificates" means GNMA, FNMA and FHLMC Certificates.

"amortized cost" means, with respect to Mortgage Assets, the purchase price as adjusted for subsequent amortization of discount or premium and for principal repayments.

"ARM" means a Mortgage Loan or any Mortgage Loan underlying a Mortgage Security that features adjustments of the underlying interest rate at predetermined times based on an agreed margin to an established index. An ARM is usually subject to periodic interest rate and/or payment caps and a lifetime interest rate cap.

"Asset Acquisition/Capital Allocation Policies" means the policies established by the Board of Directors, including a majority of the Independent Directors, establishing the guidelines for management in the type and quantity of Mortgage Assets that may be purchased by the Company, which policies include, without limitation, the asset acquisition policies, the credit risk management policies and the capital and leverage policies.

"Board of Directors" means the Board of Directors of the Company.

"Capital Stock" means the Common Stock, Preferred Stock, and any additional classes of Capital Stock authorized by the Board of Directors in the future.

"carrying value" means the value placed on an asset or liability for balance sheet presentation purposes. With respect to Mortgage Securities and Interest Rate Agreements, the carrying value equals management's estimate of the bid-side market value of the asset. With respect to Mortgage Loans and associated Interest Rate Agreements, the carrying value equals the Company's amortized cost net of any specific credit reserves established for such assets. Management generally bases its estimate on the lowest of third-party bid-side indications of market value obtained on a regular basis from firms making a market in or lending against such assets. With respect to all other balance sheet items, carrying value equals amortized cost.

"CMOs" or "Collateralized Mortgage Obligations" means adjustable- or fixed-rate debt obligations (bonds) that are collateralized by Mortgage Loans or mortgage certificates. CMOs are structured so that principal and interest payments received on the collateral are sufficient to make principal and interest payments on the bonds. Such bonds may be issued by United States government-sponsored entities or private issuers in one or more classes with fixed or adjustable interest rates, maturities and degrees of subordination which are characteristics designed for the investment objectives of different bond purchasers.

"Code" means the Internal Revenue Code of 1986, as amended.

"Commercial CMOs" means CMOs collateralized by Commercial Mortgage Loans.

"Commercial Mortgage Assets" means Commercial Mortgage Loans and Commercial Mortgage Securities.

"Commercial Mortgage Loans" means Mortgage Loans secured by commercial property.

"Commercial Mortgage Securities" means Mortgage Securities representing an interest in, or secured by, Commercial Mortgage Loans.

"Commercial Privately-Issued Certificates" means Pass-Through Certificates representing an interest in Commercial Mortgage Loans.

"Commodity Exchange Act" means the Commodity Exchange Act, as amended (7 U.S.C. ** 1 et seq.)

"Common Stock" means the Company's shares of Common Stock, $0.01 par value per share.

"Company" means Redwood Trust, Inc., a Maryland corporation.

"Compensation Committee" means the committee of the Board of Directors appointed to review compensation issues and, among other things, administer the Stock Option Plan.

"Conforming Mortgage Loan" means Single-Family Mortgage Loans that either comply with requirements for inclusion in credit support programs sponsored by FHLMC or FNMA or are FHA or VA Loans.

"coupon rate" means, with respect to Mortgage Assets, the annualized cash interest income actually received from the asset, expressed as a percentage of the face value of the asset. The difference between the gross margin and the net margin reflects loan servicing fees and other pre-determined contractual deductions. The fully-indexed gross coupon rate equals the current yield on the ARM index (six month LIBOR, one year Treasury, etc.) plus the gross margin. The actual coupon rate paid by the borrower may be lower than the fully-indexed gross rate at the initiation of the loan if originated at a "teaser rate" or during periods of rising interest rates due to the limitations of the ARM adjustment schedule and the periodic and life caps. If so, the coupon rate paid by the borrower would move towards the fully-indexed gross rate over time.

"Dollar-Roll Agreement" means an agreement to sell a security for delivery on a specified future date and a simultaneous agreement to repurchase the same or a substantially similar security on a specified future date.

"DERs" means dividend equivalent rights under the Company's Stock Option Plan.

"DRP" means the Dividend Reinvestment and Stock Purchase Plan adopted by the Company.

"11th District Cost of Funds Index" or "COFI" means the index made available monthly by the Federal Home Loan Bank Board of San Francisco of the cost of funds of members of the Federal Home Loan Bank's 11th District.

"ERISA" means the Employee Retirement Income Security Act of 1974.

"ERISA Plan" means a pension, profit-sharing, retirement or other employee benefit plan or account which is subject to ERISA.

"Exchange Act" means the Securities Exchange Act of 1934, as amended.

"Exercise Price" means the price payable to the Company to exercise an outstanding Warrant or Stock Option.

"face value" means, with respect to Mortgage Assets, the outstanding principal balance of Mortgage Loans or Mortgage Securities comprising the Mortgage Assets. In the absence of credit losses, the face value equals the sum of the principal repayments that will be received by the Company over the life of the Mortgage Asset.

"FASB" means the Financial Accounting Standards Board.

"Federal Reserve Board" means the Board of Governors of the Federal Reserve System.

"FHA" means the United States Federal Housing Administration.

"FHA Loans" means Mortgage Loans insured by the FHA.

"FHLMC" means the Federal Home Loan Mortgage Corporation.

"FHLMC Certificates" means mortgage participation certificates issued by FHLMC, either in certificate or book-entry form.

"FNMA" means the Federal National Mortgage Association.

"FNMA Certificates" means mortgage participation certificates issued by FNMA, either in certificate or book-entry form.

"fully-indexed rate" means, with respect to ARMs, the rate that would be paid by the borrower ("gross") or received by the Company as owner of the Mortgage Asset ("net") if the coupon rate on the ARM were able to adjust immediately to a market rate without being subject to adjustment periods, periodic caps, or life caps. It is equal to the current yield of the ARM index plus the gross or net margin.

"GNMA" means the Government National Mortgage Association.

"GNMA Certificates" means fully modified pass-through mortgage-backed certificates guaranteed by GNMA and issued either in certificate or book- entry form.

"gross margin" means, with respect to ARMs, the amount to be added to the underlying index to determine the coupon rate to be paid by the borrower. The term "gross" is used to differentiate payments made by the borrower with the lower "net" payments actually received by the Company after the acquisition of a Mortgage Asset.

"haircut" means the over-collateralization amount required by a lender in connection with certain collateralized borrowings.

"HUD" means the Department of Housing and Urban Development.

"Independent Director" means a director of the Company who is not an officer or employee of the Company.

"interest-only strip" or "IO" means a type of mortgage security which receives a portion of the interest payments from an underlying pool of mortgage loans but will receive little or no principal payments and hence will have little or no face value. The market value and yield of an IO are unusually sensitive to the prepayment rates experienced on and anticipated for the underlying pool of mortgage loans. The market values and yields of IOs may increase as interest rates increase and, in certain conditions, IOs may act in a counter-cyclical manner as compared to other Mortgage Assets.

"interest rate adjustment indices" means, in the case of Mortgage Assets, any of the objective indices based on the market interest rates of a specified debt instrument (such as United States Treasury Bills in the case of the Treasury Index and United States dollar deposits in London in the case of LIBOR) or based on the average interest rate of a combination of debt instruments (such as the 11th District Cost of Funds Index), used as a reference base to reset the interest rate for each adjustment period on the Mortgage Asset, and in the case of borrowings, is used herein to mean the market interest rates of a specified debt instrument (such as reverse repurchase agreements for Mortgage Securities) as well as any of the objective indices described above that are used as a reference base to reset the interest rate for each adjustment period

under the related borrowing instrument.

"interest rate adjustment period" means, in the case of Mortgage Assets, the period of time set forth in the debt instrument that determines when the interest rate is adjusted and, with respect to borrowings, is used to mean the term to reset or maturity of a short-term, fixed-rate debt instrument (such as a 30-day reverse repurchase agreement) as well as the period of time set forth in a long-term, adjustable-rate debt instrument that determines when the interest rate is adjusted.

"Interest Rate Agreements" means interest rate options, interest rate swaps, interest rate futures and options on interest rate futures.

"Investment Company Act" means the Investment Company Act of 1940, as amended.

"ISOs" means qualified incentive stock options granted under the Stock Option Plan which meet the requirements of Section 422 of the Code.

"LIBOR" means London Inter-Bank Offered Rate as it may be defined, and for a period of time specified, in a Mortgage Asset or borrowing of the Company.

"lifetime interest rate cap" or "life cap" means, with respect to adjustable rate Mortgage Assets, in the case of an adjustable-rate Mortgage Loan, the maximum coupon rate that may accrue during any period over the term of such Mortgage Loan as stated in the governing instruments evidencing such Mortgage Loan, and in the case of an adjustable-rate Mortgage Security, the maximum average coupon rate that may accrue during any period over the term of such Mortgage Security as stated in the governing instruments thereof. With respect to certain long-term borrowings, the maximum coupon rate that may accrue during any period over the term of such borrowing.

"liquidity capital cushion" is a term defined in the Company's Risk-Adjusted Capital Policy. It represents a portion of the capital the Company is required to maintain as part of this policy in order to continue to make asset acquisitions. The liquidity capital cushion is that part of the required base which is in excess of the Company's haircut requirements.

"Mezzanine Securities" means Mortgage Securities rated below the two highest levels but no lower than a single "B" level under the S&P rating system (or comparable level under other rating systems) and are supported by one or more classes of Subordinated Securities which bear Realized Losses prior to the classes of Mezzanine Securities.

"Mortgage Assets" means (i) Single-Family Mortgage Assets, (ii) Multifamily Mortgage Assets, and (iii) Commercial Mortgage Assets.

"Mortgage Equity Interest" means the ownership of the equity portion of a mortgage spread lending subsidiary trust wherein the assets of the trust are funded with long-term debt, the debt and other liabilities of the trust are non-recourse to the Company, and liquidity risk is essentially eliminated.

"Mortgage Loans" means Single-Family Mortgage Loans, Multifamily Mortgage Loans and Commercial Mortgage Loans.

"Mortgage Note" means a promissory note evidencing a Mortgage Loan.

"Mortgage Securities" means (i) Pass-Through Certificates and (iii) CMOs.

"Mortgaged Property" means a one- to four-unit residential property which may be a detached home, townhouse, condominium or other dwelling unit, or multifamily or commercial property, securing a Mortgage Note.

"Multifamily CMOs" means CMOs backed by Multifamily Mortgage Loans.

"Multifamily Mortgage Assets" means Multifamily Mortgage Loans and Multifamily Mortgage Securities.

"Multifamily Mortgage Loans" means Mortgage Loans secured by multifamily (in excess of four units) property.

"Multifamily Mortgage Securities" means Mortgage Securities representing an interest in, or secured by, Multifamily Mortgage Loans.

"Multifamily Privately-Issued Certificates" means Pass-Through Certificates evidencing ownership in a pool of Multifamily Mortgage Loans issued by private institutions.

"Net Income" is the income of the Company as calculated using Generally Accepted Accounting Principles (GAAP); Net Income may differ from taxable income.

"net margin" is part of the calculation of the coupon rate to be received by the Company as owner of an ARM. The term "net" is used to differentiate payments actually received by the Company from a Mortgage Asset from the higher "gross" payment made by the borrower.

"Nonconforming Mortgage Loans" means conventional Single-Family and Multifamily Mortgage Loans that do not conform to one or more requirements of FHLMC or FNMA for participation in one or more of such agencies' mortgage loss credit support programs.

"NQSOs" means options to acquire Company Common Stock granted pursuant to the Stock Option Plan which do not meet the requirements of Section 422 of the Code.

"Ownership Limit" means 9.8% of the outstanding shares of Capital Stock, as may be increased or reduced by the Board of Directors of the Company.

"Pass-Through Certificates" means securities (or interests therein) evidencing undivided ownership interests in a pool of Mortgage Loans, the holders of which receive a "pass-through" of the principal and interest paid in connection with the underlying Mortgage Loans in accordance with the specific pool structure.

"periodic interest rate cap" or "periodic cap" means, with respect to ARMs, the maximum change in the coupon rate permissible under the terms of the loan at each coupon adjustment date. Periodic caps limit both the speed by which the coupon rate can adjust upwards in a rising interest rate environment and the speed by which the coupon rate can adjust downwards in a falling rate environment.

"Preferred Stock" means the Class B 9.74% Cumulative Convertible Preferred Stock.

"Privately-Issued Certificates" means privately-issued Pass-Through Certificates issued by the Company or an affiliate of the Company or other third party issuer.

"Qualified Hedges" means bona fide interest rate swap, cap, floor or other interest rate agreements entered into by the Company solely to hedge adjustable-rate indebtedness that the Company incurred to acquire or carry Qualified REIT Real Estate Assets and any futures and options, or other investments (other than Qualified REIT Real Estate Assets) made by the Company to hedge its Mortgage Assets or borrowings that have been determined by a favorable opinion of counsel to generate qualified income for purposes of the 95% Gross Income Test applicable to REITs.

"Qualified REIT Real Estate Assets" means Pass-Through Certificates, Mortgage Loans, Agency Certificates, and other assets of the type described in section 856(c) (6) (B) of the Code.

"Qualified REIT Subsidiary" means a corporation whose stock is entirely owned by the REIT at all times during such corporation's existence.

"Qualifying Interests" means "mortgages and other liens on and interests in real estate," as defined in Section 3(c) (5) (C) under the Investment Company Act.

"rating" means (i) the rating assigned to an asset by one or more of the four nationally-recognized rating agencies as adjusted to the rating scale under the S&P rating system, (ii) in the case of assets rated differently by such rating agencies, the rating deemed by management to most appropriately reflect such asset's credit quality or (iii) for unrated assets, the Company's deemed comparable rating.

"Realized Losses" means losses incurred in respect of Mortgage Assets upon foreclosure sales and other liquidations of underlying mortgaged priorities that result in failure to recover all amounts due on the loans secured thereby.

"REIT" means Real Estate Investment Trust.

"REIT Provision of the Code" means Sections 856 through 860 of the Code.

"REMIC" means Real Estate Mortgage Investment Conduit.

"residuals" means the right to receive the remaining or residual cash flows from a pool of Mortgage Loans or Mortgage Securities after distributing required amounts to the holders of interests in or obligations backed by such loans or securities and after payment of any required pool expenses.

"reverse repurchase agreement" means a borrowing device evidenced by an agreement to sell securities or other assets to a third-party and a simultaneous agreement to repurchase them at a specified future date and price, the price difference constituting the interest on the borrowing.

"Risk-Adjusted Capital Policy" means the policy established by the Company which limits management's ability to acquire additional assets during such times that the actual capital base of the Company is less than a required

amount defined in the policy. The required amount is the sum of the haircuts required by the Company's secured lenders (the required haircut) and the additional capital levels called for under the policy which are determined with reference to the various risks inherent in the Company's Mortgage Assets (the liquidity capital cushion).

"Rule 144" means Rule 144 promulgated under the Securities Act.

"S&P" means Standard & Poor's Corporation.

"SEC" means the United States Securities and Exchange Commission.

"Securities" means the Preferred Stock, the Common Stock, the Warrants and the Common Stock issuable pursuant to the exercise of Warrants.

"Securities Act" means the Securities Act of 1933, as amended.

"Senior Securities" means a class of Mortgage Security that has a priority right to receive principal and/or interest from the underlying pool of Mortgage Loans.

"Senior-Subordinated Mortgage Securities" means a series of Pass-Through Certificates of CMOs in which one or more classes have a priority right to receive principal and/or interest payments from the underlying pool of Mortgage Loans.

"Sequoia" means the special-purpose finance subsidiary of Redwood Trust, Inc.

"Servicer" means a servicer or subservicer of the Mortgage Loans pursuant to a servicing agreement with the Company or other third-parties.

"SFAS" means Statement of Financial Accounting Standards issued by the FASB.

"Short-Term Debt" means reverse repurchase agreements, notes payable, revolving lines of credit and/or any other collateralized short-term borrowings.

"Short-Term Investments" means the short-term bank certificates of deposit, short-term United States treasury securities, short-term United States government agency securities, commercial paper, repurchase agreements, short-term CMOs, short-term asset-backed securities and other similar types of short-term investment instruments, all of which will have maturities or average lives of less than one year.

"Single-Family CMOs" means CMOs backed by Single-Family Mortgage Loans.

"Single-Family Mortgage Assets" means Single-Family Mortgage Loans and Single-Family Mortgage Securities.

"Single-Family Mortgage Loans" means Mortgage Loans secured by single-family (one- to four-units) residential property.

"Single-Family Mortgage Securities" means Mortgage Securities representing an interest in, or secured by, Single-Family Mortgage Loans.

"Single-Family Privately-Issued Certificates" means Pass-Through Certificates evidencing ownership in a pool of Single-Family Mortgage Loans issued by private institutions.

"SMMEA" means the Secondary Mortgage Market Enhancement Act of 1984.

"Special Tax Counsel" means the law firm of Giancarlo & Gnazzo, a Professional Corporation.

"Stock Option Plan" means the Amended and Restated 1994 Executive and Non-employee Stock Option Plan adopted by the Company.

"Subordinated Securities" means a class of Mortgage Securities that is subordinated to one or more other classes of Mortgage Securities, all of which classes share the same collateral.

"Tax-Exempt Entity" means a qualified pension, profit-sharing or other employee retirement benefit plan, Keogh plans, bank commingled trust funds for such plans, individual retirement accounts and other similar entities intended to be exempt from United States Federal income taxation.

"Treasury Department" means the United States Department of Treasury.

"Treasury Index" means the weekly average yield of U.S. Treasury securities, adjusted to a constant maturity of one year, as published by the Board of Governors of the Federal Reserve System.

"UBTI" means "unrelated business taxable income" as defined in Section 512 of the Code.

"VA" means the United States Department of Veterans Affairs.

"VA Loans" means Mortgage Loans partially guaranteed by the VA under the Servicemen's Readjustment Act of 1944, as amended.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

REDWOOD TRUST, INC.

Dated: March 11, 1998

By: /s/ George E. Bull

George E. Bull
Chairman and Chief Executive Officer

Pursuant to the requirements the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<TABLE>
<CAPTION>

Signature	Title	Date
/s/ George E. Bull	George E. Bull Chairman of the Board and Chief Executive Officer (Principal Executive Officer)	March 11, 1998
/s/ Douglas B. Hansen	Douglas B. Hansen Director, President and Chief Financial Officer (Principal Financial Officer)	March 11, 1998
/s/ Frederick H. Borden	Frederick H. Borden Vice Chairman of the Board and Secretary	March 11, 1998
/s/ Vickie L. Rath	Vickie L. Rath Vice President, Treasurer and Controller (Principal Accounting Officer)	March 11, 1998
/s/ Dan A. Emmett	Dan A. Emmett Director	March 11, 1998
/s/ Thomas F. Farb	Thomas F. Farb Director	March 11, 1998
/s/ Nello Gonfiantini	Nello Gonfiantini Director	March 11, 1998
/s/ Charles J. Toeniskoetter	Charles J. Toeniskoetter Director	March 11, 1998

</TABLE>

REDWOOD TRUST, INC.

CONSOLIDATED FINANCIAL STATEMENTS AND

INDEPENDENT AUDITORS' REPORT

FOR INCLUSION IN FORM 10-K

ANNUAL REPORT FILED WITH

SECURITIES AND EXCHANGE COMMISSION

DECEMBER 31, 1997

REDWOOD TRUST, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

REDWOOD TRUST, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

<TABLE>
<CAPTION>

	December 31, 1997	December 31, 1996
<S>	<C>	<C>
ASSETS		
Mortgage assets:		
Mortgage securities, net	$ 1,814,796	$ 1,627,953
Mortgage loans, net	1,551,826	525,475
	3,366,622	2,153,428
Cash and cash equivalents:		
Unrestricted	24,892	11,068
Restricted	24,657	--
	49,549	11,068
Accrued interest receivable	23,119	14,134
Interest rate agreements	2,100	2,601
Other assets	2,807	2,966
	$ 3,444,197	$ 2,184,197
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Short-term debt	$ 1,914,525	$ 1,953,103
Long-term debt, net	1,172,801	--
Accrued interest payable	14,476	14,060
Accrued expenses and other liabilities	2,172	761

Dividends payable	5,686	5,268
	3,109,660	1,973,192
Commitments and contingencies (See Note 11)		
STOCKHOLDERS' EQUITY		
Preferred stock, par value $0.01 per share; Class B 9.74% Cumulative Convertible 909,518 and 1,006,250 shares authorized, issued and outstanding ($28,882 aggregate liquidation preference)	26,736	29,579
Common stock, par value $0.01 per share; 49,090,482 and 48,993,750 shares authorized; 14,284,657 and 10,996,572 issued and outstanding	143	110
Additional paid-in capital	324,555	187,507
Net unrealized loss on assets available-for-sale	(10,071)	(3,460)
Dividends in excess of net income	(6,826)	(2,731)
	334,537	211,005
	$ 3,444,197	$ 2,184,197

</TABLE>

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

REDWOOD TRUST, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share data)

<TABLE>
<CAPTION>

<S>	Years Ended December 31, 1997 <C>	1996 <C>	1995 <C>
INTEREST INCOME			
Mortgage assets	$ 197,278	$ 66,424	$ 15,494
Cash and investments	1,326	860	232
	198,604	67,284	15,726
INTEREST EXPENSE			
Short-term debt	140,140	49,191	10,608
Long-term debt	20,137	--	--
	160,277	49,191	10,608
Net interest rate agreements expense	3,741	1,158	339
NET INTEREST INCOME	34,586	16,935	4,779
Provision for credit losses	2,930	1,696	493
Net (gain)/loss on sale transactions	(563)	--	--
Operating expenses	4,658	2,554	1,131
NET INCOME	27,561	12,685	3,155
Less cash dividends on Class B preferred stock	2,815	1,148	--
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	$ 24,746	$ 11,537	$ 3,155
NET INCOME PER SHARE			
Basic	$ 1.86	$ 1.45	$ 0.95
Diluted	$ 1.81	$ 1.32	$ 0.85
Weighted average shares of common stock and common stock equivalents:			
Basic	13,334,163	7,950,175	3,314,042
Diluted	13,680,410	8,744,184	3,703,803
Dividends declared per Class A preferred share	$ --	$ --	$ 0.500
Dividends declared per Class B preferred share	$ 3.020	$ 1.141	$ --

Dividends declared per common share	$ 2.150	$ 1.670	$ 0.460

</TABLE>

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

REDWOOD TRUST, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY For the years ended December 31,
1997, 1996 and 1995 (In thousands, except share data)
Net

<TABLE>
<CAPTION>

	Preferred stock				Common stock		
	Class A		Class B				Additional
	Shares	Amount	Shares	Amount	Shares	Amount	paid-in capital
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Balance, December 31, 1994	1,666,063	$ 22,785	--	--	208,332	$ 2	$ 19
Net income	--	--	--	--	--	--	--
Conversion of preferred stock	(1,666,063)	(22,785)	--	--	1,667,134	17	22,768
Issuance of common stock	--	--	--	--	3,641,833	36	51,108
Dividends declared:							
Class A preferred	--	--	--	--	--	--	--
Common	--	--	--	--	--	--	--
Net unrealized loss on assets available-for-sale	--	--	--	--	--	--	--
Balance, December 31, 1995	--	--	--	--	5,517,299	55	73,895
Net income	--	--	--	--	--	--	--
Issuance of Class B preferred stock	--	--	1,006,250	29,579	--	--	--
Issuance of common stock	--	--	--	--	5,479,273	55	113,612
Dividends declared:							
Class B preferred	--	--	--	--	--	--	--
Common	--	--	--	--	--	--	--
Net unrealized gain on assets available-for-sale	--	--	--	--	--	--	--
Balance, December 31, 1996	--	--	1,006,250	29,579	10,996,572	110	187,507
Net income	--	--	--	--	--	--	--
Conversion of preferred stock	--	--	(96,732)	(2,843)	96,732	1	2,842
Issuance of common stock	--	--	--	--	4,031,353	41	157,321

Repurchase of common stock	--	--	--	--	(840,000)	(9)	(23,115)
Dividends declared:							
Class B preferred	--	--	--	--	--	--	--
Common	--	--	--	--	--	--	--
Net unrealized loss on assets available-for-sale	--	--	--	--	--	--	--
Balance, December 31, 1997	--	--	909,518	$ 26,736	14,284,657	$ 143	$ 324,555

<CAPTION>

	Net unrealized gain (loss) on assets available-for-sale	Dividends in excess of net income	Total
Balance, December 31, 1994	$ (2,557)	$ 31	$ 20,280
Net income	--	3,155	3,155
Conversion of preferred stock	--	--	--
Issuance of common stock	--	--	51,144
Dividends declared:			
Class A preferred	--	(833)	(833)
Common	--	(2,537)	(2,537)
Net unrealized loss on assets available-for-sale	(2,919)	--	(2,919)
Balance, December 31, 1995	(5,476)	(184)	68,290
Net income	--	12,685	12,685
Issuance of Class B preferred stock	--	--	29,579
Issuance of common stock	--	--	113,667
Dividends declared:			
Class B preferred	--	(1,148)	(1,148)
Common	--	(14,084)	(14,084)
Net unrealized gain on assets available-for-sale	2,016	--	2,016
Balance, December 31, 1996	(3,460)	(2,731)	211,005
Net income	--	27,561	27,561
Conversion of preferred stock	--	--	--
Issuance of common stock	--	--	157,362
Repurchase of common stock	--	--	(23,124)
Dividends declared:			
Class B preferred	--	(2,815)	(2,815)
Common	--	(28,841)	(28,841)
Net unrealized loss on assets available-for-sale	(6,611)	--	(6,611)
Balance, December 31, 1997	$ (10,071)	$ (6,826)	$ 334,537

</TABLE>

The accompanying notes are an integral part of these consolidated financial

statements.

REDWOOD TRUST, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
<TABLE>
<CAPTION>

	Years Ended December 31, 1997	1996	1995
<S>	<C>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 27,561	$ 12,685	$ 3,155
Adjustments to reconcile net income to net cash provided by operating activities:			
Amortization of mortgage asset premium and discount, net	23,361	5,197	(356)
Amortization of deferred bond issuance costs	533	--	--
Amortization of long-term debt premium	(131)	--	--
Depreciation and amortization	148	96	64
Provision for credit losses on mortgage assets	2,930	1,696	493
Amortization of interest rate agreements	3,155	749	339
Net (gain)/loss on sale transactions	(563)	--	--
Increase in accrued interest receivable	(8,985)	(12,267)	(2,527)
(Increase) decrease in other assets	11	(985)	(346)
Increase in accrued interest payable	416	12,770	614
Increase in accrued expenses and other	1,411	534	198
Net cash provided by operating activities	49,847	20,475	1,634
CASH FLOWS FROM INVESTING ACTIVITIES:			
Net increase in restricted cash	(24,657)	--	--
Purchases of mortgage securities	(978,979)	(1,455,267)	(327,816)
Purchases of mortgage loans	(1,322,732)	(527,597)	(26,756)
Proceeds from sales of mortgage securities	88,284	--	--
Principal payments on mortgage securities	684,150	231,942	38,517
Principal payments on mortgage loans	288,982	26,482	307
Purchases of interest rate agreements	(7,892)	(4,427)	(1,069)
Net cash used in investing activities	(1,272,844)	(1,728,867)	(316,817)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net proceeds from (repayments on) short-term borrowings	(38,578)	1,582,787	269,940
Proceeds from long-term borrowings	1,285,197	--	--
Repayments on long-term borrowings	(112,798)	--	--
Net proceeds from issuance of Class B preferred stock	--	29,579	--
Net proceeds from issuance of common stock	157,362	113,667	51,144
Repurchases of common stock	(23,124)	--	--
Dividends paid	(31,238)	(11,398)	(2,103)
Net cash provided by financing activities	1,236,821	1,714,635	318,981
Net increase in cash and cash equivalents	13,824	6,243	3,798
Cash and cash equivalents at beginning of period	11,068	4,825	1,027
Cash and cash equivalents at end of period	$ 24,892	$ 11,068	$ 4,825
Supplemental disclosure of cash flow information:			
Cash paid for interest expense	$ 160,690	$ 36,831	$ 9,994
Non-cash transactions:			
Conversion of preferred stock	$ 2,843	$ --	$ 22,785

</TABLE>

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

REDWOOD TRUST, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 1997

NOTE 1. THE COMPANY

Redwood Trust, Inc. ("Redwood Trust") was incorporated in Maryland on April 11, 1994 and commenced operations on August 19, 1994. During 1997, Redwood Trust formed Sequoia Mortgage Funding Corporation ("Sequoia"), a special-purpose finance subsidiary. Redwood Trust and Sequoia (collectively, the "Company") acquire and manage real estate mortgage assets ("Mortgage Assets") which may be acquired as whole loans ("Mortgage Loans") or as mortgage securities representing interests in or obligations backed by pools of mortgage loans ("Mortgage Securities"). The Company currently acquires Mortgage Assets that are secured by single-family real estate properties throughout the United States. The Company utilizes both debt and equity to finance its acquisitions. The Company may also use other securitization techniques to enhance the value and liquidity of the Company's Mortgage Assets.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

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

Certain amounts for prior years have been reclassified to conform with the 1997 presentation.

INCOME TAXES

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

MORTGAGE ASSETS

The Company's Mortgage Assets consist of Mortgage Securities and Mortgage Loans. Interest income is accrued based on the outstanding principal amount of the Mortgage Assets and their contractual terms. Discounts and premiums relating to Mortgage Assets are amortized into interest income over the lives of the Mortgage Assets using methods that approximate the effective yield method. Gains or losses on the sale of Mortgage Assets are based on the specific identification method.

Mortgage Securities

Statement of Financial Accounting Standards ("SFAS") No. 115, Accounting for Certain Investments in Debt and Equity Securities, requires the Company to classify its Mortgage Securities as either trading investments, available-for-sale investments or held-to-maturity investments. Although the Company generally intends to hold

most of its Mortgage Securities until maturity, it may, from time to time, sell any of its Mortgage Securities as part of its overall management of its balance sheet. Accordingly, to maintain flexibility, the Company currently classifies all of its Mortgage Securities as available-for-sale. All assets classified as available-for-sale are reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity.

Unrealized losses on Mortgage Securities that are considered other-than-temporary, as measured by the amount of decline in fair value attributable to factors other-than-temporary, are recognized in income and the carrying value of the Mortgage Security is adjusted. Other- than-temporary unrealized losses are based on management's assessment of various factors affecting the expected cash flow from the Mortgage Securities, including an other-than-temporary deterioration of the credit quality of the underlying mortgages and/or the credit protection available to the related mortgage pool.

Mortgage Loans

Mortgage Loans are carried at their unpaid principal balance, net of unamortized discount or premium and specific credit reserves established for such assets.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less. The carrying amount of cash equivalents approximates their fair value.

DEFERRED BOND ISSUANCE COSTS

Costs incurred in connection with the issuance of Long-Term Debt in the form of collateralized mortgage bonds are deferred and amortized over the estimated lives of the Long-Term Debt using the interest method adjusted for the effects of prepayments. Deferred bond issuance costs are included in the carrying value of the Long-Term Debt.

INTEREST RATE AGREEMENTS

The Company utilizes various types of Interest Rate Agreements to hedge the interest rate and liquidity risks inherent in its investment and financing strategies.

SFAS No. 119, Disclosure about Derivative Financial Instruments, requires the Company to provide certain disclosures concerning its derivative instruments according to a set of prescribed guidelines. The nature of the Company's investment and financing strategies exposes the Company to interest rate risk. As part of its asset/liability management activities, the Company uses interest rate options, interest rate swaps and interest rate futures (collectively "Interest Rate Agreements") to hedge exposures or modify the interest rate characteristics of related balance sheet items. Currently, the Company enters into all Interest Rate Agreements as hedges. Under the Company's hedging policy, a specific portfolio of assets and liabilities with similar economic characteristics such as a low life strike, variable interest rate based on a market- sensitive index, similar expected prepayment rate behavior and similar periodic caps, is identified. The hedge instruments are chosen as the ones probable of substantially reducing the interest rate risk being hedged, and a high degree of correlation is maintained on an on-going basis. These hedge instruments are intended to reduce the interest rate risk being hedged by providing income to offset potential reduced net interest income under certain interest rate scenarios. The Company periodically evaluates the effectiveness of these hedges under various interest rate scenarios.

Interest Rate Agreements that are hedging available-for-sale Mortgage Securities are carried at fair value with unrealized gains and losses reported as a separate component of equity, consistent with the reporting of unrealized gains and losses on the related securities. Similarly, Interest Rate Agreements that are used to hedge Mortgage Loans, short-term debt or long-term debt are carried at amortized cost.

Net premiums on interest rate option agreements are amortized as a component of net interest income over the effective period of the interest rate option using the effective interest method. The income and/or expense related to interest rate option and swap agreements is recognized on an accrual basis. Realized gains and losses from the settlement or early termination of Interest Rate Agreements are deferred and amortized into net interest income over the remaining term of the original Interest Rate Agreement, or, if shorter, over the remaining term of the associated hedged asset or liability, as adjusted for estimated future principal repayments. In the event that a hedged asset or liability is sold or extinguished, any related hedging gains or losses would be recognized as an adjustment to the gain or loss on the disposition of the related asset or liability.

Unrealized losses on Interest Rate Agreements that are considered other-than-temporary are recognized in income and the carrying value of the Interest Rate Agreement is adjusted. The other-than-temporary decline is measured as the amount of the decline in fair value attributable to factors that are other-than-temporary. Other-than-temporary unrealized losses are based on management's assessment of various factors affecting the Interest Rate Agreements, for example, a serious deterioration of the ability of the counterparty to perform under the terms of the Interest Rate Agreement.

DEBT

Short-term and long-term debt are carried at their unpaid principal balances, net of any unamortized discount or premium and any unamortized deferred bond issuance costs. Any discount or premium is recognized as an adjustment to interest expense using the effective interest method based on the maturity schedule of the related borrowings.

NET INCOME PER SHARE

Net income per share for the years ended December 31, 1997, 1996 and 1995 is shown in accordance with SFAS No. 128, Earnings Per Share, which was effective for fiscal years ended after December 15, 1997 and requires restatement of prior period earnings per share ("EPS"). Basic net income per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the diluted net income available to common stockholders by the weighted average number of common shares and common equivalent shares outstanding during the period. The common

equivalent shares are calculated using the treasury stock method which assumes that all dilutive common stock equivalents are exercised and the funds generated by the exercise are used to buy back outstanding common stock at the average market price during the reporting period.

The following tables provide reconciliations of the numerators and denominators of the basic and diluted net income per share computations for the years ended December 31, 1997, 1996 and 1995.

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31, 1997		
(IN THOUSANDS, EXCEPT SHARE DATA)	INCOME (NUMERATOR)	SHARES (DENOMINATOR)	PER-SHARE AMOUNT
<S>	<C>	<C>	<C>
Net Income	$ 27,561		
Cash dividends on Class B preferred stock	(2,815)		
Basic EPS - Income available to common stockholders	24,746	13,334,163	$ 1.86
Effect of dilutive securities -			
Stock options		191,513	
Stock warrants (a)		154,734	
Diluted EPS - Income available to common stockholders	$ 24,746	13,680,410	$ 1.81

</TABLE>

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31, 1996		
(IN THOUSANDS, EXCEPT SHARE DATA)	INCOME (NUMERATOR)	SHARES (DENOMINATOR)	PER-SHARE AMOUNT
<S>	<C>	<C>	<C>
Net Income	$ 12,685		
Cash dividends on Class B preferred stock	(1,148)		
Basic EPS - Income available to common stockholders	11,537	7,950,175	$ 1.45
Effect of dilutive securities -			
Stock options	175,391		
Stock warrants (a)	618,618		
Diluted EPS - Income available to common stockholders	$ 11,537	8,744,184	$ 1.32

</TABLE>

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31, 1995		
(IN THOUSANDS, EXCEPT SHARE DATA)	INCOME (NUMERATOR)	SHARES (DENOMINATOR)	PER-SHARE AMOUNT
<S>	<C>	<C>	<C>
Net Income	$ 3,155		
Cash dividends on Class B preferred stock	0		
Basic EPS - Income available to common stockholders	3,155	3,314,042	$ 0.95
Effect of dilutive securities -			
Stock options		173,716	
Stock warrants (a)		216,045	
Diluted EPS - Income available to common stockholders	$ 3,155	3,703,803	$ 0.85

</TABLE>

(a) The Stock warrants expired on December 31, 1997.

USE OF ESTIMATES

The preparation of financial statements in conformity with Generally Accepted Accounting Principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. Actual results could differ from those estimates. The primary estimates inherent in the accompanying consolidated financial statements are discussed below.

Fair Value. The Company uses estimates in establishing fair value for its investments available-for-sale. Management bases its fair value estimates primarily on third party bid price indications, such as bid indications provided by dealers who make markets in these assets and asset valuations made by collateralized lenders, when such indications are available. Estimates of fair value for all remaining investments available-for-sale are based primarily

on management's judgment. However, the fair value reported reflects estimates and may not necessarily be indicative of the amounts the Company could realize in a current market exchange. The fair value of all on- and off- balance sheet financial instruments is presented in Notes 3, 6 and 9.

Allowance for Credit Losses. An allowance for credit losses is maintained at a level deemed appropriate by management to provide for known, future losses as well as unidentified potential losses in its Mortgage Asset portfolio. The allowance is based upon management's assessment of various factors affecting its Mortgage Assets, including current and projected economic conditions, delinquency status and credit protection. In determining the allowance for credit losses, the Company's credit exposure is considered based on its credit risk position in the mortgage pool. These estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the periods in which they become known. The reserve is increased by provisions charged to income from operations. When a loan or portions of a loan are determined to be uncollectible, the portion deemed uncollectible is charged against the allowance and subsequent recoveries, if any, are credited to

the allowance. The Company's actual credit losses may differ from those estimates used to establish the allowance.

RECENT ACCOUNTING PRONOUNCEMENTS

On June 30, 1997, the Financial Accounting Standards Board ("FASB") issued SFAS No. 130, Reporting Comprehensive Income. This statement requires companies to classify items of other comprehensive income by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position, and is effective for financial statements issued for fiscal years beginning after December 15, 1997. The impact to the Company of adopting SFAS No. 130 is not expected to be significant.

NOTE 3. MORTGAGE ASSETS

At December 31, 1997, Mortgage Assets consisted of the following:

<TABLE>
<CAPTION>

	MORTGAGE SECURITIES		MORTGAGE	
(IN THOUSANDS)	AGENCY	NON-AGENCY	LOANS	TOTAL
<S>	<C>	<C>	<C>	<C>
Mortgage Assets, Gross	$ 953,937	$ 825,438	$ 1,519,837	$ 3,299,212
Unamortized Discount	(174)	(12,268)	0	(12,442)
Unamortized Premium	32,722	18,606	34,844	86,172
Amortized Cost	986,485	831,776	1,554,681	3,372,942
Allowance for Credit Losses	0	(2,076)	(2,855)	(4,931)
Gross Unrealized Gains	2,598	3,984	0	6,582
Gross Unrealized Losses	(4,286)	(3,685)	0	(7,971)
Carrying Value	$ 984,797	$ 829,999	$ 1,551,826	$ 3,366,622

</TABLE>

At December 31, 1996, Mortgage Assets consisted of the following:

<TABLE>
<CAPTION>

	MORTGAGE SECURITIES		MORTGAGE	
(IN THOUSANDS)	AGENCY	NON-AGENCY	LOANS	TOTAL
<S>	<C>	<C>	<C>	<C>
Mortgage Assets, Gross	$ 939,936	$ 662,276	$ 515,033	$ 2,117,245
Unamortized Discount	(234)	(15,717)	(142)	(16,093)
Unamortized Premium	26,939	16,366	11,012	54,317
Amortized Cost	966,641	662,925	525,903	2,155,469
Allowance for Credit Losses	0	(1,752)	(428)	(2,180)
Gross Unrealized Gains	3,173	2,791	0	5,964
Gross Unrealized Losses	(873)	(4,952)	0	(5,825)
Carrying Value	$ 968,941	$ 659,012	$ 525,475	$ 2,153,428

</TABLE>

At December 31, 1997 and 1996, all investments in Mortgage Assets consisted of interests in adjustable-rate mortgages on residential properties. Agency Mortgage Securities ("Agency Securities") represent securitized interests in pools of adjustable-rate mortgages from the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association. The Agency Securities are guaranteed as to principal and interest by these United States government-sponsored entities. The original maturity of the majority of the Mortgage Assets

is thirty years; the actual maturity is subject to change based on the prepayments of the underlying mortgage loans.

At December 31, 1997 and 1996, the average annualized effective yield on the Mortgage Assets was 6.86% and 7.11%, respectively, based on the amortized cost of the assets. The coupons on most of the adjustable-rate mortgage securities and loans owned by the Company are limited by periodic caps (generally interest rate adjustments are limited to no more than 1% every six months or 2% every year) and lifetime caps. At December 31, 1997 and 1996, the weighted average lifetime cap was 12.06% and 11.73%, respectively.

During the second half of 1997, the Company sold Mortgage Securities with a face value of approximately $87.0 million. Proceeds and realized gains and losses on the sales of Mortgage Securities for the year ended December 31, 1997 are presented below. No such sales occurred for the years ended December 31, 1996 or 1995.

(IN THOUSANDS)	1997
Proceeds from sales of available-for-sale securities	$ 88,284
Available-for-sale securities gains	$ 746
Available-for-sale securities losses	(28)
Write-down on related interest rate agreements	(155)
Net gain on sales of available-for-sale securities	$ 563

NOTE 4. ALLOWANCE FOR CREDIT LOSSES

The following table summarizes the activity in the Allowance for Credit Losses for the years ended December 31:

(IN THOUSANDS)	1997	1996	1995
Balance at January 1	$ 2,180	$ 490	$ 0
Provision for credit losses	2,930	1,696	493
Charge-offs	(179)	(6)	(3)
Balance at December 31	$ 4,931	$ 2,180	$ 490

The Allowance for Credit Losses is classified on the Consolidated Balance Sheets as a component of Mortgage Assets.

NOTE 5. COLLATERAL FOR LONG-TERM DEBT

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

The components of the Bond Collateral at December 31, 1997 are summarized as follows:

(IN THOUSANDS)	1997
Mortgage loans	$1,191,487
Restricted cash and cash equivalents	24,657
Accrued interest receivable	7,401
	$1,223,545

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

NOTE 6. INTEREST RATE AGREEMENTS

The amortized cost and carrying value of the Company's Interest Rate Agreements at December 31, 1997 and 1996 are summarized as follows:

(IN THOUSANDS)	1997	1996
Amortized Cost	$ 10,781	$ 6,200
Gross Unrealized Gains	650	156
Gross Unrealized Losses	(9,331)	(3,755)
Carrying Value	$ 2,100	$ 2,601

The following table summarizes the aggregate notional amounts of all of the Company's Interest Rate Agreements as well as the credit exposure related to these instruments at December 31, 1997 and 1996.

	NOTIONAL AMOUNTS		CREDIT EXPOSURE (A)	
(IN THOUSANDS)	1997	1996	1997	1996
Interest Rate Options	$4,862,200	$2,231,200	$ 0	$ 0
Interest Rate Swaps	473,000	405,000	12,392	2,727
Interest Rate Futures	58,000	0	46	0
Total Interest Rate Agreements	$5,393,200	$2,636,200	$ 12,438	$ 2,727

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

Interest Rate Options, which include caps, floors and collars (collectively, "Options"), are agreements which transfer, modify or reduce interest rate risk in exchange for the payment of a premium when the contract is initiated. Interest rate cap agreements provide cash flows to the Company to the extent that a specific interest rate index exceeds a fixed rate. Conversely, interest rate floor agreements produce cash flows to the Company to the extent that the referenced interest rate index falls below the agreed upon fixed rate. Interest rate collar agreements consist of the purchase of a cap agreement subsidized by the sale of a floor agreement, thus incorporating both of the above mentioned types of cash flows. The Company's credit risk on the Options is limited to the amortized cost of the Options agreements.

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

Interest Rate Futures ("Futures") are contracts for the delivery of securities

or cash in which the seller agrees to deliver on a specified future date, a specified instrument (or the cash equivalent), at a specified price or yield. Under these agreements, if the Company has sold (bought) the futures, the Company will generally receive additional cash flows if interest rates rise (fall). Conversely, the Company will generally pay additional cash flows if interest rates fall (rise).

In general, the Company has incurred credit risk to the extent that the counterparties to the Interest Rate Agreements do not perform their obligations under the Interest Rate Agreements. If one of the counterparties does not perform, the Company would not receive the cash to which it would otherwise be entitled under the Interest Rate Agreement. In order to mitigate this risk, the Company has only entered into Interest Rate Agreements with counterparties rated A or better or that are transacted on a national exchange. Furthermore, the Company has entered into Interest Rate Agreements with several different counterparties in order to reduce the risk of credit exposure to any one counterparty.

NOTE 7. SHORT-TERM DEBT

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

At December 31, 1997, the Company had $1.9 billion of Short-Term Debt outstanding with a weighted average borrowing rate of 6.00% and a weighted average remaining maturity of 64 days. This debt was collateralized with $2.0 billion of Mortgage Assets. At December 31, 1996, the Company had $2.0 billion of Short-Term Debt outstanding with a weighted average borrowing rate of 5.83% and a weighted average remaining maturity of 98 days. This debt was collateralized with $2.1 billion of Mortgage Assets.

At December 31, 1997 and 1996, the Short-Term Debt had the following remaining maturities:

<TABLE>
<CAPTION>

(IN THOUSANDS)	1997	1996
<S>	<C>	<C>
Within 30 days	$ 823,545	$ 268,042
30 to 90 days	533,543	667,567
Over 90 days	557,437	1,017,494
Total Short-Term Debt	$1,914,525	$1,953,103

</TABLE>

For the years ended December 31, 1997, 1996 and 1995, the average balance of Short-Term Debt was $2.4 billion, $0.9 billion and $0.2 billion with a weighted average interest cost of 5.86%, 5.71% and 6.06%, respectively. The maximum balance outstanding during the years ended December 31, 1997, 1996 and 1995 was $3.1 billion, $2.0 billion and $0.4 billion, respectively.

NOTE 8. LONG-TERM DEBT

During the third and fourth quarters of 1997, the Company issued $1.28 billion of Long-Term Debt in the form of collateralized mortgage bonds. The Long-Term Debt was issued by two business trusts established by the Company's wholly-owned subsidiary, Sequoia Mortgage Funding Corporation ("Sequoia"). Each series of Long-Term Debt consists of two classes of bonds at variable rates of interest. Payments received on the Bond Collateral are used to make payments on the Long-Term Debt. The obligations under the Long-Term Debt are payable solely from the Bond Collateral and are otherwise non-recourse to the Company. The maturity of each class is directly affected by the rate of principal prepayments on the related Bond Collateral. The Long-Term Debt is also subject to redemptions according to the specific terms of the individual indentures as defined in the corresponding prospectus. As a result, the actual maturity of any class of this series of Long-Term Debt is likely to occur earlier than its stated maturity.

The components of the Long-Term Debt along with selected other information are summarized below:

<TABLE>
<CAPTION>

(IN THOUSANDS)	DECEMBER 31, 1997
<S>	<C>
Long-Term Debt	$ 1,170,709
Unamortized premium on Long-Term Debt	5,795
Deferred bond issuance costs	(3,703)

Total Long-Term Debt	$ 1,172,801
Range of coupons on bonds	6.0583% to 6.5033%
Stated maturities	2024 - 2029

</TABLE>

For the year ended December 31, 1997, the average effective interest cost for Long-Term Debt, as adjusted for the amortization of bond premium, deferred bond issuance costs and other related expenses, was 6.31%. Interest paid on Long-Term Debt for the year ended December 31, 1997 totaled $16.7 million.

NOTE 9. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying amounts and estimated fair values of the Company's financial instruments at December 31, 1997 and 1996. SFAS No. 107, Disclosures about Fair Value of Financial Instruments, defines the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced liquidation sale.

<TABLE>
<CAPTION>

(IN THOUSANDS)	1997		1996	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
<S>	<C>	<C>	<C>	<C>
Assets				
Mortgage Assets	$3,366,622	$3,367,381	$2,153,428	$2,153,428
Interest Rate Agreements	$ 2,100	$ 1,522	$ 2,601	$ 2,601
Liabilities				
Long-Term Debt	$1,172,801	$1,172,938	0	0

</TABLE>

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

NOTE 10. STOCKHOLDER'S EQUITY

CLASS B 9.74% CUMULATIVE CONVERTIBLE PREFERRED STOCK

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

As of December 31, 1997, 96,732 shares of the Class B Preferred Stock have been converted into 96,732 shares of the Company's Common Stock. At December 31, 1997 and 1996, there were 909,518 and 1,006,250 shares of the Class B Preferred Stock outstanding, respectively.

STOCK OPTION PLAN

The Company has adopted a Stock Option Plan for executive officers, employees and non-employee directors (the "Plan"). The Plan authorizes the Board of Directors (or a committee appointed by the Board of Directors) to grant "incentive stock options" as defined under Section 422 of the Code ("ISOs"), options not so qualified ("NQSOs"), deferred stock, restricted stock, performance shares, stock appreciation rights and limited stock appreciation rights ("Awards") and dividend equivalent rights ("DERs") to such eligible recipients other than non-employee directors. Non-employee directors are automatically provided annual grants of NQSOs with DERs pursuant to a formula under the Plan.

The number of shares of Common Stock available under the Plan for options and Awards, subject to certain anti-dilution provisions, is 15% of the Company's total outstanding shares of Common Stock. At December 31, 1997 and 1996, 1,158,404 and 1,138,737 shares of Common Stock, respectively, were available for grant. Of the shares of Common Stock available for grant, no more than 500,000 shares of Common Stock shall be cumulatively available for grant as ISOs. At December 31, 1997 and 1996, 354,265 and 299,633 ISOs had been granted, respectively. The exercise price for ISOs granted under the Plan may not be less than the fair market value of shares of Common Stock at the time the ISO is granted. All stock options granted under the Plan vest no earlier than ratably over a four year period from the date of grant and expire within ten

years after the date of grant.

The Company's Plan permits certain stock options granted under the plan to accrue stock DERs. For the years ended December 31, 1997, 1996 and 1995, the stock DERs accrued on NQSOs that had a stock DER feature resulted in charges to operating expenses of $437,393, $328,374 and $54,513, respectively. Stock DERs represent shares of stock which are issuable to holders of stock options when the holders exercise the underlying stock options. The number of stock DER shares accrued are based on the level of the Company's dividends and on the price of the stock on the related dividend payment date.

A summary of the status of the Company's Plan as of December 31 and changes during the years ending on those dates is presented below.

(IN THOUSANDS, EXCEPT SHARE DATA)	1997 SHARES	1997 WEIGHTED AVERAGE EXERCISE PRICE	1996 SHARES	1996 WEIGHTED AVERAGE EXERCISE PRICE	1995 SHARES	1995 WEIGHTED AVERAGE EXERCISE PRICE
Outstanding options at January 1	421,583	$ 19.05	310,857	$ 9.48	188,333	$ 0.11
Options granted	460,328	37.08	141,300	36.01	166,972	17.55
Options exercised	(54,485)	0.89	(42,083)	0.11	(47,083)	0.11
Dividend equivalent rights earned	13,218	0.00	11,509	0.00	2,635	0.00
Outstanding options at December 31	840,644	29.79	421,583	19.05	310,857	9.48
Options exercisable at year-end	81,774	22.10	27,109	24.48	0	na
Weighted average fair value of options granted during the year	$ 3.17		$ 2.34		$ 0.01	

The following table summarizes information about stock options outstanding at December 31, 1997.

RANGE OF EXERCISE PRICES	OPTIONS OUTSTANDING: NUMBER OUTSTANDING AT 12/31/97	OPTIONS OUTSTANDING: WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE	OPTIONS OUTSTANDING: WEIGHTED-AVERAGE EXERCISE PRICE	OPTIONS EXERCISABLE: NUMBER EXERCISABLE AT 12/31/97	OPTIONS EXERCISABLE: WEIGHTED-AVERAGE EXERCISE PRICE
$0 to 8	83,294	7.2	$ 0.71	11,552	$ 1.58
17 to 19	155,972	7.9	18.19	41,493	18.15
20 to 30	98,976	9.8	23.62	1,750	23.74
36 to 38	381,300	9.0	37.45	26,979	36.88
45 to 53	121,102	9.5	45.68	0	0.00
$0 to 53	840,644	8.8	29.79	81,774	22.10

At December 31, 1997, the Company had one Stock Option Plan, which is described above. The Company applies Accounting Principles Board ("APB") Opinion 25 and related interpretations in accounting for this plan. Accordingly, no compensation cost has been recognized for its Plan. Had compensation cost for the Company's Plan been determined consistent with SFAS No. 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

		YEAR ENDED DECEMBER 31, 1997	1996	1995
Net Income	As reported	$ 24,746	$ 11,537	$ 3,155
(IN THOUSANDS)	Pro Forma	$ 24,504	$ 11,535	$ 3,155
Basic earnings	As reported	$ 1.86	$ 1.45	$ 0.95
per share	Pro Forma	$ 1.84	$ 1.45	$ 0.95
Diluted	As reported	$ 1.81	$ 1.32	$ 0.85
earnings per share	Pro Forma	$ 1.79	$ 1.32	$ 0.85

For purposes of determining values for use in the above table, the 1997 values are based on American valuation using the Black/Scholes option pricing model as of the various grant dates, using the following principal assumptions: expected stock price volatility 33%, risk free rates of return based on the 5 year treasury rate at the date of grant and a post-option dividend growth rate of 10%. No adjustments have been made for forfeitures or non-transferability.

The actual value, if any, that the option recipient will realize from these options will depend solely on the increase in the stock price over the option price when the options are exercised.

STOCK PURCHASE WARRANTS
For the years ended December 31, 1997 and 1996, 412,484 and 1,252,169 Warrants were exercised, respectively. Each Warrant entitled the holder to purchase 1.000667 shares of the Company's Common Stock at an exercise price of $15.00 per share. The Warrants expired on December 31, 1997.

STOCK REPURCHASES
In 1997, the Company's Board of Directors approved the repurchase of up to 1,455,000 shares of the Company's Common Stock. Pursuant to this repurchase program, the Company repurchased 840,000 shares of its Common Stock for $23.1 million during 1997. The repurchased shares have been returned to the Company's authorized but unissued shares of Common Stock.

DIVIDENDS
The Company declared and paid the following dividends for the years ended December 31, 1997 and 1996:

<TABLE>
<CAPTION>

DECLARATION DATE	RECORD DATE	PAYABLE DATE	TOTAL DIVIDENDS (IN THOUSANDS)	DIVIDENDS PER SHARE CLASS B PREFERRED STOCK	DIVIDENDS PER SHARE COMMON STOCK
<S>	<C>	<C>	<C>	<C>	<C>
12/12/97	12/31/97	1/21/98	$5,686	$0.755	$0.350
9/8/97	9/30/97	10/21/97	$9,433	$0.755	$0.600
6/12/97	6/30/97	7/21/97	$8,638	$0.755	$0.600
3/5/97	3/31/97	4/21/97	$7,899	$0.755	$0.600
12/16/96	12/31/96	1/21/97	$5,268	$0.755	$0.410
9/16/96	9/30/96	10/21/96	$4,016	$0.386	$0.400
6/14/96	6/28/96	7/18/96	$3,408	--	$0.400
3/11/96	3/29/96	4/19/96	$2,540	--	$0.460

</TABLE>

Under the Internal Revenue Code of 1986, a dividend declared by a REIT in October, November or December of a calendar year and payable to shareholders of record as of a specified date in such month, will be deemed to have been paid by the Company and received by the shareholders on the last day of that calendar year, provided the dividend is actually paid before February 1st of the following calendar year. Therefore, the dividend declared in December 1997 which was paid in January 1998 is considered taxable income to shareholders in the year declared. The Company's dividends are not eligible for the dividends received deduction for corporations.

NOTE 11. COMMITMENTS AND CONTINGENCIES

At December 31, 1997, the Company had entered into a commitment to purchase $7.3 million of Mortgage Assets for settlement in January 1998.

At December 31, 1997, the Company is obligated under non-cancelable operating leases with expiration dates through 2001. The future minimum lease payments under these non-cancelable leases are as follows: 1998 through 2000 - $197,304; 2001 - $65,768.

NOTE 12. SUBSEQUENT EVENTS

During January and February, 1998, pursuant to its stock repurchase program (see Note 10), the Company repurchased 214,100 shares of the Company's Common Stock for $4.2 million.

[COOPERS & LYBRAND LETTERHEAD]

REPORT OF INDEPENDENT ACCOUNTANTS

Board of Directors
Redwood Trust, Inc.
Mill Valley, California

We have audited the accompanying consolidated balance sheets of Redwood Trust, Inc. and Subsidiary (the Company) as of December 31, 1997 and 1996 and the related consolidated statements of operations, stockholders' equity and cash

flows for each of the three years in the period ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 1997 and 1996, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1997, in conformity with generally accepted accounting principles.

/s/ COOPERS & LYBRAND L.L.P.

San Francisco, California
February 25, 1998

REDWOOD TRUST, INC.

SUMMARY OF QUARTERLY RESULTS
(unaudited)
(In thousands, except share data)

<TABLE>
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	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
<S>	<C>	<C>	<C>	<C>
Year ended December 31, 1997				
Operating results:				
Interest income	$53,984	$56,543	$49,509	$38,568
Interest expense	46,531	45,888	38,958	28,900
Interest rate agreement expense	1,269	1,038	839	595
Net interest income	6,184	9,617	9,712	9,073
Net income	5,083	7,546	7,721	7,211
Net income available to common stockholders	4,397	6,859	7,034	6,456
Net income per share - diluted	0.30	0.47	0.52	0.53
Dividends declared per common share	0.350	0.600	0.600	0.600
Dividends declared per Class B preferred share	0.755	0.755	0.755	0.755
Year ended December 31, 1996				
Operating results:				
Interest income	$25,881	$19,371	$12,901	$ 9,131
Interest expense	19,467	14,447	9,075	6,202
Interest rate agreement expense	402	350	255	151
Net interest income	6,012	4,574	3,571	2,778
Net income	4,844	3,387	2,500	1,954
Net income available to common stockholders	4,084	2,999	2,500	1,954
Net income per share - diluted	0.39	0.32	0.29	0.32
Dividends declared per common share	0.410	0.400	0.400	0.460
Dividends declared per Class B preferred share	0.755	0.386	0.000	0.000

</TABLE>

REDWOOD TRUST, INC.
INDEX TO EXHIBIT

<TABLE>

<CAPTION>

Exhibit Number		Sequentially Numbered Page
11.1	Computation of Earnings per Share	112
21	List of Subsidiaries	113
23	Consent of Accountants	114
27	Financial Data Schedule	115

</TABLE>

EXHIBIT 11.1

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

	Twelve Months Ended December 31, 1997	Twelve Months Ended December 31, 1996	Twelve Months Ended December 31, 1995
Basic:			
Average common shares outstanding	13,334,163	7,950,175	3,314,042
Total	13,334,163	7,950,175	3,314,042
Net Income	$24,746,164	$11,537,318	$ 3,154,831
Per Share Amount	$ 1.86	$ 1.45	$ 0.95
Diluted:			
Average common shares outstanding	13,334,163	7,950,175	3,314,042
Net effect of dilutive stock options outstanding during the period -- based on the treasury stock method	191,513	175,391	173,716
Net effect of dilutive stock warrants outstanding during the period -- based on the treasury stock method	154,734	618,618	216,046
Total	13,680,410	8,744,184	3,703,804
Net Income	$24,746,164	$11,537,318	$ 3,154,831
Per Share Amount	$ 1.81	$ 1.32	$ 0.85

EXHIBIT 21

LIST OF SUBSIDIARIES
OF
REDWOOD TRUST, INC.

Sequoia Mortgage Funding Corporation
Sequoia Mortgage Trust 1
Sequoia Mortgage Trust 2

EXHIBIT 23

[COOPERS & LYBRAND LETTERHEAD]

CONSENT OF INDEPENDENT ACCOUNTANTS

We consent to the incorporation by reference in the registration statements on Form S-3 (Nos. 33-97398, 333-25643 and 333-18061) and on form S-8/S-3 (No. 333-20253) of our report dated February 25, 1998, on our audits of the consolidated financial statements of Redwood Trust, Inc. and Subsidiary as of December 31, 1997 and 1996, and for the years ended December 31, 1997, 1996 and 1995, which report is included in this Annual Report on Form 10-K. We also consent to the reference to our firm under the caption "Experts."

/s/ COOPERS & LYBRAND L.L.P.

San Francisco, California
March 12, 1998

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM DECEMBER 31, 1997 ANNUAL REPORT ON FORM 10-K AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.
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