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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: MARCH 31, 1996

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: 0-26436

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)

Indicate by check mark whether the Registrant (1) has filed all documents and reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ___

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Common Stock ($.01 par value) 8,418,945 as of May 10, 1996

REDWOOD TRUST, INC.
FORM 10-Q

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

REDWOOD TRUST, INC.

BALANCE SHEETS
(In thousands, except share data)

<TABLE>
<CAPTION>

	March 31, 1996	December 31, 1995
ASSETS		
<S>	<C>	<C>
Cash and cash equivalents	$ 9,705	$ 4,825
Mortgage assets	565,159	432,244
Interest rate agreements	1,233	547
Accrued interest receivable	4,496	3,270
Other assets	720	671
	$ 581,313	$ 441,557
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Reverse repurchase agreements	$ 471,372	$ 346,335
Notes payable	37,349	23,981
Accrued interest payable	1,616	1,290
Accrued expenses and other liabilities	290	227
Dividends payable	2,540	1,434
	513,167	373,267
Commitments and contingencies (See Note 10)		
STOCKHOLDERS' EQUITY		
Common stock, par value $.01 per share; Authorized 50,000,000 shares, issued and outstanding 5,521,376 and 5,517,299 shares	55	55
Additional paid-in capital	73,926	73,895
Net unrealized loss on assets available for sale	(5,065)	(5,476)
Undistributed income (deficit)	(770)	(184)
	68,146	68,290
	$ 581,313	$ 441,557

</TABLE>

The accompanying notes are an integral part of these financial statements

REDWOOD TRUST, INC.

STATEMENTS OF OPERATIONS
(In thousands, except share data)

<TABLE>
<CAPTION>

Three Months Ended	
March 31, 1996	March 31, 1995

INTEREST INCOME		
Mortgage assets	$ 8,914	$ 2,155
Cash and investments	217	15
	9,131	2,170
INTEREST EXPENSE	6,202	1,533
INTEREST RATE AGREEMENTS		
Interest rate agreement expense	151	16
NET INTEREST INCOME	2,778	621
Provision for credit losses	332	18
Net interest income after provision for credit losses	2,446	603
General and administrative expenses	492	201
NET INCOME	$ 1,954	$ 402
NET INCOME PER SHARE		
Primary	$ 0.32	$ 0.19
Fully diluted	$ 0.32	$ 0.19
Weighted average shares of common stock and common stock equivalents:		
Primary	6,129,587	2,115,161
Fully diluted	6,132,648	2,115,161
Dividends declared per preferred share	$ 0.00	$ 0.20
Dividends declared per common share	$ 0.46	$ 0.00

The accompanying notes are an integral part of these financial statements

REDWOOD TRUST, INC.

STATEMENTS OF STOCKHOLDERS' EQUITY

For the Three Months Ended March 31, 1996
(In thousands, except share data)

	Common Stock		Additional Paid-in Capital	Net Unrealized Loss on Assets Available for Sale	Undistributed Income (Deficit)	Total
	Shares	Amount				
Balance, December 31, 1995	5,517,299	$55	$ 73,895	($5,476)	($ 184)	$68,290
Shares issued pursuant to dividend reinvestment plan	4,077	--	79	--	--	$ 79
Offering costs	--	--	(48)	--	--	($ 48
Net income	--	--	--	--	1,954	$ 1,954
Common stock dividends declared	--	--	--	--	(2,540)	($2,540
Fair value adjustment on assets available for sale	--	--	--	411	--	$

411

Balance, March 31, 1996	5,521,376	$55	$ 73,926	($5,065)	($ 770)	$68,146

</TABLE>

The accompanying notes are an integral part of these financial statements

REDWOOD TRUST, INC.

STATEMENTS OF CASH FLOWS
(In thousands, except share data)

<TABLE>
<CAPTION>

	Three Months Ended	
	March 31, 1996	March 31, 1995
<S>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 1,954	$ 402
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of mortgage asset premium and discount, net	530	(215)
Depreciation and amortization	17	4
Provision for credit losses on mortgage assets	332	18
Amortization of interest rate cap agreements	151	16
Increase in accrued interest receivable	(1,226)	(111)
Decrease (increase) in other assets	(66)	45
Increase (decrease) in accrued interest payable	326	(11)
Increase (decrease) in accrued expenses and other	63	63
Net cash provided by operating activities	2,081	211
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of mortgage assets	(166,852)	(24,115)
Principal payments on mortgage assets	32,814	2,673
Purchase of interest rate cap agreements	(165)	(294)
Net cash used in investing activities	(134,203)	(21,736)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net borrowings from reverse repurchase agreements	125,037	15,695
Net borrowings from notes payable	13,368	5,927
Private placement issuance costs	0	(4)
Proceeds from stock issued pursuant to dividend reinvestment plan	79	
Common stock issuance costs	(48)	
Dividends paid	(1,434)	(167)
Net cash provided by financing activities	137,002	21,451
Net increase (decrease) in cash and cash equivalents	4,880	(74)
Cash and cash equivalents at beginning of period	4,825	1,027
Cash and cash equivalents at end of period	$ 9,705	$ 953
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 5,876	$ 1,544

</TABLE>

The accompanying notes are an integral part of these financial statements

REDWOOD TRUST, INC.

NOTES TO FINANCIAL STATEMENTS
March 31, 1996

NOTE 1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Redwood Trust, Inc. (the "Company") was incorporated in Maryland on April 11, 1994. At incorporation 208,332 shares of the Company's common stock, par value $.01 per share ("Common Stock") were issued to various officers and employees of the Company.

On August 19, 1994, upon receipt of the net proceeds from the first closing of its private placement of Units, the Company commenced its operations of acquiring and managing mortgage assets. Each Unit consisted of one share of Class A Convertible Preferred Stock, par value $.01 per share ("Preferred Stock") and one Stock Purchase Warrant ("Warrant"). In this first closing, the Company issued 1,226,465 Units at a price of $15 per Unit. The Company received proceeds of $16,815,877, net of an underwriting discount of $1.05 per share and other offering costs.

In October 1994, the Company completed a second closing of its private placement of Units. The Company issued an additional 439,598 Units at a price of $15 per Unit. The Company received proceeds of $5,968,937, net of an underwriting discount of $1.05 per share and other offering costs.

On August 9, 1995, the Company completed its initial public offering of 3,593,750 shares of common stock at $15.50 per share (the "Initial Public Offering"). The Company received proceeds of $51,132,396, net of an underwriting discount of $1.085 per share and other offering costs. Concurrent with the completion of the Initial Public Offering, all 1,666,063 outstanding shares of Class A Convertible Preferred Stock converted into 1,667,134 shares of Common Stock.

The Company's primary source of revenue is from the acquisition and management of real estate mortgage loans and mortgage securities (together "Mortgage Assets"). The Company acquires Mortgage Assets that are secured by single-family, multifamily and commercial real estate properties throughout the Untied States, with a special emphasis on properties located in the State of California.

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.

A summary of the Company's significant accounting policies follows:

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.

Mortgage Assets

The Company's mortgage assets ("Mortgage Assets") may consist of mortgage loans, mortgage loans which have been securitized by the Company following acquisition, mortgage loans which have been securitized by others prior to acquisition by the Company and interest only strips ("IO Strips").

Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities ("SFAS 115"), requires the Company to classify its investments as either trading

investments, available-for-sale investments or held-to-maturity investments. Although the Company generally intends to hold most of its Mortgage Assets until maturity, it may, from time to time, sell any of its Mortgage Assets as part of its overall management of its balance sheet. Accordingly, this flexibility requires the Company to classify all of its Mortgage Assets 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 Assets 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 cost basis of the Mortgage Asset is adjusted. Other-than-temporary unrealized losses are based on management's assessment of various factors affecting the Mortgage Assets; primarily, a deterioration of the credit

quality of the underlying mortgages, or a deterioration of the credit protection available related to the mortgage loan pool.

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.

IO Strips are accounted for under the prospective method. Under this method, income is amortized over the asset's estimated life based on a method which provides a constant yield. At the end of each quarter, the yield over the remaining life of the asset is recalculated based on expected future cash flows. This new yield is then used to calculate the subsequent quarter's financial statement income.

Under certain extended high interest rate periods, or in the event of extremely high prepayment rates on the collateral, the return on the Company's investment in an IO Strip could be zero or negative. In the event that the projected return on an investment in an IO Strip falls below a risk free rate, the Company would record a write down of such investment to its fair value.

Interest Rate Agreements

The rate the Company pays on its short-term and variable borrowings will rise and fall without limit as short-term market interest rates fluctuate. The rate the Company earns on its adjustable rate assets, however, is limited by periodic and lifetime caps.

Under the Company's hedging policy the Company does not hedge specific assets or liabilities, but rather the Company hedges the risk of overall limitations to its interest income. To utilize hedge accounting, the policy requires risk reduction and that there be at least a 50% correlation between changes in the estimated fair value of the assets or liabilities hedged and the hedge instruments. Interest Rate Agreements, which include interest rate cap agreements (the "Cap Agreements") and interest rate swap agreements (the "Swap Agreements"), entered into by the Company are intended to provide income throughout their effective period to offset potential reduced net interest income under certain rising interest rate scenarios. The Company periodically evaluates the effectiveness of these hedges under various interest rate scenarios.

The Company accounts for the Interest Rate Agreements as hedges. Because the Mortgage Assets are carried at fair value, the Company's Interest Rate Agreements are carried at fair value, with unrealized gains and losses reported as a separate component of equity.

The cost of each Cap Agreement is amortized over the effective period of that Cap Agreement using the effective interest method. The income and expense related to each Swap Agreement is recognized on an accrual basis. Gains and losses on early termination of Interest Rate Agreements are amortized as a component of net interest income over the remaining term of the original Interest Rate Agreement,

or, if shorter, over the remaining term of associated Mortgage Assets as adjusted for estimated future principal prepayments.

Unrealized losses on Interest Rate Agreements that are considered other than temporary are recognized in income and the cost basis 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; primarily, a deterioration of the ability of the counterparty to perform under the terms of the Interest Rate Agreement.

Premises, Furniture and Equipment

Leasehold improvements are stated at cost and are amortized on a straight-line basis over the life of the lease. Furniture and equipment is stated at cost and depreciated on an accelerated basis over its estimated useful life. Expenditures for repairs and maintenance are charged to expense when

incurred. Premises and equipment totaled $119,312 at March 31, 1996 and $113,515 at December 31, 1995. Depreciation expense and leasehold improvements amortization for the three months ended March 31, 1996 and March 31, 1995 totaled $8,895 and $4,059, respectively. Accumulated depreciation and leasehold improvement amortization totaled $37,297 at March 31, 1996 and $31,367 at December 31, 1995.

Income Taxes

The Company has elected to be taxed as a Real Estate Investment Trust ("REIT") and intends to comply with the REIT provisions of the Internal Revenue Code (the "Code") and the corresponding provisions of State law. Accordingly, the Company will not be subject to Federal or state income tax to the extent of its distributions to stockholders. In order to maintain its status as a REIT, the Company is required, among other requirements, to distribute at least 95% of its taxable income.

Earnings per Share

Earnings per share are based on the weighted average shares of common stock outstanding plus common equivalent shares arising from the effect of convertible preferred stock, using the if-converted method, and dilutive stock options and warrants, using the treasury stock method. The treasury stock method calculation assumes all dilutive stock options and warrants 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, for primary earnings per share, or at the end of period market price if higher, for fully diluted earnings per share.

Credit Risk

Most of the Company's Mortgage Assets have protection from some degree of credit loss either through subordination, insurance, third party guarantees, or other means. Many of the Company's privately issued Mortgage Assets have received ratings from one or more of the four nationally recognized credit rating agencies. Based on these ratings, and on credit criteria similar to those used by rating agencies, the Company assigns a "rating equivalent" to each Mortgage Asset. For purposes of assigning a rating equivalent to unrated pools of whole loans or unrated securitized pools of mortgage loans, the Company assigns a series of ratings to different portions of the pool according to the Company's estimation of how the pool would currently be structured and rated if it were newly securitized. At March 31, 1996, the privately issued Mortgage Assets held by the Company had rating equivalents ranging from AAA to unrated, with a weighted average of AA; the weighted average rating equivalent of all the Company's Mortgage Assets was AA+. At December 31, 1995, the privately issued Mortgage Assets held by the Company had rating equivalents ranging from AAA to unrated, with a weighted average of A+; the weighted average rating equivalent of all the Company's Mortgage Assets was AA+.

An allowance for credit losses is maintained at a level deemed appropriate by management to provide for known 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 privately issued 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 allowance is increased by provisions charged to operations. When a loan or portions of a loan is determined to be uncollectible, the portion deemed uncollectible is charged against the allowance and subsequent recoveries, if any, are credited to the allowance. During the three months ended March 31, 1996 and March 31, 1995 the Company provided for $331,516 and $18,436 in credit losses, respectively. During the three months ended March 31, 1996 and March 31, 1995 the Company incurred no in charge-offs. The reserve balance at March 31, 1996 and December 31, 1995 was $821,229 and $489,713, respectively.

NOTE 2. MORTGAGE ASSETS

Mortgage Assets Excluding IO Strip

At March 31, 1996, Mortgage Assets, excluding IO Strips, consisted of the following:

<TABLE>
<CAPTION>

(IN THOUSANDS)	FEDERAL HOME LOAN MORTGAGE CORPORATION	FEDERAL NATIONAL MORTGAGE ASSOCIATION	PRIVATELY ISSUED MORTGAGE ASSETS	TOTAL
<S>	<C>	<C>	<C>	<C>
Mortgage Assets, Gross	$ 81,985	$ 210,041	$ 281,781	$ 573,807
Unamortized Discount	0	(294)	(16,560)	(16,854)
Unamortized Premium	1,839	4,253	3,480	9,572
Amortized Cost	83,824	214,000	268,701	566,525
Allowance for Credit Losses	0	0	(821)	(821)
Gross Unrealized Gains	265	970	613	1,848
Gross Unrealized Losses	(217)	(487)	(3,926)	(4,630)
Estimated Fair Value	$ 83,872	$ 214,483	$ 264,567	$ 562,922

</TABLE>

At December 31, 1995, Mortgage Assets, excluding IO Strips, consisted of the following:

<TABLE>
<CAPTION>

(IN THOUSANDS)	FEDERAL HOME LOAN MORTGAGE CORPORATION	FEDERAL NATIONAL MORTGAGE ASSOCIATION	PRIVATELY ISSUED MORTGAGE ASSETS	TOTAL
<S>	<C>	<C>	<C>	<C>
Mortgage Assets, Gross	$ 46,160	$ 190,061	$ 207,404	$ 443,625
Unamortized Discount	0	(313)	(16,719)	(17,032)
Unamortized Premium	907	3,608	1,535	6,050
Amortized Cost	47,067	193,356	192,220	432,643
Allowance for Credit Losses	0	0	(490)	(490)
Gross Unrealized Gains	334	1,033	874	2,241
Gross Unrealized Losses	(110)	(458)	(4,345)	(4,913)
Estimated Fair Value	$ 47,291	$ 193,931	$ 188,259	$ 429,481

</TABLE>

At March 31, 1996 and December 31, 1995, all investments in Mortgage Assets consisted of interests in adjustable rate mortgages on residential properties. A majority of such properties are located in the State of California. The securitized interests in pools of adjustable rate mortgages from the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association are guaranteed as to principal and interest by those US government agencies. The original maturity of the vast majority of the Mortgage Assets is over a period of thirty years; the actual maturity is subject to change based on the prepayments of the underlying mortgage loans.

At March 31, 1996, the average annualized effective yield was 7.59% based on the amortized cost of the assets and 7.67% based on the fair value of the assets. At December 31, 1995, the average annualized effective yield on the Mortgage Assets was 7.66% based on the amortized cost of the assets and 7.74% based on the fair value of the assets.

Most of the adjustable rate mortgage securities and loans are limited by periodic caps (generally interest rate adjustments are limited to no more than 1% every six months) and lifetime caps. At March 31, 1996 and December 31, 1995 the weighted average lifetime cap was 11.53% and 11.54%, respectively.

IO Strips

The amortized cost and fair value of the Company's IO Strips are summarized as follows:

<TABLE>
<CAPTION>

(IN THOUSANDS)	MARCH 31, 1996	DECEMBER 31, 1995
<S>	<C>	<C>

Amortized Cost	$3,218	$3,593
Gross Unrealized Gains	0	0
Gross Unrealized Losses	(981)	(830)
Estimated Fair Value	$2,237	$2,763

</TABLE>

The average annualized effective yield at March 31, 1996 on the IO Strips was 8.76% based on the amortized cost of the assets and 13.14% based on the fair value of the assets. The average annualized effective yield at December 31, 1995 on the IO Strips was 9.99% based on the amortized cost of the assets and 13.61% based on the fair value of the assets.

NOTE 3. INTEREST RATE AGREEMENTS

The amortized cost and fair value of the Company's Interest Rate Agreements are summarized as follows:

<TABLE>
<CAPTION>

(IN THOUSANDS)	MARCH 31, 1996	DECEMBER 31, 1995
<S>	<C>	<C>
Amortized Cost	$2,534	$2,521
Gross Unrealized Gains	0	0
Gross Unrealized Losses	(1,302)	(1,974)
Estimated Fair Value	$1,233	$ 547

</TABLE>

Cap Agreements

The Company had twenty-seven outstanding Cap Agreements at March 31, 1996 and twenty-three outstanding Cap Agreements at December 31, 1995. Potential future earnings from each of these Cap Agreements are based on variations in the London Interbank Offered Rate ("LIBOR"). Three of the Cap Agreements at March 31, 1996 and December 31, 1995 had contractually stated notional amounts which vary over the life of the Cap Agreement. The sum of the notional amounts of the Company's Cap Agreements in effect was $400,500,000 and $302,000,000 at March 31, 1996 and December 31, 1995, respectively. The weighted average cap strike rate during the three months ended March 31, 1996 was 7.36%. The weighted average cap strike rate during the three months ended March 31, 1995 was 7.85%. Under these Cap Agreements the Company will receive

cash payments should an agreed-upon reference rate, either one-month or three-month LIBOR, increase above the strike rates of the Cap Agreements.

Cap Agreements outstanding at March 31, 1996 are as follows:

<TABLE>
<CAPTION>

(DOLLARS IN THOUSANDS) YEAR	AVERAGE CAP NOTIONAL FACE AMOUNT	AVERAGE CAP STRIKE RATE	LOW CAP STRIKE RATE	HIGH CAP STRIKE RATE	EXPECTED CAP EXPENSE AMORTIZATION
<S>	<C>	<C>	<C>	<C>	<C>
1996 (last 9 months)	$378,151	7.33%	5.50%	12.00%	$ 486
1997	254,957	8.02%	5.50%	12.00%	458
1998	110,657	9.12%	7.13%	12.00%	355
1999	82,400	9.49%	7.50%	12.00%	304
2000	52,889	8.95%	7.50%	10.00%	255
2001	33,082	8.55%	7.50%	9.00%	220
2002	24,616	8.68%	8.00%	9.00%	157
2003	22,634	8.67%	8.00%	9.00%	145
2004	21,834	8.67%	8.00%	9.00%	135
2005	5,216	8.53%	8.50%	9.00%	20
Total					$2,534

</TABLE>

Swap Agreements

The Company had one outstanding Swap Agreement at March 31 1996 and December 31, 1995. The Swap Agreement outstanding at March 31, 1996 and December 31, 1995 is as follows:

<TABLE>
<CAPTION>

PAYS FIXED/RECEIVES VARIABLE:	NOTIONAL FACE AMOUNT (IN THOUSANDS)	INTEREST RATE COMPANY PAYS	INTEREST RATE COMPANY RECEIVES
<S>	<C>	<C>	<C>
April 1996 to April 1997	$ 10,000	6.97%	3 Month LIBOR
April 1997 to April 1998	$ 10,000	7.18%	3 Month LIBOR

</TABLE>

The Company has incurred credit risk to the extent that the counter-parties to the Interest Rate Agreements do not perform their obligations under the Interest Rate Agreements. Potential credit write offs are limited to the amortized cost of the Cap Agreements. In addition, for both Cap and Swap Agreements, if one of the counter-parties 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 entered into Interest Rate Agreements only with counter-parties rated A or better and has entered into Interest Rate Agreements with eight different counter-parties in order to reduce the risk of credit exposure to any one counter-party.

There have been no terminations of Interest Rate Agreements as of March 31, 1996 or December 31, 1995.

NOTE 4. REVERSE REPURCHASE AGREEMENTS AND NOTES PAYABLE

The Company has entered into both reverse repurchase agreements and notes payable (together "Borrowings") to finance acquisitions of a portion of its Mortgage Assets. These Borrowings are collateralized by a portion of the Company's Mortgage Assets. At no time are more than 34% of the Borrowings with any one investment banking firm. At March 31, 1996, Mortgage Assets actually pledged had an estimated fair value of $539,571,815. At December 31, 1995, Mortgage Assets actually pledged had an estimated fair value of $386,321,449.

At March 31, 1996 the Company had $508,721,000 of Borrowings outstanding with a weighted average borrowing rate of 5.62% and a weighted average maturity of 48 days. At December 31, 1995, the Company had $370,316,047 of Borrowings outstanding with a weighted average borrowing rate of 6.01% and a weighted

average remaining maturity of 74 days. At March 31, 1996 and December 31, 1994, the Borrowings had the following remaining maturities:

<TABLE>
<CAPTION>

(IN THOUSANDS)	MARCH 31, 1996	DECEMBER 31, 1995
<S>	<C>	<C>
Within 30 days	$221,555	$ 75,808
30 to 90 days	227,234	175,921
Over 90 days	59,932	118,587
Total Borrowings	$508,721	$370,316

</TABLE>

For the three months ended March 31, 1996, the average balance of Borrowings was $435,978,990 with a weighted average interest cost of 5.72%. For the three months ended March 31, 1995 the average balance of Borrowings was $102,961,000 with a weighted average interest cost of 6.04%. The maximum balance outstanding during the three months ended March 31, 1996 was $508,721,000. The maximum balance outstanding during the three months ended March 31, 1995 was $121,998,000.

NOTE 5. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying amounts and estimated fair values of the Company's financial instruments at March 31, 1996 and December 31, 1995 . FASB statement 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>

	MARCH 31, 1996		DECEMBER 31, 1995	
(IN THOUSANDS)	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
Assets				

<S>	<C>	<C>	<C>	<C>
Mortgage Assets	$562,922	$562,922	$429,481	$429,481
IO Strips	2,237	2,237	2,763	2,763
Interest Rate Agreements	1,233	1,233	547	547

</TABLE>

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. 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. Cash and cash equivalents, interest receivable, reverse repurchase agreements and accrued liabilities are reflected in the financial statements at their amortized costs, which approximates their fair value because of the short-term nature of these instruments.

NOTE 6. CLASS A CONVERTIBLE PREFERRED STOCK

Prior to the Initial Public Offering the Company was authorized to issue up to 12,000,000 shares of Preferred Stock, $.01 par value, in one or more series and to fix the powers, designations, preferences and rights of each series. The Preferred Stock ranked senior to the Company's Common Stock as to dividends and liquidation rights. Following the closing of the Initial Public Offering, the Company filed Articles Supplementary to reclassify all authorized and unissued shares of Preferred Stock and all shares of Preferred Stock received upon conversion of Preferred Stock into Common Stock as authorized and unissued shares of Common Stock.

NOTE 7. STOCK PURCHASE WARRANTS

At March 31, 1996 and December 31, 1995 there were 1,665,063 and 1,665,063 Warrants outstanding, respectively. Each Warrant entitles the holder to purchase 1.000667 share of the Company's common stock at an exercise price of $15.00 per share. The Warrants remain exercisable until December 31, 1997.

NOTE 8. STOCK OPTION PLAN

The Company has adopted a Stock Option Plan for executive officers, key employees and non-employee directors (the "Stock Option Plan"). The Stock Option 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 Stock Option Plan.

The number of shares of Common Stock available under the Stock Option Plan for options and Awards, subject to certain anti-dilution provisions, is 500,000 shares of Common Stock. The exercise price for ISOs granted under the Stock Option Plan may not be less than the fair market value of shares of Common Stock at the time the ISO is granted. No options were granted during the three months ended March 31, 1996. During the year ended December 31, 1995 each of the four non-employee directors was automatically granted an additional 2,500 NQSOs at an exercise price of $7.18 per share and employees were granted 156,972 NQSOs at exercise prices ranging from $17.38 to $21.50 per share. On July 19, 1995, 47,083 options were exercised at prices ranging from $0.10 to $0.11 per share resulting in proceeds to the Company of $5,079. During the year ended December 31, 1994 the Company granted 40,000 options at an exercise price of $0.10 per share, 20,000 of which were NQSOs and 20,000 of which were ISOs, and 148,333 ISOs at an exercise price of $0.11 per share. All stock options granted under the Stock Option 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 Stock Option Plan permits NQSOs granted under the plan to accrue DERs. The first quarter 1996 dividend resulted in non-cash charges to general and administrative expenses of $84,919 for DERs accruing on NQSOs outstanding on the record date of the dividend. The 1995 dividends on common stock resulted in non-cash charges to general and administrative expenses of $54,513 for DERs accruing on NQSOs outstanding on the record date of the dividend. DERs represent shares of stock which are issuable to holders of NQSOs when the holders exercise the underlying NQSOs based on the price of the stock on the dividend payment date. A total of 6,540 shares have been granted as DERs as of March 31, 1996. At March 31, 1996 a total of 361,845 of the 500,000 available options had been granted as options or DERs (47,083

of which had been exercised) leaving 138,155 of the options available for grant.

In October 1995, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation." Under the provisions of SFAS No. 123, compensation cost is measured at the grant date based on the fair value of the award and is recognized over the service period, which is usually the vesting period. The Company is required to either recognize compensation expense under this method or to disclose the pro forma net income and earnings per share effects based on the SFAS No. 123 fair value methodology. SFAS No. 123 applies to financial statements for fiscal years beginning after December 15, 1995. The Company will implement the requirements of SFAS No. 123 in 1996 and will only adopt the disclosure provisions of this statement; accordingly, this statement will have no impact on the financial position and the results of operations when adopted.

NOTE 9. DIVIDENDS

On March 11, 1996 the Company declared a dividend of $2,539,833, or $0.46 per common share. This dividend was paid on April 19, 1996 to shareholders of record as of March 29, 1996.

On March 17, 1995, the Company declared a dividend of $333,213, or $0.20 per preferred share. This dividend was paid on April 21, 1995 to preferred shareholders of record as of March 31, 1995. On June 19, 1995, the Company declared a dividend of $499,819, or $0.30 per preferred share. This dividend was paid on July 21, 1995 to preferred shareholders of record as of June 30, 1995. On September 15, 1995, the Company declared a dividend of $1,103,264, or $0.20 per common share. This dividend was paid on October 20, 1995 to

common shareholders of record as of September 29, 1995. On December 13, 1995, the Company declared a dividend of $1,434,500, or $0.26 per common share. This fourth quarter 1995 dividend was paid on January 19, 1996 to common shareholders of record as of December 29, 1995.

Under the Internal Revenue Code of 1986, a dividend declared by a REIT in December of a calendar year, payable to shareholders of record as of a specified date in December, will be deemed to have been paid by the Company and received by the shareholders on that record date if the dividend is actually paid before February 1st of the following calendar year. Therefore, the dividends declared in December 1995 and 1994 which were paid in January 1996 and 1995, respectively, are considered taxable income to shareholders in the year declared. The Company's dividends are not eligible for the dividends received deduction for corporations.

NOTE 10. COMMITMENTS AND CONTINGENCIES

As of March 31, 1996 the Company had entered into a commitment to purchase a Federal National Mortgage Association Asset for approximately $8,000,000 and a commitment to purchase a privately issued Mortgage Asset for approximately $46,500,000. At March 31, 1996 and December 31, 1995, the Company had no other outstanding commitments to purchase or sell Mortgage Assets or to purchase, sell or terminate Interest Rate Agreements. The Company also had no commitments to enter into additional reverse repurchase agreements or other borrowings.

Rental expense for office properties under operating leases for the three months ended March 31, 1996 and March 31, 1995 was $24,062 and $15,724, respectively. Future minimum rental commitments as of March 31, 1996 under noncancelable operating leases with initial or remaining terms of more than one year, are as follows:

<TABLE>
<CAPTION>

(IN THOUSANDS) YEAR ENDING DECEMBER 31,	MINIMUM RENTAL COMMITMENT AS OF DECEMBER 31, 1995
1996	72
1997	88
Total	$160

</TABLE>

Because the lease is in the Company's name, the above amounts represent 100% of the minimum future rental commitments. However, the Company shares certain office expenses, such as lease payments and utilities,

on a pro rata basis with GB Capital. GB Capital is owned by certain officers of the Company. This arrangement is covered by an Administrative Services and Facilities Sharing Agreement. For the three months ended March 31, 1995, the Company was bearing 70% of the lease expenses and GB Capital was bearing 30%. For the three months ended March 31, 1996, the Company was bearing 95% of the lease expenses and GB Capital was bearing 5%.

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

OVERVIEW

Redwood Trust Inc. (the "Company") commenced operations in August 1994 following the first closing of its private placement of equity capital. On August 9, 1995, the Company tripled its equity base through its Initial Public Offering of Common Stock (IPO). On April 19, 1996 the Company raised an additional $54.5 million in equity through a secondary offering of Common Stock. The Company has grown since its inception and intends to continue to grow. The operating results and financial condition of the Company reflect this growth and should be interpreted accordingly. Performance may differ should the Company reach a state wherein its asset size is stable and the Company's equity capital base is fully utilized as described under the Company's Risk-Adjusted Capital Policy.

The Company is a portfolio lending company which acquires and manages both single-family real estate mortgage loans which have been originated to high-quality underwriting standards and securitized interests in pools of single family mortgage loans (collectively, "Mortgage Assets"). To date, the Company has acquired Mortgage Assets secured by single-family real estate properties throughout the United States, with an emphasis on properties located in the State of California. Substantially all of the Company's current Mortgage Assets have coupon rates which adjust over time (subject to certain limitations and lag periods) in conjunction with changes in short-term interest rates. The Company may also acquire fixed-rate single-family Mortgage Assets, multi-family and commercial Mortgage Assets in the future.

All of the Company's income to date has been net interest income generated from its Mortgage Assets and its cash balances ("earning assets"). The Company funds its acquisitions of earning assets with both borrowings and cash raised from issuance of equity capital. For that portion of the balance sheet funded with equity capital ("equity-funded lending"), net interest income is primarily a function of the yield generated from earning assets. Due to the adjustable-rate nature of its earning assets, management expects that income from this source will tend to increase as short-term interest rates rise and will tend to decrease as short-term interest rates fall.

For the portion of the balance sheet made up of earning assets funded with borrowings ("spread lending"), the Company generates net interest income to the extent that there is a positive spread between the yield on earning assets and the cost of borrowed funds and interest rate agreements. Net interest income from spread lending is a function of both the spread and the total volume of spread lending assets. Income from spread lending may fall following an increase in short-term interest rates. In these conditions, spread lending income may, after a lag period, be restored to its former level as earning asset yields adjust to market conditions. Income from spread lending may increase following a fall in short-term interest rates; this increase may be temporary as earning asset yields adjust to the new market conditions after a lag period.

Management believes that in a rising short-term interest rate environment the net result of these effects on the equity-funded lending and spread lending portions of the Company's balance sheet may be, after a lag period, an overall increase in earnings and dividends relative to what they would have been otherwise. Similarly, the net result of a falling interest rate environment may be a decrease in earnings and dividends relative to what they would have been otherwise. In each case, however, the Company will seek to maintain, after initial adjustment lags, a constant or widening relationship between the earnings and dividend yield of the Company and the level of short-term interest rates.

The Company seeks to generate secular growth in earnings and dividends per share in a variety of ways, including through (i) issuing new Common Stock and increasing the size of the balance sheet when opportunities in the mortgage market are likely to allow growth in earnings per share, (ii) seeking to improve productivity by increasing the size of the balance sheet at a rate faster than operating expenses increase, (iii) changing the mix of Mortgage Asset types on the balance sheet in an effort to improve risk-adjusted returns, (iv) seeking to

benefit by an increased market value of assets and lower borrowing costs should Mortgage Asset quality improve with seasoning, mortgage principal repayments, and improvements in real estate markets and the general economy, and (v)

increasing the efficiency with which the Company utilizes its equity capital over time by increasing the Company's use of debt when prudent and by issuing subordinated debt, preferred stock or other forms of debt and equity.

The Company intends to seek to increase dividends and earnings per share by continuing to follow its current business strategy. The Company intends to acquire Mortgage Assets until the asset base has reached a size wherein the Company's equity capital base is fully utilized as described under the Company's Risk-Adjusted Capital Policy. The Company intends to continue its primary focus on the acquisition of single-family adjustable-rate Mortgage Assets such as high-quality whole Mortgage Loans and mortgage securities rated AAA and AA. The Company will seek to increase participation in its Dividend Reinvestment Plan.

The Company intends to continue to increase its equity capital base through various offerings. Management will increase its equity base when it believes existing shareholders are likely to benefit from such offerings through earnings and dividends per share that may be increased as compared to the level of earnings and dividends the Company would likely generate without such offerings.

RESULTS OF OPERATIONS: FIRST QUARTER 1996 VERSUS FIRST QUARTER 1995

REPORTING PERIODS

The 1994 fiscal year ("fiscal 1994") commenced with the start of Company operations on August 19, 1994 and finished December 31, 1994. Fiscal year 1995 ("1995"), the four quarters of 1995 and the first quarter of 1996 correspond to their calendar equivalents.

NET INCOME SUMMARY

From the first quarter of 1995 to the first quarter of 1996, the Company reported significant increases in total dividends, GAAP and taxable income. Total dividends declared rose from $0.3 million to $2.5 million. GAAP income rose from $0.4 million to $2.0 million. Taxable income rose from $0.4 million to $2.5 million.

Dividends, GAAP income and taxable income per share also increased significantly. Quarterly dividends increased by 130%, from $0.20 per share of Preferred Stock in the first quarter of 1995 to $0.46 per Common in the first quarter of 1996. GAAP income per share rose by 68%, from $0.19 to $0.32 over the same period. Taxable income per share entitled to a dividend rose 84%, from $0.25 to $0.46.

The primary factors driving this growth in dividends and profits were an increase in the Company's average equity base from $21.8 million to $68.7 million and an increase in the returns earned on this equity.

Return on equity increased as net interest income increased more rapidly than did credit expenses and general and administrative expenses. On a GAAP basis for the first quarters of 1995 and 1996, net interest income as a percent of equity increased from 11.54% to 16.25%. Credit expenses increased from 0.34% to 1.94% of equity and general and administrative expenses decreased from 3.74% to 2.88% of equity. The resulting net GAAP return on equity increased by 3.97%, from 7.46% to 11.43%.

On a taxable income basis for the first quarters of 1995 and 1996, net interest income as a percent of equity increased from 11.26% to 17.28%, while credit expenses remained at 0.00% of equity and general and administrative expenses decreased from 3.68% to 2.36% of equity. The resulting net taxable return on equity increased by 7.34%, from 7.58% to 14.92%.

Net interest income as a percent of equity from the first quarter of 1995 to the first quarter of 1996 increased for GAAP income and for taxable as: (i) the yield on the Company's earning assets increased, thus increasing returns from the equity-funded lending part of the balance sheet, (ii) spread lending became more profitable as the Company increased the spread between the yield on earning assets and the cost of borrowing

and hedging, and (iii) the Company increased the amount of its spread lending activities relative to its equity base (the Company's capital was closer to being fully employed).

GAAP INCOME AND TAXABLE INCOME

Income as calculated according to generally accepted accounting principles (GAAP income) differs from income as calculated for tax purposes (taxable income) for various reasons. This distinction is important to the Company's shareholders as dividends are based on taxable income. While the Company does not pay taxes so long as it meets the REIT requirements, each year the Company completes a corporate tax form wherein taxable income is calculated as if the Company were to be taxed. This taxable income level determines the amount of dividends the Company will pay out over time.

DIFFERENCES BETWEEN GAAP INCOME AND TAXABLE INCOME

The table below summarizes the differences between GAAP income and taxable income for the first quarters of 1996 and 1995. Interest income differs due to different methods of calculating the rate of amortization into income of the discount created when Mortgage Assets are acquired at a price below the principal value of the mortgages. Credit expense differs between tax and GAAP methods because the Company takes credit provisions in order to build a credit reserve for GAAP whereas only actual credit losses are deducted in calculating taxable income. General and administrative expenses differ due to differing treatment of leasehold amortization, certain stock option expenses, and other items.

TABLE 1
GAAP INCOME AND TAXABLE INCOME

<TABLE>
<CAPTION>

	1996 QUARTER 1 GAAP INCOME	1996 QUARTER 1 TAXABLE INCOME	1996 QUARTER 1 GAAP/TAX DIFFERENCES	1995 QUARTER 1 GAAP INCOME	1995 QUARTER 1 TAXABLE INCOME	1995 QUARTER 1 GAAP/TAX DIFFERENCES
			(DOLLARS IN THOUSANDS)			
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Interest Income	$9,131	$9,306	$175	$2,170	$2,155	$(15)
Interest Expense	6,202	6,202	0	1,533	1,533	0
Interest Rate Agreement Expense	151	151	0	16	16	0
Net Interest Income	2,778	2,953	175	621	606	(15)
Credit Expense	332	0	332	18	0	18
General & Administrative Expense	492	404	88	201	198	3
Net Income	$1,954	$2,549	$595	$ 402	$ 408	$ 6

</TABLE>

INTEREST INCOME AND THE EARNING ASSET YIELD

On average, the Company had $501.7 million in earning assets during the first three months of 1996 as compared to the $123.2 million on average for the same time period in 1995. The Company's sole source of income to date has been the interest income earned from these earning assets. As a portfolio lender, the Company expects to continue to rely on interest income as its primary source of income in the future.

On a GAAP basis, total interest income for the first quarter rose from $2.2 million in 1995 to $9.1 million in 1996 as the GAAP yield on earning assets rose from 7.14% to 7.32%. These yields were 0.53% and 1.99% over the average daily six-month LIBOR rate during those periods.

On a taxable basis, total interest income rose from $2.2 million in the first quarter of 1995 to $9.3 million in 1996 as the earning asset based increased and the yield on earning assets rose from 7.09% to 7.46%. These yields were 0.48% and 2.13% higher than the average daily six-month LIBOR interest rate during those periods. The table below shows the Company's balances of cash and Mortgage

on a taxable income and a GAAP basis, and the weighted average yield on earning assets as compared to the six-month LIBOR rate.

TABLE 2
EARNING ASSET YIELD

<TABLE>
<CAPTION>

GAAP	TAXABLE

	GAAP INTEREST INCOME	AVERAGE EARNING ASSETS	GAAP YIELD ON EARNING ASSETS	DAILY AVERAGE SIX-MONTH LIBOR	YIELD VERSUS AVERAGE SIX-MONTH LIBOR	TAXABLE INTEREST INCOME	TAXABLE YIELD ON EARNING ASSETS	YIELD VERSUS AVERAGE SIX-MONTH LIBOR
				(DOLLARS IN THOUSANDS)				
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	$ 1,296	$ 56,361	6.31%	6.03%	0.28%	$ 1,267	6.17%	0.14%
1995, Quarter 1	2,170	123,196	7.14%	6.61%	0.53%	2,155	7.09%	0.48%
1995, Quarter 2	2,961	161,164	7.37%	6.16%	1.21%	2,996	7.46%	1.30%
1995, Quarter 3	3,985	211,310	7.48%	5.88%	1.60%	4,034	7.57%	1.69%
1995, Quarter 4	6,610	367,448	7.14%	5.74%	1.40%	6,716	7.25%	1.51%
1996, Quarter 1	9,131	501,749	7.32%	5.33%	1.99%	9,306	7.46%	2.13%

</TABLE>

The majority of the Company's Mortgage Assets have coupons which adjust up and down as a function of changes in the six-month LIBOR rate, which is the benchmark short-term interest rate the Company uses when evaluating the yield performance of its assets. LIBOR is the London Inter-Bank Offered Rate and represents the wholesale funding rates of international money center banks when they borrow from each other in U.S. dollars. It is closely related to the rate on large certificates of deposit (CDs) offered by U.S. domestic banks. For the first three months of 1995, the average six-month LIBOR rate was 6.61%; for the first three months of 1996, the average six-month LIBOR rate was 5.33%

The Company was able to increase its earning asset yield despite the decrease in short term interest rates as (i) the Company acquired assets with higher yields during 1995, (ii) the coupon rate on low-initial-coupon ("teaser") adjustable-rate mortgages acquired during fiscal 1994 and early 1995 had time to adjust upwards towards the full potential coupon rate, and (iii) short-term interest rates generally declined. Declines in short-term interest rates generally have a temporary positive effect on the earning asset yield relative to LIBOR as there is a lag in the adjustment of Mortgage Asset coupons to market conditions.

The mortgage principal repayment rate for the Company was 9% in the first quarter of 1995 and 26% in the first quarter of 1996. The principal repayment rate was similar for the Company's assets acquired at a premium and those acquired at a discount throughout these periods. Economically, the Company may have benefited from the increase in the rate of mortgage principal repayment for a variety of reasons, including that the Company has had a greater balance of discount than premium. Nevertheless, faster principal repayments had a negative effect on the Company's earning asset yield due to the Company's treatment of premium and discount amortization. The Company adjusts its rate of premium amortization monthly based on actual principal repayments received. For discounts, however, the Company's amortization schedules are determined using a fixed principal repayment rate assumption which would be changed only if the Company believed that long-term mortgage principal repayment rates had changed. As a result, premium amortization accelerates as compared to discount amortization as the rate of principal repayment increases. This lowers the earning asset yield and reported earnings. Another result of the faster premium amortization rate in the latter part 1995 and thus far in 1996 is that the Company has a larger net discount balance on its balance sheet at this time than it would have otherwise. This discount balance (net of the effect of any credit losses) will be amortized into income over time, thus benefiting future income.

The Company may acquire new Mortgage Assets with coupons that are initially low relative to prevailing short-term interest rates. As a result, the overall earning asset yield relative to six-month LIBOR may be temporarily lower during periods of rapid asset growth such as the Company has experienced following its various equity offerings.

In addition to Mortgage Assets with coupons linked to the six-month LIBOR index, the Company also acquires assets with coupons linked to the one-year Treasury Bill rate, the one-month LIBOR rate, the six-month bank CD rate, and other indices. To the extent these other indices rise or fall relative to six-month LIBOR, the Company's earning asset yield versus six-month LIBOR would also rise or fall over time.

INTEREST EXPENSE AND THE COST OF FUNDS

The Company's largest expense is the cost of borrowed funds. From the first quarter of 1995 and 1996, interest expense increased from $1.5 million to $6.2 million as average borrowed funds rose from $103.0 million to $436.0 million. The average cost of funds during these two periods fell from 6.04% to 5.72%. Interest expense is calculated in the same manner for GAAP and tax purposes.

The Company's cost of funds was 57 basis points under the average daily six-month LIBOR rate in the first quarter of 1995 but was 39 basis points over the average six-month LIBOR rate in the first quarter of 1996. The cost of funds in the first quarter of 1995 benefited from an extension of liabilities in late 1994. In addition, the cost of funds was higher relative to short-term interest rates in the first quarter of 1996 due to acquisitions during 1995 and 1996 of whole Mortgage Loans and other assets with higher funding costs, due to falling short-term interest rates, and due to a significant increase in the one-month LIBOR rate relative to the six-month LIBOR rate. The bulk of the Company's borrowings in 1995 and in the first quarter of 1996 had monthly interest rate resets, so changes in the Company's cost of funds have been more highly correlated with changes in the one-month LIBOR rate than with the six-month LIBOR rate. By basing the bulk of its borrowings on one-month LIBOR, the Company benefited in 1995 and the first quarter of 1996 relative to a strategy of using longer-term borrowings.

The following table shows the Company's cost of funds as compared to the average daily six-month LIBOR rate.

TABLE 3
COST OF FUNDS

<TABLE>
<CAPTION>

	AVERAGE BORROWED FUNDS	GAAP AND TAXABLE INTEREST EXPENSE	COST OF FUNDS	COST OF FUNDS VERSUS SIX-MONTH LIBOR	AVERAGE SIX-MONTH LIBOR	ONE-MONTH LIBOR RELATIVE TO SIX-MONTH LIBOR
			(DOLLARS IN THOUSANDS)			
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	$ 37,910	$ 760	5.50%	(0.53%)	6.03%	(0.51%)
1995, Quarter 1	102,961	1,533	6.04%	(0.57%)	6.61%	(0.56%)
1995, Quarter 2	139,979	2,191	6.28%	0.12%	6.16%	(0.08%)
1995, Quarter 3	159,794	2,432	6.04%	0.16%	5.88%	0.01%
1995, Quarter 4	295,089	4,452	5.99%	0.25%	5.74%	0.11%
1996, Quarter 1	435,979	6,202	5.72%	0.39%	5.33%	0.10%

</TABLE>

NET INTEREST RATE AGREEMENT EXPENSE

As part of its asset/liability management process, the Company enters into interest rate agreements such as interest rate caps and interest rate swaps ("hedges"). These agreements are used solely to reduce interest rate risk. The agreements are designed to provide income and capital appreciation to the Company in the event that short-term interest rates rise quickly (see Footnote 3 to the Financial Statements).

The net interest rate agreement expense, or hedging expense, equals income from these agreements less the associated expense and is calculated in the same manner for GAAP and tax. The net interest rate agreement expense was $15,592 in the first quarter of 1995 and $151,232 in the first quarter of 1996. As a percentage of average earning assets, the net hedging expense equaled 0.05% in the first three months of 1995 and 0.12% for

the same period in 1996. As a percentage of average borrowings, the net hedging expense equaled 0.06% in the first quarter of 1995 and 0.16% in the first quarter of 1996. The primary reason hedging expenses increased as a percentage of assets and borrowings was that in early 1995 the Company focused primarily on hedging future periods (as reflected in higher hedging expenses in mid-1995) while relying on the extension of borrowings to protect income in the short-term. In early 1996, the Company utilized primarily one-month borrowings and thus focused on hedging both current and future periods.

Net interest rate agreement expense as a percentage of assets and borrowings has generally declined since mid-1995 due to a flatter yield curve and lower levels of interest rate volatility.

TABLE 4
NET INTEREST RATE AGREEMENT EXPENSE

<TABLE>
<CAPTION>

	INTEREST RATE AGREEMENT INCOME	INTEREST RATE AGREEMENT EXPENSE	NET INTEREST RATE AGREEMENT EXPENSE	NET EXPENSE AS % OF AVERAGE ASSETS	NET EXPENSE AS % OF AVERAGE BORROWINGS
			(DOLLARS IN THOUSANDS)		
<S>	<C>	<C>	<C>	<C>	<C>

Fiscal 1994	$ 0	$ 8	$ 8	0.04%	0.06%
1995, Quarter 1	0	16	16	0.05%	0.06%
1995, Quarter 2	0	82	82	0.20%	0.23%
1995, Quarter 3	0	112	112	0.21%	0.28%
1995, Quarter 4	0	129	129	0.14%	0.17%
1996, Quarter 1	0	151	151	0.12%	0.14%

</TABLE>

NET INTEREST INCOME FROM EQUITY-FUNDED LENDING AND SPREAD LENDING

For the purpose of analyzing net interest income, the Company has divided its balance sheet activities into two parts: equity-funded lending and spread lending. Each of these two portions of the Company's balance sheet has a different dynamic with respect to changes in interest rates, asset/liability strategy, growth, and other factors.

Spread lending is that part of the Company's business wherein earning assets are funded with borrowings. Profits from spread lending are a function of the volume of spread lending assets and the spread the Company earns between its average earning asset rate and the cost of borrowed funds and interest rate hedging agreements. In the first quarter of 1996, the Company earned 57% of its GAAP net interest income from spread lending.

Equity-funded lending is that part of the Company's business wherein earning assets are funded with cash received from the issuance of equity capital. Profits from equity-funded lending are a function of the average yield on earning assets and the percentage of the Company's equity base which is invested in earning assets. In the first quarter of 1996, the Company earned 43% of its GAAP net interest income from equity-funded lending.

Management believes equity-funded lending has a large influence on the Company's profitability relative to financial institutions which have lower equity-to-asset ratios and relative to financial institutions which have intangible capital or have significant amounts of non-earning assets or net working capital on their books. For example, in the first quarter of 1996 approximately 96% of the Company's equity was invested in earning assets.

When analyzing the profitability of equity-funded lending and spread lending, the Company does not assign specific assets to each type of lending, but rather assumes that one portion of aggregate earning assets is funded with equity and another portion of the aggregate earning assets is funded with borrowings. The Company assigns all borrowing and hedging costs to spread lending and assigns all non-earning assets to equity-funded lending.

SPREAD LENDING PROFITABILITY

On a GAAP basis, spread lending profits increased from $0.3 million in the first quarter of 1995 to $1.6 million in the first quarter of 1996. The total amount of spread lending undertaken by the Company increased from $103.0 million to $436.0 million over this time frame.

The spread earned, or spread lending profits divided by spread lending assets, increased from 1.04% in the first quarter of 1995 to 1.46% in the first quarter of 1996. The amount of spread lending relative to the size of the Company's equity base increased from 4.72 times to 6.34 times. As a result of the increase in spread and the increase in the relative amount of spread lending, the contribution of spread lending to the Company's GAAP return on equity increased from 4.92% in the first quarter of 1995 to 9.25% in the first quarter of 1996.

The table below shows the components making up the Company's spread as calculated on a GAAP basis, the ratio of spread lending assets to equity, and the contribution made to return on equity from spread lending net interest income.

TABLE 5
GAAP SPREAD LENDING PROFITABILITY

<TABLE>
<CAPTION>

	GAAP EARNING ASSET YIELD FOR SPREAD LENDING VS. SIX-MONTH LIBOR	COST OF FUNDS VS. SIX-MONTH LIBOR	NET INTEREST RATE AGREEMENT EXPENSE/ BORROWINGS	GAAP SPREAD	SPREAD LENDING ASSETS	GAAP NET INTEREST INCOME FROM SPREAD LENDING	SPREAD LENDING ASSETS OVER AVERAGE EQUITY	GAAP SPREAD LENDING INCOME OVER AVERAGE EQUITY

(DOLLARS IN THOUSANDS)

<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	0.45%	(0.53%)	(0.06%)	0.92%	$ 37,910	$ 127	1.94x	1.78%
1995, Quarter 1	0.53%	(0.57%)	(0.06%)	1.04%	102,961	265	4.72	4.92%
1995, Quarter 2	1.21%	0.12%	(0.23%)	0.86%	139,979	299	6.20	5.32%
1995, Quarter 3	1.60%	0.16%	(0.28%)	1.16%	159,794	469	3.08	3.59%
1995, Quarter 4	1.40%	0.25%	(0.17%)	0.98%	295,456	727	4.10	4.01%
1996, Quarter 1	1.99%	0.39%	(0.14%)	1.46%	435,979	1,581	6.34	9.25%

</TABLE>

On a taxable income basis, the Company's spread widened from 0.99% in the first quarter of 1995 to 1.60% in the first quarter of 1996. The contribution of spread lending to the Company's taxable return on equity increased from 4.68% to 10.14%.

The table below shows the components making up the Company's spread as calculated on a taxable income basis, the ratio of spread lending assets to equity, and the contribution made to return on equity from spread lending net interest income.

TABLE 6
TAXABLE SPREAD LENDING PROFITABILITY

<TABLE>
<CAPTION>

	TAXABLE EARNING ASSET YIELD FOR SPREAD LENDING VS. SIX-MONTH LIBOR	COST OF FUNDS VS. SIX-MONTH LIBOR	NET INTEREST RATE AGREEMENT EXPENSE/ BORROWINGS	TAXABLE SPREAD	SPREAD LENDING ASSETS	TAXABLE NET INTEREST INCOME FROM SPREAD LENDING	SPREAD LENDING ASSETS OVER AVERAGE EQUITY	SPREAD LENDING TAXABLE INCOME OVER AVERAGE EQUITY
	-----	-----	----------	------	------	-------	------	------
				(DOLLARS IN THOUSANDS)				
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	0.30%	(0.53%)	(0.06%)	0.77%	$ 37,910	$ 106	1.94x	1.48%
1995, Quarter 1	0.48%	(0.57%)	(0.06%)	0.99%	102,961	252	4.72	4.68%
1995, Quarter 2	1.30%	0.12%	(0.23%)	0.95%	139,979	330	6.20	5.87%
1995, Quarter 3	1.69%	0.16%	(0.28%)	1.25%	159,794	505	3.08	3.87%
1995, Quarter 4	1.51%	0.25%	(0.17%)	1.09%	295,456	813	4.10	4.48%
1996, Quarter 1	2.13%	0.39%	(0.14%)	1.60%	435,979	1,733	6.34	10.14%

</TABLE>

EQUITY-FUNDED LENDING PROFITABILITY

The bulk of the cash the Company has received from its equity offerings has been invested directly into earning assets. Since the Company has not borrowed funds to acquire these equity-funded earning assets, the yield earned goes directly into net interest income. Equity also funds a small amount of non-earning assets such as leasehold improvements and net working capital. In the first quarter of 1995, 93% of equity was invested in earning assets. In the first quarter of 1996, 96% of equity was invested in earning assets.

The contribution to return on equity from equity-funded lending on a GAAP basis was 6.62% in the first quarter of 1995 and 7.00% in the first quarter of 1996. On a taxable basis, the contribution to return on equity from equity-funded lending was 6.58% and 7.14% for these periods, respectively. Equity-funded profitability increased due to increasing earning asset yields and to an increasing percentage of equity invested in earning assets. The table below summarizes the Company's equity-funded lending profitability.

TABLE 7
EQUITY-FUNDED LENDING PROFITABILITY

<TABLE>
<CAPTION>

	AVERAGE EQUITY	PERCENT OF EQUITY INVESTED IN EARNING ASSETS	EQUITY-FUNDED EARNING ASSETS	GAAP EARNING ASSET YIELD FOR EQUITY-FUNDED LENDING	GAAP EQUITY-FUNDED NET INTEREST INCOME	GAAP EQUITY-FUNDED NET INTEREST INCOME AS % OF AVERAGE EQUITY	TAXABLE EARNING ASSET YIELD FOR EQUITY-FUNDED LENDING	TAXABLE EQUITY-FUNDED NET INTEREST INCOME	TAXABLE EQUITY-FUNDED NET INTEREST INCOME AS % OF AVERAGE EQUITY

(DOLLARS IN THOUSANDS)

<S> <C> <C> <C> <C> <C> <C> <C> <C> <C>

Fiscal 1994	$19,584	94%	$18,451	5.96%	$ 401	5.62%	5.86%	$ 394	5.52%
1995, Quarter 1	21,820	93%	20,236	7.14%	356	6.62%	7.09%	354	6.58%
1995, Quarter 2	22,561	94%	21,185	7.37%	389	6.92%	7.46%	394	7.00%
1995, Quarter 3	51,868	99%	51,516	7.48%	972	7.43%	7.57%	983	7.52%
1995, Quarter 4	71,991	100%	71,991	7.14%	1,301	7.17%	7.25%	1,322	7.28%
1996, Quarter 1	68,743	96%	65,788	7.32%	1,197	7.00%	7.46%	1,220	7.14%

</TABLE>

TOTAL NET INTEREST INCOME

Net interest income equals interest income less interest expense and net interest rate agreement expense. Net interest income is the total profit before credit and operating expenses generated both by equity-funded earning assets and by spread lending. GAAP net interest income increased from $0.6 million in the first quarter

of 1995 to $2.8 million in the first quarter of 1996. Taxable net interest income increased from $0.6 million to $3.0 million over the same period.

The net interest margin equals net interest income as a percentage of average assets. The net interest margin on a GAAP taxable basis was 2.00% in the first three months of 1995 and 2.20% for the same period of 1996. The net interest margin on a taxable basis was 1.96% in the first quarter of 1995 and 2.34% in the first quarter of 1996.

Net interest income as a percent of equity on a GAAP basis increased from 11.54% in the first quarter of 1995 to 16.25% in the first quarter of 1996. On a taxable basis, net interest income as a percent of equity increased from 11.26% to 17.28%. These significant increases in profitability were primarily a result of an increase in spread lending profitability, although equity-funded lending profitability increased as well.

TABLE 8
NET INTEREST INCOME

<TABLE>
<CAPTION>

	GAAP NET INTEREST INCOME	GAAP NET INTEREST MARGIN	GAAP SPREAD LENDING INCOME AS A % OF AVERAGE EQUITY	GAAP EQUITY-FUNDED LENDING INCOME AS A % OF AVERAGE EQUITY	GAAP NET INTEREST INCOME/ AVERAGE EQUITY	TAXABLE NET INTEREST INCOME	TAXABLE NET INTEREST MARGIN	TAXABLE SPREAD LENDING INCOME AS % OF AVERAGE EQUITY	EQUITY-LENDING INCOME AS % OF AVERAGE EQUITY	TAXABLE FUNDED TAXABLE NET INTEREST INCOME/ AVERAGE EQUITY
	(DOLLARS IN THOUSANDS)									
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	$ 528	2.51%	1.78%	5.62%	7.40%	$ 500	2.37%	1.48%	5.52%	7.00%
1995, Quarter 1	621	2.00%	4.92%	6.62%	11.54%	606	1.96%	4.68%	6.58%	11.26%
1995, Quarter 2	688	1.69%	5.32%	6.92%	12.24%	724	1.77%	5.87%	7.00%	12.87%
1995, Quarter 3	1,442	2.67%	3.59%	7.43%	11.02%	1,488	2.76%	3.87%	7.52%	11.39%
1995, Quarter 4	2,029	2.16%	4.01%	7.17%	11.18%	2,135	2.28%	4.48%	7.28%	11.76%
1996, Quarter 1	2,778	2.20%	9.25%	7.00%	16.25%	2,953	2.34%	10.14%	7.14%	17.28%

</TABLE>

GAINS AND LOSSES ON SALE

To date, the Company has not sold Mortgage Assets or interest rate agreements. Should the Company sell Mortgage Assets in the future, the difference between the sale price and the historical amortized cost of the Mortgage Asset would be a realized gain or loss and would increase or decrease income accordingly. The gain or loss may differ for GAAP and tax purposes and the sale price may differ from the asset's carrying value on the Company's balance sheet. Depending on circumstances, realized gains or losses on the sale of interest rate agreements may be realized as income immediately or may be amortized over time. The Company does not expect to sell assets on a frequent basis, but may sell existing assets and interest rate agreements in order to acquire new assets that management believes might have higher risk-adjusted returns or to manage its balance sheet as part of its asset/liability management process.

CREDIT EXPENSES

In the first quarter of 1995, the Company's GAAP provision for credit losses was $18,436 and the Company experienced no actual credit losses. In the first quarter of 1996, credit expenses for GAAP were $331,516 and the Company experienced no actual credit losses. Since the Company's inception in 1994, the Company has taken credit provisions of $825,226 and has experienced $3,997 in actual credit losses.

In 1995, the Company started making regular allowances for credit losses. The Company has experienced insignificant credit losses to date, but losses may be experienced on its Mortgage Assets in the future. This is particularly true for below-BBB rating equivalent assets and whole Mortgage Loans. The Company regularly evaluates the potential for future credit losses by analyzing each of its Mortgage Securities and whole Mortgage Loans. The Company's method for assessing potential credit loss analyzes both the

probability of a default resulting in loss and the loss severity, or potential amount of such loss. To assess the probability of default, the Company monitors the delinquency and foreclosure statistics for the pools of loans underlying its Mortgage Securities and for its Mortgage Loans. The Company applies certain factors to such statistics, depending on the characteristics of the loans involved, current and projected economic conditions and other considerations, to calculate expected default levels. The Company then applies an expected loss per default factor to the default levels to produce an aggregate loss severity, or expected loss per pool of loans. The probability of loss to each of the Company's Mortgage Assets is then estimated, based on the credit support available for such asset, the risk of non-pro rata losses being incurred and any other pertinent factors. Based on such review, an allowance for credit losses is taken if appropriate in management's judgment.

The IRS does not allow corporations to reduce taxable income by taking credit provisions. Only actual realized credit losses are deducted from taxable income. As a result, the credit expense for GAAP will exceed the credit expense for taxable income in years when credit provisions exceed actual charge-offs; actual charge-offs could exceed credit provisions in the future, in which case the taxable income credit expense would exceed the GAAP credit expense.

With respect to whole Mortgage Loans (unsecuritized mortgage loans), the Company's current practice is to maintain a credit reserve equal to thirty basis points (0.30%) of the historical amortized cost of the loans. The Company anticipates that reserves will be maintained at this level unless the credit outlook for the loans deteriorates. Through March 31, 1996, the Company had experienced no actual credit losses on whole Mortgage Loans.

With respect to securitized Mortgage Assets rated BBB or better, the Company takes no GAAP credit provisions unless the credit quality of an asset has deteriorated to a point where the Company believes a credit provision would be warranted. The Company has not taken any GAAP credit provisions for such assets nor have there been any credit losses.

With respect to securitized Mortgage Assets which have credit ratings below BBB or, if unrated, an equivalent credit quality, the Company takes on-going credit provisions against GAAP income. In reviewing the adequacy of the level of credit reserves for these assets, the Company reviews the level of 90+ day delinquencies in the mortgage pools, estimates the likely percentage of delinquencies that will result in default, and estimates the likely percentage of principal loss per defaulted loan to determine the aggregate loss severity. After taking into consideration the benefit of any third-party credit enhancements and the level of the Company's historical amortized cost for the asset, the Company makes an estimate of possible future realized credit losses. In the first quarter of 1995, GAAP credit provisions for these assets were $18,436 while actual credit losses were zero. In the first quarter of 1996, GAAP credit provisions for these assets were $336,258 while actual credit losses

were zero. The increase in credit provisions from the first three months of 1995 to the same period of 1996 was due to an increase in the amount of these assets the Company owned during these periods.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses ("operating expense" or "G&A expense") increased from $201,265 in the first quarter of 1995 to $491,971 in the first quarter of 1996 as measured for GAAP income. For taxable income, G&A expense increased from $197,987 in the first quarter of 1995 to $403,958 in the first quarter of 1996. Differences in the methods of calculating G&A expenses for GAAP and taxable income arise from the treatment of leasehold expenses, certain stock option costs, and other expense items. G&A expenses increased from the first three months of 1995 to the first three months of 1996 as the number of employees and the scope of the Company's operations increased and as certain officers' salaries grew as a function of the increase in the size of the Company's equity base.

TABLE 9
GENERAL AND ADMINISTRATIVE EXPENSES

<TABLE>
<CAPTION>

	GAAP CASH COMP AND BENEFITS EXPENSE	GAAP STOCK OPTION AND DER EXPENSE	GAAP OTHER G&A EXPENSE	TOTAL GAAP G & A EXPENSE	TAXABLE CASH COMP AND BENEFITS EXPENSE	TAXABLE STOCK OPTION AND DER EXPENSE	TAXABLE OTHER G&A EXPENSE	TOTAL TAXABLE G & A EXPENSE
	(DOLLARS IN THOUSANDS)							
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	$ 63	$ 0	$ 83	$146	$ 63	$ 0	$ 83	$146
1995, Quarter 1	81	0	120	201	81	0	117	198
1995, Quarter 2	81	0	117	198	81	0	114	195
1995, Quarter 3	197	7	160	364	197	55	156	408
1995, Quarter 4	103	47	218	368	103	0	214	317
1996, Quarter 1	233	85	174	492	233	0	171	404

</TABLE>

The Company has grown rapidly since its inception in 1994 and the increases in G&A expenses reflect such growth. However, the Company's operating expenses have not grown as rapidly as its income, assets, equity or number of employees have increased. From the first quarter of 1995 to the first quarter of 1996, the Company's efficiency ratio (G&A expense as a percentage of net interest income) decreased from 32% to 18% on a GAAP basis and from 33% to 14% on a taxable basis. The ratio of G&A expenses to average assets declined from 0.65% to 0.39% on a GAAP basis and from 0.64% to 0.32% on a taxable basis over the same time frame.

From the first quarter of 1995 to the first quarter of 1996, the ratio of G&A expenses to average equity decreased from 3.74% to 2.88% on a GAAP basis and from 3.68% to 2.36% on a taxable basis. Management considers this ratio to be the most important measure of the Company's productivity. Average assets per employee rose from $25 million in the first quarter of 1995 to $69 million in the first quarter of 1996. The Company had five employees at March 31, 1995 and nine employees at March 31, 1996.

TABLE 10
OPERATING EXPENSE RATIOS

<TABLE>
<CAPTION>

	GAAP EFFICIENCY RATIO	TAXABLE EFFICIENCY RATIO	GAAP G&A EXP/ AVE ASSETS	TAXABLE G&A EXP/ AVE ASSETS	GAAP G&A EXP/ AVERAGE EQUITY	TAXABLE G&A EXP/ AVERAGE EQUITY	AVERAGE ASSETS PER AVERAGE # OF EMPLOYEES ($MM)
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	28%	29%	0.69%	0.69%	2.05%	2.05%	$ 12
1995, Quarter 1	32%	33%	0.65%	0.64%	3.74%	3.68%	25
1995, Quarter 2	29%	27%	0.49%	0.48%	3.52%	3.47%	33

1995, Quarter 3	25%	27%	0.67%	0.76%	2.79%	3.12%	39
1995, Quarter 4	18%	15%	0.39%	0.34%	2.03%	1.75%	53
1996, Quarter 1	18%	14%	0.39%	0.32%	2.88%	2.36%	69

</TABLE>

The Company expects its G&A expenses to increase in the subsequent quarters of 1996. Compensation expenses will rise with the planned addition of at least one new employee and because certain compensation expenses will increase automatically as a result of the Company's April 1996 equity offering. With these salary increases, certain officers' salaries will have reached their "salary cap" and will grow in the future only as a function of the consumer price index. Despite anticipated increases in future operating expenses, management believes that the Company's operating expenses are likely over time to continue to grow at a slower rate than its asset or equity base and thus management believes that the Company's operating expense ratios are likely to continue to improve over time should the Company grow.

NET INCOME AND RETURNS ON EQUITY AND ASSETS

GAAP net income increased from $0.4 million in the first quarter of 1995 to $2.0 million in the first quarter of 1996. GAAP return on equity increased from 7.46% to 11.43%. Taxable net income increased from $0.4 million in the first quarter of 1995 to $2.5 million in the first quarter of 1996. Return on equity as measured for taxable income increased from 7.58% to 14.92%.

TABLE 11
COMPONENTS OF RETURN ON EQUITY

<TABLE>
<CAPTION>

(DOLLARS IN THOUSANDS)

	GAAP NET INCOME	GAAP NET INTEREST INCOME/ AVERAGE EQUITY	GAAP CREDIT EXPENSE/ AVERAGE EQUITY	GAAP GENERAL & ADMIN EXPENSE/ AVERAGE EQUITY	GAAP RETURN ON EQUITY	TAXABLE NET INCOME	TAXABLE NET INTEREST INCOME/ AVERAGE EQUITY	TAXABLE CREDIT EXPENSE/ AVERAGE EQUITY	TAXABLE GENERAL & ADMIN EXPENSE/ AVERAGE EQUITY	TAXABLE RETURN ON EQUITY
Fiscal 1994	$ 382	7.40%	0.00%	2.05%	5.35%	$ 353	7.00%	0.00%	2.05%	4.95%
1995, Quarter 1	402	11.54%	0.34%	3.74%	7.46%	408	11.26%	0.00%	3.68%	7.58%
1995, Quarter 2	449	12.24%	0.72%	3.52%	8.00%	528	12.87%	0.00%	3.47%	9.40%
1995, Quarter 3	994	11.02%	0.64%	2.79%	7.59%	1,082	11.39%	0.00%	3.12%	8.27%
1995, Quarter 4	1,310	11.18%	1.93%	2.03%	7.22%	1,814	11.76%	0.02%	1.75%	9.99%
1996, Quarter 1	1,954	16.25%	1.94%	2.88%	11.43%	2,549	17.28%	0.00%	2.36%	14.92%

</TABLE>

The Company's GAAP return on assets increased from 1.30% in the first quarter of 1995 to 1.55% in the first quarter of 1996. The Company's taxable return on assets increased from 1.32% in the first three months of 1995 to 2.02% in the first three months of 1996.

TABLE 12
COMPONENTS OF RETURN ON ASSETS

<TABLE>
<CAPTION>

	GAAP INTEREST INCOME/ AVERAGE ASSETS	GAAP COST OF FUNDS AND HEDGING EXPENSE AVERAGE ASSETS	GAAP NET INTEREST MARGIN	GAAP CREDIT PRVSN/ AVERAGE ASSETS	GAAP G&A EXP./ AVERAGE ASSETS	GAAP RETURN ON AVERAGE ASSETS
Fiscal 1994	6.15%	(3.64%)	2.51%	(0.00%)	(0.69%)	1.82%
1995, Quarter 1	7.00%	(5.00%)	2.00%	(0.05%)	(0.65%)	1.30%
1995, Quarter 2	7.26%	(5.57%)	1.69%	(0.10%)	(0.49%)	1.10%
1995, Quarter 3	7.38%	(4.71%)	2.67%	(0.16%)	(0.67%)	1.84%
1995, Quarter 4	7.05%	(4.89%)	2.16%	(0.37%)	(0.39%)	1.40%

1996, Quarter 1	7.24%	(5.04%)	2.20%	(0.26%)	(0.39%)	1.55%

<CAPTION>

	TAXABLE INTEREST INCOME/ AVERAGE ASSETS	TAXABLE COST OF FUNDS AND HEDGING EXPENSE AVERAGE ASSETS	TAXABLE NET INTEREST MARGIN	TAXABLE CREDIT PRVSN/ AVERAGE ASSETS	TAXABLE G&A EXP./ AVERAGE ASSETS	TAXABLE RETURN ON AVERAGE ASSETS
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	6.01%	(3.64%)	2.37%	(0.00%)	(0.69%)	1.68%
1995, Quarter 1	6.96%	(5.00%)	1.96%	(0.00%)	(0.64%)	1.32%
1995, Quarter 2	7.34%	(5.57%)	1.77%	(0.00%)	(0.48%)	1.29%
1995, Quarter 3	7.47%	(4.71%)	2.76%	(0.00%)	(0.76%)	2.00%
1995, Quarter 4	7.17%	(4.89%)	2.28%	(0.00%)	(0.34%)	1.94%
1996, Quarter 1	7.38%	(5.04%)	2.34%	(0.00%)	(0.32%)	2.02%

</TABLE>

DIVIDENDS AND TAXABLE INCOME

The Company intends to declare and pay out as dividends 100% of its taxable income over time. The Company's current practice is to declare quarterly dividends per share immediately following the regular March, June, September, and December Board meetings. In general, the Company has endeavored to declare a quarterly dividend per share which would result in the distribution of most or all of the taxable income earned in that quarter. This is not an exact process, however; at the time of the dividend announcement neither the total level of taxable income for the quarter nor the number of shares that will be outstanding and eligible to receive a dividend at quarter end are known. In addition, considerations other than the desire to pay out most of the taxable earnings for a quarter may take precedence when the Board determines the level of dividends. The

Company's quarterly dividend payments are likely to be irregular, as they will rise and fall with trends in taxable income and other factors.

To date, the Company has been cautious with its dividend per share declaration for a variety of reasons, including the fact that the Company does not know at the time of declaration what taxable earnings for the quarter will be or, due to possible Warrant exercises, how many share of Common Stock will outstanding at the record date. The result is that the Company has earned taxable income exceeding dividends declared. On a cumulative basis through March 31, 1996, this undistributed taxable income is $472,703.

TABLE 13
DIVIDEND SUMMARY

<TABLE>
<CAPTION>

	TAXABLE NET INCOME	PREFERRED OR COMMON SHARES ELIGIBLE TO RECEIVE DIVIDENDS	TAXABLE NET INCOME PER SHARE ELIGIBLE TO RECEIVE DIVIDENDS	DIVIDEND PER SHARE DECLARED	TOTAL DIVIDEND	DIVIDEND PAY-OUT RATIO	UNDISTRIBTD TAXABLE INCOME	CUMULATIVE UNDISTRIBTD TAXABLE INCOME
	(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)							
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	$ 353	1,401,904	$ 0.25	$ 0.25	$ 350	99%	$ 3	$ 3
1995, Quarter 1	408	1,666,063	0.25	0.20	333	82%	75	78
1995, Quarter 2	528	1,666,063	0.32	0.30	500	95%	28	106
1995, Quarter 3	1,082	5,516,313	0.20	0.20	1,103	102%	(21)	85
1995, Quarter 4	1,814	5,517,299	0.33	0.26	1,435	79%	379	464
1996, Quarter 1	2,548	5,521,376	0.46	0.46	2,540	100%	9	473

</TABLE>

DIFFERENCES BETWEEN PRIMARY EARNINGS PER SHARE AND DIVIDENDS DECLARED

The Company's earnings per share (EPS) for the first quarter of 1996 of $0.32 was lower than the Company's dividend declaration of

$0.46 per share. The number of shares used to calculate EPS is larger than the number of shares entitled to a dividend due to the Company's warrants and options; this factor accounted for $0.03 of the difference between EPS and dividends. The remaining gap of $0.11 was caused by GAAP/taxable income differences in credit expenses ($0.06 per share), amortization ($0.03 per share), and G&A expenses ($0.02 per share).

The Company's earnings per share for the first quarter of 1995 of $0.19 was lower than the dividends declared of $0.20 per share. The taxable income earned during the quarter was $0.25 per share entitled to a dividend; the undistributed taxable income was held by the Company for distribution at a later date. The gap between the EPS of $0.19 and the taxable earnings per share of $0.25 during this quarter was caused by a different number of shares used in the denominator (resulting in a $0.05 per share difference) and a $0.01 difference between GAAP and taxable income.

<TABLE>
<CAPTION>

TABLE 14
DIFFERENCES BETWEEN GAAP EARNINGS PER SHARE AND DIVIDENDS DECLARED

	PER SHARE								AVERAGE NUMBER	NUMBER
	DIVIDEND DECLARED	UNDIST-RIBUTED TAXABLE EARNINGS	TAXABLE EARNINGS	GAAP VS. TAX G&A EXPENSES	GAAP VS. TAX AMRTZTN	GAAP VS. TAX CREDIT EXPENSES	DILUTION	GAAP EARNINGS	OF SHARES RECEIVING DIVIDENDS	OF PRIMARY SHARES
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	$ 0.25	$ 0.05	$ 0.25	$ 0.00	$ 0.02	$ 0.00	$ (0.07)	$ 0.20	1,401,904	1,916,846
1995, Quarter 1	0.20	0.05	0.25	0.00	0.00	(0.01)	(0.05)	0.19	1,666,063	2,061,417
1995, Quarter 2	0.30	0.02	0.32	0.00	(0.02)	(0.02)	(0.07)	0.21	1,666,063	2,119,667
1995, Quarter 3	0.20	0.00	0.20	0.01	(0.01)	(0.02)	0.05	0.23	5,516,313	4,358,309
1995, Quarter 4	0.26	0.07	0.33	(0.01)	(0.02)	(0.06)	(0.02)	0.22	5,517,299	6,079,507
1996, Quarter 1	0.46	0.00	0.46	(0.02)	(0.03)	(0.06)	(0.03)	0.32	5,521,376	6,129,587

</TABLE>

FINANCIAL CONDITION

SUMMARY

Management believes the Company is well capitalized for the level of risks undertaken. The Company's assets are single-family mortgages. A substantial majority of these assets are further credit-enhanced beyond the inherent value of a mortgage secured by a first lien on a residential property. The liquidity of a substantial majority of the Company's assets has been enhanced through the securitization and credit rating process. The interest rate risks of the Company's assets and liabilities are closely matched; all of the mortgages are adjustable-rate mortgages financed with equity and variable-rate borrowings. Interest rate risks which remain on the balance sheet after this matching program are mitigated through the Company's interest rate hedging program. The Company has uncommitted borrowing facilities in excess of its needs and, based on the quality of its assets, believes it will continue to be able to access borrowed funds without difficulty. The Company takes credit provisions to reserve for credit risk. The Company has low operating expenses and a high percentage of its equity invested in earning assets. The Company's capital base is tangible capital: all of the Company's earning assets and interest rate agreements are marked-to-market at liquidation value. The Company has no intangible assets or goodwill. Nevertheless, the Company maintains an equity-to-assets ratio that is higher than that of many banks, savings and loans, insurance companies, and REITs that act as mortgage portfolio lenders.

MORTGAGE ASSETS

Through March 31, 1996, all of the Company's acquisitions of Mortgage Assets have been adjustable-rate mortgages on single-family residential properties or interests in securitized pools of such mortgages. All of the mortgage loans which underlie the Company's Mortgage Assets are secured with a first lien position with respect to the underlying single-family properties. The majority of the Company's Mortgage Assets are further credit-enhanced by third parties who have agreed (through insurance, subordination, or other means) to absorb all credit losses in the pool up to a specified limit (which varies by Mortgage Asset). As a result, the majority of the Company's Mortgage Assets are rated AAA by one or more nationally-recognized rating

agencies. The average credit rating equivalent of the Company's Mortgage Assets at December 31, 1995 and March 31, 1996 was AA+.

The Company acquired $24.1 million Mortgage Assets in the first quarter of 1995 for an average price of 94.80% of principal value. The Company acquired $166.9 million in Mortgage Assets in the first quarter of 1996 for an average price of 102.60% of principal value. Mortgage principal repayments received were $2.7 million in the first three months of 1995 for an average annualized principal repayment rate of 9% and were $32.8 million in the first three months of 1996 for an average principal repayment rate of 26%. To date, the Company has not sold Mortgage Assets, although it may do so in the future.

A relatively high percentage of the single-family adjustable-rate mortgages in the United States are secured by properties located in California. This is particularly true for single-family adjustable-rate mortgages within the loan balance range of $200,000 and $500,000 targeted by the Company. At December 31, 1995 and March 31, 1996, the percentage of the Company's Mortgage Assets which had mortgaged properties located in California was 65% and 64%, respectively. Management believes single-family property values in California were generally stable during 1995 and thus far in 1996.

The table below summarizes the Company's Mortgage Assets, the average credit rating equivalent and the average California concentration as well as the Company's Mortgage Assets acquisitions and monthly principal repayment rates.

TABLE 15
MORTGAGE ASSET SUMMARY

<TABLE>
<CAPTION>

	MORTGAGE PRINCIPAL VALUE AT PERIOD END	AMORTIZED COST AT PERIOD END	CARRYING VALUE AT PERIOD END	AVERAGE CREDIT RATING EQUIV. AT PERIOD END	% IN CALIF AT PERIOD END	ASSET ACQUISITIONS AT COST	AVE PRICE PAID	PRINCIPAL RE-PAYMENTS RECEIVED	ANNUALIZED PRINCIPAL REPAYMENTS AS A % OF AVERAGE MTG. ASSETS
	(DOLLARS IN THOUSANDS)								
Fiscal 1994	$120,627	$120,135	$117,477	AAA-	72%	$121,297	99.53%	$ 1,244	7%
1995, Quarter 1	143,393	141,792	141,860	AA+	73%	24,116	94.80%	2,673	9%
1995, Quarter 2	178,429	174,415	175,242	AA+	72%	35,355	93.11%	2,934	7%
1995, Quarter 3	298,718	298,894	298,785	AA+	65%	132,640	103.14%	8,319	16%
1995, Quarter 4	443,625	436,236	432,244	AA+	65%	162,461	95.78%	24,898	27%
1996, Quarter 1	573,807	569,744	565,159	AA+	64%	166,852	102.60%	32,814	26%

</TABLE>

At December 31, 1995, the Company had on its balance sheet as part of the Mortgage Asset account a total of $17.0 million of unamortized discount (which is the difference between the remaining principal value and current historical amortized cost of Mortgage Assets acquired at a price below principal value) and a total of $9.6 million of unamortized premium (which is the difference between the remaining principal value and the current historical amortized cost of Mortgage Assets acquired at a price above principal value). The net discount at December 31, 1995 was $7.4 million, or 1.7% of the total amortized cost of Mortgage Assets. At March 31, 1996, the Company had a total of $16.9 million of unamortized discount and $12.8 million of unamortized premium for a net discount of $4.1 million, or 0.7% of the total amortized cost of Mortgage Assets.

Discount balances will be amortized as an increase in interest income over the life of discount Mortgage Assets and premium balances will be amortized as a decrease in interest income over the life of premium Mortgage Assets. If mortgage principal repayment rates increase over the life of these Mortgage Assets, the Company's rate of income recognition over this entire period should increase, all other factors being equal, as the average life of the assets will decrease and the Company will amortize its net discount balance into income over a shorter time period. Similarly, if mortgage principal repayment rates decrease over the life these assets, the average life will increase and

the Company's rate of income recognition over this entire period should decrease. The accounting effects of changes in the rate of mortgage principal repayment on the Company's rate of income recognition in the short-term, however, are likely to be the opposite of that described above due to the Company's treatment of amortization of premium and discount for accounting purposes (see "Interest Income and Earning Asset Yield.")

In the second half of 1995, the Company acquired a limited amount of interest-only strip ("IO") Mortgage Assets (see Footnote 2 to the Financial Statements). The carrying value of these IOs was $2.8 million at December 31, 1995 and $2.2 million at March 31, 1996. These IOs receive a fixed rate of interest on a pool of adjustable-rate mortgages but receive no principal payments. Since IOs have no principal value, the entire acquisition price is recorded as premium; the acquisition of the IOs caused the average price paid for Mortgage Assets in the third quarter of 1995 to be at a premium to principal value (see Table 15). The potential risks and

rewards of owning IO strip Mortgage Assets are similar in many ways to the mortgage servicing business; IOs are also known as "excess servicing" strips. The slower the rate of mortgage principal repayment in the underlying mortgage pool, the more income the IO owner will receive over time. The faster the rate of mortgage principal repayment, the less income the IO owner will receive over time. Accounting convention calls for an IO asset to be written down to market value for income statement purposes should the future projected cash flow yield drop below a certain level due to greater-than-expected mortgage principal repayment rates. The price the Company paid for its IOs incorporated a rapid principal repayment rate assumption although principal repayment rates to date have been faster than expected. Should principal repayment rates accelerate beyond their already rapid levels, a negative accounting adjustment could become necessary. Management believes the Company's IOs are potentially attractive earning assets which also serve to reduce the level of net discount on the Company's balance sheet. Thus, over longer periods of time, the IOs may reduce the Company's overall level of sensitivity to changes in mortgage principal repayment rates.

Since the Company's inception, the majority of the Company's Mortgage Assets had principal and interest payments that were fully guaranteed by the government-sponsored agencies FNMA or FHLMC (see Footnote 2 to the Financial Statements). The Company may lower its percentage of agency-guaranteed Mortgage Assets in the future.

At December 31, 1995, the Company owned partial interests in 30 pools of residential adjustable-rate mortgage loans which were not guaranteed by a Federal agency ("privately-issued assets"). The privately-issued assets owned by the Company had a market value of $165 million. The total principal balance of the mortgages in these pools was $3.5 billion, the majority of which were located in California, had original loan balances of $200,000 to $500,000 and were originated in 1993 or later. Each of these privately-issued assets had varying degrees of credit-enhancement from normal credit losses; most of these assets were, in turn, providing credit-enhancement to more senior interests issued from the same pool. On the basis of the quality of the loans in the pools, the degree of credit-enhancement, and the degree to which these interests were subordinated to other interests, the Company's privately-issued assets were rated or had a credit rating equivalent of A+ on average.

At March 31, 1996, the Company owned partial interests in 35 pools of privately-issued assets. These partial interests had a market value of $242 million. The total principal balance of the mortgages in these pools was $3.9 billion, the majority of which were located in California, had original loan balances of $200,000 to $500,000 and were originated in 1993 or later. With the exception of $232,124 in "first loss" interests, each of the Company's interests had varying degrees of credit-enhancement from normal credit losses; most of these interests were, in turn, providing credit-enhancement to more senior interests issued from the same pool. The Company's privately-issued assets at quarter-end were rated or had a credit rating equivalent of AA on average.

The single-family mortgage industry uses terms such as "FNMA/FHLMC" underwriting and "A", "A-", "B", and "C" quality underwriting to describe the standards used when assessing the credit and level of documentation of a mortgage loan, although these terms are not standardized and usage can differ. The Company uses these terms as follows: (i) "FNMA/FHLMC" underwriting standards are those which have been developed over the years by the government-sponsored agencies for the high-quality mortgage loans (generally with balances less than $207,000) which they acquire and guarantee, (ii) "A" quality underwriting generally applies to loans with original loan balances which are larger than the FNMA/FHLMC limits but have been underwritten to standards which are similar in most respects to FNMA/FHLMC standards or otherwise would generally be considered by the Company to meet high-quality standards, (iii) "A-" quality underwriting applies

to loans which do not meet some of the "A" quality credit or documentation standards but otherwise have one or more positive compensating factors, and (iv) "B" and "C" quality underwriting standards generally apply to loans where the borrower has a lower quality credit history (typically these loans have lower loan-to-value ratios to compensate for potential increased credit risk) or loans which otherwise do not meet "A" type underwriting criteria. By references to "high-quality" whole Mortgage Loans herein, the Company is referring to its loans underwritten to "FNMA/FHLMC," "A" or "A-" standards.

A substantial majority of mortgage loans underlying the Company's Mortgage Assets have been underwritten to high-quality "A" or "FNMA/FHLMC" underwriting standards. To a lesser degree, the

Company owns securitized and credit-enhanced interests in mortgage pools which contain some loans underwritten to "A-" standards. The Company does not specifically track the total volume of loans with "A-" as opposed to "A" or "FNMA/FHLMC" quality underwriting in its pools as management believes that, for most of its assets, the distinction between these types of underwriting is likely to be immaterial given the level of credit-enhancement protection. Of the Company's privately-issued Mortgage Assets as of December 31, 1995 and March 31, 1996, approximately $30.0 million and $28.8 million, respectively, were interests in pools of mortgage loans containing a material amount of loans underwritten to "B" and "C" quality underwriting standards. The Company only acquires such Mortgage Assets when they have substantial levels of third-party credit- enhancement and a credit rating of at least AA. To date, all such Mortgage Assets have been rated AA and third-party credit enhancement levels have ranged from 7.6% to 23.5% of such mortgage pools.

In the fourth quarter of 1995, the Company started acquiring high-quality whole Mortgage Loans generally underwritten to "A" quality standards. No such loans were acquired in the first quarter of 1996. These loans have not been pooled, securitized or rated. If whole Mortgage Loans of the quality acquired to date by the Company were pooled, securitized and rated, management believes that over 90% of the pool would receive a rating of AAA or AA.

The table below shows the balance of the Company's whole Mortgage Loans and the Company's securitized Mortgage Assets segregated by credit rating. Unrated securitized assets have been assigned a credit rating equivalent by management.

TABLE 16
MORTGAGE ASSETS BY CREDIT RATING EQUIVALENT

<TABLE>
<CAPTION>

END OF PERIOD	WHOLE MORTGAGE LOAN CARRYING VALUE	AAA/ AA RATING EQUIV. CARRYING VALUE	A/ BBB RATING EQUIV. CARRYING VALUE	BB/ OTHER RATING EQUIV. CARRYING VALUE	WHOLE LOAN PERCENT OF TOTAL	AAA/ AA RATING EQUIV. PERCENT OF TOTAL	A/ BBB RATING EQUIV. PERCENT OF TOTAL	BB/ OTHER RATING EQUIV. PERCENT OF TOTAL
				(DOLLARS IN THOUSANDS)				
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	$ 0	$109,548	$ 4,761	$ 3,168	0.0%	93.2%	4.1%	2.7%
1995, Quarter 1	0	125,237	10,988	5,635	0.0%	88.3%	7.7%	4.0%
1995, Quarter 2	0	150,846	11,306	13,092	0.0%	86.0%	6.5%	7.5%
1995, Quarter 3	0	263,344	16,338	19,103	0.0%	88.1%	5.5%	6.4%
1995, Quarter 4	26,450	355,784	25,171	24,839	6.1%	82.4%	5.8%	5.7%
1996, Quarter 1	24,861	490,189	26,258	23,852	4.4%	86.8%	4.6%	4.2%

</TABLE>

The following table shows the average characteristics of the Company's Mortgage Assets at the end of each reporting period. The index level is the weighted average rate of the various short-term interest rate indices which determine coupon adjustments. Unless limited by periodic or lifetime caps, the Mortgage Asset coupons adjust at the end of each adjustment period to the level of the index plus the net margin. The fully-indexed rate is the current index plus the net margin: this is the maximum level to which the coupon could adjust should interest rates remain unchanged. The rate of adjustment of the current coupon to the fully-indexed rate is determined by the adjustment periods and the periodic caps of the Mortgage Loans.

TABLE 17
MORTGAGE ASSET CHARACTERISTICS

<TABLE>
<CAPTION>

AVERAGE

END OF PERIOD	COUPON RATE	INDEX LEVEL	NET MARGIN	FULLY-INDEXED RATE	MONTHS TO NEXT ADJUSTMENT	LIFETIME CAP	MORTGAGE ASSET YIELD
Fiscal 1994	6.00%	6.94%	2.25%	9.19%	3	11.48%	6.60%
1995, Quarter 1	6.53%	6.47%	2.24%	8.71%	3	11.57%	7.23%
1995, Quarter 2	6.94%	5.99%	2.21%	8.20%	3	11.54%	7.74%
1995, Quarter 3	7.35%	5.86%	2.20%	8.06%	4	11.56%	7.81%
1995, Quarter 4	7.50%	5.44%	2.08%	7.52%	3	11.54%	7.74%
1996, Quarter 1	7.59%	5.47%	2.11%	7.58%	3	11.53%	7.67%

The table below segments the Company's Mortgage Assets by type of adjustment index, coupon adjustment frequency and periodic cap adjustment.

TABLE 18
MORTGAGE ASSETS BY INDEX

	SIX-MONTH LIBOR INDEX	ONE-MONTH LIBOR INDEX	SIX-MONTH BANK CD INDEX	ONE-YEAR TREASURY INDEX	SIX-MONTH TREASURY INDEX	ELEVENTH DISTRICT COST OF FUNDS INDEX	NATIONAL MORTGAGE CONTRACT RATE	INTEREST-ONLY MORTGAGE ASSETS
Adjustment Frequency/Loan	6 months	1 month	6 months	12 months	6 months	1 month	12 months	n/a
Average Adjustment/Pool	3 months	1 month	3 months	6 months	3 months	1 month	6 months	n/a
Annualized Periodic Cap	2%	none	2%	2%	2%	none	2%	n/a

% of Total Mortgage Assets at Period End

Fiscal 1994	78.2%	3.9%	17.9%	0.0%	0.0%	0.0%	0.0%	0.0%
1995, Quarter 1	78.7%	3.1%	17.3%	0.9%	0.0%	0.0%	0.0%	0.0%
1995, Quarter 2	83.0%	2.5%	13.8%	0.7%	0.0%	0.0%	0.0%	0.0%
1995, Quarter 3	66.8%	1.4%	11.6%	11.5%	7.6%	0.0%	0.0%	1.1%
1995, Quarter 4	59.7%	7.7%	12.8%	12.5%	5.0%	1.7%	0.0%	0.6%
1996, Quarter 1	63.1%	6.5%	8.9%	14.9%	3.6%	1.3%	1.3%	0.4%

Whole Loan Mortgage Assets

In the fourth quarter of 1995, the Company commenced the acquisition of individual single-family residential Mortgage Loans which have not been pooled or securitized (whole Mortgage Loans). The Company did not purchase additional Mortgage Loans in the first quarter of 1996. The Company seeks to acquire high-quality single-family Mortgage Loans ("A" quality underwriting) when management believes the risk-adjusted returns on equity potentially available to shareholders from such assets may exceed potential returns from the acquisition of securitized mortgage loans. While whole Mortgage Loans are expected to produce higher earning asset yields than the bulk of the Company's securitized Mortgage Assets, the acquisition of whole Mortgage Loans also increases the Company's cost of funds versus prevailing LIBOR rates and exposes the Company to potential credit losses. The Company may securitize its whole Mortgage Loans in the future in order to lower borrowing costs. Credit losses will occur in the whole Mortgage Loan portfolio. The Company has provided for a GAAP credit reserve of $79,234 as of December 31, 1995, which is thirty basis points (0.30%) of the amortized cost of its whole Mortgage Loans. As of March 31, 1995 this reserve was reduced to $74,492 reflecting the principal reduction in the Company's whole Mortgage Loans. No credit losses on whole Mortgage Loans have been incurred to date.

The Company defines Non-Performing Assets ("NPAs") as whole loans which are delinquent more than 90 days. At December 31, 1995 the Company had no Non-Performing Assets. As of March 31, 1996, Company's Non-Performing Assets were $190,252, reflecting one loan in foreclosure.

TABLE 19
WHOLE MORTGAGE LOAN SUMMARY

<TABLE>
<CAPTION>

<S>	AT MARCH 31, 1996 <C>	AT DECEMBER 31, 1995 <C>
	(ALL RATIOS BASED ON % OF TOTAL LOAN PORTFOLIO BALANCES UNLESS NOTED)	
Face Value	$24,830,547	$26,411,412
Amortized Cost	24,865,544	26,450,045
Adjustable-Rate	100%	100%
Single-Family	100%	100%
"A" Quality Underwriting	100%	100%
First Lien	100%	100%
Owner-Occupied	100%	100%
Property Located in Northern California	30%	30%
Property Located in Southern California	46%	44%
Number of Loans	101	109
Average Loan Size	$ 245,847	$ 242,307
Original Loan Balance in Excess of $500,000	25%	25%
Average Original Loan to Value Ratio (LTV)	77%	76%
Original LTV greater than 80%	27%	26%
Percent of Original LTV greater than 80% with Mortgage Insurance	100%	100%
1994 Origination	2%	2%
1995 Origination	98%	98%
Non-Performing Assets (90+ days delinq.)	$ 190,252	0
Number of non-performing loans (90+ days delinq.)	1	0
Non-Performing Assets as % of Total Loan Balances	0.77%	0.00%
Credit Reserves	$ 74,492	$ 79,234
Credit Reserves as % of NPA's	39%	N/A
Credit Reserves as % of Total Loan Balances	0.30%	0.30%

</TABLE>

SECURITIZED MORTGAGE ASSETS WITH A CREDIT RATING EQUIVALENT OF AAA TO BBB

At December 31, 1995 and March 31, 1996, 88% and 91% of the Company's Mortgage Assets, respectively, were interests in securitized pools of single-family mortgage loans which had a rating of AAA through BBB from one or more of the nationally-recognized rating agencies, or, if not rated, had equivalent credit quality in the view of management. In addition to including mortgages with first liens on the value of each of the underlying properties, each of these mortgage pools has an additional level of credit-enhancement provided by a third party designed to reduce the risk of credit loss to the Company. In the event, however, that credit losses in these pools are higher than expected or in the event of default of FNMA, FHLMC or another third party guarantor, credit losses to the Company could result. The Company continuously monitors the credit quality of its assets and will provide for GAAP credit reserves accordingly; management is comfortable that GAAP credit provisions are not warranted for these assets at this time.

SECURITIZED MORTGAGE ASSETS WITH A CREDIT RATING EQUIVALENT BELOW BBB

The Company acquires limited amounts of securitized Mortgage Assets with a credit rating equivalent of less than BBB when management believes that the cash flow and return on equity, net of expected credit losses, over the life of the asset will be attractive. These assets have high potential yields but also are costly to finance. These assets may be highly beneficial to the Company over their life, although any such benefits are likely to be realized chiefly in later years. Future benefits may include possible credit rating upgrades and market value improvements as the mortgage interests senior to the Company's position prepay (this would lead to lower

borrowing costs and an expanded equity base for the Company) and the eventual return of principal (net of credit losses) which was purchased at a discount. If credit losses exceed management's expectations, however, net losses on these assets could result.

The bulk of the Company's securitized assets with a credit rating equivalent below BBB are credit-enhanced and thus credit losses will not be incurred by the Company until total credit losses in the related mortgage pool exhaust the credit-enhancement. The level of credit losses in these pools has been insignificant to date; the full

original levels of credit-enhancement to the Company's positions are generally intact. Management expects that these pools will experience credit losses in the future and that in some pools all of the credit-enhancement will be exhausted, leading to credit losses in the Company's positions. Any such losses are limited to the Company's amortized cost in the asset.

In the case of "first loss" assets (subordinated interests with no credit enhancement), all credit losses in the related pool of mortgages will reduce the principal value of the "first loss" asset and will be recognized as a credit loss by the Company. The amortized cost of the Company's first loss assets at December 31, 1995 and March 31, 1996 was $227,997 and $232,124, respectively; the limit of the Company's potential credit losses on these assets is equal to the amortized cost. As the Company's cost basis in "first loss" assets is low relative to their principal value, the Company's realized credit loss will equal only 10-15% of the realized credit losses to the pools.

<TABLE>
<CAPTION>

TABLE 20
SUMMARY OF BELOW BBB-RATED SECURITIZED MORTGAGE ASSETS

(DOLLARS IN THOUSANDS)

<S>	PRINCIPAL VALUE PERIOD END <C>	AMORTIZED COST PERIOD END <C>	GAAP CREDIT PROVISION <C>	ACTUAL LOSSES <C>	GAAP CREDIT RESERVES PERIOD END <C>	GAAP CREDIT RESERVE/ AMORTIZED COST <C>
Fiscal 1994	$ 3,628	$ 3,377	$ 0	$ 0	$ 0	0.00%
1995, Quarter 1	6,779	5,836	18	0	18	0.32%
1995, Quarter 2	17,009	13,351	41	0	59	0.44%
1995, Quarter 3	25,638	19,964	84	0	143	0.72%
1995, Quarter 4	41,290	28,857	271	4	410	1.42%
1996, Quarter 1	39,311	27,429	336	0	747	2.72%

</TABLE>

The Company monitors the delinquent loans and the quality of mortgage servicing in these pools. Delinquencies and defaults in the various mortgage pools in which the Company has an interest may have widely different credit loss implications for the Company due to the level of credit-enhancement and the level of the Company's amortized cost in the asset. One of the tools the Company uses to monitor its possible credit exposure and to assess the adequacy of its GAAP credit reserves is to calculate the level of realized loss the Company would incur if most or all of the mortgage loans in these pools which are more than 90 days delinquent eventually default and if the total loss to the mortgage pool on defaulted loans equaled 10% to 40% of the loan balance ("loss severity"). See Table 22.

Over the entire period of time the Company has owned these pools through March 31, 1996, of a total original balance of $2.2 billion of mortgages in these pools representing over 10,750 loans, four loans with a total loan balance of $904,717 have defaulted and resulted in a credit loss to these pools. The average loss severity realized by the mortgage pools on the default of these four loans was 10% of the loan balance. Based on limited data from other mortgage pools, however, management believes a loss severity assumption of 20% to 30% is reasonable; actual experience could be more severe.

Delinquencies have risen in these pools. This increase in delinquencies as a percent of the current remaining principal balance is a function of the normal seasoning of the mortgage pools, of mortgage principal repayments and of a small general increase in mortgage delinquencies nationwide. For these reasons, management expects delinquencies as a percent of current remaining principal balance to continue to rise in 1996.

All pools in which the Company owns an interest are performing within expectations with the exception of three pools issued from one mortgage conduit. Delinquencies have risen in these pools; mortgage servicing difficulties related to a servicing transfer and other factors may be partially responsible for this increase. Management is monitoring the efforts of the conduit and the servicers to address these servicing issues.

The table below shows the likely credit loss to the Company that may result from loans which were part of the Company's securitized mortgage assets with a credit rating equivalent below BBB and which were delinquent more than 90 days as of March 31, 1996. The table assumes a variety of possible default frequencies and loss severities. For example, if 95% of the over-90-day delinquent loans in those assets as of March 31, 1996 eventually default with a 25% loss severity, the Company would likely realize a credit loss of approximately $92,000. GAAP credit reserves for these assets at March 31, 1996 were $746,738. The table reflects potential credit loss only for those loans

delinquent more than 90 days at March 31, 1996 and does not purport to reflect potential losses over the life of the related pools.

TABLE 22
POTENTIAL CREDIT LOSSES DUE TO 90+ DAY DELINQUENCIES AS OF MARCH 31, 1996
FOR SECURITIZED MORTGAGE ASSETS WITH CREDIT RATING EQUIVALENT BELOW BBB

LOSS SEVERITY	90% DEFAULT FREQUENCY	95% DEFAULT FREQUENCY	100% DEFAULT FREQUENCY
	(DOLLARS IN THOUSANDS)		
10%	$ 23	$ 24	$ 26
15%	35	36	38
20%	46	49	51
25%	58	92	94
30%	361	488	615
35%	743	982	1,234
40%	1,407	1,771	2,171

INTEREST RATE AGREEMENTS

The Company's interest rate agreements are assets carried on the balance sheet at estimated liquidation value. There is a risk that the counter-parties to the interest rate agreements will not be able to perform under these contracts. All of the counter-parties to the Company's interest rate agreements have a credit rating of at least "A". Potential accounting losses from counter-party risk are limited to the Company's amortized cost basis in these agreements, which was $2.5 million at December 31, 1995 and $2.5 million at March 31, 1996.

BORROWINGS

To date, the Company's debt has consisted entirely of borrowings collateralized by a pledge of the Company's Mortgage Assets. These borrowings appear on the balance sheet as reverse repurchase agreements and notes payable. The size of the market for borrowings of this type is measured in the trillions of dollars; institutions with high-quality pledgable assets such as banks, savings and loans, brokerage firms, federal agencies and the Federal Reserve Bank are the largest U.S. borrowers in this market. The Company has established uncommitted borrowing facilities in this market in amounts in excess of its needs.

All of the Company's Mortgage Assets are currently accepted as collateral for such borrowings. On average, the Company could borrow 94% to 96% of the market value of its Mortgage Assets. The Company, however, limits its borrowings, and thus its potential asset growth, in order to maintain unused borrowing capacity and thus increase the liquidity and strength of its balance sheet.

The term to maturity of the Company's borrowings has ranged from one day to seven months, with a weighted average term to maturity of 74 days at December 31, 1995 and 48 days at March 31, 1996. Many of

the Company's borrowings have a cost of funds which adjusts monthly based on a fixed spread over or under the one-month LIBOR interest rate or daily based on the Fed Funds rate. As a result, the average term to the next rate adjustment for the Company's borrowings is typically shorter than the term to maturity: at December 31, 1995 and at March 31, 1996, the weighted average term to next rate adjustment was 26 days and 19 days, respectively. The average rate on the Company's borrowing at December 31, 1995 was 6.01% and at March 31, 1996 it was 5.62%.

TABLE 22
BORROWING SUMMARY

END OF PERIOD	MARKET VALUE OF PLEDGABLE MORTGAGE ASSETS	ESTIMATED BORROWING CAPACITY AS A % OF PLEDGABLE ASSETS	ESTIMATED BORROWING CAPACITY	TOTAL BORROWINGS	AVERAGE TERM TO MATURITY	AVERAGE TERM TO RATE ADJUSTMENT	RATE ON BORROWINGS OUTSTANDING AT PERIOD-END
			(DOLLARS IN THOUSANDS)				
Fiscal 1994	$ 117,477	95.6%	$ 112,283	$ 100,376	112 days	70 days	5.80%
1995, Quarter 1	141,860	94.3%	133,719	121,998	97 days	27 days	6.25%
1995, Quarter 2	175,242	95.4%	167,192	155,881	64 days	28 days	6.23%
1995, Quarter 3	298,785	94.5%	282,432	228,826	38 days	31 days	5.95%
1995, Quarter 4	432,244	94.6%	408,998	370,316	74 days	26 days	6.01%

1996, Quarter 1	565,159	95.2%	537,783	508,721	48 days	19 days	5.62%

</TABLE>

LIQUIDITY

A financial institution has ample liquidity when it is able to meet the demands made upon it for cash payments with its cash reserves, operating cash flow, borrowing capacity, proceeds from asset sales, or other sources of cash. Liquidity allows the Company to purchase additional Mortgage Assets and allows the Company to pledge additional assets to secure existing borrowings should the value of pledged assets decline. Potential immediate sources of liquidity for the Company include cash balances and unused borrowing capacity. The Company typically pledges its least liquid Mortgage Assets for secured borrowings so that the Company's pool of unpledged Mortgage Assets consist of its most liquid assets. Unused borrowing capacity will vary over time as the market value of the Company's Mortgage Assets vary and due to other factors. Potential immediate sources of liquidity equaled 12% of borrowings at year end 1995 and 8% of borrowings at March 31, 1996. The maintenance of liquidity is one of the goals of the Company's Risk-Adjusted Capital Policy; under this policy, asset growth is limited in order to preserve unused borrowing capacity for liquidity management purposes.

The Company's balance sheet generates liquidity on an on-going basis through mortgage principal repayments and net earnings held prior to payment as dividends. Should the Company's needs ever exceed these on-going sources of liquidity plus the immediate sources of liquidity discussed above, management believes that the Company's Mortgage Assets and interest rate agreements could be sold in most circumstances to raise cash. The table below shows the potential immediate sources of liquidity available to the Company.

TABLE 23
POTENTIAL IMMEDIATE SOURCES OF LIQUIDITY

<TABLE>
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END OF PERIOD	CASH BALANCE	ESTIMATED UNUSED BORROWING CAPACITY	POTENTIAL IMMEDIATE SOURCES OF LIQUIDITY (CASH + EST. UNUSED BORROWING CAPACITY)	POTENTIAL IMMEDIATE SOURCES OF LIQUIDITY AS % OF BORROWINGS
		(DOLLARS IN THOUSANDS)		
<S>	<C>	<C>	<C>	<C>
Fiscal 1994	$ 1,027	$ 11,907	$ 12,934	13%
1995, Quarter 1	953	11,721	12,674	10%
1995, Quarter 2	1,620	11,311	12,931	8%
1995, Quarter 3	1,150	53,606	54,756	24%
1995, Quarter 4	4,825	38,682	43,507	12%
1996, Quarter 1	9,705	29,062	38,767	8%

</TABLE>

STOCKHOLDERS' EQUITY

The Company's GAAP equity base as measured on a historical cost basis decreased slightly in the first quarter of 1996 as dividends, which are based on taxable earnings, exceeded GAAP earnings. This created a larger deficit in the "Undistributed Earnings" account, which is part of stockholders' equity. As measured on a historical cost basis, the equity base decreased from $73.8 million, or $13.37 per share, at December 31, 1995 to $73.2 million, or $13.27 per share, at March 31, 1996.

The Company's GAAP equity base as reported in its financial statements reflects the mark-to-market of its assets. On this basis, the equity base decreased from $68.3 million, or $12.38 per share, at December 31, 1995 to $68.1 million, or $12.35 per share, at March 31, 1996. This change reflects a positive net asset mark-to-market adjustment of $410,762 offset by the excess of dividends over GAAP earnings mentioned above.

With the Company's "available-for-sale" accounting treatment, unrealized fluctuations in market values of assets are reflected on the balance sheet by changing the carrying value of the asset and reflecting the change in stockholders' equity under "Net Unrealized Losses on Assets Available for Sale". Unrealized market value fluctuations do not impact income. By accounting for its assets in this manner on its balance sheet, the Company hopes to provide useful information to shareholders and creditors and to preserve flexibility to sell assets in the future without having to change accounting methods.

As a result of this mark-to-market accounting treatment, the

reported book value and book value per share of the Company are likely to fluctuate far more than if the Company used historical amortized cost accounting. As a result, comparisons with companies that use historical cost accounting for some or all of their balance sheet may be misleading.

Positive mark-to-market changes will increase the Company's equity base and allow the Company to increase its spread lending activities while negative changes will tend to limit spread lending growth under the Company's Risk-Adjusted Capital Policy. A very large negative change in the net market value of Mortgage Assets and interest rate agreements might impair the Company's liquidity position, requiring the Company to sell assets with the likely result of realized losses upon sale.

An unrealized loss is created each time the Company acquires a Mortgage Asset or enters into an interest rate agreement; the Company immediately marks down the asset to reflect the difference between the acquisition cost and a conservative estimate of bid-side market value. This mark-down spread can be as much as 5% of acquisition value for lower-rated Mortgage Assets and interest rate agreements. As a result, in the absence of other factors, the Company's net unrealized loss is expected to grow as the balance sheet grows.

"Net Unrealized Losses on Assets Available for Sale" was $5.5 million, or 1.2% of assets, at December 31, 1995 and was $5.1 million, or 0.9% of assets, at March 31, 1996. Despite rising interest rates during the quarter, the market values of the Company's Mortgage Assets were generally stable. The market value of the Company's interest rate hedging agreements rose during the quarter along with rising interest rates; this increase was sufficient to overcome the negative effect of the bid/ask spread on Mortgage Assets acquired during the quarter, resulting in a positive net mark-to-market gain.

The table below shows the Company's equity capital base as reported and on a historical amortized cost basis. The historical cost equity capital base is influenced by common stock issuance, the level of GAAP earnings as compared to dividends declared, and other factors. The GAAP reported equity capital base is influenced by these factors plus changes in the "Net Unrealized Losses on Assets Available for Sale" account.

TABLE 24
STOCKHOLDERS' EQUITY

<TABLE>
<CAPTION>

END OF PERIOD	TOTAL ASSETS	NET UNREALIZED LOSSES ON ASSETS AVAILABLE FOR SALE	NET UNREALIZED LOSSES AS % OF TOTAL ASSETS	HISTORICAL AMORTIZED COST EQUITY BASE	GAAP REPORTED EQUITY BASE	HISTORICAL AMORTIZED COST EQUITY PER SHARE	GAAP REPORTED EQUITY PER SHARE
			(DOLLARS IN THOUSANDS)				
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	$ 121,528	$ (2,557)	(2.1%)	$ 22,837	$ 20,280	$ 12.18	$ 10.82
1995, Quarter 1	145,440	(549)	(0.4%)	22,901	22,352	12.22	11.93
1995, Quarter 2	179,321	(314)	(0.2%)	22,847	22,533	12.19	12.02
1995, Quarter 3	303,394	(1,551)	(0.5%)	74,024	72,473	13.42	13.14
1995, Quarter 4	441,557	(5,476)	(1.2%)	73,766	68,290	13.37	12.38
1996, Quarter 1	581,313	(5,065)	(0.9%)	73,211	68,146	13.27	12.35

</TABLE>

WARRANTS

At year end 1995 and March 31, 1996, the Company had 1,665,063 Warrants outstanding. These Warrants currently trade on NASDAQ under the symbol RWTIW. Each Warrant gives the holder the right until December 31, 1997 to buy 1.000667 shares of Common Stock at a price per share of $15.00. If the Company's Common Stock continues to trade at a price above $15.00 per share, the remaining Warrants are likely to be exercised sometime in the next two years. If all these Warrants are exercised, the Company will receive new equity capital of approximately $25 million. If a significant number of the Warrants were to be exercised in a short period of time, earnings and dividends per share may be affected for a period of time as the Company works to employ the new capital. The impact of Warrant exercises on earnings and dividends per share in the longer run may or may not be negative, depending on the incremental return on equity earned on the Warrant exercise proceeds.

CAPITAL ADEQUACY/RISK-ADJUSTED CAPITAL POLICY

Stockholders' equity as a percent of total assets was 15.5% at December 31, 1995 and 11.7% at March 31, 1996. The Company's target equity-to-assets ratio at March 31, 1996 was also 11.7%; the Company

was fully utilizing its equity at the end of the first quarter of 1996. This level of equity capitalization is higher than that of many banks, savings and loans, insurance companies, and REITs that act as mortgage portfolio lenders.

The Company's target equity-to-assets ratio varies over time as a function of management's opinion of the level of risk of its assets and liabilities, the Company's liquidity position, the level of unused borrowing capacity, and the over-collateralization levels required by lenders when the Company pledges assets to secure borrowings. The Company currently seeks to maintain an equity-to-assets ratio of 7% to 10% for assets which have low credit risk, relatively low interest rate risk, good liquidity, and low lender over-collateralization requirements. For less liquid assets with credit risk, the Company currently seeks to maintain an equity-to-

assets ratio of 40% to 100%. Thus the overall target equity-to-assets ratio will vary over time as a function of the asset mix and other factors. As shown in Table 25, the target equity-to-assets ratio has been declining since mid-1995 due primarily to a change in asset mix. In general, the target equity-to-assets ratio is more than double the over-collateralization amounts required by the Company's secured lenders.

The target equity-to-assets ratio is determined through a Board-level process called for in the Company's Risk-Adjusted Capital ("RAC") Policy. Should the actual equity-to-assets ratio of the Company fall below the target level due to asset acquisitions and/or asset market value fluctuations, management will cease the acquisition of new assets. Management will, at that time, present a plan to the Board to bring the Company back to its target equity-to-assets ratio; in many circumstances, this would be accomplished in time by waiting for the balance of Mortgage Assets to reduce through principal repayments.

The table below shows the Company's actual and target equity-to-assets ratios and the Company's actual asset size as compared to its full potential asset size given its equity capital base and the guidelines of the Company's RAC Policy. Management anticipates that the target equity-to-assets ratio may continue to drop in the future as the Company shifts its asset mix towards an increased emphasis on high-quality whole Mortgage Loans and securitized Mortgage Assets rated AAA and AA.

TABLE 25
EXCESS CAPITAL AND ASSET GROWTH POTENTIAL

<TABLE>
<CAPTION>

END OF PERIOD	EQUITY CAPITAL	TARGET EQUITY TO ASSETS RATIO	ACTUAL EQUITY TO ASSETS RATIO	EXCESS CAPITAL	POTENTIAL ASSET SIZE WITH SAME ASSET MIX	ACTUAL ASSET SIZE	ASSET GROWTH POTENTIAL WITH SAME ASSET MIX
			(DOLLARS IN THOUSANDS)				
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	$ 20,280	10.84%	16.69%	$ 6,716	$ 187,050	$ 121,528	$ 65,522
1995, Quarter 1	22,352	12.41%	15.37%	3,970	180,173	145,440	34,733
1995, Quarter 2	22,533	12.95%	12.57%	(1,069)	173,989	179,321	(5,332)
1995, Quarter 3	72,473	13.08%	23.89%	32,155	554,183	303,394	250,789
1995, Quarter 4	68,290	12.59%	15.47%	12,028	542,431	441,557	100,874
1996, Quarter 1	68,146	11.72%	11.72%	26	581,540	581,313	227

</TABLE>

In April 1996, the Company successfully completed a secondary stock offering bringing in an additional $54.5 million in equity. If the Company utilizes the same 11.72% target equity to assets ratio it had at March 31, 1996, the potential asset size of the Company currently exceeds $1.1 billion as a result of the April 1996 equity offering.

ASSET/LIABILITY MANAGEMENT AND EFFECT OF CHANGES IN INTEREST RATES

Management continually reviews the Company's asset/liability strategy with respect to interest rate risk, mortgage prepayment risk, credit risk and the related issues of capital adequacy and liquidity. The Company seeks attractive risk-adjusted shareholder returns while seeking to maintain a strong balance sheet and pattern of net income which is stable and growing over time relative to its competitors in the banking and savings and loan industries.

The Company seeks to manage the extent to which net income changes as a function of changes in interest rates by matching adjustable-rate assets with variable-rate liabilities and by mitigating the potential impact on net income of periodic and lifetime coupon adjustment restrictions in the assets through entering into interest

rate agreements.

Changes in interest rates also may have an effect on the rate of mortgage principal repayment; the Company seeks to mitigate the effect of changes in the mortgage principal repayment rate from an economic point of view by balancing assets purchased at a premium with assets purchased at a discount. However, due to the Company's accounting practices, changes in the rate of mortgage principal repayment have differing effects on premium and discount amortization schedules. When the rate of mortgage principal repayments has increased above expected levels, the Company has increased premium amortization at a faster rate than discount amortization. This accounting practice leads to a lower level of accounting income, compared to what it would have been otherwise, during periods of rapid mortgage principal repayments.

The net effect of changes in interest rates, relative changes in one- and six-month LIBOR rates, changes in short-term rates relative to longer-term interest rates, changes in mortgage principal repayment rates, changes in the market values of assets and interest rate agreements, and other factors cannot be determined in advance. In general, the Company's goal is to stabilize spread lending income over longer periods of time and allow income from equity-funded lending to rise as interest rates rise and fall as short-term interest rates fall. If the Company achieves this goal, the Company's return on equity will maintain over time a constant or widening spread to the level of short-term interest rates.

INTEREST RATE SENSITIVITY GAP

The table below shows the Company's cumulative interest rate sensitivity gap, or maturity gap, for periods of one month to one year as a percentage of total assets. The interest rate sensitivity gap is a tool used by financial institutions such as banks and savings and loans to analyze the possible effects of interest rate changes on net income over time. This gap analysis ignores many important factors, however. In the Company's case, it ignores the effect of the Company's hedging activities, the effect of the periodic and lifetime caps in the Company's assets, the effect of changes in mortgage principal repayment rates and other factors. Nevertheless, the gap analysis can provide some useful information on the interest rate risk profile of a financial institution.

A negative cumulative gap over a particular period means that the amount of liabilities that will have an expense rate adjusting to prevailing market conditions during that period will be greater than the amount of assets that will have an earning rate adjustment. Thus a negative gap implies that increasing interest rates would result in a falling level of net interest income during the time period in question, as the cost of funds on the liabilities would adjust more quickly to the interest rate increase than would the interest income from the assets. A negative gap also implies that falling interest rates would result in an increasing level of net interest during the period in question. The table below shows that the Company's two-month cumulative gap as a percentage of total assets was negative 36.4% at year end 1995 and negative 47.2% at March 31, 1996. This suggests that the initial short-term response on the Company's net interest income would be negative to increasing interest rates and would be positive to decreasing interest rates, although the Company's interest rate agreements may mitigate the short-term negative effect of rising rates. For the Company, the relevant interest rates are short-term interest rates such as LIBOR.

A positive interest rate sensitivity gap over a particular period means that a greater amount of assets than liabilities will have an earning or expense rate adjustment to prevailing market conditions during that period. The table below shows that the Company had a positive cumulative six-month gap of 9.3% at the end of 1995 and 4.3% at the end of the first quarter of 1996. This implies that the impact on net interest income of increasing interest rates may be positive within six months even though the initial impact for the first three months may have been negative. Similarly, this six-month gap analysis implies that falling interest rates may result in a decrease in net interest income within six months even though the initial impact for the first three months may have been positive. Although the Company's balance sheet does have these tendencies, since a variety of factors have been ignored it is not possible to assess from this gap analysis what the actual impact on the Company's net income of such interest rate changes would be, especially over shorter time periods.

Since virtually all of the Company's assets and liabilities have income or expense rates which adjust to market conditions within one year, the Company's cumulative twelve-month interest rate sensitivity gap, which

was 14.7% at year end 1995 and 11.1% at March 31, 1996, applies to time periods longer than one year as well. The Company has a positive

twelve-month interest rate sensitivity gap, even though virtually all assets and liabilities adjust within one year, because the Company has more earning assets than interest-bearing liabilities.

TABLE 27
INTEREST RATE SENSITIVITY GAP

END OF PERIOD	CUMULATIVE 1-MONTH GAP AS A % OF TOTAL ASSETS	CUMULATIVE 2-MONTH GAP AS A % OF TOTAL ASSETS	CUMULATIVE 3-MONTH GAP AS A % OF TOTAL ASSETS	CUMULATIVE 4-MONTH GAP AS A % OF TOTAL ASSETS	CUMULATIVE 5-MONTH GAP AS A % OF TOTAL ASSETS	CUMULATIVE 6-MONTH GAP AS A % OF TOTAL ASSETS	CUMULATIVE 9-MONTH GAP AS A % OF TOTAL ASSETS	CUMULATIVE 12-MONTH GAP AS A % OF TOTAL ASSETS
Fiscal 1994	(3.0%)	(0.1%)	4.6%	(0.8%)	1.2%	14.9%	14.9%	14.9%
1995, Quarter 1	(45.7%)	(40.5%)	(26.9%)	(11.7%)	0.1%	13.9%	14.1%	14.3%
1995, Quarter 2	(39.1%)	(48.9%)	(32.7%)	(17.3%)	(2.6%)	11.4%	11.6%	11.7%
1995, Quarter 3	(50.6%)	(34.3%)	(18.8%)	(5.6%)	4.2%	17.6%	20.3%	22.6%
1995, Quarter 4	(48.2%)	(36.4%)	(25.8%)	(15.8%)	(2.9%)	9.3%	12.2%	14.7%
1996, Quarter 1	(61.9%)	(47.2%)	(34.1%)	(20.7%)	(7.9%)	4.3%	7.9%	11.1%

EQUITY DURATION

The Company uses "equity duration" to measure the stability of the market value of its assets with respect to the size of its equity base as interest rates fluctuate. Equity duration is a theoretical calculation of the projected percentage change in the reported equity base of the Company that would occur if short-term and long-term interest rates moved up or down by 1% overnight. The Company's goal is to maintain an equity duration of less than 15%. In practice, the Company believes it has maintained an equity duration of less than 10%.

INFLATION

Virtually all of the Company's assets and liabilities are financial in nature. As a result, 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 principals (GAAP) and the Company's dividends are determined by 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.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

At March 31, 1996, there were no pending legal proceedings to which the Company as a party or of which any of its property was subject.

Item 2 . Changes in Securities

None

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit 11 to Part I - Computation of Earnings Per Share for the three months ended March 31, 1996 and March 31, 1995.

Exhibit 27 - Financial Data Schedule

(b) Reports on Form 8-K

None

SIGNATURES

Pursuant to the requirements of the Securities 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: May 10, 1996 By: /s/ Douglas B. Hansen

Douglas B. Hansen
President and Chief Financial Officer
(authorized officer of registrant)

Dated: May 10, 1996 By: /s/ Vickie L. Rath

Vickie L. Rath
Vice President, Treasurer and Controller
(principal accounting officer)

REDWOOD TRUST, INC.
INDEX TO EXHIBIT

<TABLE>
<CAPTION>

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27	Financial Data Schedule	47

</TABLE>

EXHIBIT 11

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

	THREE MONTHS ENDED MARCH 31, 1996	THREE MONTHS ENDED MARCH 31, 1995
PRIMARY:		
Average common shares outstanding	5,521,376	208,332
Average preferred shares outstanding (A)	0	1,666,063
Net effect of dilutive stock options outstanding during the period -- based on the treasury stock method	164,227	187,022
Net effect of dilutive stock warrants outstanding during the period -- based on the treasury stock method	443,984	53,744
Total	6,129,587	2,115,161
Net Income	$1,954,190	$ 401,677
Per Share Amount	$ 0.32	$ 0.19
FULLY DILUTED:		
Average common shares outstanding	5,521,376	208,332
Average preferred shares outstanding (A)	0	1,666,063
Net effect of dilutive stock options outstanding during the period -- based on the treasury stock method	164,548	187,022
Net effect of dilutive stock warrants outstanding during the period -- based on the treasury stock method	446,724	53,744
Total	6,132,648	2,115,161
Net Income	$1,954,190	$ 401,677
Per Share Amount	$ 0.32	$ 0.19

(A) Preferred shares considered common stock equivalents for all periods as there is no stated yield and there is an automatic conversion feature to convert the preferred to common with no additional proceeds to the company.

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1996 QUARTERLY REPORT ON FORM 10-Q AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE
TO SUCH FINANCIAL STATEMENTS.
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