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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: SEPTEMBER 30, 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 stock, as of the last practicable date.

Class B Preferred Stock ($.01 par value)	1,006,250 as of November 8,1996
Common Stock ($.01 par value)	9,138,872 as of November 8,1996

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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>
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<S>	September 30, 1996 <C>	December 31, 1995 <C>
ASSETS		
Cash and cash equivalents	$ 14,599	$ 4,825
Mortgage assets	1,375,870	432,244
Interest rate agreements	873	547
Accrued interest receivable	10,781	3,270
Other assets	1,355	671
	$ 1,403,478	$ 441,557
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Short-term borrowings	$ 1,225,094	$ 370,316
Accrued interest payable	10,379	1,290
Accrued expenses and other liabilities	472	227
Dividends payable	4,016	1,434
	1,239,961	373,267
Commitments and contingencies (See Note 11)		
STOCKHOLDERS' EQUITY		
Preferred stock, par value $0.01 per share: Class B 9.74% Cumulative Convertible 1,006,250 and 0 shares authorized; 1,006,250 and 0 shares issued and outstanding ($31,582 aggregate liquidation preference)	29,712	0
Common stock, par value $0.01 per share; 48,993,750 and 50,000,000 shares authorized; 9,069,653 and 5,517,299 shares issued and outstanding	91	55
Additional paid-in capital	138,081	73,895
Net unrealized loss on assets available for sale	(2,060)	(5,476)
Dividends in excess of net income	(2,307)	(184)
	163,517	68,290
	$ 1,403,478	$ 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)

	Three Months Ended September 30, 1996	Three Months Ended September 30, 1995	Nine Months Ended September 30, 1996	Nine Months Ended September 30, 1995
INTEREST INCOME				
Mortgage assets	$ 19,121	$ 3,936	$ 40,734	$ 9,031
Cash and investments	250	50	669	85
	19,371	3,986	41,403	9,116
INTEREST EXPENSE	14,447	2,432	29,724	6,155
INTEREST RATE AGREEMENTS				
Interest rate agreement expense	349	112	756	210
NET INTEREST INCOME	4,575	1,442	10,923	2,751
Provision for credit losses	516	84	1,324	143
Net interest income after provision for credit losses	4,059	1,358	9,599	2,608
Operating expenses	672	364	1,758	763
NET INCOME	$ 3,387	$ 994	$ 7,841	$ 1,845
Net income	3,387	994	7,841	1,845
Less cash dividends on Class B preferred stock	(388)	--	(388)	--
Net income available to common stockholders	2,999	994	7,453	1,845
NET INCOME PER SHARE				
Primary	$ 0.32	$ 0.24	$ 0.90	$ 0.67
Fully diluted	$ 0.31	$ 0.24	$ 0.89	$ 0.67
Weighted average shares of common stock and common stock equivalents:				
Primary	9,516,174	4,183,138	8,246,815	2,747,642
Fully diluted	9,657,395	4,183,138	8,402,542	2,747,642
Dividends declared per Class A preferred share	$ --	$ --	$ --	$ 0.50

Dividends declared per Class B preferred share	$ 0.386	$ --	$ 0.386	$ --
Dividends declared per common share	$ 0.40	$ 0.20	$ 1.26	$ 0.20

</TABLE>

The accompanying notes are an integral part of these financial statements

REDWOOD TRUST, INC.

STATEMENTS OF STOCKHOLDERS' EQUITY

For the Nine Months Ended September 30, 1996
(In thousands, except share data)

<TABLE>
<CAPTION>

	Class B Preferred Stock	Common Stock	Additional Paid-in Capital	Net Unrealized Loss on Assets Available for Sale	Undistributed Income / (Deficit)	Total
Balance, December 31, 1995	--	$ 55	$ 73,895	($ 5,476)	($ 184)	$ 68,290
Net income	--	--	--	--	1,954	1,954
Issuance of common stock	--	--	79	--	--	79
Offering costs	--	--	(48)	--	--	(48)
Dividends declared	--	--	--	--	(2,540)	(2,540)
Fair value adjustment on assets available for sale	--	--	--	411	--	411
Balance, March 31, 1996	--	55	73,926	(5,065)	(770)	68,146
Net income	--	--	--	--	2,500	2,500
Issuance of common stock	--	29	55,303	--	--	55,332
Offering costs	--	--	(304)	--	--	(304)
Conversion of stock warrants	--	1	1,516	--	--	1,517
Dividends declared	--	--	--	--	(3,408)	(3,408)
Fair value adjustment on assets available for sale	--	--	--	512	--	512
Balance, June 30, 1996	--	85	130,441	(4,553)	(1,678)	124,295
Net income	--	--	--	--	3,387	3,387
Issuance of common stock	--	1	495	--	--	496
Issuance of Class B preferred stock	29,868	--	--	--	--	

						29,868
Offering costs	(156)	--	(163)	--	--	(319)
Conversion of stock warrants	--	5	7,308	--	--	7,313
Dividends declared:						
Common	--	--	--	--	(3,628)	(3,628)
Class B Preferred	--	--	--	--	(388)	(388)
Fair value adjustment on assets available for sale	--	--	--	2,493	--	2,493
Balance, September 30, 1996	$ 29,712	$ 91	$ 138,081	($ 2,060)	($ 2,307)	$ 163,517

</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 September 30,		Nine Months Ended September 30,	
	1996	1995	1996	1995
<S>	<C>	<C>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net income	$ 3,387	$ 994	$ 7,841	$ 1,845
Adjustments to reconcile net income to net cash provided by operating activities:				
Amortization of mortgage asset premium and discount, net	1,435	(157)	2,989	(575)
Depreciation and amortization	25	18	60	43
Provision for credit losses on mortgage assets	516	84	1,324	143
Amortization of interest rate cap agreements	208	112	548	210
(Increase) in accrued interest receivable	(3,489)	(753)	(7,511)	(1,265)
(Increase) decrease in other assets	420	(282)	(744)	(296)
Increase in accrued interest payable	6,327	493	9,089	135
Increase in accrued expenses and other	111	92	245	152
Net cash provided by operating activities	8,940	601	13,841	392
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of mortgage assets	(443,860)	(132,640)	(1,106,896)	(192,111)
Principal payments on mortgage assets	76,942	8,319	162,814	13,927
Purchases of interest rate cap agreements	(660)	(481)	(1,314)	(813)
Net cash used in investing activities	(367,578)	(124,802)	(945,396)	(178,997)
CASH FLOWS FROM FINANCING ACTIVITIES:				

Net borrowings from reverse repurchase agreements	328,880	72,945	854,778	128,450
Net proceeds from issuance of Class B preferred stock	29,712	--	29,712	--
Net proceeds from issuance of common stock	7,646	51,286	64,221	51,278
Dividends paid	(3,408)	(500)	(7,382)	(1,000)
Net cash provided by financing activities	362,830	123,731	941,329	178,728
Net increase (decrease) in cash and cash equivalents	4,192	(470)	9,774	123
Cash and cash equivalents at beginning of period	10,407	1,620	4,825	1,027
Cash and cash equivalents at end of period	$ 14,599	$ 1,150	$ 14,599	$ 1,150
Supplemental disclosure of cash flow information:				
Cash paid for interest	$ 8,120	$ 2,432	$ 20,635	$ 6,514

</TABLE>

The accompanying notes are an integral part of these financial statements

REDWOOD TRUST, INC.

NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 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 $17 million, 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 $6 million, 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 million, 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.

On April 19, 1996, the Company completed its second public offering of 2,875,000 shares of common stock at $20.25 per share. The Company received proceeds of $55 million, net of an underwriting discount of $1.164 per share and other offering costs.

On August 8, 1996, the Company completed its public offering of 1,006,250 shares of Class B 9.74% Cumulative Convertible Preferred stock ("Class B preferred stock") at $31.00 per share. The Company received proceeds of $30 million, net of an underwriting discount of $1.317 per share and other offering costs.

During September, 1996, the Company completed a Universal Shelf Registration. With this Registration Statement, the Company may offer Common Stock, Preferred Stock, Warrants and Shareholder Rights from time to time. The aggregate maximum offering price of all securities to be issued pursuant to this Registration Statement is $200,000,000.

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 real estate properties throughout the United 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 expected cash flow from the Mortgage Assets, including an other-than-temporary deterioration of the credit quality of the underlying mortgages and/or the credit protection available to the related mortgage pool.

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"), interest rate swap agreements (the "Swap Agreements") and interest rate collar agreements (the "Collar Agreements"), entered into by the Company are intended to provide income 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 and the net cost or payment received on each Collar Agreement is amortized over the effective period of that Cap or Collar 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 serious 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 $233,244 at September 30, 1996 and $113,515 at December 31, 1995. Depreciation expense and leasehold improvements amortization for the three and nine months ended September 30, 1996 totaled $16,514 and $35,066, respectively. Depreciation expense and leasehold improvements amortization for the three and nine months ended September 30, 1995 totaled $9,879 and $17,995, respectively. Accumulated depreciation and leasehold improvement amortization totaled $66,433 at September 30, 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 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 September 30, 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 and nine months ended September 30, 1996 the Company provided for $515,895 and $1,324,080 in credit losses, respectively. During the three and nine months ended September 30, 1995 the Company provided for $84,044 and $143,079 in credit losses, respectively. During the three and nine months ended September 30, 1996 and September 30, 1995 the Company incurred no charge-offs. The reserve balance at September 30, 1996 and December 31, 1995 was $1,813,794 and $489,713, respectively.

NOTE 2. MORTGAGE ASSETS

Mortgage Assets Excluding IO Strip

At September 30, 1996, Mortgage Assets, excluding IO Strips, consisted of the following:

<TABLE>
<CAPTION>

(IN THOUSANDS)	FEDERAL HOME LOAN MORTGAGE CORPORATION	FEDERAL NATIONAL MORTGAGE ASSOCIATION	NON-AGENCY MORTGAGE ASSETS	TOTAL
<S>	<C>	<C>	<C>	<C>
Mortgage Assets, Gross	$ 259,831	$ 595,497	$ 505,734	$ 1,361,062
Unamortized Discount	0	(243)	(16,095)	(16,338)
Unamortized Premium	7,243	15,650	6,980	29,873

Amortized Cost	267,074	610,904	496,619	1,374,597
Allowance for Credit Losses	0	0	(1,814)	(1,814)
Gross Unrealized Gains	752	1,683	2,679	5,114
Gross Unrealized Losses	(212)	(691)	(3,397)	(4,300)
Estimated Fair Value	$ 267,614	$ 611,896	$ 494,087	$ 1,373,597

</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	NON-AGENCY 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 September 30, 1996 and December 31, 1995, all investments in Mortgage Assets consisted of interests in adjustable rate mortgages on residential properties. A majority of the Non-Agency Mortgage Asset 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 September 30, 1996, the average annualized effective yield was 6.97% based on the amortized cost of the assets and 6.97% 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 September 30, 1996 and December 31, 1995 the weighted average lifetime cap was 11.69% 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)	SEPTEMBER 30, 1996	DECEMBER 31, 1995
<S>	<C>	<C>
Amortized Cost	$ 2,734	$ 3,593
Gross Unrealized Gains	42	0
Gross Unrealized Losses	(503)	(830)
Estimated Fair Value	$ 2,273	$ 2,763

</TABLE>

The average annualized effective yield at September 30, 1996 on the IO Strips was 11.10% based on the amortized cost of the assets and 13.35% 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)	SEPTEMBER 30, 1996	DECEMBER 31, 1995
<S>	<C>	<C>
Amortized Cost	$ 3,286	$ 2,521
Gross Unrealized Gains	54	0
Gross Unrealized Losses	(2,467)	(1,974)
Estimated Fair Value	$ 873	$ 547

</TABLE>

Cap Agreements

The Company had forty outstanding Cap Agreements at September 30, 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 September 30, 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 $482,500,000 and $302,000,000 at September 30, 1996 and December 31, 1995, respectively. The weighted average cap strike rate during the three and nine months ended September 30, 1996 was 7.11% and 7.18%. The weighted average cap strike rate during the three and nine months ended September 30, 1995 was 7.86% and 7.64%. 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 September 30, 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 3 months)	$421,571	7.29%	5.50%	12.00%	$ 193
1997	547,392	8.04%	5.50%	12.00%	822
1998	269,657	8.73%	6.94%	12.00%	703
1999	176,197	9.32%	6.94%	12.00%	529
2000	97,889	9.06%	7.50%	10.00%	362
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					$ 3,286

</TABLE>

Collar Agreement

At September 30, 1996, the Company had entered into one outstanding collar agreement, consisting of the purchase of a cap agreement subsidized by the sale of a floor agreement. On the cap portion, the Company will receive net hedge income to the extent that three month LIBOR exceeds 7.50%. On the floor portion, the Company will incur a net hedge expense to the extent that three month LIBOR falls below 5.91%

The Collar Agreement outstanding at September 30, 1996 is as follows:

<TABLE>
<CAPTION>

EFFECTIVE PERIOD:	NOTIONAL FACE AMOUNT (IN THOUSANDS)	INDEX	CAP STRIKE RATE	FLOOR STRIKE RATE	EXPECTED COLLAR EXPENSE AMORTIZATION
<S>	<C>	<C>	<C>	<C>	<C>
October 1996 to July 1999	$20,000	3 mo LIBOR	7.50%	5.91%	$0

</TABLE>

Swap Agreements

The Company has entered into three types of Interest Rate Swap Agreements summarized as follows:

Fixed vs. Floating Rate Swap Agreements:
The Company had six outstanding Fixed vs. Floating Rate Swap Agreements ("Fixed Pay Rate Swaps") at September 30, 1996 and one outstanding Fixed Pay Rate Swap at December 31, 1995. The sum of the notional amounts of the Company's Fixed Pay Rate Swaps in effect was $70,000,000 and $10,000,000 at September 30, 1996 and December 31, 1995, respectively. Under these swap agreements, the Company receives the 3 month LIBOR rate and pays the fixed rate shown below.

(DOLLARS IN THOUSANDS)

YEAR	AVERAGE SWAP NOTIONAL FACE AMOUNT	AVERAGE PAY RATE	LOW PAY RATE	HIGH PAY RATE
1996 (last 3 months)	$ 82,554	6.30%	6.01%	6.97%
1997	109,699	6.27%	6.01%	7.18%
1998 (first 5 months)	25,828	6.59%	6.40%	7.18%

Periodic Swap Agreements:
As of September 30, 1996, the Company had entered into three Periodic Swap Agreements designed to produce income to the Company in the event that the three month LIBOR rate rises sharply. In each of these swaps, the Company receives income on the notional face at a rate equal to three month LIBOR less 0.230% to 0.265% and pays income on the notional face on the lesser of (a) three month LIBOR or (b) the prior period's LIBOR plus 0.50%. The average notional face of these swaps is $110 million, with $90 million maturing in August 1999 and $20 million maturing in September 1999.

(DOLLARS IN THOUSANDS)

YEAR	AVERAGE SWAP NOTIONAL FACE AMOUNT	AVERAGE SPREAD RECEIVED	LOW SPREAD RECEIVED	HIGH SPREAD RECEIVED
1996 (last 3 months)	$110,000	-0.255%	-0.265%	-0.230%
1997	110,000	-0.255%	-0.265%	-0.230%
1998	110,000	-0.255%	-0.265%	-0.230%
1999 (first 9 months)	98,242	-0.257%	-0.265%	-0.230%

Basis Swap Agreements:
As of September 30, 1996, the Company had entered into five LIBOR/Treasury bill Basis Swap Agreements totaling $160 million. These Basis Swap Agreements, in conjunction with the Company's other swap and cap agreements, are designed to reduce the potential risks in that portion of the Company's balance sheet wherein Treasury-based assets are funded with LIBOR-based liabilities. The Basis Swap Agreements will produce net hedge income for the Company to the extent that three month LIBOR exceeds the average three month Treasury bill rate by 0.440% to 0.465% and will produce a net hedge expense for the Company to the extent that the spread between these two indices is narrower than 0.440% to 0.465%. Half of the Company's $160 million in Basis Swap Agreements were effective at the end of the third quarter of 1996; the remainder will be effective by

December 31, 1996. The maturities of these Basis Swap Agreements are as follows: $30 million in June 1998, $50 million in December 1998, $30 million in June 1999 and $50 million in December 1999.

(DOLLARS IN THOUSANDS)

YEAR	AVERAGE SWAP NOTIONAL FACE AMOUNT	AVERAGE SPREAD PAID	LOW SPREAD PAID	HIGH SPREAD PAID
1996 (last 3 months)	$ 61,087	0.450%	0.440%	0.465%
1997	160,000	0.453%	0.440%	0.465%
1998	144,877	0.455%	0.440%	0.465%
1999	64,712	0.464%	0.460%	0.465%

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 Cap, Swap and Collar 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 twelve 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 September 30, 1996 or December 31, 1995.

NOTE 4. SHORT-TERM BORROWINGS

The Company has entered into reverse repurchase agreements, notes payable and a revolving line of credit (together "Short-Term Borrowings") to finance acquisitions of a portion of its Mortgage Assets. These Short-Term Borrowings are collateralized by a portion of the Company's Mortgage Assets.

In September 1996, the Company entered into a $20 million, one-year revolving line of credit agreement with a financial institution. The agreement requires that the Company maintain certain financial ratios. The Company is in compliance with all requirements. Interest rates on borrowings under this facility are based on LIBOR. At September 30, 1996, borrowings under this facility totaled $19,943,000 and were committed through October 15, 1996.

At September 30, 1996 the Company had $1,225,094,000 of Short-Term Borrowings outstanding with a weighted average borrowing rate of 5.782% and a weighted average maturity of 102 days. These borrowings were collateralized with $1,289,471,000 of Mortgage Assets. At December 31, 1995, the Company had $370,316,047 of Short-Term Borrowings outstanding with a weighted average borrowing rate of 6.01% and a weighted average remaining maturity of 74 days. These borrowing were collateralized with $386,321,000 of Mortgage Assets.

At September 30, 1996 and December 31, 1995, the Short-Term Borrowings had the following remaining maturities:

<TABLE>
<CAPTION>

(IN THOUSANDS)	SEPTEMBER 30, 1996	DECEMBER 31, 1995
<S>	<C>	<C>
Within 30 days	$ 221,265	$ 75,808
30 to 90 days	253,477	175,921
Over 90 days	750,352	118,587
Total Borrowings	$1,225,094	$ 370,316

</TABLE>

For the three and nine months ended September 30, 1996, the average balance of Short-Term Borrowings was $999,229,000 and $696,725,000, respectively with a weighted average interest cost of 5.78% and 5.69%. For the three and nine months ended September 30, 1995 the average balance of Short-Term Borrowings was $159,794,000 and $134,431,000, respectively with a weighted average interest cost of 6.09% and 6.10%. The maximum balance outstanding during the nine months ended September 30, 1996 was $1,225,094,000. The maximum balance outstanding during the year ended December 31, 1995 was $370,316,000.

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 September 30, 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>

	SEPTEMBER 30, 1996	DECEMBER 31, 1995

(IN THOUSANDS)	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
<S>	<C>	<C>	<C>	<C>
Assets				
Mortgage Assets	$1,373,597	$1,373,597	$ 429,481	$ 429,481
IO Strips	2,273	2,273	2,763	2,763
Interest Rate Agreements	873	873	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

In 1994 the Company issued 1,666,063 shares of Class A Convertible Preferred Stock. The Class A Preferred Stock ranked senior to the Company's Common Stock as to dividends and liquidation rights. Concurrent with the completion of the Initial Public Offering on August 9, 1995, all 1,666,063 outstanding shares of Class A Convertible Preferred Stock converted into 1,667,134 shares of Common Stock.

NOTE 7. CLASS B CONVERTIBLE PREFERRED STOCK

On August 8, 1996, the Company issued 1,006,250 shares of Class B 9.74% Cumulative Convertible Preferred Stock. Each share of the Class B Preferred Stock is convertible at the option of the holder at any time into one share of Common Stock. The Class B Preferred Stock will be redeemable by the Company after September 30, 1999. The Class B Preferred Stock pays a dividend equal to the greater of (i) $0.755 per quarter or (ii) an amount equal to the quarterly dividend declared on the number of shares of the Common Stock into which the Class B Preferred Stock is convertible. The Class B Preferred Stock ranks senior to the Company's Common Stock as to the payment of dividends and liquidation rights.

NOTE 8. STOCK PURCHASE WARRANTS

At September 30, 1996 and December 31, 1995 there were 1,076,431 and 1,665,063 Warrants outstanding, respectively. Each Warrant entitles the holder to purchase 1.000667 shares of the Company's common stock at an exercise price of $15.00 per share. The Warrants remain exercisable until December 31, 1997.

NOTE 9. 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 15% of the Company's total outstanding shares of Common Stock. At September 30, 1996 and December 31, 1995, 983,097 and 142,060 shares of Common Stock, respectively, were available for grant. Of the shares of Common Stock available for grant, no more than 500,000 shares of Common Stock shall be cumulatively available for grant as ISOs. At September 30, 1996 and December 31, 1995, 168,333 ISOs had been granted. 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. 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 stock options granted under the plan to accrue DERs. For the three and nine months ended September 30, 1996, the DERs accrued on NQSOs resulted in non-cash charges to general and administrative expenses of $80,592 and $244,916, respectively. These non-cash charges were $7,200 for both the three and nine months ended September 30, 1995. DERs represent shares of stock which are issuable to holders of stock options when the holders exercise the underlying stock options. The number of DER shares accrued are based on the level of the Company's dividends and on the price of the stock on the related dividend payment date.

Information with respect to stock option and DER activity is as follows:

<TABLE>
<CAPTION>

<S>	NINE MONTHS ENDED SEPTEMBER 30, 1996 <C>	YEAR ENDED DECEMBER 31, 1995 <C>
Outstanding options at beginning of period:	310,857	188,333
Options granted	10,000	166,972
Options exercised	(42,083)	(47,083)
Dividend equivalent rights earned	9,411	2,635
Outstanding options at end of period	288,185	310,857
Exercise price per share:		
For options exercised during period	$0.10 - $0.11	$0.10 - $0.11
For options outstanding end of period	$0.10 - $24.63	$0.10 - $21.50

</TABLE>

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 10. 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 June 14, 1996 the Company declared a dividend of $3,408,046, or $0.40 per common share. This dividend was paid on July 18, 1996 to shareholders of record as of June 28, 1996. On September 16, 1996 the Company declared a dividend of $388,413 and $3,627,861, or $0.386 per Class B preferred share and $0.40 per common share, respectively. These dividends were paid on October 21, 1996 to shareholders of record as of September 30, 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 dividend declared in December 1995 which was paid in January 1996 is considered taxable income to shareholders in the year declared. The Company's dividends are not eligible for the dividends received deduction for corporations.

NOTE 11. COMMITMENTS AND CONTINGENCIES

As of September 30, 1996 the Company had entered into a commitment to purchase $23 million of Mortgage Assets for settlement in October 1996. At September 30, 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 and nine months ended September 30, 1996 was $28,647 and $79,108, respectively. Rental expense for office properties under operating leases for the three and nine months ended September 30, 1995 was $16,098 and $47,920, respectively.

Future minimum rental commitments as of September 30, 1996 under noncancelable operating leases with initial or remaining terms of more than one year, are as follows:

<TABLE>
<CAPTION>

YEAR ENDING DECEMBER 31,	MINIMUM RENTAL COMMITMENT AS OF SEPTEMBER 30, 1996 (IN THOUSANDS)
<S>	<C>
1996	30
1997	121
1998	121
1999	121
2000	121
2001	40
Total	$554

</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 and nine months ended September 30, 1996, the Company was bearing 95% of the lease expenses and GB Capital was bearing 5%. For the three and nine months ended September 30, 1995, the Company was bearing 70% of the lease expenses and GB Capital was bearing 30%.

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

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

SAFE HARBOR STATEMENT

"Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995: Statements in this discussion regarding Redwood Trust, Inc. (the "Company") and its business which are not historical facts are "forward-looking statements" that involve risks and uncertainties. For a discussion of such risks and uncertainties, which could cause actual results to differ from those contained in the forward-looking statements, see "Risk Factors" commencing on Page 18 of the Company's preferred stock offering prospectus, dated August 8, 1996 (Registration Statement No. 333-08363).

OVERVIEW

Redwood Trust, Inc. is a mortgage finance company which acquires and manages mortgage assets using its equity and borrowed funds. The Company's source of earnings is net interest income, or the interest income earned on mortgages less the interest expense paid on borrowed funds. The Company believes its primary competitors are other financial institutions, such as banks and savings and loan institutions, which seek to earn spread income from managing mortgage assets. Compared to most of its competitors, the Company believes it benefits from a lower cost of operations and from its status as a Real Estate Investment Trust ("REIT"). As a REIT, the Company does not pay corporate Federal income taxes so long as the Company pays out as dividends an amount equal to at least 95% of its taxable income and satisfies certain other conditions.

The Company's strategy is to focus solely on being a highly efficient spread lender. Instead of maintaining an in-house mortgage origination staff, the Company acquires mortgage assets from mortgage origination companies and from the secondary mortgage market. The Company out-sources mortgage servicing functions. Rather than build a retail branch banking system to gather deposits, the Company accesses borrowed funds in the capital markets. This strategy enables the Company to keep its operating costs low. In the third quarter of 1996, the Company's operating expenses to assets ratio was 0.23% and its efficiency ratio (operating expenses to net interest income) was 15%.

As of September 30, 1996, all of the Company's mortgage assets consisted of adjustable-rate, first-lien mortgages on single-family properties or mortgage securities evidencing an interest in such mortgages. In the future, the Company may acquire fixed-rate single-family mortgage loans as well as mortgage loans on multi-family or commercial properties.

The Company acquires individual whole mortgage loans (9% of total mortgage assets as of September 30, 1996), mortgage securities evidencing an interest in pools of mortgage loans which have been fully insured against credit losses by one of the Federal government mortgage agencies (64%), mortgage securities which have partial private-sector credit-enhancement through insurance, subordination, or other means sufficient to warrant an investment-grade credit rating from one of the nationally-recognized credit rating firms (25%), and mortgage securities which are subordinated and have higher levels of credit risk such that they have received a rating below BBB (2%). The average credit rating equivalent of the Company's mortgage assets is AA+.

The Company is an "A" quality mortgage lending company: the Company does not own mortgages originated to "B", "C", or "D" quality origination or documentation standards except in limited circumstances when the Company has a degree of credit protection sufficient to eliminate most of the potential credit risk from such loans.

In general, the Company seeks to acquire "A" quality single-family mortgage assets consisting of mortgages with loan balances between $207,000 and $500,000, with a target average loan balance of $250,000 to $300,000. Because of their size, these "jumbo" loans are not eligible to be acquired or guaranteed by the Federal government mortgage agencies (FNMA, FHLMC). The Company also acquires FNMA and FHLMC mortgage securities.

As of September 30, 1996, 69% of the non-FNMA, non-FHLMC mortgage assets owned by the Company were secured by single-family residential properties located in California. Management believes that the economy and the trend of residential housing values in California have been generally stable to improving in the first nine months of 1996.

The coupon rate the Company earns on its mortgage assets increases or falls in conjunction with changes in short-term interest rates, as does the rate the Company pays on its borrowings. The coupon rate on each mortgage generally adjusts on a one, six or twelve month cycle; the average term-to-next-adjustment for all of the Company's mortgage assets was 4 months as of September 30, 1996. Borrowings have maturities ranging from one to twelve months; the average term-to-next-adjustment for borrowings was 2.4 months as of September 30, 1996. Coupon rate adjustments on the Company's mortgages are limited by periodic and lifetime caps; the Company's hedging program seeks to mitigate the negative effects such coupon caps may have on spread income should short-term interest rates increase rapidly. Because the Company's adjustable-rate earning assets exceed its liabilities, the Company believes that rising short-term interest rates may lead to higher net earnings after a lag period, all other factors being equal. Similarly, falling short-term interest rates may lead to reduced net earnings after a lag period.

The Company seeks to generate secular growth in earnings and dividends per share in a variety of ways, including through (i) issuing new equity 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.

To date, the Company has grown rapidly by issuing new capital and acquiring new mortgage assets. While the Company believes such growth has significantly increased its long-term earnings per share potential, the near-term effect has been a reduction in reported earnings per share as compared to what earnings likely would have been without such growth. The Company intends to continue to pursue growth when management believes that such growth is likely to be additive to earnings per share potential.

In the third quarter of 1996, the Company issued 1,006,250 shares of Class B 9.74% Cumulative Convertible Preferred Stock. For purposes of calculating net income available to common shareholders, the dividends payable on these preferred shares is deducted. Given the characteristics of this preferred stock, the Company includes it in its equity base for determining selected performance ratios.

RESULTS OF OPERATIONS: THREE MONTHS ENDING SEPTEMBER 30, 1996 VERSUS THREE MONTHS ENDING SEPTEMBER 30, 1995 AND FIRST NINE MONTHS OF 1996 VERSUS FIRST NINE MONTHS OF 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. All subsequent reporting periods correspond to their calendar equivalents.

CHANGE IN CALCULATION METHOD FOR CERTAIN PREVIOUSLY REPORTED YIELDS AND RATIOS

Certain previously reported yields and ratios have been changed for this report due to a number of changes in calculation methods, including a change in the "day-count" convention used by the Company and an adjustment to average daily balance figures. These changes are not material, however, management has made these changes in an effort to make the presentation of these figures more useful and consistent.

NET INCOME SUMMARY

Net earnings in the third quarter of 1996 were $3.0 million, an increase of 200% over the $1.0 million the Company earned in the third quarter of 1995. The primary reason total earnings increased was that average assets increased by nearly $1 billion, or 438%, from the 1995 period to the 1996 period. For a similar reason, net earnings in the first nine months of 1996 of $7.5 million represent a more than fourfold increase over net earnings of $1.8 million in the first nine months of 1995. The table below presents the Company's quarterly net income by major income and expense category.

TABLE 1
NET INCOME

<TABLE>
<CAPTION>

	Interest Income	Interest Expense	Interest Rate Agreement Expense	Net Interest Income	Credit Provision Expense	Operating Expenses
			(dollars in thousands)			
<S>	<C>	<C>	<C>	<C>	<C>	<C>
1995, 1st Nine Months	$ 9,116	$ 6,155	$ 210	$ 2,751	$ 143	$ 763
1996, 1st Nine Months	41,403	29,724	756	10,923	1,324	1,758
Fiscal 1994	$ 1,296	$ 760	$ 8	$ 528	$ 0	$ 146
1995, Quarter 1	2,170	1,533	16	621	19	201
1995, Quarter 2	2,961	2,191	82	688	40	198
1995, Quarter 3	3,986	2,432	112	1,442	84	364
1995, Quarter 4	6,610	4,453	129	2,029	350	368
1996, Quarter 1	9,131	6,202	151	2,777	331	492
1996, Quarter 2	12,901	9,075	255	3,571	477	594
1996, Quarter 3	19,371	14,447	349	4,575	516	672

</TABLE>

<TABLE>
<CAPTION>

	Net Income Before Preferred	Preferred	Net Income After Preferred

	Dividends	Dividends	Dividends
	(dollars in thousands)		
1995, 1st Nine Months	$ 1,845	$ 0	$ 1,845
1996, 1st Nine Months	7,841	388	7,453
Fiscal 1994	$ 382	$ 0	$ 382
1995, Quarter 1	401	0	401
1995, Quarter 2	450	0	450
1995, Quarter 3	994	0	994
1995, Quarter 4	1,311	0	1,311
1996, Quarter 1	1,954	0	1,954
1996, Quarter 2	2,500	0	2,500
1996, Quarter 3	3,387	388	2,999

</TABLE>

Earnings per share in the third quarter of 1996 were $0.32, representing an increase of 33% over the $0.24 per share earned in the third quarter of 1995. Earnings per share increased due to an increase in return on average equity from 7.66% to 9.41% and an increase in the equity per share the Company had available with which to generate earnings from $13.14 to $16.23. Equity (or book value) per share increased due to accretive stock offerings at prices in excess of book value in April 1996 (common stock) and August 1996 (preferred stock). Third quarter 1996 earnings per share were 10% higher than the $0.29 reported in the second quarter of 1996. This quarterly EPS increase also resulted from an increase in return on average equity and an increase in the book value per share.

Two factors served to limit the Company's return on average equity during the third quarter of 1996. The Company was under-invested in mortgage assets relative to its equity base and capital policy guidelines, with 84% of the Company's capital base employed in earning assets on average during the quarter. In addition, the Company estimates that the average coupon during the period of 7.52% was 0.47% below the average fully-indexed coupon level for this period. This lower-than-full-potential coupon was primarily a result of the rapid pace of acquisitions of mortgages during the second and third quarter. The newly acquired mortgages had coupons which were less than fully-indexed. As of September 30, 1996, the average coupon rate on the Company's assets was 0.36% below the fully-indexed level.

For the first nine months of 1996, earnings per share were $0.90, an increase of 34% versus the comparable period in 1995. Return on average equity for the two nine month periods increased from 7.64% to 9.63% and book value per share increased from $13.14 to $16.23.

The table below presents information on shares outstanding, earnings per share, book value per share and return on average equity (ROE).

TABLE 2
EARNINGS PER SHARE, BOOK VALUE PER SHARE
AND RETURN ON AVERAGE EQUITY

<TABLE>
<CAPTION>

	AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	POTENTIAL DILUTION DUE TO WARRANTS AND OPTIONS	TOTAL NUMBER OF PRIMARY SHARES	BOOK VALUE PER COMMON SHARE OUTSTANDING AT END OF PERIOD	BOOK VALUE PER COMMON AND PREFERRED SHARE OUTSTANDING AT END OF PERIOD	RETURN ON AVERAGE COMMON EQUITY	RETURN ON AVERAGE COMMON AND PREFERRED EQUITY	EARNINGS PER PRIMARY SHARE ("EPS")
1995, 1st Nine Months	2,571,888	175,754	2,747,642	$13.14	$ 13.14	7.64%	7.64%	$ 0.67
1996, 1st Nine Months	7,360,916	885,899	8,246,815	14.75	16.23	9.60%	9.63%	0.90
Fiscal 1994	1,676,080	240,766	1,916,846	$10.82	$ 10.82	5.40%		

							5.40%	$ 0.20
1995, Quarter 1	1,874,395	240,766	2,115,161	11.93	11.93	7.36%	7.36%	0.19
1995, Quarter 2	1,874,395	188,699	2,063,094	12.02	12.02	7.97%	7.97%	0.22
1995, Quarter 3	3,944,129	239,009	4,183,138	13.14	13.14	7.66%	7.66%	0.24
1995, Quarter 4	5,516,310	563,197	6,079,507	12.38	12.38	7.28%	7.28%	0.22
1996, Quarter 1	5,521,376	608,211	6,129,587	12.34	12.34	11.37%	11.37%	0.32
1996, Quarter 2	7,813,974	786,258	8,600,232	14.59	14.59	8.88%	8.88%	0.29
1996, Quarter 3	8,732,326	783,848	9,516,174	14.75	16.23	9.32%	9.41%	0.32

</TABLE>

DIVIDEND SUMMARY

Dividends paid to common shareholders for the third quarter of 1996 were $0.40 per share, which was twice the $0.20 dividend paid in the same quarter one year earlier. Dividends paid to preferred shareholders were $0.386 per share, reflecting the minimum quarterly preferred dividend of $0.755 pro-rated for the partial period from the preferred stock issuance date to the end of the quarter. No such preferred stock was outstanding a year earlier. Total dividends (common plus preferred) paid for the third quarter of 1996 were $4.0 million versus $1.1 million paid for the same time period in 1995.

Dividends in the first nine months of 1996 were $1.26 per share, an increase of 80% over the $0.70 per share dividend paid in the first nine months of 1995. Total dividends paid for the first nine months of 1996 were $10.0 million; total dividends paid for the same period the prior year were $1.9 million.

TABLE 3
DIVIDENDS

<TABLE>
<CAPTION>

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)

	COMMON SHARES OUTSTANDING EARNING DIVIDEND	TAXABLE INCOME AFTER PREFERRED DIVIDENDS PER COMMON SHARE OUTSTANDING	COMMON DIVIDEND DECLARED PER SHARE	TOTAL COMMON DIVIDEND	PREFERRED SHARES OUTSTANDING EARNING DIVIDEND	PREFERRED DIVIDEND DECLARED PER SHARE	TOTAL PREFERRED DIVIDEND	TOTAL COMMON AND PREFERRED DIVIDENDS DECLARED
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
1995, 1st Nine Months	2,766,134	$0.73	$0.70	$1,936	0	$0.000	$ 0	$1,936
1996, 1st Nine Months	7,599,794	1.28	1.26	9,576	1,006,250	0.386	388	9,964
Fiscal 1994	1,401,904	$0.25	$0.25	$ 350	0	$0.000	$ 0	$ 350
1995, Quarter 1	1,666,063	0.25	0.20	333	0	0.000	0	333
1995, Quarter 2	1,666,063	0.32	0.30	500	0	0.000	0	500
1995, Quarter 3	5,516,313	0.20	0.20	1,103	0	0.000	0	1,103
1995, Quarter 4	5,517,299	0.33	0.26	1,435	0	0.000	0	1,435
1996, Quarter 1	5,521,376	0.46	0.46	2,540	0	0.000	0	2,540
1996, Quarter 2	8,520,116	0.37	0.40	3,408	0	0.000	0	3,408
1996, Quarter 3	9,069,653	0.40	0.40	3,628	1,006,250	0.386	388	4,016

</TABLE>

The Company's policy is to distribute over time as dividends 100% of its earnings as calculated for tax purposes. Through September 30, 1996, cumulative taxable income has exceeded cumulative dividends paid or declared by $0.2 million; the Company intends to distribute this excess taxable income as part of the Company's regular quarterly dividend in the future.

Taxable income currently exceeds income as calculated according to generally accepted accounting principles (GAAP income) because (i) taxable income credit expense equals actual credit losses rather than credit provisions (actual credit losses through September 30, 1996 have been minor), (ii) amortization methods differ for discount that has been created when mortgages have been acquired at a price below principal value, (iii) dividend equivalent rights which accrue on stock options are deducted from GAAP income as an operating expense but are not deducted from taxable income, and (iv) operating expenses differ in certain other aspects. Management believes taxable income is a closer approximation of current cash flow generation than is GAAP income.

Dividends per share have exceeded earnings per share because taxable income has exceeded GAAP income and because the number of shares eligible at quarter end to receive a dividend has generally been smaller than the number of primary shares used to calculate earnings per share. The table below presents the major differences between GAAP and taxable income.

TABLE 4
TAXABLE INCOME

<TABLE>
<CAPTION>

	GAAP NET INCOME BEFORE PREFERRED DIVIDENDS	TAXABLE CREDIT EXPENSE DIFFERENCES	TAXABLE OPERATING EXPENSES AND MORTGAGE AMORTIZATION DIFFERENCES	TAXABLE INCOME BEFORE PREFERRED DIVIDENDS	TAXABLE INCOME AFTER PREFERRED DIVIDENDS	TAXABLE INCOME RETURN ON COMMON EQUITY	TAXABLE INCOME RETURN ON TOTAL EQUITY
			(DOLLARS IN THOUSANDS)				
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
1995, 1st Nine Months	$ 1,845	$ 143	$ 31	$ 2,019	$ 2,019	8.36%	8.36%
1996, 1st Nine Months	7,841	1,324	574	9,739	9,351	12.05%	11.96%
Fiscal 1994	$382	$ 0	$ (28)	$ 354	$ 354	4.99%	4.99%
1995, Quarter 1	401	19	(12)	408	408	7.48%	7.48%
1995, Quarter 2	450	40	38	528	528	9.37%	9.37%
1995, Quarter 3	994	84	5	1,082	1,082	8.35%	8.35%
1995, Quarter 4	1,311	347	156	1,814	1,814	10.08%	10.08%
1996, Quarter 1	1,954	331	264	2,549	2,549	14.83%	14.83%
1996, Quarter 2	2,500	477	165	3,142	3,142	11.16%	11.16%
1996, Quarter 3	3,387	516	145	4,048	3,660	11.37%	11.25%

</TABLE>

COUPON INCOME ON MORTGAGE ASSETS

The average coupon on the Company's mortgage assets was 7.52% during the third quarter of 1996, an increase from the 7.47% average coupon rate in the second quarter of 1996. The coupon rate in the third quarter rose because (i) the short-term interest rate indices which determine coupons on mortgage assets increased (as approximated in the table below by the increase in the six month average of the six-month LIBOR rate) and (ii) towards the end of the third quarter, coupons on the mortgage assets which the Company acquired in the second and third quarters began to adjust towards their fully-indexed levels.

In the second and third quarter of 1996, the Company acquired $940 million in mortgage assets; these new assets represented a substantial portion of the Company's total mortgage assets as of September 30, 1996. These assets were generally acquired with initial coupon rates below their fully-indexed rate and, as of the end of the third quarter, many of these new mortgage assets had not yet had a coupon adjustment since being acquired by the Company.

In the last few quarters the Company has generally been acquiring mortgages at a premium price to the face value of the mortgages. In the third quarter of 1996, the average historical amortized cost of the mortgages on the Company's books moved above par. As a result, the average coupon yield (coupon income divided by the adjusted average mortgage acquisition price) in the third quarter of 1996 of 7.44% was lower than the average coupon rate of 7.52%.

In the third quarter of 1995, the coupon rate was 7.29%, or 0.77% lower than the estimated average fully-indexed rate during the quarter. This gap between the coupon rate and the fully-indexed rate was due primarily to the acquisition of mortgages in late 1994 and early 1995 that had low initial coupon rates. Since many of these mortgage acquisitions were made at a discount price, the yield on the mortgages was higher than the low coupon would suggest due to the Company's low basis in the assets and the boost to income from discount amortization.

The table below presents the Company's average coupon rates and coupon yields on its mortgage assets as compared to the fully-indexed rates and a benchmark of the six month average of the six-month LIBOR rate.

TABLE 5
COUPON INCOME ON MORTGAGE ASSETS

<TABLE>
<CAPTION>

	COUPON INCOME	AVERAGE PRINCIPAL VALUE OF MORTGAGES	AVERAGE COUPON RATE DURING PERIOD	SIX MONTH AVERAGE OF SIX-MONTH LIBOR	AVERAGE COUPON VERSUS SIX MONTH AVERAGE OF SIX-MONTH LIBOR	AVERAGE FULLY-INDEXED RATE DURING PERIOD	AVERAGE COUPON VERSUS FULLY INDEXED RATE	AVERAGE BOOK PRICE	AVERAGE COUPON YIELD
	(DOLLARS IN THOUSANDS)								
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
1995, 1st Nine Months	$ 8,457	$ 163,880	6.88%	6.28%	0.60%	8.32%	(1.44%)	98.84%	6.96%
1996, 1st Nine Months	43,724	773,571	7.54%	5.59%	1.95%	7.82%	(0.28%)	100.21%	7.52%
Fiscal 1994	$ 1,102	$ 50,070	6.09%	5.07%	1.02%	8.68%	(2.59%)	100.02%	6.09%
1995, Quarter 1	1,940	122,835	6.32%	6.25%	0.07%	8.75%	(2.44%)	99.47%	6.35%
1995, Quarter 2	2,738	160,537	6.82%	6.48%	0.34%	8.33%	(1.51%)	98.53%	6.92%
1995, Quarter 3	3,779	207,338	7.29%	6.10%	1.19%	8.06%	(0.77%)	98.71%	7.39%
1995, Quarter 4	6,682	352,251	7.59%	5.82%	1.77%	7.74%	(0.16%)	99.27%	7.64%
1996, Quarter 1	9,445	488,762	7.73%	5.62%	2.11%	7.43%	0.30%	98.85%	7.82%
1996, Quarter 2	13,722	734,347	7.47%	5.49%	1.98%	7.82%	(0.35%)	99.95%	7.48%
1996, Quarter 3	20,557	1,094,081	7.52%	5.65%	1.87%	7.99%	(0.47%)	100.98%	7.44%

</TABLE>

AMORTIZATION OF PREMIUM AND DISCOUNT AND EFFECTS OF CHANGES IN MORTGAGE PRINCIPAL REPAYMENT RATES

The average annualized principal repayment rate of the Company's mortgage assets in the third quarter was 28%. The comparable rate was 16% for the third quarter of 1995. Annualized mortgage principal repayments averaged 28% for the first nine months of 1996 and 11% for the first nine months of 1995.

The primary direct earnings impact of changes in the rate of mortgage principal repayment is the effect on the rate at which the Company amortizes (as an expense) premium balances paid on the acquisition of mortgage assets. The Company writes off premium at a rate equal to the actual monthly mortgage principal repayment rate of the associated mortgage assets. Due to the increase in mortgage principal repayment speeds, the average annualized rate of premium amortization was 25% of the premium balance in the third quarter of 1996 versus 15% in the same quarter a year earlier.

The amortization of discount into income serves to partially offset the effects of premium amortization. The rate at which the Company amortizes discount balances into income, however, is far less sensitive to short-term changes in the rate of mortgage principal repayment.

The Company recognizes two types of discount. When the Company is able to acquire high-credit-quality mortgage assets at a discount due to very low initial coupon rates, the Company amortizes the associated discount into income in the short-term to offset the effect of the low coupon. In early 1995, most of the Company's discount balances were of this type. Accordingly, the Company took its discount balances into income at a rapid rate. Virtually all of this type of discount had been taken into income by the end of the third quarter of 1995.

When the Company acquires discount mortgage assets that have a material amount of credit risk, the Company uses what management believes to be conservative assumptions regarding the future cash flows of such mortgages to determine a discount amortization schedule for that asset. The result is that such discount is amortized into income at a relatively slow rate which does not fluctuate significantly with short-term changes in the actual rate of mortgage principal repayment even though more rapid principal repayments may benefit the long-term economics of owning these discount mortgages. As shown in the table below, despite rapid principal repayment rates, the annualized discount amortization rate was 7% of the discount balance in third quarter and was 6% for the first nine months of 1996.

As a result of the Company's methods of amortizing premium and discount, faster mortgage principal repayment speeds have led to lower earnings in 1996 than would otherwise have been reported. In calculating its interest income for the third quarter of 1996, the Company added $0.27 million in discount amortization to its coupon income and then deducted $1.71 million in premium amortization. As shown in Table 7, the net effect in the third quarter of premium and discount amortization was a reduction in net mortgage yield of 0.49%. In the third quarter of 1995, the net effect of amortization was to add 0.30% to the net mortgage yield. For the first nine months of 1996, the reduction in net mortgage yield due to amortization was 0.47%; for the same period in 1995, amortization added 0.48% to the net mortgage yield.

The Company's earnings sensitivity to changes in the mortgage principal repayment rate has been increasing as the Company continues to acquire mortgage assets at premium prices. Management believes that the sensitivity of earnings to a one percentage point change in the mortgage principal repayment rate, all other factors being equal, was approximately $0.01 per share per quarter as of September 30, 1996.

TABLE 6
AMORTIZATION ON MORTGAGE ASSETS

<TABLE>
<CAPTION>

(DOLLARS IN THOUSANDS)

<S>	AVERAGE DISCOUNT BALANCE <C>	DISCOUNT AMORT <C>	ANNUAL RATE OF DISCOUNT AMORT <C>	AVERAGE PREMIUM BALANCE <C>	PREMIUM AMORT <C>	ANNUAL RATE OF PREMIUM AMORT <C>	NET AVERAGE PREMIUM/ (DISC) BALANCE <C>	NET AMORT INCOME/ (EXPENSE) <C>	NET MORTGAGE PRINCIPAL REPAYMTS RECEIVED <C>	NET MORTGAGE PRINCIPAL REPAYMT RATE <C>
1995, 1st Nine Months	$ 3,678	$751	27%	$ 1,779	$ 176	13%	$ (1,899)	$ 575	$ 13,927	11%
1996, 1st Nine Months	16,716	693	6%	18,344	3,682	27%	1,628	(2,989)	162,814	28%
Fiscal 1994	$440	$101	63%	$ 450	$ 19	12%	$ 10	$ 82	$ 1,244	7%
1995, Quarter 1	1,440	234	65%	785	19	10%	(655)	215	2,673	9%
1995, Quarter 2	3,528	237	27%	1,175	34	12%	(2,353)	203	2,934	7%
1995, Quarter 3	6,017	280	19%	3,351	123	15%	(2,666)	157	8,319	16%
1995, Quarter 4	10,889	210	8%	8,314	429	21%	(2,575)	(219)	24,898	28%
1996, Quarter 1	16,941	177	4%	11,299	707	25%	(5,642)	(530)	32,814	27%
1996, Quarter 2	16,739	245	6%	16,402	1,268	31%	(337)	(1,023)		

									53,058	29%
1996, Quarter 3	16,471	271	7%	27,233	1,706	25%	10,762	(1,435)	76,942	28%

</TABLE>

EARNING ASSET YIELD

The Company's earning assets consist of its mortgage assets and its cash balances. The mortgage asset yield is a function of the coupon yield and the amortization of premium and discount. The cash yield is a function of short-term interest rates and other factors. The earning asset yield in the third quarter of 1996 was 6.92%, or 1.27% over the six month average of six-month LIBOR. The margin between the earning asset yield and the level of short-term interest rates narrowed in this quarter, for the most part due to the Company's rapid growth. The earning asset yield was 7.64%, or 1.54% over the six month average of six-month LIBOR, in the third quarter of 1995. For the first nine months of 1996, the earning asset yield was 7.02% (1.43% over average LIBOR) and in the first nine months of 1995 the earning asset yield was 7.41% (1.13% over average LIBOR).

TABLE 7
EARNING ASSET YIELD

<TABLE>
<CAPTION>

	COUPON YIELD	EFFECT OF NET DISCOUNT/ (PREMIUM) AMORTIZATION	NET MORTGAGE YIELD	CASH YIELD	EARNING ASSET YIELD	SIX-MONTH AVERAGE OF SIX-MONTH LIBOR	YIELD VS. SIX-MONTH AVERAGE OF SIX-MONTH LIBOR
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
1995, 1st Nine Months	6.96%	0.48%	7.44%	5.41%	7.41%	6.28%	1.13%
1996, 1st Nine Months	7.52%	(0.47%)	7.05%	5.58%	7.02%	5.59%	1.43%
Fiscal 1994	6.09%	0.53%	6.62%	4.73%	6.40%	5.07%	1.33%
1995, Quarter 1	6.35%	0.77%	7.12%	4.96%	7.09%	6.25%	0.84%
1995, Quarter 2	6.92%	0.49%	7.42%	5.57%	7.40%	6.48%	0.92%
1995, Quarter 3	7.39%	0.30%	7.68%	5.53%	7.64%	6.10%	1.54%
1995, Quarter 4	7.64%	(0.24%)	7.40%	5.48%	7.34%	5.82%	1.52%
1996, Quarter 1	7.82%	(0.37%)	7.45%	5.93%	7.40%	5.62%	1.78%
1996, Quarter 2	7.48%	(0.51%)	6.97%	5.61%	6.94%	5.49%	1.45%
1996, Quarter 3	7.44%	(0.49%)	6.95%	5.30%	6.92%	5.65%	1.27%

</TABLE>

COST OF BORROWED FUNDS AND HEDGING AND THE INTEREST RATE SPREAD

From the second to the third quarter of 1996, the cost of borrowed funds increased from 5.57% to 5.78%. This increase was due primarily to an increase in short-term interest rates (as shown in Table 8 by an increase in the six month average of six-month LIBOR) and to an increase in the percentage of the balance sheet consisting of whole loans (which, on average, are more costly to fund than securitized mortgage assets). The cost of hedging declined slightly, from 0.16% of average borrowed funds in the second quarter to 0.14% in the third quarter. The all-in cost of funds and hedging was 5.92% for the third quarter of 1996. The all-in cost of funds and hedging in the third quarter of 1995 was 6.37%. In the third quarter of both of these years, the all-in cost of funds and hedging was 0.27% over the average LIBOR rate.

For the first nine months of 1995 and 1996, the all-in cost of funds and hedging was 6.31% and 5.83%, respectively. The all-in cost of funds for these periods was 0.03% and 0.24% over the six month average of six-month LIBOR.

Hedging costs, or interest rate agreement expenses, consist of the amortization of premium paid for interest rate cap agreements, net of any income received, plus the net on-going expense or income from interest rate swap and collar agreements. In an interest rate cap agreement, the Company pays an up-front premium to a counter-party; the counter-party will make payments to the Company if LIBOR rises above a certain level. In an interest rate swap agreement, the Company typically does not make an up-front payment. The Company agrees to pay a fixed rate of interest to a counter-party on a certain notional amount; the counter-party in turn pays to the Company a floating rate of interest on the same notional amount. In a collar agreement, the Company generally does not make an initial payment, will incur a hedge expense if the index falls below the floor strike rate and will have hedge income if the index exceeds the cap strike rate. The Company has also entered into a periodic cap designed to serve as a hedge against short-term interest rates rising faster than 0.50% per quarter. In addition, the Company has entered into Treasury versus LIBOR basis swaps to reduce potential risks arising from Treasury-based mortgage assets funded with LIBOR-based borrowings. These basis swaps will provide increased income to the Company should short-term LIBOR rates increase relative to short-term Treasury rates and will increase hedging expense for the Company should that spread narrow. See "Note 3. Interest Rate Agreements" to the Notes to Financial Statements for further details.

Hedging costs in the third quarter of 1996 and the first nine months of 1996 were lower relative to the size of the balance sheet than in the same time periods of 1995 due to a flatter yield curve and lower levels of interest rate volatility in 1996. In addition, the Company reduced its hedging activities somewhat in the second and third quarters of 1996 in conjunction with the extension of the maturities of its borrowings.

The interest rate spread is the difference between the earning asset yield and the all-in cost of funds and hedging; it measures the profitability of that portion of the balance sheet wherein earning assets are funded with borrowings. The interest rate spread for the third quarter of 1996 was 1.00%. This was lower than the 1.21% earned in the second quarter of 1996 and the 1.27% earned in the third quarter of 1995. As discussed above, the compression of the spread in the third quarter is primarily a product of the Company's rapid growth in the second and third quarters.

The interest rate spread in the first nine months of 1996 of 1.19% was slightly wider than the spread in the first nine months of 1995 of 1.10%. Relative to 1995, increased asset yields (relative to short-term interest rates) and lower hedging costs in 1996 offset a higher cost of funds (relative to short-term interest rates).

TABLE 8
COST OF BORROWED FUNDS AND HEDGING

<TABLE>
<CAPTION>

	COST OF FUNDS	SIX MONTH AVERAGE OF SIX-MONTH LIBOR	COST OF FUNDS VS. SIX-MONTH AVERAGE OF SIX-MONTH LIBOR	COST OF HEDGING	COST OF FUNDS AND HEDGING	COST OF FUNDS AND HEDGING VS. SIX-MONTH AVERAGE OF SIX-MONTH LIBOR	EARNING ASSET YIELD	INTEREST RATE SPREAD
1995, 1st Nine Months	6.10%	6.28%	(0.17%)	0.21%	6.31%	0.03%	7.41%	1.10%
1996, 1st Nine Months	5.69%	5.59%	0.10%	0.14%	5.83%	0.24%	7.02%	1.19%
Fiscal 1994	5.55%	5.07%	0.48%	0.06%	5.61%	0.54%	6.40%	0.79%
1995, Quarter 1	5.96%	6.25%	(0.29%)	0.06%	6.02%	(0.23%)	7.09%	1.07%
1995, Quarter 2	6.26%	6.48%	(0.22%)	0.23%	6.49%	0.01%	7.40%	0.91%
1995, Quarter 3	6.09%	6.10%	(0.01%)	0.28%	6.37%	0.27%	7.64%	1.27%
1995, Quarter 4	6.04%	5.82%	0.22%	0.18%	6.22%	0.40%	7.34%	1.12%
1996, Quarter 1	5.69%	5.62%	0.07%	0.14%	5.83%	0.21%	7.40%	1.57%
1996, Quarter 2	5.57%	5.49%	0.08%	0.16%	5.73%	0.24%	6.94%	1.21%
1996, Quarter 3	5.78%	5.65%	0.13%	0.14%	5.92%	0.27%	6.92%	1.00%

</TABLE>

CREDIT PROVISIONS

Credit provisions for the third quarter of 1996 were $0.52 million, or 0.18% of average assets and 1.43% of average equity during the quarter. In the third quarter of 1995, credit provisions were $0.08 million, or 0.16% of average assets and 0.65% of average equity. Credit provisions were lower in the third quarter of 1995 as the Company had not yet acquired its whole loans or many of the mortgage securities rated below

BBB which it currently owns. These credit expenses represent provisions only; there were no actual credit losses in either of these periods.

For similar reasons, the credit provisions for the first nine months of 1996 of $1.32 million (equaling 0.22% of average assets and 1.63% of average equity) were higher than the credit provisions for the same time period in 1995 of $0.14 million (which equaled 0.11% of average assets and 0.59% of average equity). There were no actual credit losses in either of these periods.

The Company takes on-going quarterly credit provisions to build a credit reserve for possible future losses from its mortgage assets. Such credit provisions were taken at a rate of approximately $113,000 per month during the third quarter of 1996. In addition, each quarter the Company takes a provision of 0.30% of the balance of whole loans acquired during that quarter plus the amount of any interest accrued on non-performing assets. In the third quarter, this portion of the provision totaled $178,000. The rate at which the Company takes credit provisions may be adjusted in the future based on the Company's review of credit reserve adequacy.

The table below summarizes the Company's credit provisions and actual credit losses. Please also see "Financial Condition -- Credit Reserves" below.

TABLE 9
CREDIT PROVISIONS AND ACTUAL CREDIT LOSSES

<TABLE>
<CAPTION>

	CREDIT PROVISIONS ON WHOLE LOANS	CREDIT PROVISIONS ON SECURITIZED ASSETS	TOTAL CREDIT PROVISIONS	ACTUAL CREDIT LOSSES ON WHOLE LOANS	ACTUAL CREDIT LOSSES ON SECURITIZED ASSETS	TOTAL ACTUAL CREDIT LOSSES	ANNUALIZED CREDIT PROVISIONS TO AVERAGE ASSETS	ANNUALIZED CREDIT PROVISIONS TO AVERAGE EQUITY
				(DOLLARS IN THOUSANDS)				
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
1995, 1st Nine months	$ 0	$ 143	$ 143	$ 0	$ 0	$ 0	0.11%	0.59%
1996, 1st Nine months	313	1,011	1,324	0	0	0	0.22%	1.63%
Fiscal 1994	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	0.00%	0.00%
1995, Quarter 1	0	19	19	0	0	0	0.06%	0.34%
1995, Quarter 2	0	40	40	0	0	0	0.10%	0.72%
1995, Quarter 3	0	84	84	0	0	0	0.16%	0.65%
1995, Quarter 4	79	271	350	0	4	4	0.38%	1.95%
1996, Quarter 1	(5)	336	331	0	0	0	0.26%	1.93%
1996, Quarter 2	140	337	477	0	0	0	0.25%	1.69%
1996, Quarter 3	178	338	516	0	0	0	0.18%	1.43%

</TABLE>

OPERATING EXPENSES

Operating expenses were $0.67 million in the third quarter of 1996. This was an increase from the $0.36 million of operating expenses incurred in the same quarter in 1995. Nevertheless, the Company was significantly more productive in the third quarter of 1996 as compared to the third quarter of 1995, as measured by the efficiency ratio (operating expenses to net interest income) dropping from 25% to 15%, the operating-expenses-to-average-assets ratio dropping from 0.68% to 0.23% and the operating-expenses-to-average-equity ratio dropping from 2.81% to 1.87%. Average assets per employee increased from $39 million to $115 million.

For the first nine months of 1995 to the first nine months of 1996, operating expenses increased from $0.76 million to $1.76 million.

Nevertheless, measures of operating expense productivity improved over that time period as well.

The table below presents the Company's operating expenses and selected ratios measuring the Company's operating efficiency.

TABLE 10
OPERATING EXPENSES

<TABLE>
<CAPTION>

	CASH COMP AND BENEFITS EXPENSE	NON-CASH STOCK OPTION AND DER EXPENSE	OTHER NON-CASH OPERATING EXPENSE	OTHER CASH OPERATING EXPENSE	TOTAL OPERATING EXPENSE	OPERATING EXPENSE/ NET INTEREST INCOME	OPERATING EXPENSE/ AVERAGE ASSETS	OPERATING EXPENSE/ AVERAGE EQUITY	AVE. AVERAGE ASSETS PER # OF EMPLOYEES ($MM)
	(DOLLARS IN THOUSANDS)								
1995, 1st Nine Months	$359	$ 7	$ 43	$354	$ 763	28%	0.61%	3.16%	$ 33
1996, 1st Nine Months	848	245	17	648	1,758	16%	0.29%	2.16%	92
Fiscal 1994	$ 63	$ 0	$ 42	$ 41	$ 146	28%	0.70%	2.07%	$ 12
1995, Quarter 1	81	0	37	83	201	32%	0.64%	3.69%	25
1995, Quarter 2	81	0	(20)	137	198	29%	0.48%	3.51%	33
1995, Quarter 3	197	7	26	134	364	25%	0.68%	2.81%	39
1995, Quarter 4	103	48	96	120	368	18%	0.40%	2.04%	53
1996, Quarter 1	233	85	(3)	177	492	18%	0.39%	2.86%	69
1996, Quarter 2	305	79	(5)	214	594	17%	0.31%	2.11%	84
1996, Quarter 3	310	81	25	256	672	15%	0.23%	1.87%	115

</TABLE>

COMPONENTS OF RETURN ON AVERAGE EQUITY

Table 11 below shows elements of the Company's income statement expressed as a percentage of average equity.

TABLE 11
COMPONENTS OF RETURN ON AVERAGE EQUITY
(EQUITY-BASED METHOD)

<TABLE>
<CAPTION>

	INTEREST RATE SPREAD	DEBT/ EQUITY RATIO	SPREAD LENDING RETURN ON AVERAGE EQUITY	EQUITY-FUNDED LENDING RETURN ON AVERAGE EQUITY	NET INTEREST INCOME RETURN ON AVERAGE EQUITY	CREDIT PROVISIONS/ AVERAGE EQUITY	OPERATING EXPENSE/ AVERAGE EQUITY	RETURN ON AVERAGE COMMON AND PREFERRED EQUITY	RETURN ON AVERAGE COMMON EQUITY
1995, 1st Nine months	1.10%	4.18x	4.56%	6.83%	11.39%	0.59%	3.16%	7.64%	7.64%
1996, 1st Nine months	1.19%	6.42x	7.59%	5.83%	13.42%	1.63%	2.16%	9.63%	9.60%
Fiscal 1994	0.79%	1.94x	1.82%	5.65%	7.47%	0.00%	2.07%	5.40%	5.40%
1995, Quarter 1	1.07%	4.72x	5.07%	6.32%	11.39%	0.34%	3.69%	7.36%	

									7.36%
1995, Quarter 2	0.91%	6.20x	5.61%	6.59%	12.20%	0.72%	3.51%	7.97%	7.97%
1995, Quarter 3	1.27%	3.08x	3.92%	7.20%	11.12%	0.65%	2.81%	7.66%	7.66%
1995, Quarter 4	1.12%	4.10x	4.61%	6.66%	11.27%	1.95%	2.04%	7.28%	7.28%
1996, Quarter 1	1.57%	6.34x	9.99%	6.17%	16.16%	1.93%	2.86%	11.37%	11.37%
1996, Quarter 2	1.21%	5.78x	7.02%	5.66%	12.68%	1.69%	2.11%	8.88%	8.88%
1996, Quarter 3	1.00%	6.94x	6.94%	5.77%	12.71%	1.43%	1.87%	9.41%	9.32%

</TABLE>

Net interest income as a percentage of equity of 12.71% in the third quarter of 1996 was similar to the 12.68% earned in the second quarter of 1996. The Company earned a narrower spread but maintained its net interest income earnings rate through better capital utilization. The overall return on equity (ROE) rose as a result of decreased credit provisions and operating expenses as a percentage of equity.

As compared to the third quarter of 1995, ROE in the third quarter of 1996 was higher due to greater net interest income earnings as a percentage of equity and a significantly improved operating expense ratio. For similar reasons, the ROE for the first nine months of 1996 exceeded that earned in the same period the year before.

The table below shows the components of the Company's income statement expressed as a percentage of average assets.

TABLE 12
COMPONENTS OF RETURN ON AVERAGE EQUITY
(ASSET-BASED METHOD)

<TABLE>
<CAPTION>

<S>	INTEREST INCOME/ AVERAGE ASSETS <C>	COST OF FUNDS AND HEDGING EXPENSE/ AVERAGE ASSETS <C>	NET INTEREST MARGIN <C>	CREDIT PROVISION/ AVERAGE ASSETS <C>	OPERATING EXPENSE/ AVERAGE ASSETS <C>	RETURN ON AVERAGE ASSETS <C>	AVERAGE ASSETS TO AVERAGE COMMON AND PREFERRED EQUITY <C>	RETURN ON AVERAGE COMMON AND PREFERRED EQUITY <C>	RETURN ON AVERAGE COMMON EQUITY <C>
1995, 1st Nine Months	7.23%	5.05%	2.18%	0.11%	0.61%	1.46%	5.22x	7.64%	7.64%
1996, 1st Nine Months	6.82%	5.02%	1.80%	0.22%	0.29%	1.29%	7.46x	9.63%	9.60%
Fiscal 1994	6.20%	3.68%	2.53%	0.00%	0.70%	1.83%	2.95x	5.40%	5.40%
1995, Quarter 1	6.91%	4.93%	1.98%	0.06%	0.64%	1.28%	5.76x	7.36%	7.36%
1995, Quarter 2	7.24%	5.55%	1.69%	0.10%	0.48%	1.10%	7.25x	7.97%	7.97%
1995, Quarter 3	7.44%	4.75%	2.69%	0.16%	0.68%	1.86%	4.13x	7.66%	7.66%
1995, Quarter 4	7.11%	4.93%	2.18%	0.38%	0.40%	1.41%	5.16x	7.28%	7.28%
1996, Quarter 1	7.20%	5.01%	2.19%	0.26%	0.39%	1.54%	7.38x	11.37%	11.37%
1996, Quarter 2	6.73%	4.87%	1.86%	0.25%	0.31%	1.30%	6.81x	8.88%	8.88%
1996, Quarter 3	6.73%	5.14%	1.59%	0.18%	0.23%	1.18%	8.00x	9.41%	9.32%

</TABLE>

As compared to the second quarter of 1996, the net interest margin and the return on average assets in the third quarter of 1996 narrowed due to the compression of the interest rate spread (as discussed above) and the greater utilization of leverage. Partially offsetting the effects of spread compression were improved credit provision and operating expense ratios. With the greater utilization of the Company's capital, ROE increased despite a lower return on assets (ROA). Similarly, the

ROA was lower and the ROE was higher in the third quarter and first nine months of 1996 as compared to the same periods in 1995.

FINANCIAL CONDITION

SUMMARY

Management believes the Company is well capitalized for the level of risk 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. The Company takes credit provisions to reserve for potential future credit losses. 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 estimated 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.

END OF PERIOD BALANCE SHEET

The table below shows the components of the Company's balance sheet over time.

TABLE 13
END OF PERIOD BALANCE SHEET

<TABLE>
<CAPTION>

(DOLLARS IN THOUSANDS)

END OF PERIOD	CASH	MORTGAGE ASSETS	INTEREST RATE AGREEMENTS	RECEIVABLES AND OTHER ASSETS	TOTAL ASSETS	BORROWINGS	PAYABLES	COMMON AND PREFERRED EQUITY	PREFERRED EQUITY	COMMON EQUITY
Fiscal 1994	$ 1,027	$ 117,477	$1,892	$ 1,132	$ 121,528	$ 100,376	$ 871	$ 20,281	$ 0	$ 20,281
1995, Quarter 1	953	141,860	1,434	1,193	145,440	121,998	1,090	22,352	0	22,352
1995, Quarter 2	1,620	175,242	825	1,634	179,321	155,881	907	22,533	0	22,533
1995, Quarter 3	1,150	298,785	809	2,650	303,394	228,826	2,095	72,473	0	72,473
1995, Quarter 4	4,825	432,244	547	3,941	441,557	370,316	2,951	68,290	0	68,290
1996, Quarter 1	9,705	565,159	1,233	5,216	581,313	508,721	4,447	68,145	0	68,145
1996, Quarter 2	10,407	1,007,480	1,351	9,092	1,028,330	896,214	7,821	124,295	0	124,295
1996, Quarter 3	14,599	1,375,870	873	12,136	1,403,478	1,225,094	14,867	163,517	29,712	133,805

</TABLE>

AVERAGE DAILY BALANCE SHEET

The table below shows the estimated average daily balances over time of the components of the Company's balance sheet.

TABLE 14
AVERAGE DAILY BALANCE SHEET

<TABLE>
<CAPTION>

	MORTGAGE	INTEREST RATE	RECEIVABLES AND OTHER	TOTAL	COMMON AND PREFERRED

END OF PERIOD	CASH	ASSETS	AGREEMENTS	ASSETS	ASSETS	BORROWINGS	PAYABLES	EQUITY	PREFERRED EQUITY	COMMON EQUITY
				(DOLLARS IN THOUSANDS)						
1995, 1st Nine Months	$ 2,102	$ 161,881	$1,082	$ 3,123	$ 168,188	$134,431	$ 1,564	$ 32,193	$ 0	$ 32,193
1996, 1st Nine Months	15,975	770,830	1,388	21,628	809,821	696,725	4,523	108,572	5,097	103,475
Fiscal 1994	$ 6,627	$ 49,498	$ 790	$ 948	$ 57,862	$ 37,910	$ 368	$ 19,584	$ 0	$ 19,584
1995, Quarter 1	1,217	121,116	1,399	1,958	125,691	102,894	977	21,820	0	21,820
1995, Quarter 2	1,466	158,606	1,020	2,559	163,651	139,979	1,111	22,561	0	22,561
1995, Quarter 3	3,597	204,999	831	4,819	214,247	159,794	2,585	51,868	0	51,868
1995, Quarter 4	10,709	349,296	730	10,999	371,734	295,089	4,653	71,991	0	71,991
1996, Quarter 1	14,639	478,645	667	13,095	507,046	435,979	2,324	68,743	0	68,743
1996, Quarter 2	14,402	729,143	1,658	21,566	766,768	651,643	2,472	112,653	0	112,653
1996, Quarter 3	18,854	1,101,074	1,833	30,129	1,151,890	999,229	8,728	143,933	15,179	128,754

</TABLE>

MORTGAGE ASSET ACQUISITIONS

The two principal criteria the Company uses when acquiring mortgage assets are: (i) the mortgages must be "A" quality in terms of underwriting and documentation standards, or must be credit-enhanced to the AAA or AA credit-rating level, and (ii) the risk-adjusted returns on equity the Company anticipates earning on such assets must be attractive across a variety of economic scenarios relative to the Company's cost of capital and relative to other available mortgage assets.

During the third quarter of 1996, the Company acquired mortgage assets of $444 million, thereby increasing the Company's net total mortgage balance by 37%. Whole mortgage loans represented 14% of the acquisitions in the third quarter of 1996. FHLMC- and FNMA-guaranteed mortgages represented 70% and private-label

mortgage securities represented 16% of the quarter's acquisitions. The average price paid for mortgage assets acquired during the quarter was 102.74% of principal value. The pricing in excess of face value for these assets as compared to past acquisitions reflects, on average, the higher credit ratings, higher initial coupons and higher net margins of these recently acquired assets. The average initial coupon of the acquired mortgages was 7.53%, which was 0.49% lower than the fully-indexed coupon rate toward which these coupons will adjust over time based on the index levels at the time of acquisition. The table below summarizes the characteristics of the Company's mortgage asset acquisitions.

TABLE 15
MORTGAGE ASSET ACQUISITIONS

<TABLE>
<CAPTION>

	ASSET ACQUISITIONS AT COST	AVERAGE PRICE VERSUS PRINCIPAL VALUE	AVERAGE INITIAL COUPON	"A" QUALITY WHOLE LOANS	FHLMC & FNMA GUARANTEED MORTGAGES	AAA &AA RATED MORTGAGE SECURITIES	A & BBB RATED MORTGAGE SECURITIES	BELOW BBB RATED MORTGAGE SECURITIES
				(DOLLARS IN THOUSANDS)				
1995, 1st Nine Months	$ 192,111	100.05%	7.14%	0.0%	54.7%	30.8%	5.9%	8.6%
1996, 1st Nine Months	1,106,896	102.55%	7.44%	10.2%	67.3%	22.5%	0.0%	0.0%
Fiscal 1994	$ 121,297	99.53%	5.87%	0.0%	64.8%	28.1%	4.3%	2.8%
1995, Quarter 1	24,116	94.80%	6.78%	0.0%	15.1%	49.1%	25.6%	10.2%
1995, Quarter 2	35,355	93.11%	6.42%	0.0%	65.8%	13.1%	0.0%	21.1%
1995, Quarter 3	132,640	103.14%	7.40%	0.0%	59.0%	32.3%	3.8%	4.9%
1995, Quarter 4	162,461	95.78%	7.39%	16.5%	52.4%	20.1%	5.5%	5.5%
1996, Quarter 1	166,852	102.60%	7.60%	0.0%	47.6%	52.4%	0.0%	0.0%
1996, Quarter 2	496,184	102.36%	7.30%	9.9%	71.5%	18.6%	0.0%	0.0%
1996, Quarter 3	443,860	102.74%	7.53%	14.4%	69.9%	15.7%	0.0%	0.0%

</TABLE>

SUMMARY OF MORTGAGE ASSET CHARACTERISTICS

As of September 30, 1996, all the Company's mortgage assets were single-family, adjustable-rate, first-lien mortgages or securitized interests in pools of such loans. The average historical amortized cost of these assets (before credit provision write-downs) was 101.20% of principal value. The estimated bid-side market value of these assets (which the Company uses as the carrying value of mortgages on its balance sheet) was 101.09% of principal value. The average credit rating equivalent at September 30, 1996 was AA+. For all the mortgage assets owned by the Company, 45% of the underlying properties were located in California. Excluding the FHLMC- and FNMA-guaranteed mortgages, 69% of the properties underlying the Company's mortgage assets were located in California. The table below summarizes the Company's mortgage asset balances.

TABLE 16
MORTGAGE ASSET SUMMARY

<TABLE>
<CAPTION>

(DOLLARS IN THOUSANDS)

END OF PERIOD	MORTGAGE PRINCIPAL VALUE	AMORTIZED COST	AMORTIZED COST TO PRINCIPAL VALUE	ESTIMATED BID-SIDE MARKET VALUE	ESTIMATED BID-SIDE MARKET VALUE TO PRINCIPAL VALUE	AVERAGE CREDIT RATING EQUIV.	PERCENT IN CALIFORNIA	PERCENT IN CALIFORNIA EXCLUDING FHLMC & FNMA MORTGAGES
Fiscal 1994	$ 120,627	$ 120,135	99.59%	$ 117,477	97.39%	AA+	72%	82%
1995, Quarter 1	143,393	141,792	98.88%	141,860	98.93%	AA+	73%	80%
1995, Quarter 2	178,429	174,415	97.75%	175,242	98.21%	AA+	72%	80%
1995, Quarter 3	298,718	298,894	100.06%	298,785	100.02%	AA+	65%	77%
1995, Quarter 4	443,625	436,236	98.33%	432,244	97.43%	AA+	65%	71%
1996, Quarter 1	573,807	569,744	99.29%	565,159	98.49%	AA+	64%	69%
1996, Quarter 2	1,005,765	1,011,847	100.60%	1,007,480	100.17%	AA+	51%	67%
1996, Quarter 3	1,361,062	1,377,331	101.20%	1,375,870	101.09%	AA+	45%	69%

</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 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 over time should interest rates remain unchanged. The rate of adjustment of the current coupon to the fully-indexed rate is determined by the length of the adjustment periods and the periodic caps of the mortgage loans.

TABLE 17
AVERAGE MORTGAGE ASSET CHARACTERISTICS

<TABLE>
<CAPTION>

END OF PERIOD	MORTGAGE COUPON RATE	INTEREST RATE INDEX LEVEL	MORTGAGE NET MARGIN	MORTGAGE FULLY-INDEXED RATE	COUPON RATE VS. FULLY-INDEXED RATE	AVERAGE NUMBER OF MONTHS TO NEXT ADJUSTMENT	LIFETIME CAP	MORTGAGE ASSET YIELD
Fiscal 1994	6.00%	6.94%	2.25%	9.19%	(3.19%)	3	11.48%	6.60%
1995, Quarter 1	6.53%	6.47%	2.24%	8.71%	(2.18%)	3	11.57%	7.23%
1995, Quarter 2	6.94%	5.99%	2.21%	8.20%	(1.26%)	3	11.54%	7.74%
1995, Quarter 3	7.35%	5.86%	2.20%	8.06%	(0.71%)	4	11.56%	7.81%
1995, Quarter 4	7.50%	5.44%	2.08%	7.52%	(0.02%)	3	11.54%	7.74%
1996, Quarter 1	7.59%	5.47%	2.11%	7.58%	0.01%	3	11.53%	7.67%
1996, Quarter 2	7.42%	5.72%	2.21%	7.93%	(0.51%)	4	11.71%	6.98%

1996, Quarter 3	7.55%	5.70%	2.21%	7.91%	(0.36%)	4	11.69%	6.99%

</TABLE>

As of the end of the third quarter of 1996, 50% of the Company's mortgage assets had coupon rates which adjusted as a function of changes in the wholesale cost of funds of money-center banks (the LIBOR and CD indices), 49% adjusted as a function of short-term U.S. Treasury interest rates and 1% adjusted off other indices. The coupon adjustment cycle is every six months for 51% of total mortgages, every twelve months for 46% of total mortgages and monthly for 2% of total mortgages. Approximately 1% of mortgages have other re-pricing terms. The periodic caps for 97% of the mortgage assets were either 1% per six months or 2% per year; 2% of the mortgages had no periodic caps and 1% had other cap structures. The table below segments the Company's mortgage assets by adjustment index, coupon adjustment frequency and periodic cap adjustment

TABLE 18
MORTGAGE ASSETS BY INDEX

<TABLE>
<CAPTION>

	SIX-MONTH LIBOR INDEX	ONE-MONTH LIBOR INDEX	SIX-MONTH BANK CD INDEX	ONE-YEAR TREASURY INDEX	SIX-MONTH TREASURY INDEX	OTHER
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Adjustment Frequency/Loan	6 months	1 month	6 months	12 months	6 months	various
Average Adjustment/Pool	3 months	1 month	3 months	6 months	3 months	various
Annualized Periodic Cap	2%	none	2%	2%	2%	various

</TABLE>

<TABLE>
<CAPTION>

	% OF TOTAL MORTGAGE ASSETS AT PERIOD END					
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	78.2%	3.9%	17.9%	0.0%	0.0%	0.0%
1995, Quarter 1	78.7%	3.1%	17.3%	0.9%	0.0%	0.0%
1995, Quarter 2	83.0%	2.5%	13.8%	0.7%	0.0%	0.0%
1995, Quarter 3	66.8%	1.4%	11.6%	11.5%	7.6%	1.1%
1995, Quarter 4	59.7%	7.7%	12.8%	12.5%	5.0%	2.3%
1996, Quarter 1	63.1%	6.5%	8.9%	14.9%	3.6%	3.0%
1996, Quarter 2	54.1%	3.2%	3.4%	33.3%	4.4%	1.6%
1996, Quarter 3	45.5%	2.2%	2.4%	45.7%	3.0%	1.2%

</TABLE>

At the end of the third quarter of 1996, whole mortgage loans were $127.7 million, or 9.3% of total mortgage assets. Due to the "A" quality underwriting and documentation standards the Company requires for these loans, management believes that over 90% of the balance of these loans would receive a credit rating of AAA or AA should the Company securitize these loans and seek a credit rating from the credit rating agencies in the future. Securitized loans with a credit rating equivalent of BBB or better were $1.2 billion, or 88.8% of the Company's total mortgage assets and securitized mortgage loans with a credit rating equivalent of below BBB represented 1.9% of the total as of September 30, 1996. Unrated securitized assets have been assigned a credit rating equivalent by management. The table below shows the balance of the Company's whole mortgage loans and the Company's securitized mortgage assets segregated by credit rating.

TABLE 19
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	25,838	24,272	4.4%	86.8%	4.6%	4.2%
1996, Quarter 2	69,666	886,990	25,753	25,070	6.9%	88.0%	2.6%	2.5%
1996, Quarter 3	127,695	1,196,887	25,748	25,540	9.3%	86.9%	1.9%	1.9%

</TABLE>

WHOLE MORTGAGE LOANS

As of September 30, 1996, the Company owned 478 whole loans with a total loan balance of $126.4 million. All of these loans were adjustable-rate, single-family loans underwritten to "A" quality standards. The average loan size was $264,490. California loans represent 85% of the total outstanding balance. Loans with original loan-to-

value ratios in excess of 80% represent 32% of the total outstanding balance; each of these loans is credit-enhanced with primary mortgage insurance which served to bring the effective original loan-to-value ratio to 75% or less. After giving effect to this mortgage insurance, the average original loan-to-value ratio of the Company's whole loans was 73%. In addition, for $11.7 million of these loans the Company has recourse to an "A"-rated third party for any losses which may occur prior to August 2001. The table below presents selected characteristics of the Company's whole loan mortgage assets.

TABLE 20
WHOLE MORTGAGE LOAN SUMMARY

<TABLE>
<CAPTION>

(ALL RATIOS BASED ON % OF TOTAL LOAN PORTFOLIO BALANCES UNLESS NOTED)	AT SEPTEMBER 30, 1996	AT DECEMBER 31,1995
	(ALL DOLLARS IN THOUSANDS)	
<S>	<C>	<C>
Face Value	$126,426	$26,411
Amortized Cost	127,809	26,449
Adjustable-Rate	100%	100%
Single-Family	100%	100%
"A" Quality Underwriting	100%	100%
First Lien	100%	100%
Primary Residence	99%	100%
Property Located in Northern California	34%	30%
Property Located in Southern California	51%	44%
Top Ten States as of 9/30/96		
California	84.8%	74.5%
Minnesota	2.5%	0.0%
Colorado	1.5%	3.2%
Oregon	1.3%	2.3%
Ohio	1.3%	0.7%
Michigan	1.3%	0.0%
Utah	1.1%	0.5%
Washington	1.0%	3.8%
Texas	1.0%	3.9%
Connecticut	0.6%	1.3%
Number of Loans	478	109
Average Loan Size	$ 264	$ 242
Loan Balance in Excess of $500,000	12%	23%
Average Original Loan to Value Ratio (LTV)	78%	76%
Original LTV greater than 80%	32%	26%
Percent of Original LTV greater than 80% with Mortgage Insurance	100%	100%
Effective Original LTV including Primary Mortgage Insurance	73%	72%
1993 Origination	7%	0%
1994 Origination	43%	2%
1995 Origination	32%	98%
1996 Origination	18%	0%
Non-Performing Assets (90+ days delinquent)	$ 404	$ 0
Number of Non-Performing Loans (90+ days delinquent)	3	0
Non-Performing Assets as % of Total Loan Balances	0.3%	0.0%

</TABLE>

The Company defines non-performing assets ("NPAs") as whole loans which are delinquent more than 90 days. As of September 30, 1996, the Company's NPAs were $403,606, reflecting three loans in foreclosure. At December 31, 1995 the Company had no non-performing assets. The Company has experienced no actual whole loan credit losses through September 30, 1996.

SECURITIZED MORTGAGES RATED AAA TO BBB

At September 30, 1996, 89% of the Company's mortgage assets were securitized interests in pools of single-family mortgage loans which had an investment-grade credit 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. At December 31, 1995, these types of mortgage securities represented 88% of the Company's mortgage assets.

Each of these securitized interests in mortgage pools has credit-enhancement from a third-party which provides the Company with partial protection from credit losses in addition to the protection afforded by the value of the properties underlying the individual mortgages and any primary mortgage insurance on individual loans. Given the quality of the mortgage loans in these pools and the levels of additional credit-enhancement, management believes the level of credit risk for these mortgage assets is low. In the event, however, that credit losses in these pools exhaust the credit-enhancement or in the event of default of FNMA, FHLMC or another third party guarantor, credit losses to the Company could result. To date, the Company has experienced no actual credit losses from these mortgage assets.

SECURITIZED MORTGAGES RATED 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 average equity, net of expected credit losses, over the life of the asset will be attractive. Such assets had an estimated bid-side market value at September 30, 1996 of $25.5 million, or 1.9% of the Company's total mortgage assets. At December 31, 1995, the estimated market value of such assets was $24.8 million. These assets have high potential yields but also have higher levels of credit risk, are costly to finance and require a large allocation of capital under the Company's risk-adjusted capital system.

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, an expanded equity base for the Company and a lower internal risk-adjusted capital allocation. Another potential benefit is the eventual return of principal (net of credit losses) which was purchased at a discount, increasing the rate at which the Company's amortizes its discount balance into income.

The bulk of the Company's securitized assets with a credit rating equivalent below BBB are credit-enhanced, although to a lesser degree than higher-rated assets. Credit losses will not be incurred by the Company on these assets until total credit losses in the related mortgage pool exhaust the credit-enhancement. At that point, however, the rate of loss to the Company's interest may be significant as these interests are subordinated to and provide credit-enhancement for other, more senior, interests issued from the same mortgage pool.

For several of these interests owned by the Company, the underlying pools currently have levels of mortgage delinquencies in excess of management's original expectations. Delinquency levels in these pools appeared to have stabilized in the second and third quarters of 1996.

Actual pool credit losses which serve to reduce the credit-enhancement protection to the Company's below BBB-rated interests have occurred as of September 30, 1996, but a substantial majority of the aggregate original credit enhancement in these pools is still intact. The Company has experienced no credit losses from these assets.

At September 30, 1996 and December 31, 1995, the Company also owned $0.2 million of "first loss" assets. These are subordinated interests with no credit-enhancement. All credit losses in the related pools of mortgages will reduce the principal value of the Company's "first loss" asset and will be recognized as an actual credit loss by the Company. The limit of the Company's potential credit losses on these assets is equal to the amortized cost of $0.2 million. As the Company's cost basis in "first loss" assets is low relative to the mortgage principal value, the Company's realized credit loss will equal only 10-20% of the principal value of any mortgage credit losses in the pools. Total credit losses realized by the Company on "first loss" assets have been $3,997 through September 30, 1996.

CREDIT RESERVES

Through its quarterly credit provisions, the Company is building a credit reserve for future credit losses. The first step the Company takes in its on-going review of the adequacy of its credit reserve is to assess potential credit risk arising from seriously delinquent (90+ days) whole loans and seriously delinquent loans in the mortgage pools underlying the Company's securitized mortgage assets. Future credit losses from these loans will depend on the number of these loans actually defaulting, the loss severity experienced on default of the loan, the level of credit-enhancement at the pool level, and the Company's amortized cost basis in that asset. The table below shows the credit losses that could be incurred by the Company if all the seriously delinquent mortgage loans in which the Company owned an interest at September 30, 1996 were to default and result in a loss. For example, if all these loans were to default and the loss severity experienced was 25% of the loan balance, credit losses to the Company would be $703,000 (39% of the current credit reserve.) The amount of actual credit losses that will be incurred from these loans is unknown; management expects that some losses will be realized in the near future. This table addresses the potential credit risk arising from current serious delinquencies only; it does not purport to reflect potential losses that may occur over the life of these assets.

TABLE 21
POTENTIAL FUTURE CREDIT LOSSES ESTIMATED BASED ON
CURRENT 90+ DAY DELINQUENCIES ONLY

<TABLE>
<CAPTION>

END OF PERIOD	CREDIT LOSS RESERVE	CUMULATIVE ESTIMATED ACTUAL REALIZED LOSS SEVERITY	POTENTIAL FUTURE LOSSES ASSUMING LOSS SEVERITY OF 10%	POTENTIAL FUTURE LOSSES ASSUMING LOSS SEVERITY OF 15%	POTENTIAL FUTURE LOSSES ASSUMING LOSS SEVERITY OF 20%	POTENTIAL FUTURE LOSSES ASSUMING LOSS SEVERITY OF 25%	POTENTIAL FUTURE LOSSES ASSUMING LOSS SEVERITY OF 30%	POTENTIAL FUTURE LOSSES ASSUMING LOSS SEVERITY OF 35%
				(DOLLARS IN THOUSANDS)				
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	$ 0	0%	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
1995, Quarter 1	19	0%	0	0	0	0	0	0
1995, Quarter 2	59	0%	0	0	0	0	0	0
1995, Quarter 3	143	0%	0	0	0	0	0	0
1995, Quarter 4	490	9%	15	22	29	37	103	435
1996, Quarter 1	821	10%	39	58	78	227	655	1,280
1996, Quarter 2	1,298	16%	68	102	147	715	1,449	2,215
1996, Quarter 3	1,814	22%	102	154	205	703	1,254	2,196

</TABLE>

In order to complete the evaluation of the adequacy of its reserve levels, the Company then considers additional credit losses that may arise from future delinquencies.

INTEREST RATE AGREEMENTS

The Company's interest rate agreements are 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 income losses from counter-party risk are limited to the Company's amortized cost basis in these agreements, which was $3.3 million at September 30, 1996 and $2.5 million at December 31, 1995. The Company has experienced no credit losses on interest rate agreements. See "Note 3: Interest Rate Agreements" in the Notes to Financial Statements for additional information.

BORROWINGS

Through the end of the third quarter of 1996, the Company's debt has consisted entirely of borrowings collateralized by a pledge of the Company's mortgage assets. 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 current requirements.

All of the Company's mortgage assets are currently accepted as collateral for such borrowings. On average, the Company believes that total borrowing capacity has been 94% to 97% of the market value of its mortgage assets. The Company, however, has limited 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 have ranged from one day to one year. For some borrowings, the cost of funds adjusts to market levels on a regular schedule during the term of the borrowing, so the term-to-next-rate-adjustment may be shorter than the term-to-maturity. The weighted average term-to-maturity was 102 days and the weighted average term-to-next-rate-adjustment was 71 days at September 30, 1996. At December 31, 1995, the average term-to-maturity was 74 days and the average term-to-next-rate-adjustment was 26 days. The Company lengthened the term-to-next-rate-adjustment for its borrowings beginning in the second quarter of 1996 and correspondingly reduced its level of short-term interest rate hedging.

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%
1996, Quarter 2	1,007,480	95.9%	965,735	896,214	72 days	72 days	5.70%
1996, Quarter 3	1,375,870	96.1%	1,322,091	1,225,094	102 days	71 days	5.78%

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. Unused borrowing capacity is defined as estimated borrowing capacity (as shown in Table 22) less total borrowings and is based on the market value of the Company's assets at period-end. Unused borrowing capacity will vary over time as the market value of the Company's mortgage assets fluctuate and due to other factors. Potential immediate sources of liquidity as a percent of total borrowings equaled 9% at September 30, 1996 and 12% at December 31, 1995. 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

(although such sales could cause realized losses). The table below shows the potential immediate sources of liquidity available to the Company.

TABLE 23
POTENTIAL IMMEDIATE SOURCES OF LIQUIDITY

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)			
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%
1996, Quarter 2	10,407	69,521	79,928	9%
1996, Quarter 3	14,599	96,997	111,596	9%

STOCKHOLDERS' EQUITY

During the first nine months of 1996 the Company's equity base grew $95.2 million, from $68.3 million to $163.5 million. This growth was the result of the Company's April 1996 common stock offering ($54.5 million), the August 1996 preferred stock offering ($29.6 million), proceeds from the issuance of common stock upon the exercise of warrants ($8.8 million), positive mark-to-market adjustments on the Company's assets ($3.4 million), common stock sold pursuant to the Company's Dividend Reinvestment Plan ($1.0 million) and a negative adjustment (- $2.1 million) because dividends have exceeded GAAP income. Dividends generally track income as calculated for tax purposes.

Over this nine month period, book value per share grew from $12.38 to $16.23, an increase of 31%. Management believes that book value per share growth helps the Company in its efforts to generate future earnings per share growth; as book value per share increases, the Company has more equity capital per share to invest in its business.

For balance sheet purposes, the Company values all of its mortgage assets and interest rate agreements at their estimated bid-side liquidation market value. As a result, the Company's equity base and book value per share will fluctuate. The difference between market value and historical amortized cost, or "Net Unrealized Loss on Assets Available for Sale", was $2.1 million, or 0.1% of assets, as of September 30, 1996. The net unrealized loss at December 31, 1995 was $5.5 million, or 1.2% of assets. Net unrealized loss includes both mark-downs on assets taken immediately upon acquisition (as liquidation values are generally estimated to be lower than acquisition prices) and the effect of subsequent market value fluctuations.

TABLE 24
STOCKHOLDERS' EQUITY

<TABLE>
<CAPTION>

END OF PERIOD	NET UNREALIZED LOSSES ON MORTGAGE ASSETS	NET UNREALIZED LOSSES ON INTEREST RATE AGREEMENTS	TOTAL NET UNREALIZED LOSSES	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>	<C>
Fiscal 1994	$(2,657)	$ 101	$(2,556)	(2.1%)	$ 22,837	$ 20,280	$12.18	$10.82
1995, Quarter 1	86	(635)	(549)	(0.4%)	22,901	22,352	12.22	11.93
1995, Quarter 2	886	(1,200)	(314)	(0.2%)	22,847	22,533	12.19	12.02
1995, Quarter 3	34	(1,585)	(1,551)	(0.5%)	74,024	72,473	13.42	13.14
1995, Quarter 4	(3,502)	(1,974)	(5,476)	(1.2%)	73,766	68,290	13.37	12.38
1996, Quarter 1	(3,763)	(1,302)	(5,065)	(0.9%)	73,211	68,146	13.26	12.34
1996, Quarter 2	(3,068)	(1,485)	(4,553)	(0.4%)	128,847	124,295	15.12	14.59
1996, Quarter 3	353	(2,413)	(2,060)	(0.1%)	165,578	163,517	16.43	16.23

</TABLE>

CAPITAL ADEQUACY/RISK-ADJUSTED CAPITAL POLICY

Stockholders' equity as a percent of total assets was 11.7% at September 30, 1996 and 15.5% at December 31, 1995. The Company's target equity-to-assets ratio at September 30, 1996 was 10.3%. This target level of equity capitalization is higher than that of many banks, savings and loans, Federal government mortgage agencies, 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 the Company's asset mix, liquidity position, the level of unused borrowing capacity, the level of interest rates as compared to the periodic and life caps in the Company's assets, and the over-collateralization levels required by the Company's lenders. The Company has sought 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 has sought to maintain an equity-to-assets ratio of 40% to 100%.

Through September 30, 1996, the Company's per-asset capital requirements have not changed significantly since the founding of the Company, although the overall target equity-to-assets ratio has varied over time as a function of the asset mix and other factors. As shown in the table below, the target equity-to-assets ratio has been declining since mid-1995 as the Company has increased its focus on the acquisition of mortgage assets with relatively low credit risk and relatively good liquidity.

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 most circumstances, this would be accomplished over time by waiting for the balance of mortgage assets to reduce through mortgage 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 with a continued emphasis on the acquisition of high-quality whole mortgage loans and securitized mortgage assets rated AAA and AA.

With excess capital of $18.7 million as compared to its risk-adjusted capital guideline at September 30, 1996, the Company had asset growth potential of approximately $181 million assuming acquired mortgage assets have the same mix as existing mortgage assets. The Company estimates it employed approximately 84% of its capital base on average during the third quarter of 1996.

TABLE 25

EXCESS CAPITAL AND ASSET GROWTH POTENTIAL

<TABLE>
<CAPTION>

(DOLLARS IN THOUSANDS)

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	ESTIMATED PERCENT OF CAPITAL EMPLOYED DURING PERIOD
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	$ 20,280	10.84%	16.69%	$ 6,716	$ 187,048	$ 121,528	$ 65,520	30%
1995, Quarter 1	22,352	12.41%	15.37%	3,970	180,173	145,440	34,733	70%
1995, Quarter 2	22,533	12.95%	12.57%	(1,069)	173,989	179,321	(5,332)	94%
1995, Quarter 3	72,473	13.08%	23.89%	32,155	554,183	303,394	250,789	55%
1995, Quarter 4	68,290	12.59%	15.47%	12,028	542,431	441,557	100,874	69%
1996, Quarter 1	68,146	11.72%	11.72%	26	581,540	581,313	227	87%
1996, Quarter 2	124,295	10.77%	12.09%	13,566	1,154,303	1,028,330	125,973	74%
1996, Quarter 3	163,517	10.32%	11.65%	18,664	1,584,315	1,403,478	180,837	84%

</TABLE>

WARRANTS

At September 30, 1996, the Company had 1,076,431 warrants outstanding; at December 31, 1995 the Company had 1,665,063 warrants outstanding. In the first nine months of 1996, 588,632 warrants were exercised, thus generating additional equity proceeds to the Company of $8.8 million. 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 on or prior to December 31, 1997. If all these warrants are exercised, the Company will receive additional new equity capital of approximately $16.1 million.

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 principal repayment 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 hedging through the use of interest rate agreements to mitigate the potential impact on net income of periodic and lifetime caps (coupon adjustment restrictions) in the assets.

A primary goal of the Company's asset/liability strategy is to preserve liquidity by managing the volatility of the net market value of the Company's balance sheet as shown in the stockholders' equity account. In the event of an increase in short-term interest rates, the market value of the Company's mortgage assets would likely fall, particularly in the short-term. The Company anticipates that, in such an event, the market value of its interest rate agreements would likely rise and partially offset decreases in mortgage values. See "Asset/Liability Management and Effect of Changes in Interest Rates -- Equity Duration" below.

Changes in interest rates also may have an effect on the rate of mortgage principal repayment; the Company generally 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. Such balancing may not always be possible, however. As discussed earlier, the Company has purchased assets in 1996 at prices

in excess of par value, and thus has significantly increased the net unamortized premium balance. In addition, 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 repayment increases, the Company accelerates premium amortization at a faster rate than discount amortization. This accounting practice leads to a lower level of accounting income, compared to what it otherwise would have been, during periods of rapid mortgage principal repayments. See "Results of Operations -- Amortization of Premium and Discount and Effect of Changes in Principal Repayment Rates" above.

Although the net effects on earnings of changes in interest rates, mortgage prepayment rates, and other factors cannot be determined in advance, management believes, given the balance sheet as of September 30, 1996, that some of the following effects may occur in an environment of rising short-interest rates: (i) earnings on that portion of the balance sheet funded with equity may rise over time as the coupons on adjustable rate mortgages adjust upwards, (ii) earnings on that portion of the balance sheet funded with borrowings (spread lending) may be initially reduced as borrowing costs rise more quickly than the coupons on adjustable rate mortgages, although most or all of the spread might be restored over time as the mortgage coupons fully adjust to the rate change, (iii) earnings may benefit from net hedge income or reduced net hedge expense from interest rate agreements, (iv) premium amortization expenses may be reduced if the rate of mortgage principal repayment diminishes. All other factors being equal, the net effect of an increase in short-term interest rates may be an initial drop in earnings followed by increased earnings after a lag period. The length of any such lag period would likely be determined by the speed and extent of the change in interest rates. Management believes each of these effects would likely be reversed in an environment of falling short-term interest rates. All other factors being equal, therefore, the net effect of falling short-term interest rates could be an initial increase in earnings followed by decreased earnings after a lag period.

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 short-term interest rates rise and fall as short-term interest rates fall. If the Company achieves this goal, the Company's return on average equity, earnings and dividends would maintain a constant or widening spread to the level of short-term interest rates over time.

INTEREST RATE SENSITIVITY GAP BEFORE HEDGING

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. The gap measures the amount of assets that mature or have a coupon adjustment in a particular period as compared to the amount of liabilities similarly adjusting during that time. A negative gap implies that rising interest rates will lead to lower earnings, while a positive gap implies that rising interest rates will lead to higher earnings. Lower interest rates would have the opposite effect. In each case, these effects are limited to the particular time period for which the gap is calculated.

As applied to the Company, this gap analysis ignores the effect of the Company's hedging activities (interest rate agreements), 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 Company's interest rate risk profile.

The Company's two-month cumulative gap as a percentage of total assets was negative 16% at September 30, 1996. This suggests that the initial impact on the Company's earnings of rising interest rates would be negative. Falling interest rates would have the opposite effect. The Company had a cumulative nine-month gap of positive 3% at September 30, 1996. This implies that the impact on net interest income of increasing interest rates may be positive within nine months even though the initial impact could have been negative. Falling interest rates would likely have the opposite effect.

Although the Company's balance sheet does have these characteristics, since a variety of factors (such as interest rate agreements) have not been taken into account in the gap analysis, it is not possible to assess, solely on this

basis, what the actual impact of such interest rate changes on the Company's net income 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 positive 12% at September 30, 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 (a portion of the Company's earning assets are funded with equity).

The negative short-term interest rate sensitivity gap was reduced at the end of the second and third quarter of 1996 compared to earlier periods because the Company extended the average maturity of its liabilities beginning in the second quarter of 1996.

TABLE 26
INTEREST RATE SENSITIVITY GAP EXCLUDING INTEREST RATE AGREEMENTS

<TABLE>
<CAPTION>

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
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Fiscal 1994	(3%)	(0%)	5%	(1%)	1%	15%	15%	15%
1995, Quarter 1	(46%)	(41%)	(27%)	(12%)	0%	14%	14%	14%
1995, Quarter 2	(39%)	(49%)	(33%)	(17%)	(3%)	11%	12%	12%
1995, Quarter 3	(51%)	(34%)	(19%)	(6%)	4%	18%	20%	23%
1995, Quarter 4	(48%)	(36%)	(26%)	(16%)	(3%)	9%	12%	15%
1996, Quarter 1	(62%)	(47%)	(34%)	(21%)	(8%)	4%	8%	11%
1996, Quarter 2	(13%)	(10%)	(3%)	(6%)	(6%)	(2%)	5%	12%
1996, Quarter 3	(21%)	(16%)	(9%)	(10%)	(8%)	(4%)	3%	12%

</TABLE>

INTEREST RATE AGREEMENTS

The Company's interest rate agreements materially alter the interest rate risk profile suggested by the interest rate sensitivity gap analysis. See "Results of Operations -- Cost of Borrowed Funds and Hedging and the Interest Rate Spread" above and "Note 3. Interest Rate Agreements" of the Notes to Financial Statements for further detail and information.

The interest rate agreements are designed to produce income for the Company as short-term interest rates rise to partially or fully offset possible losses of net interest income from the spread lending portion of the Company's balance sheet. These agreements can be thought of as serving to limit potential increases in the costs of the Company's borrowings or, alternatively, as serving to remove some of the periodic and lifetime caps imbedded in the Company's assets. In addition, the interest rate agreements are designed to appreciate in market value in most circumstances in which short-term interest rates rise sharply, thereby partially offsetting likely concurrent declines in the market value of the Company's mortgage assets.

The Company has also entered into Treasury/LIBOR basis swaps designed, in conjunction with the Company's other interest rate agreements, to partially offset potential negative effects on the Company's earnings and mark-to-market equity balances should LIBOR interest rates materially increase as compared to U.S. Treasury interest rates. A portion of the Company's balance sheet consists of mortgages with coupons set as a function of short-term U.S. Treasury interest rates; these assets are funded with borrowings with a cost of funds more closely linked to short-term LIBOR rates.

INTEREST RATE FUTURES AND OPTIONS

The Company intends to commence the limited use of interest rate futures and listed options on interest rate futures as part of its on-going interest rate risk management process. These instruments are in some ways similar to the interest rate agreements currently in use by the Company; the Company intends to use them in a similar manner and for hedging purposes only. The Company currently plans to limit the aggregate amount of funds that the Company will deposit as original margin on futures plus premiums on listed options to less than 1% of the Company's total assets, after taking into account unrealized gains and unrealized losses on any such contracts. The Company currently plans to seek to limit its use of futures and listed options so that its net profits from such instruments will be limited to 5% or less of the Company's gross taxable income on an annual basis.

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%. Should interest rates increase by more than 1%, the Company believes its equity duration would increase.

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 principles (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 September 30, 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

On August 8, 1996, the Company issued its Class B 9.74% Cumulative Convertible Preferred Stock (the "Preferred Stock"). Under the terms of the Preferred Stock, no dividends may be paid on shares of Common Stock unless full cumulative dividends have been paid on the Preferred Stock.

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 3.4* - Articles Supplementary of the Registration relating to the Preferred Stock, filed August 9, 1996.

Exhibit 4.3* - Preferred Stock Certificate.

Exhibit 11 to Part I - Computation of Earnings Per Share for the three and six months ended September 30, 1996 and September 30, 1995.

Exhibit 27 - Financial Data Schedule

* Incorporated by reference to the correspondingly numbered exhibit to the Registration Statement on Form S-11 (333-08363) filed by the Registrant on July 18, 1996.

(b) Reports

No filings on Form 8-K were made.

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: November 8, 1996 By: /s/ Douglas B. Hansen

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

Dated: November 8, 1996 By: /s/ Vickie L. Rath

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

REDWOOD TRUST, INC.
INDEX TO EXHIBIT

EXHIBIT 11.1

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

<TABLE>
<CAPTION>

	Three Months Ended September 30, 1996	Nine Months Ended September 30, 1996
<S>	<C>	<C>
PRIMARY:		
Average common shares outstanding	8,732,326	7,360,916
Net effect of dilutive stock options outstanding during the period -- based on the treasury stock method..	162,393	186,576
Net effect of dilutive stock warrants outstanding during the period -- based on the treasury stock method..	621,455	699,324
Total	9,516,174	8,246,815
Net Income	$2,999,205	$7,453,284

Per Share Amount	$ 0.32	$ 0.90
FULLY DILUTED:		
Average common shares outstanding	8,732,326	7,360,916
Net effect of dilutive stock options outstanding during the period -- based on the treasury stock method..	180,891	204,202
Net effect of dilutive stock warrants outstanding during the period -- based on the treasury stock method..	744,178	837,425
Total	9,657,395	8,402,542
Net Income	$2,999,205	$7,453,284
Per Share Amount	$ 0.31	$ 0.89

</TABLE>

EXHIBIT 11.1

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

<TABLE>
<CAPTION>

<S>	Three Months Ended September 30, 1995 <C>	Nine Months Ended September 30, 1995 <C>
Primary:		
Average common shares outstanding	3,219,754	1,223,170
Average preferred shares outstanding (A)	724,375	1,348,718
Net effect of dilutive stock options outstanding during the period -- based on the treasury stock method	154,886	175,754
Net effect of dilutive stock warrants outstanding during the period -- based on the treasury stock method	84,123	N/A
Total	4,183,138	2,747,642
Net Income	$ 993,815	$1,845,134
Per Share Amount	$ 0.24	$ 0.67
Fully Diluted:		
Average common shares outstanding	3,219,754	1,223,170
Average preferred shares outstanding (A)	724,375	1,348,718
Net effect of dilutive stock options outstanding during the period -- based on the treasury stock method	154,886	175,754
Net effect of dilutive stock warrants outstanding during the period -- based on the treasury stock method	84,123	N/A

Total	4,183,138	2,747,642
	==========	==========
Net Income	$ 993,815	$1,845,134
	==========	==========
Per Share Amount	$ 0.24	$ 0.67
	==========	==========

</TABLE>

(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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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM SEPTEMBER 30, 1996 QUARTERLY REPORT ON FORM 10-Q AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

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<NAME> REDWOOD TRUST

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