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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, 1999

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 ($.01 par value) 902,068 as of November 10, 1999 Common Stock ($.01 par value) 8,780,417 as of November 10, 1999

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REDWOOD TRUST, INC.
FORM 10-Q

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PART I. FINANCIAL INFORMATION
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

REDWOOD TRUST, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)
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<S>	September 30, 1999 (Unaudited) <C>	December 31, 1998 <C>
ASSETS		
Mortgage loans: held-for-sale		
Residential	$ 21,588	$ 265,914
Commercial	17,877	8,287
	39,465	274,201

Mortgage loans: held-for-investment, net		
Residential	1,019,046	1,131,300
	1,019,046	1,131,300
Mortgage securities: trading	918,057	1,257,655
Mortgage securities: available-for-sale, net	19,235	7,707
U.S. Treasury securities	--	48,009
Cash and cash equivalents	31,427	55,627
Restricted cash	4,927	12,857
Interest rate agreements	2,684	2,517
Accrued interest receivable	12,679	18,482
Investment in RWT Holdings, Inc.	12,432	15,124
Loans to RWT Holdings, Inc.	19,375	6,500
Receivable from RWT Holdings, Inc.	330	445
Other assets	1,812	2,024
	$ 2,081,469	$ 2,832,448

LIABILITIES AND STOCKHOLDERS' EQUITY

LIABILITIES		
Short-term debt	$ 854,465	$ 1,257,570
Long-term debt, net	994,355	1,305,560
Accrued interest payable	4,967	10,820
Accrued expenses and other liabilities	4,097	3,022
Dividends payable	687	686
	1,858,571	2,577,658
Commitments and contingencies (See Note 13)		
STOCKHOLDERS' EQUITY		
Preferred stock, par value $0.01 per share; Class B 9.74% Cumulative Convertible 909,518 shares authorized, issued and outstanding ($28,882 aggregate liquidation preference)	26,736	26,736
Common stock, par value $0.01 per share; 49,090,482 shares authorized; 8,955,317 and 11,251,556 issued and outstanding	89	113
Additional paid-in capital	244,190	279,201
Accumulated other comprehensive income	(1,852)	(370)
Cumulative earnings	13,098	6,412
Cumulative distributions to stockholders	(59,363)	(57,302)
	222,898	

		254,790
	-----------	-------- ---
	$ 2,081,469	$ 2,832,448
	===========	===========

</TABLE>

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

REDWOOD TRUST, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share data)
(Unaudited)

<TABLE>
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	Three Months Ended September 30,		Nine Months Ended September 30,	
	1999	1998	1999	1998
<S>	<C>	<C>	<C>	<C>
INTEREST INCOME				
Mortgage loans: held-for-sale				
Residential	$ 1,001	$ --	$ 6,715	$ --
Commercial	452	--	821	--
	1,453	--	7,536	--
Mortgage loans: held-for-investment				
Residential	16,816	37,594	49,646	93,308
	16,816	37,594	49,646	93,308
Mortgage securities: trading	14,507	22,728	49,571	22,864
Mortgage securities: available-for-sale	1,061	776	2,723	51,731
U.S. Treasury securities	--	--	913	--
Cash and cash equivalents	718	460	1,988	1,298
Total interest income	34,555	61,558	112,377	169,201
INTEREST EXPENSE				
Short-term debt	(11,887)	(31,528)	(38,517)	(92,812)
Long-term debt	(15,503)	(24,642)	(50,901)	(59,623)
Total interest expense	(27,390)	(56,170)	(89,418)	(152,435)
Net interest rate agreements expense	(457)	(247)	(1,527)	(3,248)
NET INTEREST INCOME	6,708	5,141	21,432	13,518
Provision for credit losses	(416)	638	(1,132)	(726)
Equity in earnings (losses) of RWT Holdings, Inc.	(6,350)	(1,575)	(12,591)	

				(2,156)
Operating expenses	(964)	(1,029)	(2,617)	(3,545)
Other income	39	--	80	139
NET INCOME (LOSS) BEFORE NET UNREALIZED AND REALIZED GAINS (LOSSES) ON ASSETS	(983)	3,175	5,172	7,230
Net unrealized and realized gains (losses) on assets	(2,068)	(40,293)	1,513	(41,016)
Net income (loss) before preferred dividend and change in accounting principle	(3,051)	(37,118)	6,685	(33,786)
Less cash dividends on Class B preferred stock	(687)	(687)	(2,060)	(2,060)
Net income (loss) before change in accounting principle	(3,738)	(37,805)	4,625	(35,846)
Cumulative transition effect of adopting SFAS No. 133 (See Note 2)	--	(10,061)	--	(10,061)
NET INCOME (LOSS) AVAILABLE TO COMMON STOCKHOLDERS	$ (3,738)	$ (47,866)	$ 4,625	$ (45,907)
EARNINGS PER SHARE:				
Basic Earnings Per Share:				
Net income (loss) before change in accounting principle	$ (0.39)	$ (2.85)	$ 0.46	$ (2.59)
Cumulative transition effect of adopting SFAS No. 133	$ --	$ (0.76)	$ --	$ (0.73)
Net income (loss)	$ (0.39)	$ (3.61)	$ 0.46	$ (3.32)
Diluted Earnings Per Share:				
Net income (loss) before change in accounting principle	$ (0.39)	$ (2.85)	$ 0.45	$ (2.59)
Cumulative transition effect of adopting SFAS No. 133	$ --	$ (0.76)	$ --	$ (0.73)
Net income (loss)	$ (0.39)	$ (3.61)	$ 0.45	$ (3.32)
Weighted average shares of common stock and common stock equivalents:				
Basic	9,481,418	13,247,908	10,090,305	13,823,020
Diluted	9,570,931	13,311,528	10,189,625	13,915,644

</TABLE>

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

REDWOOD TRUST, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands, except share data)
(Unaudited)
<TABLE>
<CAPTION>

	Class B Preferred stock		Common stock		Additional paid-in capital
	Shares	Amount	Shares	Amount	
<S>	<C>	<C>	<C>	<C>	<C>
Balance, December 31, 1998	909,518	$26,736	11,251,556	$113	$279,201
Comprehensive income:					
Net income (loss) before preferred dividend and change					

in accounting principle	--	--	--	--	--
Net unrealized loss on assets available-for-sale	--	--	--	--	--
Total comprehensive income	--	--	--	--	--
Issuance of common stock	--	--	12,361	--	1
Repurchase of common stock	--	--	(1,077,600)	(11)	(16,024)
Dividends declared:					
Preferred	--	--	--	--	--
Common	--	--	--	--	--
Balance, March 31, 1999	909,518	26,736	10,186,317	102	263,178
Comprehensive income:					
Net income (loss) before preferred dividend and change in accounting principle	--	--	--	--	--
Net unrealized loss on assets available-for-sale	--	--	--	--	--
Total comprehensive income	--	--	--	--	--
Repurchase of common stock	--	--	(256,600)	(3)	(3,994)
Dividends declared:					
Preferred	--	--	--	--	--
Common	--	--	--	--	--
Balance, June 30, 1999	909,518	26,736	9,929,717	99	259,184
Comprehensive income:					
Net income (loss) before preferred dividend and change in accounting principle	--	--	--	--	--
Net unrealized income on assets available-for-sale	--	--	--	--	--
Total comprehensive loss	--	--	--	--	--
Repurchase of common stock	--	--	(974,400)	(10)	(14,994)
Dividends declared:					
Preferred	--	--	--	--	--
Common	--	--	--	--	--
Balance, September 30, 1999	909,518	$26,736	8,955,317	$89	$244,190

</TABLE>

REDWOOD TRUST, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands, except share data)
(Unaudited)
<TABLE>
<CAPTION>

<S>	Accumulated other comprehensive income <C>	Cumulative earnings <C>	Cumulative distributions to stockholders <C>	Total <C>
Balance, December 31, 1998	$(370)	$6,412	$(57,302)	$254,790
Comprehensive income:				
Net income (loss) before preferred dividend and change in accounting principle	--	6,541	--	6,541
Net unrealized loss on assets available-for-sale	(412)	--	--	(412)
Total comprehensive income	--	--	--	6,129

Issuance of common stock	--	--	--	1
Repurchase of common stock	--	--	--	(16,035)
Dividends declared:				
Preferred	--	--	(687)	(687)
Common	--	--	--	--
Balance, March 31, 1999	(782)	12,953	(57,989)	244,198
Comprehensive income:				
Net income (loss) before preferred dividend and change in accounting principle	--	3,196	--	3,196
Net unrealized loss on assets available-for-sale	(1,136)	--	--	(1,136)
Total comprehensive income	--	--	--	2,060
Repurchase of common stock	--	--	--	(3,997)
Dividends declared:				
Preferred	--	--	(687)	(687)
Common	--	--	--	--
Balance, June 30, 1999	(1,918)	16,149	(58,676)	241,574
Comprehensive income:				
Net income (loss) before preferred dividend and change in accounting principle	--	(3,051)	--	(3,051)
Net unrealized income on assets available-for-sale	66	--	--	66
Total comprehensive loss	--	--	--	(2,985)
Repurchase of common stock	--	--	--	(15,004)
Dividends declared:				
Preferred	--	--	(687)	(687)
Common	--	--	--	--
Balance, September 30, 1999	$(1,852)	$13,098	$(59,363)	$222,898

</TABLE>

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

REDWOOD TRUST, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

<TABLE>
<CAPTION>

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1999	1998	1999	1998
<S>	<C>	<C>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net income (loss) available to common stockholders	$ (3,738)	$ (47,866)	$ 4,625	$ (45,907)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:				
Depreciation and amortization	1,212	7,305	5,601	29,730
Provision for credit losses	416	(638)	1,132	726
Equity in (earnings) losses of RWT Holdings, Inc.	6,350	1,575	12,591	2,156
Net unrealized and realized (gains) losses on assets	2,068	40,293	(1,513)	

				41,016
Cumulative transition effect of adopting SFAS No. 133	--	10,061	--	10,061
Purchases of mortgage loans: held-for-sale	(27,194)	--	(98,949)	--
Proceeds from sales of mortgage loans: held-for-sale	71,481	--	121,619	--
Principal payments on mortgage loans: held-for-sale	3,089	--	58,327	--
Purchases of mortgage securities: trading	(72,867)	(135,717)	(76,592)	(366,884)
Proceeds from sales of mortgage securities: trading	--	--	7,668	--
Principal payments on mortgage securities: trading	89,701	227,233	404,702	227,233
Purchases of U.S. Treasury securities	--	--	(45,844)	--
Proceeds from sales of U.S. Treasury securities	--	--	90,519	--
Purchases of interest rate agreements	(279)	(11,898)	(912)	(13,923)
Proceeds from sales of interest rate agreements	250	2,769	1,371	2,769
(Increase) decrease in accrued interest receivable	273	(3,496)	5,803	(1,931)
Decrease in other assets	155	3,329	74	323
Decrease in accrued interest payable	(319)	(4,523)	(5,853)	(5,324)
Increase (decrease) in accrued expenses and other liabilities	1,264	(411)	1,075	(391)
Net cash provided by (used in) operating activities	71,862	88,016	485,444	(120,346)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of mortgage loans: held-for-investment	--	(629,201)	--	(1,596,673)
Proceeds from sales of mortgage loans: held-for-investment	--	374,520	--	374,520
Principal payments on mortgage loans: held-for-investment	69,638	187,432	261,487	475,905
Purchases of mortgage securities: available-for-sale	(6,997)	--	(7,931)	--
Proceeds from sales of mortgage securities: available-for-sale	--	--	--	9,296
Principal payments on mortgage securities: available-for-sale	83	54	213	442,985
Net decrease in restricted cash	3,620	1,885	7,930	4,982
Investment in RWT Holdings, Inc., net of dividends received	--	--	(9,900)	(9,900)
Loans to RWT Holdings, Inc., net of repayments	(17,375)	--	(12,875)	--
(Increase) decrease in receivable from RWT Holdings, Inc.	(121)	55	115	(776)
Net cash provided by (used in) investing activities	48,848	(65,255)	239,039	(299,661)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Net proceeds from issuance of (repayments on) short-term debt	(68,280)	131,008	(403,105)	152,641
Proceeds (costs) from issuance of long-term debt	--	--	(337)	635,192
Repayments on long-term debt	(72,501)	(127,511)	(310,207)	(342,428)
Net proceeds from issuance of common stock	--	3	1	1,591
Repurchases of common stock	(15,004)	(33,667)	(35,036)	(39,125)
Increase in dividends payable - preferred	--	--	1	--
Dividends paid on common stock	--	(137)	--	(8,945)
Net cash provided by (used in) financing activities	(155,785)	(30,304)	(748,683)	398,926

Net decrease in cash and cash equivalents	(35,075)	(7,543)	(24,200)	(21,081)
Cash and cash equivalents at beginning of period	66,502	11,354	55,627	24,892
Cash and cash equivalents at end of period	$ 31,427	$ 3,811	$ 31,427	$ 3,811
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash paid for interest	$ 27,709	$ 60,693	$ 95,271	$ 157,759

</TABLE>

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

NOTE 1. THE COMPANY

Redwood Trust, Inc. ("Redwood Trust") was incorporated in Maryland on April 11, 1994 and commenced operations on August 19, 1994. During 1997, Redwood Trust formed Sequoia Mortgage Funding Corporation ("Sequoia"), a special-purpose finance subsidiary. Redwood Trust acquired an equity interest in RWT Holdings, Inc. ("Holdings"), a taxable affiliate of Redwood Trust, during the first quarter of 1998. For financial reporting purposes, references to the "Company" mean Redwood Trust, Sequoia and Redwood Trust's equity interest in Holdings. Redwood Trust, together with its affiliates, is a finance company specializing in mortgage assets ("Mortgage Assets") which may be acquired as whole loans ("Mortgage Loans") or as mortgage securities representing interests in or obligations backed by pools of mortgage loans ("Mortgage Securities"). Its primary activity is the financing of high quality residential mortgage loans with funds raised through long-term debt issuance. The Company also finances commercial mortgage loans and residential mortgage securities. Through its affiliate operations, the Company is developing its ability to create mortgage assets of significant value and is developing technology and processes designed to streamline access to the residential mortgage market for a wide variety of institutional mortgage investors.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Redwood Trust and Sequoia. Substantially all of the assets of Sequoia are pledged or subordinated to support long-term debt in the form of collateralized mortgage bonds ("Long-Term Debt") and are not available for the satisfaction of general claims of the Company. The Company's exposure to loss on the assets pledged as collateral is limited to its net investment, as the Long-Term Debt is non-recourse to the Company. All significant inter-company balances and transactions with Sequoia have been eliminated in the consolidation of the Company. Certain amounts for prior periods have been reclassified to conform to the 1999 presentation.

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

The consolidated financial statements included herein are unaudited; however, in the opinion of management, the interim financial information contains all adjustments, including normal recurring adjustments, necessary to present fairly the results for the interim period.

USE OF ESTIMATES

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

Fair Value. Management estimates the fair value of its financial instruments using available market information and other appropriate valuation methodologies. The fair value of a financial instrument, as defined by Statement

of Financial Accounting Standards ("SFAS") No. 107, Disclosures about Fair Value of Financial Instruments, is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced liquidation sale. Management's estimates are inherently subjective in nature and involve matters of uncertainty and judgement to interpret relevant market and other data. Accordingly, amounts realized in actual sales may differ from the fair values presented in Notes 3, 7 and 10.

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

ADOPTION OF SFAS NO. 133

The Company adopted SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, effective July 1, 1998. In accordance with the transition provisions of SFAS No. 133, the Company recorded a net-of-tax cumulative-effect-type transition adjustment of $10.1 million (loss) in earnings to recognize at fair value the ineffective portion of all interest rate agreements that were previously designated as part of a hedging relationship.

The Company, upon its adoption of SFAS No. 133, also reclassified $1.53 billion of mortgage securities from available-for-sale to trading. This reclassification resulted in an $11.9 million reclassification loss adjustment, which was transferred from other comprehensive income to current earnings effective July 1, 1998. Under the provisions of SFAS No. 133, such a reclassification does not call into question the Company's intent to hold current or future debt securities to their maturity. Immediately after the adoption of SFAS No. 133 and the reclassification, the Company elected to not seek hedge accounting for any of the Company's interest rate agreements.

MORTGAGE ASSETS

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

Mortgage Loans: Held-for-Sale

Effective September 30, 1998, the Company elected to reclassify certain short-funded Mortgage Loans from held-for-investment to held-for-sale. These Mortgage Loans are carried at the lower of cost or aggregate market value ("LOCOM"). Realized and unrealized gains and losses on these loans are recognized in "Net unrealized and realized gains (losses) on assets" on the Consolidated Statements of Operations.

Some of the Mortgage Loans purchased by the Company for which securitization or sale is contemplated are committed for sale by the Company to Holdings, or a subsidiary of Holdings, under a Master Forward Commitment Agreement. As the

forward commitment is entered into on the same date that the Company commits to purchase the loans, the price under the forward commitment is the same as the price that the Company paid for the Mortgage Loans, as established by the external market. Fair value is therefore equal to the commitment price, which is the carrying value of the Mortgage Loans. Accordingly, no gain or loss is recognized on the subsequent sales of these Mortgage Loans to Holdings or subsidiaries of Holdings.

Mortgage Loans: Held-for-Investment

Mortgage Loans held-for-investment are carried at their unpaid principal balance adjusted for net unamortized premiums or discounts, and net of the related allowance for credit losses.

Mortgage Securities: Trading

Effective July 1, 1998, concurrent with the adoption of SFAS No. 133, the Company elected to reclassify all of its short-funded Mortgage Securities from available-for-sale to trading. Mortgage Securities classified as trading are accounted for in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. Accordingly, such securities are recorded at their estimated fair market value. Unrealized and realized gains and losses on these securities are recognized as a component of "Net unrealized and realized gains (losses) on assets" on the Consolidated Statements of Operations.

Mortgage Securities: Available-for-Sale

Prior to the adoption of SFAS No. 133, the Company, in accordance with SFAS No. 115, classified all of its Mortgage Securities as available-for-sale investments as the Company, from time to time, sold some of its Mortgage Securities as part of its overall management of its balance sheet. Effective July 1, 1998, the Company reclassified all of its short-funded Mortgage Securities as trading investments, while all equity-funded Mortgage Securities remained in the available-for-sale classification. All Mortgage Securities classified as available-for-sale are carried at their estimated fair value. Current period unrealized gains and losses are excluded from net income and reported as a component of Other Comprehensive Income in Stockholders' Equity with cumulative unrealized gains and losses classified as Accumulated Other Comprehensive Income in Stockholders' Equity.

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

U.S. TREASURY SECURITIES

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

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less. At December 31, 1998, cash equivalents included $25 million in repurchase agreements.

RESTRICTED CASH

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

INTEREST RATE AGREEMENTS

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

Agreement is entered into, the Company designates the interest rate agreement as (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value" hedge), (2) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow" hedge), or (3) held for

trading ("trading" instruments). Since the adoption of SFAS No. 133, the Company has elected to designate all of its Interest Rate Agreements as trading instruments.

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

Interest Rate Agreements Classified as Trading

Interest Rate Agreements that are designated as trading are not linked to specific assets and liabilities or to a forecasted transaction, or otherwise are not designated and, therefore do not qualify for hedge accounting. Accordingly, interest rate agreements classified as trading are reported at their estimated fair value with changes in their fair value reported in current-period earnings in "Net unrealized and realized gains (losses) on assets" on the Consolidated Statements of Operations.

Interest Rate Agreements Classified as Hedges

Interest Rate Agreements that are designated as hedges are linked to specific assets and liabilities on the balance sheet or to a forecasted transaction, or otherwise qualify for hedge accounting. The Company currently does not have any Interest Rate Agreements classified as hedges.

Prior to the adoption of SFAS No. 133, Interest Rate Agreements that were hedging Mortgage Securities available-for-sale were carried at fair value with unrealized gains and losses reported as a component of Accumulated Other Comprehensive Income in Stockholders' Equity, consistent with the reporting of unrealized gains and losses on the related securities. Similarly, Interest Rate Agreements that were used to hedge Mortgage Loans, Short-Term Debt or Long-Term Debt were carried at amortized cost. Realized gains and losses from the settlement or early termination of Interest Rate Agreements were deferred and amortized into net interest income over the remaining term of the original Interest Rate Agreement, or, if shorter, over the remaining term of the associated hedged asset or liability, as adjusted for estimated future principal repayments.

DEBT

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

INCOME TAXES

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

Under the Code, a dividend declared by a REIT in October, November or December of a calendar year and payable to shareholders of record as of a specified date in such month, will be deemed to have been paid by the Company and received by the shareholders on the last day of that calendar year, provided the dividend is actually paid before February 1st of the following calendar year, and provided that the REIT has any remaining undistributed taxable income on the record date. The Company expects to pay a total of $3.4 million of preferred dividends in 1999 from 1999 taxable income.

NET INCOME (LOSS) PER SHARE

Net income (loss) per share for the three and nine months ended September 30, 1999 and 1998 is shown in accordance with SFAS No. 128, Earnings Per Share. Basic net income (loss) per share is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing the net income (loss) available to common stockholders by the weighted average number of common shares and common equivalent shares outstanding during the period. The common equivalent shares are calculated using the treasury stock method, which assumes that all dilutive common stock equivalents are exercised and the funds generated by the exercise are used to buy back outstanding common stock at the average market price during the reporting period. Due to the net loss available to common stockholders for both the three and nine months ended September 30, 1998, the addition of potential dilutive shares is anti-dilutive and therefore, the basic and diluted loss per share are the same.

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

<TABLE>
<CAPTION>

(in thousands, except share data)	Three Months Ended September 30, 1999	Three Months Ended September 30, 1998	Nine Months Ended September 30, 1999	Nine Months Ended September 30, 1998
<S>	<C>	<C>	<C>	<C>
Numerator:				
Numerator for basic and diluted earnings per share--				
Net income (loss) before preferred dividend and change in accounting principle	$ (3,051)	$ (37,118)	$ 6,685	$ (33,786)
Cash dividends on Class B preferred stock	(687)	(687)	(2,060)	(2,060)
Net income (loss) before change in accounting principle	(3,738)	(37,805)	4,625	(35,846)
Cumulative transition effect of adopting SFAS No. 133	--	(10,061)	--	(10,061)
Basic and Diluted EPS - Net income (loss) available to common stockholders	$ (3,738)	$ (47,866)	$ 4,625	$ (45,907)
Denominator:				
Denominator for basic earnings per share--				
Weighted average number of common shares outstanding during the period	9,481,418	13,247,908	10,090,305	13,823,020
Net effect of dilutive stock options	89,513	63,620	99,320	92,624
Denominator for diluted earnings per share--	9,570,931	13,311,528	10,189,625	13,915,644
Basic Earnings Per Share:				
Net income (loss) before change in accounting principle	$ (9.39)	(2.85)	$ 0.46	$ (2.59)
Cumulative transition effect of adopting SFAS No. 133	--	(0.76)	--	(0.73)
Net earnings per share	$ (0.39)	$ (3.61)	$ 0.46	$ (3.32)
Diluted Earnings Per Share:				
Net income (loss) before change in accounting principle	$ (0.39)	$ (2.85)	$ 0.45	$ (2.59)
Cumulative transition effect of adopting SFAS No. 133	--	(0.76)	--	(0.73)
Net earnings per share	$ (0.39)	$ (3.61)	$ 0.45	$ (3.32)

</TABLE>

COMPREHENSIVE INCOME

SFAS No. 130, Reporting Comprehensive Income, requires the Company to classify items of "other comprehensive income" by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet. In accordance with SFAS No. 130, current period unrealized gains and losses on assets available-

for-sale are reported as a component of Comprehensive Income on the Consolidated Statements of Stockholders' Equity with cumulative unrealized gains and losses classified as Accumulated Other Comprehensive Income in Stockholders' Equity. At September 30, 1999 and December 31, 1998, the only component of Accumulated Other Comprehensive Income was net unrealized gains and losses on assets available-for-sale.

NOTE 3. MORTGAGE ASSETS

At September 30, 1999 and December 31, 1998, investments in Mortgage Assets consisted of interests in adjustable-rate, hybrid or fixed-rate mortgages on residential and commercial properties. The hybrid mortgages have an initial fixed coupon rate for three to ten years followed by annual adjustments. Agency Mortgage Securities ("Agency Securities") represent securitized interests in pools of adjustable-rate mortgages from the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association. The Agency Securities are guaranteed as to principal and interest by these United States government-sponsored entities. The original maturity of the majority of the Mortgage Assets is thirty years; the actual maturity is subject to change based on the prepayments of the underlying mortgage loans.

At September 30, 1999 and December 31, 1998, the annualized effective yield after taking into account the amortization expense due to prepayments on the Mortgage Assets was 6.76% and 6.95%, respectively, based on the reported cost of the assets. Of the Mortgage Assets owned by the Company at September 30, 1999, 77% were adjustable-rate mortgages, 21% were hybrid mortgages and 2% were fixed-rate mortgages. The coupons on 66% of the adjustable-rate Mortgage Assets are limited by periodic caps (generally interest rate adjustments are limited to no more than 1% every six months or 2% every year) while another 34% are not limited by such periodic caps. Most of the coupons on the adjustable-rate and hybrid Mortgage Assets owned by the Company are limited by lifetime caps. At September 30, 1999 and December 31, 1998, the weighted average lifetime cap on the adjustable-rate Mortgage Assets was 11.61% and 11.81%, respectively.

At September 30, 1999 and December 31, 1998, Mortgage Assets consisted of the following:

Mortgage Loans: Held-for-Sale

<TABLE>
<CAPTION>

(in thousands)	September 30, 1999	December 31, 1998
<S>	<C>	<C>
Current Face	$40,177	$274,630
Unamortized Discount	(712)	(1,099)
Unamortized Premium	--	670
Carrying Value	$39,465	$274,201

</TABLE>

Mortgage loans held-for-sale include Residential and Commercial Mortgage Loans at September 30, 1999 and December 31, 1998. During the three and nine months ended September 30, 1999, the Company recognized net losses of $281,014 and $195,169 as a result of LOCOM adjustments on Mortgage Loans held-for-sale, respectively. Also during the three and nine months ended September 30, 1999, the Company sold Mortgage Loans held-for-sale for proceeds of $71.5 million and $121.6 million, resulting in net gains of $0 and $27,718, respectively. Additionally, as a result of the call and subsequent restructuring of a portion of the Long-Term Debt, the Company reclassified $154 million of Mortgage Loans held-for-sale to Mortgage Loans held-for-investment during the second quarter of 1999 (see Note 9). The LOCOM adjustments and net gains on sales are reflected as a component of "Net unrealized and realized gains (losses) on assets" on the Consolidated Statements of Operations. There were no LOCOM adjustments or sale transactions on held-for-sale Mortgage Loans for the three and nine months ended September 30, 1998, as the Mortgage Loans were not reclassified to held-for-sale until September 30, 1998.

Mortgage Loans: Held-for-Investment

<TABLE>
<CAPTION>

(in thousands)	September 30, 1999	December 31, 1998

Current Face	$1,010,334	$1,118,375
Unamortized Premium	13,623	16,709
Amortized Cost	1,023,957	1,135,084
Allowance for Credit Losses	(4,911)	(3,784)
Carrying Value	$1,019,046	$1,131,300

There were no sales of Mortgage Loans held-for-investment for the three and nine months ended September 30, 1999. During the three and nine months ended September 30, 1998, and prior to the reclassification, the Company sold held-for-investment Mortgage Loans with an amortized cost of $376 million. The net realized loss of $1 million on the transaction is reflected as a component of "Net Unrealized and Realized Gains (Losses) on Assets" on the Consolidated Statements of Operations. During the second quarter of 1999, as a result of the call and subsequent restructuring of a portion of the Long-Term Debt, the Company reclassified $154 million of Mortgage Loans held-for-sale to Mortgage Loans held-for-investment (see Note 9).

Mortgage Securities: Trading

(in thousands)	September 30, 1999 Agency	Non-Agency	Total	December 31, 1998 Agency	Non-Agency	Total
Current Face	$512,844	$397,555	$910,399	$609,826	$640,923	$1,250,749
Unamortized Discount	(9)	(2,841)	(2,850)	(5)	(3,084)	(3,089)
Unamortized Premium	8,924	1,584	10,508	7,602	2,393	9,995
Carrying Value	$521,759	$396,298	$918,057	$617,423	$640,232	$1,257,655

For the three and nine months ended September 30, 1999, the Company recognized a mark-to-market loss of $2.3 million and a mark-to-market gain of $2.9 million, respectively, on Mortgage Securities classified as trading. The Company sold Mortgage Securities classified as trading for proceeds of $0 and $7.7 million, respectively, for the three and nine months ended September 30, 1999. The Company reclassified all of its short-funded Mortgage Securities from available-for-sale to trading on July 1, 1998 (see Note 2). For the three and nine months ended September 30, 1998, the Company recognized a mark-to-market loss of $14.6 million on Mortgage Securities classified as trading. The mark to market adjustments are reflected as a component of "Net unrealized and realized gains (losses) on assets" on the Consolidated Statements of Operations.

Mortgage Securities: Available-for-Sale

(in thousands)	September 30, 1999 Non-Agency	December 31, 1998 Non-Agency
Current Face	$34,194	$17,281
Unamortized Discount	(12,241)	(8,015)
Amortized Cost	21,953	9,266
Allowance for Credit Losses	(867)	(1,189)
Gross Unrealized Gains	43	313
Gross Unrealized Losses	(1,894)	(683)
Carrying Value	$19,235	$7,707

No sales or write-downs of Mortgage Securities available-for-sale occurred during the three and nine months ended September 30, 1999 and the three months ended September 30, 1998. During the nine months ended

September 30, 1998, the Company sold Mortgage Securities available-for-sale with an amortized cost of $9.3 million for proceeds of $9.3 million, resulting in a net gain of $5,689. The Company also recognized a $0.7 million loss on the write-down of certain Mortgage Securities available-for-sale during the nine months ended September 30, 1998. The gains and losses on the sales and write-downs of Mortgage Securities available-for-sale are reflected as a

component of "Net unrealized and realized gains (losses) on assets" on the Consolidated Statements of Operations.

NOTE 4. RESERVE FOR CREDIT LOSSES

The following table summarizes the Reserve for Credit Losses activity:
<TABLE>
<CAPTION>

(in thousands)	Three Months Ended September 30, 1999	Three Months Ended September 30, 1998	Nine Months Ended September 30, 1999	Nine Months Ended September 30, 1998
<S>	<C>	<C>	<C>	<C>
Balance at beginning of period	$5,494	$5,784	$4,973	$4,931
Provision for credit losses	416	(638)	1,132	726
Charge-offs	(132)	(320)	(327)	(831)
Balance at end of period	$5,778	$4,826	$5,778	$4,826

</TABLE>

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

NOTE 5. U.S. TREASURY SECURITIES

The Company did not hold any U.S. Treasury securities at September 30, 1999. At December 31, 1998 U.S. Treasury securities held by the Company consisted of the following:
<TABLE>
<CAPTION>

(in thousands)	December 31, 1998
<S>	<C>
Current Face	$45,000
Unamortized Premium	3,009
Carrying Value	$48,009

</TABLE>

For the three and nine months ended September 30, 1999, the Company recognized mark-to-market losses of $0 and $3.3 million on U.S. Treasury securities and sold U.S. Treasury securities for proceeds of $0 and $90.5 million, respectively. The mark to market adjustments are reflected as a component of "Net unrealized and realized gains (losses) on assets" on the Consolidated Statements of Operations.

NOTE 6. COLLATERAL FOR LONG-TERM DEBT

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

During the second quarter of 1999, as a result of the call and subsequent restructuring of a portion of the Long-Term Debt, the Company reclassified $154 million of Mortgage Loans held-for-sale to Mortgage Loans held-for-investment (see Note 9).

The components of the Bond Collateral are summarized as follows:
<TABLE>
<CAPTION>

(in thousands)	September 30, 1999	December 31, 1998
<S>	<C>	<C>
Mortgage loans: held-for-sale	$ 0	$ 197,646
Mortgage loans: held-for-investment, net	1,019,046	1,131,300
Restricted cash	4,425	12,857
Accrued interest receivable	5,740	7,707

	$1,029,211	$1,349,510

</TABLE>

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

NOTE 7. INTEREST RATE AGREEMENTS

At September 30, 1999 and December 31, 1998, all of the Company's Interest Rate Agreements were classified as trading, and therefore, reported at fair value.

During the three and nine months ended September 30, 1999, the Company recognized net gains of $0.5 million and $2.1 million, respectively, as a result of mark-to-market adjustments on interest rate agreements classified as trading. The Company classified its interest rate agreements as trading instruments on July 1, 1998 (see Note 2), and recognized a net loss of $6.4 million as a result of mark-to-market adjustments on interest rate agreements classified as trading during the three and nine months ended September 30, 1998. The mark-to-market gains are reflected as a component of "Net Unrealized and Realized Gains (Losses) on Assets" on the Consolidated Statements of Operations.

On July 1, 1998, as a result of adopting SFAS No. 133, the Company recorded a net-of-tax cumulative-effect-type transition adjustment of $10.1 million loss in earnings to recognize at fair value the ineffective portion of Interest Rate Agreements that were previously designated as part of a hedging relationship (see Note 2). This loss is reflected on the Consolidated Statements of Operations as "Cumulative Transition Effect of Adopting SFAS No. 133." Approximately $7.6 million of this transition adjustment was transferred from other comprehensive income to current earnings.

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

<TABLE>
<CAPTION>

	Notional Amounts		Credit Exposure (a)	
(in thousands)	September 30, 1999	December 31, 1998	September 30, 1999	December 31, 1998
<S>	<C>	<C>	<C>	<C>
Interest Rate Options Purchased	$2,258,400	$3,569,200	--	--
Interest Rate Options Sold	(15,000)	--	--	--
Interest Rate Swaps	300,000	440,000	$6,590	$8,673
Eurodollar/LIBOR Futures	405,000	--	484	--
Treasury Futures	15,000	--	18	--
Total	$2,963,400	$4,009,200	$7,092	$8,673

</TABLE>

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

Interest Rate Options purchased (sold), which may include caps, floors, call and put corridors, options on futures and swaption collars (collectively, "Options"), are agreements which transfer, modify or reduce interest rate risk in exchange for the payment (receipt) of a premium when the contract is initiated. Purchased interest rate cap agreements provide cash flows to the Company to the extent that a specific interest rate index exceeds a fixed rate. Conversely, purchased interest rate floor agreements produce cash flows to the Company to the extent that the referenced interest rate index falls below the agreed upon fixed rate. Purchased call (put) corridors will cause the Company to incur a gain (loss) to the extent that the yield of the specified index is below (above) the strike rate at the time of the option expiration. The maximum gain or loss on a call (put) corridor is established at the time of the transaction by establishing a minimum (maximum) index rate. The Company will receive cash on the purchased options on futures if the futures price exceeds (is below) the call (put) option strike price at the expiration of the option. For the written options on futures, the Company receives an up-front premium for selling the option, however, the Company will pay cash on the written option if the futures price exceeds (is below) the call (put) option strike price at the expiration of the option. Purchased receiver (payor) swaption collars will cause the Company to incur a gain (loss) should the index rate be below (above) the strike rate as of the expiration date. The maximum gain or loss on a receiver (payor) swaption

is established at the time of the transaction by establishing a minimum (maximum) index rate. The Company's credit risk on the purchased Options is limited to the carrying value of the Options agreements. The credit risk on options on futures is limited due to the fact that the exchange and its members are required to satisfy the obligations of any member that fails to perform.

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

Interest Rate Futures ("Futures") are contracts for the delivery of securities or cash in which the seller agrees to deliver on a specified future date, a specified instrument (or the cash equivalent), at a specified price or yield. Under these agreements, if the Company has sold (bought) the futures, the Company will generally receive additional cash flows if interest rates rise (fall). Conversely, the Company will generally pay additional cash flows if interest rates fall (rise). Similar to options on futures, the credit risk on futures is limited by the requirement that the exchange and its members make good on obligations of any member that fails to perform.

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

NOTE 8. SHORT-TERM DEBT

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

At September 30, 1999, the Company had $854 million of Short-Term Debt outstanding with a weighted-average borrowing rate of 5.53% and a weighted-average remaining maturity of 167 days. This debt was collateralized with $899 million of Mortgage Assets. At December 31, 1998, the Company had $1.3 billion of Short-Term

Debt outstanding with a weighted-average borrowing rate of 5.62% and a weighted-average remaining maturity of 48 days. This debt was collateralized with $1.3 billion of Mortgage Assets and U.S. Treasury securities.

At September 30, 1999 and December 31, 1998, the Short-Term Debt had the following remaining maturities:

(in thousands)	September 30, 1999	December 31, 1998
Within 30 days	$28,096	$ 428,292
30 to 90 days	163,422	714,114
Over 90 days	662,947	115,164
Total Short-Term Debt	$854,465	$1,257,570

For the three and nine months ended September 30, 1999, the average balance of Short-Term Debt was $0.9 billion and $1.0 billion with a weighted-average interest cost of 5.50% and 5.22%, respectively. For the three and nine months ended September 30, 1998, the average balance of Short-Term Debt was $2.1 billion with a weighted-average interest cost of 5.93% and 5.86%, respectively. The maximum balance outstanding during the nine months ended September 30, 1999 and 1998 was $1.3 billion and $2.5 billion, respectively.

In July 1999, the Company entered into a one-year, $90 million revolving

mortgage warehousing credit facility with two banks. The facility is primarily intended to finance newly originated residential mortgage loans. At September 30, 1999, the Company had outstanding borrowings of $950,000 under this facility. Holdings may borrow under this facility as a co-borrower. At September 30, 1999, Holdings had no outstanding borrowings under this facility. Borrowings under this facility bear interest based on a specified margin over the London Interbank Offered Rate ("LIBOR"). For the three months ending September 30, 1999, the weighted-average borrowing rate under this facility was 6.44%. The Company and Holdings were in compliance with all material representations, warranties and covenants under this credit facility at September 30, 1999.

In July 1999, the Company entered into a one-year, $350 million master loan and security agreement with a Wall Street firm. The facility is primarily intended to finance newly originated commercial and residential mortgage loans. At September 30, 1999, the Company had outstanding borrowings of $14.6 million under this facility. Holdings may borrow under this facility as a co-borrower. At September 30, 1999, Holdings had outstanding borrowings of $19.2 million under this facility. Borrowings under this facility bear interest based on a specified margin over LIBOR. For the three months ending September 30, 1999, the weighted-average borrowing rate under this facility was 6.76%. The Company and Holdings were in compliance with all material representations, warranties and covenants under this credit facility at September 30, 1999.

NOTE 9. LONG-TERM DEBT

Long-Term Debt in the form of collateralized mortgage bonds is secured by a pledge of Bond Collateral. As required by the indentures relating to the Long-Term Debt, the Bond Collateral is held in the custody of trustees. The trustees collect principal and interest payments on the Bond Collateral and make corresponding principal and interest payments on the Long-Term Debt. The obligations under the Long-Term Debt are payable solely from the Bond Collateral and are otherwise non-recourse to the Company.

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

During the second quarter of 1999, the Company exercised its right to call the Long-Term Debt of Sequoia Mortgage Trust 1 ("Sequoia 1"), a series of debt issued by Sequoia. This Long-Term Debt was called on May 4, 1999. In conjunction with this call, the Company restructured and contributed the Sequoia 1 debt to Sequoia

Mortgage Trust 1A ("Sequoia 1A"), a newly formed trust, and Sequoia 1A issued Long-Term Debt collateralized by Sequoia 1 debt. As a result, the $154 million of Bond Collateral in the form of Mortgage Loans held-for-sale was reclassified to Mortgage Loans held-for-investment.

The components of the Long-Term Debt at September 30, 1999 and December 31, 1998 along with selected other information are summarized below:

<TABLE>
<CAPTION>

(in thousands)	September 30, 1999	December 31, 1998
<S>	<C>	<C>
Long-Term Debt	$993,198	$1,303,405
Unamortized premium on Long-Term Debt	4,216	5,783
Deferred bond issuance costs	(3,059)	(3,628)
Total Long-Term Debt	$994,355	$1,305,560
Range of weighted-average interest rates, by series	5.78% to 6.45%	5.75% to 6.55%
Stated maturities	2017 - 2029	2017 - 2029
Number of series	3	3

</TABLE>

For the three and nine months ended September 30, 1999, the average effective interest cost for Long-Term Debt, as adjusted for the amortization of bond premium, deferred bond issuance costs and other related expenses, was 6.01% and 6.00%, respectively. For the three and nine months ended September 30, 1998, the average effective interest cost for Long-Term Debt, as adjusted for the amortization of bond premium, deferred bond issuance costs and other related expenses, was 6.46% and 6.44%, respectively. At September 30, 1999 and December

31, 1998, accrued interest payable on Long-Term Debt was $3.1 million and $4.2 million, respectively, and is reflected as a component of Accrued Interest Payable on the Consolidated Balance Sheets.

NOTE 10. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying values and estimated fair values of the Company's financial instruments at September 30, 1999 and December 31, 1998.

(in thousands)	September 30, 1999		December 31, 1998	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Mortgage Loans: held-for-sale	$ 39,465	$ 39,465	$ 274,201	$ 274,302
Mortgage Loans: held-for-investment	$1,019,046	$1,003,734	$1,131,300	$1,120,376
Mortgage Securities: trading	$ 918,057	$ 918,057	$1,257,655	$1,257,655
Mortgage Securities: available-for-sale	$ 19,235	$ 19,235	$ 7,707	$ 7,707
U.S. Treasury Securities	--	--	$ 48,009	$ 48,009
Interest Rate Agreements	$ 2,684	$ 2,684	$ 2,517	$ 2,517
Investment in RWT Holdings, Inc.	$ 12,432	$ 12,721	$ 15,124	$ 15,132
Liabilities				
Short-Term Debt	$ 854,465	$ 854,465	$1,257,570	$1,257,570
Long-Term Debt	$ 994,355	$ 977,540	$1,305,560	$1,302,330

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

NOTE 11. STOCKHOLDERS' EQUITY

CLASS B 9.74% CUMULATIVE CONVERTIBLE PREFERRED STOCK

On August 8, 1996, the Company issued 1,006,250 shares of Class B Preferred Stock ("Preferred Stock"). Each share of the Preferred Stock is convertible at the option of the holder at any time into one share of Common

Stock. Effective October 1, 1999, the Company can either redeem or, under certain circumstances, cause a conversion of the Preferred Stock. The Preferred Stock pays a dividend equal to the greater of (i) $0.755 per share, per quarter or (ii) an amount equal to the quarterly dividend declared on the number of shares of the Common Stock into which the Preferred Stock is convertible. The Preferred Stock ranks senior to the Company's Common Stock as to the payment of dividends and liquidation rights. The liquidation preference entitles the holders of the Preferred Stock to receive $31.00 per share plus any accrued dividends before any distribution is made on the Common Stock.

As of September 30, 1999 and December 31, 1998, 96,732 shares of the Preferred Stock have been converted into 96,732 shares of the Company's Common Stock. At both September 30, 1999 and December 31, 1998, there were 909,518 shares of the Preferred Stock outstanding.

STOCK OPTION PLAN

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

The number of shares of Common Stock available under the Plan for options and Awards, subject to certain anti-dilution provisions, is 15% of the Company's total outstanding shares of Common Stock. The total outstanding shares are determined as the highest number of shares outstanding prior to any stock repurchases. At September 30, 1999 and December 31, 1998, 384,029 and 273,312 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, 1999 and December 31, 1998, 383,220 and 381,298 ISOs had been granted, respectively. The exercise price for ISOs granted under the Plan may not be less than the fair

market value of shares of Common Stock at the time the ISO is granted. All stock options granted under the Plan vest no earlier than ratably over a four-year period from the date of grant and expire within ten years after the date of grant.

The Company's Plan permits certain stock options granted under the plan to accrue stock DERs. For the three and nine months ended September 30, 1999, the stock DERs accrued on NQSOs that had a stock DER feature resulted in charges to operating expenses of $8,187. For the three and nine months ended September 30, 1998, the stock DERs accrued on NQSOs that had a stock DER feature resulted in charges to operating expenses of $0 and $55,222, respectively. Stock DERs represent shares of stock which are issuable to holders of stock options when the holders exercise the underlying stock options. The number of stock DER shares accrued is based on the level of the Company's dividends and on the price of the stock on the related dividend payment date.

A summary of the status of the Company's Plan as of September 30, 1999 and changes during the periods ending on that date is presented below.
<TABLE>
<CAPTION>

	Three Months Ended September 30, 1999		Nine Months Ended September 30, 1999	
(in thousands, except share data)	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
<S>	<C>	<C>	<C>	<C>
Outstanding options at beginning of period	1,695,954	$22.75	1,739,787	$23.58
Options granted	18,500	$14.97	151,800	$16.11
Options exercised	--	--	(12,361)	$0.11
Options canceled	(97,748)	$16.97	(262,520)	$23.71
Outstanding options at end of period	1,616,706	$23.05	1,616,706	$23.05

</TABLE>

STOCK REPURCHASES

Since September 1997, the Company's Board of Directors has approved the repurchase of 6,455,000 shares of the Company's Common Stock. Pursuant to this repurchase program, the Company repurchased 974,400 and 2,308,600 shares of its Common Stock for $15 million and $35 million during the three and nine months ended September 30, 1999, respectively. The Company repurchased 2,275,700 and 2,550,100 shares of its Common Stock for $34 million and $39 million during the three and nine months ended September 30, 1998, respectively. At September 30, 1999, there were 174,900 shares available for repurchase. The repurchased shares have been returned to the Company's authorized but unissued shares of Common Stock.

In March 1999, the Company's Board of Directors approved the repurchase of 150,000 shares of the Company's Preferred Stock. The Company did not repurchase any shares of its Preferred Stock during the three and nine months ended September 30, 1999.

NOTE 12. RELATED PARTY TRANSACTIONS

SALE OF MORTGAGE LOANS

During the three and nine months ended September 30, 1999, the Company sold $24 million and $32 million, respectively, of commercial mortgage loans to Redwood Commercial Funding ("RCF"), a subsidiary of Holdings. Pursuant to the Master Forward Commitment Agreement, the Company sold the Mortgage Loans to RCF at the same price for which the Company acquired the Mortgage Loans. Similarly, the Company purchased $22 million and $42 million of commercial mortgage loans during the three and nine months ended September 30, 1999, respectively. Under the terms of the Master Forward Commitment Agreement, the Company committed to sell the Mortgage Loans to RCF during the fourth quarter of 1999. There was no such activity for the three and nine months ended September 30, 1998.

For both the three and nine months ended September 30, 1999, the Company sold $47 million of residential mortgage loans to Redwood Residential Funding ("RRF"), a subsidiary of Holdings. Pursuant to the Master Forward Commitment Agreement, the Company sold the Mortgage Loans to RRF at the same price for which the Company acquired the Mortgage Loans. Similarly, the Company purchased or committed to purchase $4 million and $53 million of residential mortgage loans during the three and nine months ended September 30, 1999, respectively. Under the terms of the Master Forward Commitment Agreement, the Company

committed to sell the Mortgage Loans to RRF during the fourth quarter of 1999, or the first quarter of 2000. There was no such activity for the three and nine months ended September 30, 1998.

OTHER

Under a revolving credit facility arrangement, the Company may loan funds to Holdings to finance certain Mortgage Loans owned by Holdings. These loans are typically unsecured and are repaid within six months. Such loans bear interest at a rate of 3.50% over the LIBOR. At September 30, 1999 and December 31, 1998, the Company had loaned $19.4 million and $6.5 million, respectively, to Holdings in accordance with the provisions of this arrangement. During the three and nine months ended September 30, 1999, the Company earned $0.3 million and $0.7 million, respectively in interest on loans to Holdings. During both the three and nine months ended September 30, 1998, the Company earned $15,243 in interest on loans to Holdings.

The Company shares many of the operating expenses of Holdings, including personnel and related expenses, subject to full reimbursement by Holdings. During the three and nine months ended September 30, 1999, $1.2 million and $2.7 million, respectively, of Holdings' operating expenses were paid by the Company, and were subject to reimbursement by Holdings. During the three and nine months ended September 30, 1998, $0.7 million and $1.4 million, respectively, of Holdings' operating expenses were paid by the Company, and were subject to reimbursement by Holdings.

The Company may provide credit support to Holdings to facilitate Holdings' financings from third-party lenders and/or hedging arrangements with counterparties. As part of this arrangement, Holdings is authorized as a co-borrower under some of the Company's Short-Term Debt agreements subject to the Company continuing to remain jointly and severally liable for repayment. Accordingly, Holdings pays the Company credit support fees on borrowings subject to this arrangement. At September 30, 1999, the Company was providing credit support on $19.2 million of Holdings' Short-Term Debt. No such borrowings were outstanding at December 31, 1998. During the three and nine months ended September 30, 1999, the Company recognized $31,065 and $71,923 in credit support fees. Credit support fees for the three and nine months ended September 30, 1998 were $0 $138,966, respectively. Credit support fees are reflected as a component of "Other Income" on the Consolidated Statements of Operations.

NOTE 13. COMMITMENTS AND CONTINGENCIES

At September 30, 1999, the Company had entered into commitments to purchase $21.7 million of residential Mortgage Securities for settlement during October 1999. At September 30, 1999, the Company had also entered into commitments to sell $22 million of commercial Mortgage Loans to RCF and $4 million of residential Mortgage Loans to RRF for settlement during the fourth quarter of 1999 and the first quarter of 2000.

At September 30, 1999, the Company is obligated under non-cancelable operating leases with expiration dates through 2003. The future minimum lease payments under these non-cancelable leases are as follows: 1999 - $106,504; 2000 - $399,515; 2001 - $186,764; 2002 - $52,321; 2003 - $43,601.

NOTE 14. SUBSEQUENT EVENTS

The Company repurchased 174,900 shares of Common Stock for $2.1 million during October 1999, pursuant to its common stock repurchase program (see Note 11). As of November 10, 1999, there are no remaining shares authorized for repurchase under the Company's common stock repurchase program.

Through November 10, 1999, pursuant to the Company's preferred stock repurchase program (see Note 11), the Company repurchased 7,450 shares of its Preferred Stock for $0.2 million.

On October 28, 1999, the Company declared a $0.15 per share common stock dividend for the third quarter ended September 30, 1999. The common stock dividend is payable on November 22, 1999 to shareholders of record on November 8, 1999.

From October 1, 1999 through November 10, 1999, the Company committed to purchase $476 million of mortgage loans and mortgage securities.

RWT HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

ASSETS	September 30, 1999 (Unaudited)	December 31, 1998
Mortgage loans: held-for sale		
Residential	$ 20,244	$ 12,247
Commercial	28,721	-
	48,965	12,247
Cash and cash equivalents	1,480	9,711
Accrued interest receivable	367	78
Property, equipment and leasehold improvements, net	3,008	622
Other assets	316	120
	$ 54,136	$ 22,778
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Short-term debt	$ 19,207	$ -
Loans from Redwood Trust, Inc.	19,375	6,500
Payable to Redwood Trust, Inc.	330	445
Accrued restructuring charges	1,362	-
Accrued expenses and other liabilities	1,304	557
	41,578	7,502
Commitments and contingencies (See Note 10)		
STOCKHOLDERS' EQUITY		
Series A preferred stock, par value $0.01 per share; 10,000 shares authorized; 5,940 issued and outstanding ($5,940 aggregate liquidation preference)	29,700	19,800
Common stock, par value $0.01 per share; 10,000 shares authorized; 3,000 issued and outstanding	-	-
Additional paid-in capital	300	200
Accumulated deficit	(17,442)	(4,724)
	12,558	15,276
	$ 54,136	$ 22,778

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

RWT HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands)
(Unaudited)

	Three Months Ended		Nine Months Ended	For the period from April 1, 1998 (commencement of operations) to
	September 30, 1999	September 30, 1998	September 30, 1999	

September 30, 1998

REVENUES				
Interest income				
Mortgage loans: held-for-sale				
Residential	$ 350	$ -	$ 657	$ 2,779
Commercial	451	-	774	-
	801	-	1,431	2,779
Mortgage securities: trading	367	-	1,021	-
Cash and cash equivalents	79	131	295	188
Total interest income	1,247	131	2,747	2,967
Interest expense				
Short-term debt	(507)	-	(1,111)	(2,503)
Credit support fees	(31)	-	(72)	(139)
Loans from Redwood Trust, Inc.	(336)	-	(691)	(15)
Total interest expense	(874)	-	(1,874)	(2,657)
Net interest income	373	131	873	310
Net unrealized and realized gains (losses) on assets	(531)	-	84	22
Other income (expense)	-	-	48	-
Net revenues (expenses)	(158)	131	1,005	332
EXPENSES				
Compensation and benefits	(2,534)	(1,219)	(7,346)	(1,740)
General and administrative	(1,512)	(502)	(4,167)	(770)
Restructuring charge	(2,210)	-	(2,210)	-
Total expenses	(6,256)	(1,721)	(13,723)	(2,510)
NET LOSS	$ (6,414)	$ (1,590)	$(12,718)	$ (2,178)

</TABLE>

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

RWT HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands, except share data)
(Unaudited)

<TABLE>
<CAPTION>

	Series A Preferred stock		Common stock		Additional paid-in capital	Accumulate deficit	Total
	Shares	Amount	Shares	Amount			
Balance, December 31, 1998	3,960	$ 19,800	2,000	$ -	$ 200	$ (4,724)	$ 15,276
Comprehensive income:							
Net loss	-	-	-	-	-	(2,509)	(2,509)
Balance, March 31, 1999	3,960	19,800	2,000	-	200	(7,233)	12,767
Comprehensive income:							
Net loss	-	-	-	-	-	(3,795)	(3,795)
Issuance of preferred stock	1,980	9,900	-	-	-	-	9,900
Issuance of common stock	-	-	1,000	-	100	-	100
Balance, June 30, 1999	5,940	29,700	3,000	-	300	(11,028)	18,972
Comprehensive income:							
Net loss	-	-	-	-	-	(6,414)	(6,414)
Balance, September 30, 1999	5,940	$ 29,700	3,000	-	$ 300	$(17,442)	$ 12,558

</TABLE>

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

RWT HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)
<TABLE>
<CAPTION>

	Three Months Ended September 30, 1999	Three Months Ended September 30, 1998	Nine Months Ended September 30, 1999	For the period from April 1, 1998 (commencement of operations) to September 30, 1998
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net loss	$ (6,414)	$ (1,590)	$ (12,718)	

				$ (2,178)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:				
Depreciation and amortization	267	2	464	29
Net unrealized and realized (gains) losses on assets	531	-	(84)	(22)
Purchases of mortgage loans: held for sale	(79,178)	-	(231,359)	(531,038)
Proceeds from sales of mortgage loans: held for sale	49,993	-	94,009	525,418
Principal payments on mortgage loans: held for sale	472	-	1,280	5,615
Purchases of mortgage securities: trading	(4,619)	-	(4,619)	-
Proceeds from sales of mortgage securities: trading	44,969	-	99,488	-
Principal payments on mortgage securities: trading	1,206	-	3,549	-
(Increase) in accrued interest receivable	(224)	(5)	(289)	(21)
(Increase) decrease in other assets	1,239	(31)	821	(49)
Increase (decrease) in amounts due to Redwood Trust	121	(55)	(115)	776
Increase in accrued restructuring charges	1,362	-	1,362	-
Increase in accrued expenses and other liabilities	17	203	747	245
Net cash provided by (used in) operating activities	9,742	(1,476)	(47,464)	(1,225)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of property, equipment and leasehold improvements	(567)	(373)	(2,849)	(408)
Net cash used in investing activities	(567)	(373)	(2,849)	(408)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Proceeds from issuance of short-term debt	8,896	-	157,075	519,347
Repayments on short-term debt	(42,792)	-	(137,868)	(519,347)
Loans from Redwood Trust, Inc.	71,724	-	132,168	4,000
Repayment of loans from Redwood Trust, Inc.	(54,349)	-	(119,293)	(4,000)
Net proceeds from issuance of preferred stock	-	-	9,900	9,900
Net proceeds from issuance of common stock	-	-	100	100
Net cash provided by (used in) financing activities	(16,521)	-	42,082	10,000
Net increase (decrease) in cash and cash equivalents	(7,346)	(1,849)	(8,231)	8,367
Cash and cash equivalents at beginning of period	8,826	10,216	9,711	-
Cash and cash equivalents at end of period	$ 1,480	$ 8,367	$ 1,480	$ 8,367
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash paid for interest expense	$ 822	$ -	$ 1,769	

$ 2,518

Non-cash transaction:				
Securitization of mortgage loans into mortgage securities	$ -	$ -	$ 98,290	$ -
	============	=========	=============	==================

</TABLE>

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

RWT HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 1999
(UNAUDITED)

NOTE 1. THE COMPANY

RWT Holdings, Inc. ("Holdings") was incorporated in Delaware on February 13, 1998 and commenced operations on April 1, 1998. Holdings' first fiscal year-end was December 31, 1998. Holdings originates, acquires, accumulates, services and sells real estate mortgage assets ("Mortgage Assets") which may be acquired or sold as whole loans ("Mortgage Loans") or as mortgage securities representing interests in or obligations backed by pools of mortgage loans ("Mortgage Securities"). Holdings is also developing a mortgage technology business. Redwood Trust, Inc. ("Redwood Trust") owns all of the preferred stock and has a non-voting, 99% economic interest in Holdings. The consolidated financial statements include the three subsidiaries of Holdings. Redwood Commercial Funding, Inc. ("RCF") originates commercial mortgages for sale to institutional investors. Redwood Residential Funding, Inc. ("RRF") is a start-up mortgage technology services venture which is developing a business-to-business Internet-based process for linking mortgage investors to mortgage originators. Redwood Financial Services, Inc. ("RFS") was combined with Holdings' other operations in the third quarter of 1999. Holdings and its subsidiaries currently utilize both debt and equity to finance acquisitions. References to Holdings in the following footnotes refer to Holdings and its subsidiaries.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

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

The consolidated financial statements included herein are unaudited; however, in the opinion of management, the interim financial information contains all adjustments, including normal recurring adjustments, necessary to present fairly the results for the interim period.

USE OF ESTIMATES

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

Fair Value. Management estimates the fair value of its financial instruments using available market information and other appropriate valuation methodologies. The fair value of a financial instrument, as defined by Statement of Financial Accounting Standards ("SFAS") No. 107, Disclosures about Fair Value of Financial Instruments, is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced liquidation sale. Management's estimates are inherently subjective in nature and involve matters of uncertainty and judgement to interpret relevant market and other data. Accordingly, amounts realized in actual sales may differ from the fair values presented in Note 6.

ADOPTION OF SFAS NO. 133

Holdings adopted SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, effective July 1, 1998. Upon the adoption of SFAS No. 133, Holdings did not record a transition adjustment, as there were no outstanding derivative instruments. Immediately after the adoption of SFAS No. 133, Holdings elected to not seek hedge accounting for any of its derivative financial instruments employed for hedging activities.

MORTGAGE ASSETS

Holdings' Mortgage Assets consist of Mortgage Loans and Mortgage Securities. Interest is recognized as revenue when earned according to the terms of the loans and when, in the opinion of management, it is collectible.

Mortgage Loans: Held-for-Sale

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

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

Mortgage Securities: Trading

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

LOAN ORIGINATION FEES

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

CASH AND CASH EQUIVALENTS

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

DERIVATIVE FINANCIAL INSTRUMENTS

Holdings utilizes various derivative financial instruments to mitigate the risks that a change in interest rates will result in a change in the value of the Mortgage Assets. As of September 30, 1999, Holdings has entered into forward contracts for the sale of mortgage-backed securities. Holdings currently designates all derivative financial instruments as trading instruments. Accordingly, such instruments are recorded at their estimated fair market value with unrealized and realized gains and losses on these instruments recognized as a component of "Net unrealized and realized gains (losses) on assets" on the Consolidated Statements of Operations. During the three and nine months ended September 30, 1999, Holdings recognized mark-to-market gains on derivative financial instruments of $0.9 million and $1.0 million, respectively. There were no derivative financial instruments outstanding during the three and nine months ended September 30, 1998.

INCOME TAXES

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

COMPREHENSIVE INCOME

SFAS No. 130, Reporting Comprehensive Income, requires Holdings to classify items of "other comprehensive income" by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet. As of September 30, 1999 there was no other comprehensive income.

NOTE 3. MORTGAGE ASSETS

At September 30, 1999 and December 31, 1998 Mortgage Assets consisted of the following:

MORTGAGE LOANS: HELD-FOR-SALE

(IN THOUSANDS)	SEPTEMBER 30, 1999	DECEMBER 31, 1998
Current Face	$49,868	$12,072
Unamortized Premium (Discount)	(903)	175
Carrying Value	$48,965	$12,247

Mortgage Loans held for sale include residential and commercial mortgage loans. For the three and nine months ended September 30, 1999 Holdings recognized a lower of cost or market loss adjustment of $0.9 million and $1.1 million on Mortgage Loans held-for-sale, respectively. This loss is reflected as a component of "Net unrealized and realized gains (losses) on assets" on the Consolidated Statements of Operations. Also, during the three and nine months ended September 30, 1999, Holdings sold Mortgage Loans held-for-sale for proceeds of $50 million and $94 million, respectively. For the three and nine months ended September 30, 1998, Holdings sold Mortgage Loans for proceeds of $0 and $525 million, respectively.

MORTGAGE SECURITIES: TRADING

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

NOTE 4. SHORT-TERM DEBT

Holdings has entered into reverse repurchase agreements and other forms of collateralized short-term borrowings (collectively, "Short-Term Debt") to finance acquisitions of a portion of its Mortgage Assets. The average balance of Short-Term Debt outstanding during the three and nine months ended September 30, 1999 was $35 million and $27 million with a weighted average borrowing rate of 5.77% and 5.42%, respectively. The maximum balance outstanding during the nine months ended September 30, 1999 was $88 million. The average balance of Short-Term Debt outstanding during the three and nine months ended September 30, 1998 was $0 and $157 million with a weighted-average borrowing rate of 6.37%. The maximum balance outstanding during the nine months ended September 30, 1998 was $367 million.

In July 1999, Redwood Trust entered into a one-year, $90 million revolving mortgage warehousing credit facility with two banks. The facility is primarily intended to finance newly originated residential mortgage loans. Holdings may borrow under this facility as a co-borrower. At September 30, 1999, Holdings had no outstanding borrowings under this facility. Borrowings under this facility bear interest based on a specified margin over the London Interbank Offered Rate ("LIBOR"). Holdings was in compliance with all material representations, warranties and covenants under this credit facility at September 30, 1999.

In July 1999, Redwood Trust entered into a one-year, $350 million master loan and security agreement with a Wall Street firm. The facility is primarily intended to finance newly originated commercial and residential mortgage loans. Holdings may borrow under this facility as a co-borrower. At September 30, 1999, Holdings

had outstanding borrowings of $19.2 million under this facility. Borrowings under this facility bear interest based on a specified margin over LIBOR. For the three months ending September 30, 1999, the weighted-average borrowing rate under this facility was 6.76%. Holdings was in compliance with all material representations, warranties and covenants under this credit facility at

September 30, 1999.

Redwood Trust may provide credit support to Holdings to facilitate Holdings' financings from third-party lenders and/or hedging arrangements with counterparties. As part of this arrangement, Holdings is authorized as a co-borrower under some of Redwood Trust's Short-Term Debt agreements subject to Redwood Trust continuing to remain jointly and severally liable for repayment. Accordingly, Holdings pays Redwood Trust credit support fees on borrowings subject to this arrangement. At September 30, 1999, Redwood Trust was providing credit support on $19.2 million of Holdings' Short-Term Debt. No such arrangements were outstanding at December 31, 1998. These expenses are reflected as "Credit support fees" on the Consolidated Statements of Operations.

NOTE 5. RESTRUCTURING CHARGE

In the third quarter of 1999, Holdings recognized a $2.2 million charge as a result of combining the operations of RFS with other Holdings' operations. The $2.2 million reflects $1.1 million of severance and other termination-related costs, $1.0 million related to the disposition of certain facilities, premises and equipment, and $0.1 million related to other restructuring costs. At September 30, 1999 the reserve balance associated with the above charge was $1.3 million, of which $0.7 million related to severance and other termination-related costs, $0.5 million related to the disposition of certain facilities, premises and equipment, and $0.1 million related to other restructuring costs.

NOTE 6. INCOME TAXES

The provision for income taxes for the period from January 1, 1999 through September 30, 1999 amounted to $3,200 and represents minimum California franchise taxes. No tax provision has been recorded for the nine months ended September 30, 1999, as Holdings reported a loss for the period. Due to the uncertainty of realization of net operating losses, no tax benefit has been provided against the loss for the period. In addition, a valuation allowance has been provided to eliminate the deferred tax asset related to net operating loss carryforwards at September 30, 1999 and December 31, 1998. At September 30, 1999 and December 31, 1998 the valuation allowance amounted to $7.0 million and $1.8 million, respectively. At December 31, 1998, Holdings had net operating loss carryforwards of approximately $4.6 million for both Federal and state income tax purposes. The Federal and state carryforwards expire through 2013 and 2003, respectively.

NOTE 7. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying values and estimated fair values of Holdings' financial instruments at September 30, 1999 and December 31, 1998.

<TABLE>
<CAPTION>

(IN THOUSANDS)	September 30, 1999		December 31, 1998	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<S>	<C>	<C>	<C>	<C>
Assets				
Mortgage Loans: held-for-sale	$48,965	$49,254	$12,247	$12,255
Short-term debt	19,207	19,207	-	-
Loans from Redwood Trust, Inc.	19,375	19,375	6,500	6,500

</TABLE>

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

NOTE 8. STOCKHOLDERS' EQUITY

The authorized capital stock of Holdings consists of Series A Preferred Stock ("Preferred Stock") and Common Stock. Holdings is authorized to issue 10,000 shares of Common Stock, each having a par value of $0.01, and 10,000 shares of Preferred Stock, each having a par value of $0.01. All voting power is vested in the common stock.

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

Common Stock. After the liquidation preference, the holders of Preferred Stock are entitled to 99% of any remaining assets.

NOTE 9. RELATED PARTY TRANSACTIONS

PURCHASE OF MORTGAGE LOANS

During the three and nine months ended September 30, 1999, RCF purchased $24 million and $32 million, respectively, of commercial mortgage loans from Redwood Trust. Pursuant to the Master Forward Commitment Agreement, RCF purchased the Mortgage Loans from Redwood Trust at the same price for which Redwood Trust acquired the Mortgage Loans. Similarly, Redwood Trust purchased $22 million and $42 million of commercial mortgage loans during the three and nine months ended September 30, 1999, respectively. Under the terms of the Master Forward Commitment Agreement, Redwood Trust committed to sell the Mortgage Loans to RCF during the fourth quarter of 1999. There was no such activity for the three and nine months ended September 30, 1998.

For both the three and nine months ended September 30, 1999, RRF purchased $47 million of residential mortgage loans from Redwood Trust. Pursuant to the Master Forward Commitment Agreement, RRF purchased the Mortgage Loans from Redwood Trust at the same price for which Redwood Trust Acquired the Mortgage Loans. Similarly, Redwood Trust purchased, or committed to purchase, $4 million and $53 million of residential mortgage loans during the three and nine months ended September 30, 1999, respectively. Under the terms of the Master Forward Commitment Agreement, Redwood Trust committed to sell the Mortgage Loans to RRF during the fourth quarter of 1999, or the first quarter of 2000. There was no such activity for the three and nine months ended September 30, 1998.

OTHER

Under a revolving credit facility arrangement, Redwood Trust may loan funds to Holdings to finance certain Mortgage Assets owned by Holdings. These loans are typically unsecured and are repaid within six months. Such loans bear interest at a rate of 3.5% over the London Interbank Offered Rate ("LIBOR"). At September 30, 1999 and December 31, 1998, Holdings had borrowed $19.4 million and $6.5 million, respectively, from Redwood Trust in accordance with the provisions of this arrangement. During the three and nine months ended September 30, 1999, Holdings incurred $0.3 million and $0.7 million, respectively, in interest on loans from Redwood Trust. During both the three and nine months ended September 30, 1998, Holdings incurred $15,243 in interest on loans from Redwood Trust.

Redwood Trust shares many of the operating expenses of Holdings, including personnel and related expenses, subject to full reimbursement by Holdings. During the three and nine months ended September 30, 1999, $1.2 million and $2.7 million, respectively, of Holdings' operating expenses were paid by Redwood Trust. For the three and nine months ended September 30, 1998, Redwood Trust paid $0.7 million and $1.4 million, respectively, of Holdings' expenses which were subject to reimbursement by Holdings.

Holdings may borrow under several of Redwood Trust's Short-Term Debt agreements as a co-borrower. As of September 30, 1999, Holdings had borrowings of $19.2 million subject to this arrangement. At December 31, 1998, Holdings had no outstanding borrowings under these agreements (see Note 4).

NOTE 10. COMMITMENTS AND CONTINGENCIES

At September 30, 1999, Holdings is obligated under non-cancelable operating leases with expiration dates through 2006. The future minimum lease payments under these non-cancelable leases are as follows: 1999 - $142,347; 2000- $578,526; 2001 - $545,360; 2002 - $377,848; 2003 - $355,950; 2004 through 2006 - $83,388.

Rent expense was $145,191 and $530,903, respectively, for the three and nine months ended September 30, 1999. For the three and nine months ended September 30, 1998, rent expense was $33,600 and $87,067, respectively.

At September 30, 1999, RCF had entered into commitments to purchase $22 million of commercial Mortgage Loans from Redwood Trust for settlement during the fourth quarter of 1999.

At September 30, 1999, RRF had entered into commitments to purchase $4 million of residential Mortgage Loans from Redwood Trust for settlement during the fourth quarter of 1999 and the first quarter of 2000.

At September 30, 1999, RFS had entered into commitments to sell $21 million of residential Mortgage Loans for settlement during October 1999.

NOTE 11. SUBSEQUENT EVENTS

Through November 10, 1999, RRF has committed to purchase $9 million of Mortgage Loans from Redwood Trust for settlement during the first quarter of 2000.

On November 9, 1999, RCF sold $5 million of commercial Mortgage Loans.

ITEM 2. REDWOOD TRUST, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS

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

SAFE HARBOR STATEMENT

"Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995: Statements in this discussion regarding Redwood Trust, Inc., or "Redwood Trust", and our business which are not historical facts are "forward-looking statements" that involve risks and uncertainties. For a discussion of such risks and uncertainties, which could cause actual results to differ from those contained in the forward-looking statements, we refer you to "Risk Factors" commencing on Page 16 of our 1998 Annual Report.

OVERVIEW

Redwood Trust, together with its affiliates, is a finance company specializing in mortgage assets. Our primary activity is the financing of high-quality residential mortgage loans with funds raised through long-term debt issuance. We also finance commercial mortgage loans and residential mortgage securities. Through our affiliate operations, we are developing the ability to create mortgage assets of significant value and we are developing technology and processes designed to streamline access to the residential mortgage market for a variety of institutional investors.

Our core business of mortgage finance is conducted through Redwood Trust, which is a qualified real estate investment trust ("REIT"). In general, our REIT status allows us to avoid corporate income taxes by distributing to our shareholders an amount equal to at least 95% of taxable income.

We also own a 99% economic interest in a taxable affiliate company, RWT Holdings, Inc. ("Holdings"). Our investment in Holdings is accounted for under the equity method. Holdings originates commercial mortgage loans for sale to institutional investors through its Redwood Commercial Funding, Inc. ("RCF") subsidiary. Holdings also has a start-up mortgage technology services venture called Redwood Residential Funding, Inc. ("RRF"). RRF is developing a business-to-business Internet-based process for linking mortgage investors to mortgage originators.

Holdings had a third operating business, Redwood Financial Services, Inc. ("RFS"). In the third quarter of 1999, RFS' operations were combined with Holdings' other operations. This combination resulted in a $2.2 million restructuring charge in the third quarter of 1999, and a significant reduction in the headcount and ongoing operating expenses at Holdings.

In the third quarter of 1999, the net loss after preferred dividends totaled $3.7 million, or $(0.39) per common share. For the nine months ending September 30, 1999, net income to common shareholders totaled $4.6 million, or $0.45 per common share. In the third quarter of 1998, we adopted SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and adopted mark-to-market accounting for all securities funded with short-term debt. These changes in accounting methodologies resulted in a large earnings charge in that quarter. As a result of the adoptions of these accounting changes, we reported a loss of $47.9 million, or $(3.61) per share in the third quarter of 1998 and a loss of $45.9 million, or $(3.32) per share, for the nine months ending September 30, 1998.

The following is a summary of the significant components of our earnings for the three months and nine months ending September 30, 1999 and 1998. For the Holdings' operations, the nine months ending September 30, 1998 reflect the period from April 1, 1998 (the commencement of operations) to September 39, 1998. The summary includes only our share of the earnings and losses at Holdings.

<TABLE>
<CAPTION>

RESULTS OF OPERATIONS	THREE MONTHS ENDED		NINE MONTHS ENDED	
(IN THOUSANDS, EXCEPT SHARE DATE)	SEPT. 30, 1999	SEPT. 30, 1998	SEPT. 30, 1999	SEPT. 30, 1998

<S>	<C>	<C>	<C>	<C>
REIT Mortgage Finance Income	$ 5,367	$ 4,751	$ 17,763	$ 9,387
RCF Operating Results	(664)	(103)	(1,527)	(103)
RRF Operating Results	(2,530)	(522)	(5,934)	(1,103)
Preferred Dividends	(687)	(687)	(2,060)	(2,060)
Income before RFS and REIT Mark-to-Market	1,486	3,439	8,242	6,121
RFS Operating Results	(968)	(951)	(2,942)	(951)
RFS Restructuring Charge	(2,188)	0	(2,188)	0
Income (Loss) before REIT Mark-to-Market	(1,670)	2,488	(3,112)	5,170
REIT Mark-to-Market	(2,068)	(40,293)	1,513	(41,016)
Cumulative Effect of Adopting SFAS No. 133	0	(10,061)	0	(10,061)
Net Income (Loss) to Common Shareholders	$ (3,738)	$(47,866)	$ 4,625	$(45,907)
Earnings Per Share, diluted	$ (0.39)	$ (3.61)	$ 0.45	$ (3.32)
Common Dividends Per Share	$ 0.15	$ 0.00	$ 0.15	$ 0.28

</TABLE>

For more information, please visit our Web site at: http://www.redwoodtrust.com.

FINANCIAL CONDITION

Our balance sheet presents our mortgage finance assets and liabilities. It also includes, as one line item, our net investment in Holdings. Holdings' balance sheet and financial condition are presented separately with discussion and analysis beginning on Page 47.

At September 30, 1999, our reported balance sheet had $2.1 billion of assets funded with $1.9 billion of liabilities and $0.2 billion of equity. The portion of our balance sheet that is subject to recourse is $1.1 billion of assets, $0.9 billion of borrowings and $0.2 billion of equity. The ratio of equity-to-recourse-assets was 20.3%. The ratio of recourse-debt-to-equity was 3.8 to 1.0.

Our $1.1 billion of non-recourse assets and liabilities are owned by trusts created by our special-purpose finance subsidiary, Sequoia Mortgage Funding Corporation ("Sequoia"). The trusts are "bankruptcy-remote" with respect to Redwood Trust. Although the net earnings of the trusts accrue to Redwood Trust, Redwood Trust is not responsible for the repayment of Sequoia debt and Sequoia has no call on the liquidity of Redwood Trust. Our recourse exposure to Sequoia's mortgage assets is limited to our equity investments in these trusts. At September 30, 1999, these equity investments had a reported value of $33 million.

At December 31, 1998, we reported $2.8 billion in assets, of which $1.5 billion were recourse, and $2.6 billion of liabilities, of which $1.3 billion were recourse. Equity capital was $0.3 billion. The ratio of equity-to-recourse-assets was 16.7% and the ratio of recourse-debt-to-equity was 4.9 to 1.0.

MORTGAGE LOANS: HELD FOR SALE
RESIDENTIAL
We owned $22 million residential mortgage loans held for sale at September 30, 1999. These loans are carried on our balance sheet at the lower-of-cost-or-market. At December 31, 1998, we reported $266 million of residential

mortgage loans in this category, of which $198 million were part of Sequoia Mortgage Trust 1 (see below) and $68 million were funded with short-term debt and equity.

COMMERCIAL
At September 30, 1999, we owned $18 million of commercial mortgage loans originated by RCF and carried on our balance sheet as "Mortgage Loans: Held for Sale: Commercial". At December 31, 1998, we owned $8 million of commercial mortgage loans.

MORTGAGE LOANS: HELD FOR INVESTMENT
At September 30, 1999, we owned $1.0 billion of residential mortgage loans that were financed with long-term debt through trusts owned by our financing

subsidiary, Sequoia Mortgage Funding Corporation ("Sequoia"). The amount of outstanding Sequoia long-term debt amortizes as the underlying mortgages pay down. As the equity owner of these trusts, we are entitled to distributions of the net earnings of the trusts, which principally consist of the interest income earned from mortgages in each trust less the interest expense of the debt of each trust.

We currently have three series of outstanding long-term debt as discussed below. We consolidate the assets and liabilities of Sequoia on our balance sheet. Sequoia balance sheet components appear on our balance sheet as part of "Mortgage Loans: Held for Investment", "Restricted Cash", "Long-Term Debt", "Accrued Interest Receivable", and "Accrued Interest Payable".

SEQUOIA MORTGAGE TRUST 1

At September 30, 1999, Sequoia Mortgage Trust 1 ("Sequoia 1") owned $130 million in principal value of adjustable-rate residential mortgage loans and $4 million of restricted cash funded with $130 million of floating-rate collateralized mortgage bonds.

Our credit risk with respect to these loans is limited to our investment in the equity of Sequoia 1. The reported basis of this investment was $6 million at September 30, 1999.

We will have the right to call Sequoia 1's debt and re-acquire Sequoia 1's loans when the underlying mortgage loan collateral has been paid down to less than 10% of its initial securitization balance. As of September 30, 1999, the balance was at 24% of its initial level.

At December 31, 1998, the principal value of Sequoia 1's loans totaled $197 million. We also reported $13 million of cash owned by Sequoia 1 as "Restricted Cash". Total Sequoia 1 debt was $202 million.

SEQUOIA MORTGAGE TRUST 2

At September 30, 1999, Sequoia Mortgage Trust 2 ("Sequoia 2") owned $472 million in principal value of adjustable-rate residential mortgage loans funded with $467 million of floating-rate collateralized mortgage bonds.

Our credit risk with respect to these loans is limited to our investment in the equity of Sequoia 2. The reported basis of this equity interest was $17 million at September 30, 1999.

We will have the right to call Sequoia 2's debt and re-acquire Sequoia 2's loans when the underlying mortgage loan collateral has been paid down to less than 25% of its initial balance. As of September 30, 1999, the balance was at 62% of its initial level.

At December 31, 1998, the principal value of Sequoia 2's loans totaled $579 million and total Sequoia 2 debt was $571 million.

SEQUOIA MORTGAGE TRUST 3

At September 30, 1999, Sequoia Mortgage Trust 3 ("Sequoia 3") owned $408 million in principal value of residential mortgage loans funded with $398 million of long-term debt. Both the mortgage loans and debt of Sequoia 3 are fixed-rate until December 2002 and then become floating-rate.

Our credit risk with respect to these loans is limited to our investment in the equity of Sequoia 3. This investment had a reported basis of $10 million at September 30, 1999.

We will have the right to call Sequoia 3's debt and re-acquire Sequoia 3's loans beginning in December 2002.

At December 31, 1998, the principal value of Sequoia 3's loans totaled $540 million and total Sequoia 3 debt was $530 million.

MORTGAGE SECURITIES: TRADING

At September 30, 1999 and December 31, 1998, all of our mortgage securities represented interests in pools of residential mortgage loans. Our mortgage securities portfolio is marked-to-market for income statement purposes except for the 1% of mortgage securities we own that are rated below "AA". For the mark-to-market securities, the estimated bid-side market value was $0.9 billion at September 30, 1999. These assets appear on our balance sheet as "Mortgage Securities: Trading." We owned $1.3 billion in market value of these securities at December 31, 1998. For a discussion of our investments in lower-rated mortgage securities, we refer you to the section titled "Mortgage Securities: Available for Sale" below.

At September 30, 1999, 56.8% of our mark-to-market residential mortgage securities portfolio consisted of residential adjustable-rate mortgage securities issued and credit-enhanced by Fannie Mae or Freddie Mac and effectively rated "AAA". These securities totaled $0.5 billion at September 30, 1999 and $0.6 billion at December 31, 1998.

At September 30, 1999, 34.3% of our mark-to-market residential mortgage securities portfolio consisted of residential adjustable-rate mortgage securities issued by private-label security issuers. These securities were credit-enhanced through subordination or other means and were rated "AAA" or "AA". The value of these securities was $0.3 billion at September 30, 1999 and $0.6 billion at December 31, 1998.

At September 30, 1999, 5.1% of our mark-to-market residential mortgage securities portfolio consisted of mortgage securities rated "AAA" or "AA" which were backed by home equity loans, or "HEL". The value of these securities was $47 million at September 30, 1999 (99% of these were floating-rate HEL securities). The value of HEL securities was $71 million at December 31, 1998; floating-rate HEL securities were $68 million and fixed-rate HEL securities were $3 million.

At September 30, 1999, 1.8% of our mark-to-market residential mortgage securities portfolio consisted of fixed-rate, private-label collateralized mortgage obligations. These are commonly referred to as CMO's. They are rated "AAA" or "AA" and have average lives of 1 to 2 years. The value of these securities was $16 million at September 30, 1999 and $19 million at December 31, 1998.

At September 30, 1999, 1.3% of our mark-to-market residential mortgage securities portfolio consisted of fixed-rate, private-label mortgage securities rated "AA" and backed by residential mortgage loans with loan-to-value ratios in excess of 100%. The value of these securities was $12 million at September 30, 1999 and $12 million at December 31, 1998.

At September 30, 1999, 0.7% of our mark-to-market residential mortgage securities portfolio consisted of floating-rate CMO's issued by Fannie Mae or Freddie Mac and effectively rated "AAA". These securities totaled $6 million at September 30, 1999 and $17 million at December 31, 1998.

At September 30, 1999, 0.02% of our mark-to-market residential mortgage securities portfolio consisted of interest-only mortgage securities rated "AAA" or "AA". The value of these securities was $0.2 million at September 30, 1999 and $0.4 million at December 31, 1998.

MORTGAGES SECURITIES: AVAILABLE FOR SALE

In 1994 and 1995, we acquired a portfolio of subordinated mortgage securities. These securities were interests in pools of residential mortgage loans that served as the credit-enhancement for the "AAA" and other securities

issued from those pools. Through ownership of these securities, we assumed most of the credit risk of the underlying mortgage loans. These securities were either not rated or were rated "A" through "B". We sold these subordinated securities to a trust, SMFC 97-A, in a re-REMIC transaction in December 1997. SMFC 97-A issued mortgage securities to fund its acquisition of this portfolio.

We acquired from SMFC 97-A certain subordinated interests. At September 30, 1999, these securities effectively bore most of the credit risk related to $0.4 billion of underlying mortgages. Changes in market valuations of SMFC 97-A are not included in our income statement as these assets are funded with equity. The reported value of SMFC 97-A was $7 million at September 30, 1999 and $8 million at December 31, 1998. Our credit risk from SMFC 97-A is limited to our investment.

In 1999, we resumed the acquisition of lower-rated mortgage securities, defined as those with ratings of "A" or below. Mark-to-market adjustments on these securities are not recorded through the income statement but are included in "accumulated other comprehensive income" on the balance sheet. At September 30, 1999, these securities had a face value of $18 million and a reported value of $12 million. At December 31, 1998, we did not own any such securities. We generally intend to acquire additional subordinated mortgage securities in the future.

U.S. TREASURY SECURITIES

At December 31, 1998, we owned $48 million of ten-year U.S. Treasury securities as part of our asset/liability management and hedging program. We sold our ten-year U.S. Treasury securities in the first half of 1999.

CASH

We had $31 million of unrestricted cash at September 30, 1999 and $56 million at year-end 1998.

Sequoia owned cash totaling $4 million at September 30, 1999 and $13 million at year-end 1998. In consolidating Sequoia assets on our balance sheet, we reflect this cash as "Restricted Cash" since it will be used for the specific purpose of making payments to Sequoia bondholders and is not available for general corporate purposes.

INTEREST RATE AGREEMENTS
Our interest rate agreements are carried on our balance sheet at estimated market value, which was $2.7 million at September 30, 1999 and $2.5 million at December 31, 1998. Please see "Note 2. Summary of Significant Accounting Policies", "Note 7. Interest Rate Agreements" and "Note 10. Fair Value of Financial Instruments" in the Notes to Consolidated Financial Statements for more information.

INVESTMENT IN RWT HOLDINGS, INC.
We do not consolidate the assets and liabilities of Holdings on our balance sheet. We reflect the net book value of our individual investment in one line item on our balance sheet labeled "Investment in RWT Holdings, Inc."

Through September 30, 1999, we have invested $29.7 million in the preferred stock of Holdings. Our share of the operating losses at Holdings has reduced the carrying value of this investment. The carrying value was $12.4 million at September 30, 1999 and $15.1 million at December 31, 1998.

At September 30, 1999, our assets also included loans to Holdings of $19.4 million and a receivable from Holdings of $0.3 million. At December 31, 1998, loans to Holdings totaled $6.5 million and receivables from Holdings were $0.4 million.

OTHER ASSETS
Our other assets include accrued interest receivables, other receivables, fixed assets, leasehold improvements and prepaid expenses. These totaled $14.5 million at September 30, 1999 and $20.5 million at December 31, 1998.

SHORT-TERM DEBT
Short-term borrowings totaled $854 million at September 30, 1999, and totaled $1.3 billion at December 31, 1998. We pledge a portion of our mortgage securities portfolio, mortgage loan portfolio, and other investments to

secure this debt. Maturities on this debt typically range from one month to one year. The interest rate on most of this debt adjusts monthly to a spread over or under the one-month LIBOR interest rate.

LONG-TERM DEBT
At September 30, 1999, we had a total of $994 million in long-term mortgage-backed debt outstanding, net of unamortized premiums on bonds and deferred bond issuance costs. Sequoia 1 debt of $129 million and Sequoia 2 debt of $467 million is floating-rate debt. Sequoia 3 debt of $398 million is fixed-rate until December 2002; it then becomes floating-rate debt.

At December 31, 1998, Sequoia 1 had $202 million, Sequoia 2 had $574 million, and Sequoia 3 had $530 million of long-term mortgage-backed debt outstanding net of unamortized premiums on bonds and deferred bond issuance costs. The total Sequoia debt outstanding was $1.3 billion.

Sequoia debt is non-recourse to Redwood Trust. The debt is consolidated on our balance sheet and is reflected as long-term debt, which is carried at historical amortized cost. The original scheduled maturity of this debt was approximately thirty years. Since these debt balances are retired over time as principal payments are received on the underlying mortgages, the expected average life of this debt is two to six years.

OTHER LIABILITIES
Our other liabilities include accrued interest payable, accrued expenses, and dividends payable. The net balance of these accounts totaled $9.8 million at September 30, 1999 and $14.5 million at December 31, 1998. Most of the accrued interest payable is related to the Sequoia trusts discussed above.

STOCKHOLDERS' EQUITY
At September 30, 1999, total equity capital was $223 million, preferred stock equity was $27 million, and reported common equity totaled $196 million, or $21.90 per common share outstanding.

In reporting equity at September 30, 1999, we marked-to-market all earning assets and interest rate agreements except mortgage loans that were financed to maturity (Sequoia). In accordance with Generally Accepted Accounting Principles, no liabilities were marked-to-market.

If we had marked-to-market all of our assets and liabilities, equity capital would have been reported as $222 million at September 30, 1999. After subtracting out the preference value of the preferred stock and the third quarter common stock dividend, common equity on a full mark-to-market basis was $194 million and the net mark-to-market value per common share was $21.68.

At December 31, 1998, reported equity capital was $255 million, preferred stock equity was $27 million, and reported common equity was $228 million, or $20.27 per common share outstanding. Mark-to-market common equity was $220 million, or $19.53 per common share.

The mark-to-market common equity per share increased from $19.53 to $21.68 per share, an increase of 11% or $2.15 per share, during the first nine months of 1999. This increase was due to net asset appreciation, retained earnings, cash flow generated in excess of earnings, and the effects of our stock repurchase program.

We acquired 2,308,600 shares of our common stock in the first nine months of 1999 at an average price of $15.18 per share. In the fourth quarter of 1999 through November 10, 1999, we acquired an additional 174,900 shares at an average price of $12.12 per share.

RESULTS OF OPERATIONS

Our operating results include all of the reported income of our mortgage finance operations plus, as one line item on our income statement, our share of the after-tax results of operations at Holdings. Detailed results at Holdings are discussed separately below.

INTEREST INCOME

In the third quarter of 1999, interest income generated by our mortgage finance operations, including consolidated Sequoia assets, was $35 million. Our portfolio had average earning assets of $2.0 billion and earned an average yield of 6.66%. During this quarter, the average coupon rate, or the cash-earning rate on mortgage principal, was 6.88%. The reported value of assets included a net unamortized premium of 0.61% of mortgage principal totaling $12 million. We write off this net premium balance as an expense over the life of the asset. Net premium amortization expense for the quarter was $0.8 million, which reduced the earning asset yield by 0.15%. The prepayment rate on our mortgage assets, which drives the rate at which we write off premium balances, was 25% Conditional Prepayment Rate ("CPR") during the quarter. Other factors reduced the earning asset yield by 0.07%.

In the second quarter of 1999, interest income was $36 million. Our portfolio had average earning assets of $2.2 billion and earned an average yield of 6.54%. The coupon rate was 6.82%. The reported value of assets included a 0.80% net premium, or $17 million. Net premium amortization expense was $1.6 million, which reduced earning asset yield by 0.23%. Prepayments during the quarter were 30% CPR. Other factors reduced the earning asset yield by 0.05%.

Interest income declined slightly from the second quarter of 1999 to the third quarter of 1999 as we continued reducing our earning asset balances in order to free capital to fund the start-up operations at Holdings and to support our stock repurchase program. Earning asset yields increased as a result of rising short-term interest rates and slowing prepayment speeds.

In the third quarter of 1998, interest income was $62 million. The portfolio had average earning assets of $3.8 billion and earned an average yield of 6.42%. The coupon rate was 7.22%. The reported value of assets included 1.13% of net premium, or $43 million. Net premium amortization expense was $6.9 million, which reduced earning asset yield by 0.72%. Prepayments during the quarter were at a 29% CPR. Other factors reduced the earning asset yield by 0.08%.

From the third quarter of 1998 to the third quarter of 1999, we reduced our earning asset balances in order to free capital to fund the start-up operations at Holdings and fund our stock repurchases. In the third quarter of 1998, we began reporting many of our assets at market value for income statement purposes. This served to decrease our outstanding premium balance, thereby reducing the effect that prepayments had on our earning asset yields.

In the first nine months of 1999, interest income was $112 million. The portfolio had average earning assets of $2.4 billion and earned an average yield of 6.58%. The coupon rate was 6.91%. The reported value of assets included a 0.71% net premium, or $16 million. Net premium amortization expense was $5 million, which reduced earning asset yield by 0.26%. Prepayments during the period were at a 29% CPR. Other factors reduced the earning asset yield by 0.07%.

In the first nine months of 1998, interest income was $169 million. The portfolio had average earning assets of $3.4 billion and earned an average yield of 6.33%. The coupon rate was 7.45%. The reported value of assets included a 1.74% net premium, or $60 million. Net premium amortization expense was $26 million, which reduced earning asset yield by 0.98%. Prepayments during the period were at a 30% CPR. Other factors reduced the earning asset yield by 0.14%.

INTEREST EXPENSE

Interest expense in the third quarter of 1999 was $27 million. We funded our mortgage finance portfolio and other assets with an average of $233 million of equity and $1.9 billion of borrowings, including consolidated

Sequoia debt. We paid an average cost of funds of 5.80% for these borrowings. Short-term debt averaged 46% of total debt and cost us 5.50%. Long-term debt averaged 54% of total debt and cost us 6.01%.

In the second quarter of 1999, interest expense was $29 million. We funded our mortgage finance portfolio with an average of $243 million of equity and $2.1 billion of borrowings. We paid an average cost of funds of 5.55% for these borrowings. Short-term debt averaged 46% of total debt and cost us 5.07%. Long-term debt averaged 54% of total debt and cost us 5.96%.

From the second quarter of 1999 to the third quarter of 1999, total interest expense decreased as the size of our portfolio has decreased. Our cost of funds increased as short-term rates rose and we paid fees to secure committed sources of short-term financing.

In the third quarter of 1998, interest expense was $56 million. We funded our mortgage finance portfolio with an average of $293 million of equity and $3.7 billion of borrowings. We paid an average cost of funds of 6.15% for these borrowings. Short-term debt averaged 58% of total debt and cost us 5.93%. Long-term debt averaged 42% of total debt and cost us 6.43%.

From the third quarter of 1998 to the third quarter of 1999, total interest expense was lower due to a reduction in the size of the portfolio. The cost of funds decreased as short-term interest rates fell from year to year. Our borrowing costs did not fall by the full amount of the decrease in short-term interest rates during this period, as we utilized an increasing percentage of more expensive long-term debt and we incurred costs in order to secure committed short-term financing.

In the first nine months of 1999, interest expense was $89 million. We funded our portfolio with an average of $242 million of equity and $2.1 billion of borrowings. We paid an average cost of funds of 5.65% for these borrowings. Short-term debt averaged 47% of total debt and cost us 5.22%. Long-term debt averaged 53% of total debt and cost us 6.00%.

In the first nine months of 1998, interest expense was $152 million. We funded our mortgage finance portfolio with an average of $317 million of equity and $3.3 billion of borrowings. We paid an average cost of funds of 6.07% for these borrowings. Short-term debt averaged 63% of total debt and cost us 5.86%. Long-term debt averaged 37% of total debt and cost us 6.44%.

INTEREST RATE AGREEMENTS EXPENSE

We use interest rate agreements in order to strengthen our balance sheet, increase liquidity, and dampen potential earnings volatility. Net interest rate agreements expense was $0.5 million in the third quarter of 1999, $0.7 million in the second quarter of 1999, and $0.2 million in the third quarter of 1998. As a percent of average borrowings, net interest rate agreements expense was 0.10% in the third quarter of 1999, 0.14% in the second quarter of 1999, and 0.03% in the third quarter of 1999.

In adopting mark-to-market accounting for our interest rate agreements in the third quarter of 1998 through the early adoption of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, we wrote down our basis in our interest rate agreements. This market value adjustment had the effect of reducing interest rate agreement amortization expense on an on-going basis. Total interest rate agreement expense may change over time as the mix of our assets and liabilities changes. We refer you to "Note 7. Interest Rate Agreements" in the Notes to Consolidated Financial Statements for additional details.

Net interest rate agreements expense was $1.5 million in the first nine months of 1999, or 0.10% of average borrowings. In the first nine months of 1998, interest rate agreements expense was $3.2 million or 0.13% of average borrowings.

NET INTEREST INCOME

Net interest income, which equals interest income less interest expense less interest rate agreements expense, was $6.7 million in the third quarter of 1999. Our interest rate spread, which equals the yield on earning assets less

the cost of funds and hedging, was 0.76%. Our net interest margin, which equals net interest income divided by average assets, was 1.26% during this period.

In the second quarter of 1999, net interest income was $6.8 million, the interest rate spread was 0.85%, and the net interest margin was 1.18%. Net interest income fell from the second quarter of 1999 to the third quarter of 1999 due to a lower average portfolio balance during the later period.

In the third quarter of 1998, net interest income was $5.1 million, the interest rate spread was 0.24%, and the net interest margin was 0.52%. Our spread and margin increased in the third quarter of 1999 from the third quarter of 1998 due to a decrease in short-term interest rates over the past year and a recent

slowdown in prepayment speeds. The decrease in short-term interest rates reduces our cost of funds. The recent slowdown in prepayments has reduced the effect on our yield of premium amortization expenses. Thus, despite a reduction in coupon rates as short-term rates have fallen, our yield on assets was higher in the third quarter of 1999 than in the third quarter of 1998.

In the first nine months of 1999, net interest income was $21.4 million, the interest rate spread was 0.84%, and the net interest margin was 1.21%. In the first nine months of 1998, net interest income was $13.5 million, the interest rate spread was 0.13%, and the net interest margin was 0.49%.

PROVISION FOR CREDIT LOSSES

We take credit provision expenses on our mortgage loans held for investment, which are those loans financed with long-term debt and accounted for on an amortized cost basis. In the third quarter of 1999, credit provisions were $0.4 million. In the second quarter of 1999, credit provisions totaled $0.4 million. In the third quarter of 1998, as part of the mark-to-market adoption, we reversed net credit provisions of $0.6 million. Actual realized taxable credit losses totaled $0.2 million in the third quarter of 1999, $0.1 million in the second quarter of 1999, and $0.3 million in the third quarter of 1998.

In the first nine months of 1999, total credit provisions were $1.1 million. In the first nine months of 1998, total credit provisions were $0.7 million. Actual credit losses were $0.3 million in the first nine months of 1999 and $0.8 million in the first nine months of 1998.

OPERATING EXPENSES

In the third quarter of 1999, total operating expenses for our mortgage finance operations were $1.0 million. Total operating expenses for the second quarter of 1999 were $0.9 million. Total operating expenses for the third quarter of 1998 were $1.0 million.

On-going operating expenses as a percentage of assets were 0.18% in the third quarter of 1999, 0.16% in the second quarter of 1999, and 0.10% in the third quarter of 1998. Operating expenses as a percentage of equity were 1.64% in the third quarter of 1999, 1.54% in the second quarter of 1999, and 1.41% in the third quarter of 1998. These ratios have increased over time as we have decreased the size of our portfolio and reduced our equity through the repurchase of stock.

Total operating expenses for the mortgage finance operations for the first nine months of 1999 were $2.6 million. For the first nine months of 1998, operating expenses totaled $3.5 million.

Operating expenses as a percentage of assets were 0.15% in the first nine months of 1999 and 0.13% in the first nine months of 1998. Operating expenses as a percentage of equity were 1.44% in the first nine months of 1999, and 1.45% in the first nine months of 1998.

We share many operating expenses of Holdings, including personnel and related expenses. Holdings' share is subject to full reimbursement to Redwood Trust by Holdings. We incurred reimbursable operating expenses for Holdings of $1.2 million in the third quarter of 1999 and $0.7 million in the third quarter of 1998. For the nine months ending September 30, 1999, reimbursable operating expenses were $2.7 million. For the nine months ending September 30, 1998, reimbursable operating expenses were $1.4 million.

NET EARNINGS FROM MORTGAGE FINANCE OPERATIONS BEFORE MARK-TO-MARKET ADJUSTMENTS AND OTHER EFFECTS

Net earnings from mortgage finance operations before mark-to-market adjustments were $5.4 million in the third quarter of 1999. In the second quarter of 1999, net earnings before mark-to-market adjustments were $5.5 million. In the third quarter of 1998, net earnings before mark-to-market adjustments and the cumulative effect of adopting SFAS No. 133 were $4.8 million.

In the first nine months of 1999, net earnings before mark-to-market adjustments totaled $17.8 million. In the first nine months of 1998, net earnings before mark-to-market adjustments and the cumulative effect of adopting SFAS No. 133 were $9.4 million.

NET UNREALIZED AND REALIZED GAINS AND LOSSES ON ASSETS

In the third quarter of 1999, our portfolio of assets that were marked-to-market for income statement purposes had a decline in estimated market value of $2.1 million. This net loss consisted of a $2.6 million market value loss on mortgage assets and a $0.5 million market value gain on interest rate agreements. Market values for our assets fell as interest rates rose towards the end of the quarter.

In the second quarter of 1999, total net asset appreciation income was $1.4 million. This included a $0.4 million gain on mortgage assets, a $1.4 million loss on U.S. Treasury securities, and a $2.4 million gain on interest rate agreements. Market values for our mortgage assets rose as anticipated prepayment speeds fell. Changes in the U.S. Treasury securities and interest rate

agreements were a function of rising interest rates and rising volatility.

In the third quarter of 1998, we adopted mark-to-market accounting and SFAS No. 133. As a result, we recognized a $40.3 million market valuation loss through the income statement, plus a cumulative negative effect of adopting SFAS No. 133 of $10.1 million.

In the first nine months of 1999, the net gain on asset market valuations was $1.5 million. In the first nine months of 1998, asset value losses were $41.0 million and the cumulative negative effect of adopting SFAS No. 133 was $10.1 million.

NET EARNINGS FROM MORTGAGE FINANCE OPERATIONS
In the third quarter of 1999, net earnings from mortgage finance operations before preferred dividends were $3.3 million. Net earnings before preferred dividends were $7.0 million in the second quarter of 1999 and negative $45.6 million in the third quarter of 1998.

In the first nine months of 1999, net earnings from mortgage operations before preferred dividends totaled $19.3 million. In the first nine months of 1998, net losses before preferred dividends were $41.7 million.

EQUITY IN EARNINGS (LOSSES) OF RWT HOLDINGS, INC.
Our share of the losses generated by start-up operations at Holdings, our mortgage production affiliate, was $6.4 million in the third quarter of 1999. This included $2.2 million of restructuring charges at RFS. We recognized losses from Holdings of $3.8 million in the second quarter of 1999 and $1.6 million in the third quarter of 1998.

In the first nine months of 1999, our share of losses from Holdings was $12.6 million, (including $2.2 million of restructuring charges.) During the first nine months of 1998, our share of losses was $2.2 million.

We refer you to Holdings' "Consolidated Financial Statements and Notes" and Holdings' "Management's Discussion and Analysis" below for more information on Holdings.

NET INCOME In the third quarter of 1999, net losses for all of our operations were $3.0 million. After preferred dividends of $0.7 million, net income available to common stockholders was negative $3.7 million.

In the second quarter of 1999, net income from all of our operations was $3.2. After preferred dividends of $0.7 million, net income available to common shareholders was $2.5 million.

In the third quarter of 1998, net losses for all of our operations were $37.1 million. After preferred dividends of $0.7 million and the cumulative effect of adopting SFAS No. 133 of $10.1 million, the net loss was $47.9 million.

In the first nine months of 1999, net income for all of our operations was $6.7 million. After preferred dividends of $2.1 million, net income available to common stockholders was $4.6 million.

In the first nine months of 1998, net losses for all of our operations were $33.7 million. After preferred dividends of $2.1 million and the cumulative transition effect of adopting SFAS No. 133 of $10.1 million, the net loss to common stockholders was $45.9 million.

EARNINGS PER SHARE
Average diluted common shares outstanding were 9.6 million in the third quarter of 1999, 10.2 million in the second quarter of 1999, and 13.3 million in the third quarter of 1998. Diluted earnings per share were negative $0.39 in the third quarter of 1999, positive $0.25 in the second quarter of 1999, and negative $3.61 in the third quarter of 1998.

Average diluted common shares outstanding were 10.2 million in the first nine months of 1999 compared to 13.9 million in the first nine months of 1998. Diluted earnings per share were $0.45 in the first nine months of 1999 and negative $3.32 in the first nine months of 1998.

Shares outstanding declined as a result of our common stock repurchase program. We repurchased 5.2 million shares from July 1, 1998 through September 30, 1999.

DIVIDENDS
We declared a common stock dividend of $0.15 per share for the third quarter of 1999. We have not paid a common stock dividend since the second quarter of 1998. We paid common stock dividends of $0.15 per share during the first nine months of 1999 and $0.28 per share during the first nine months of 1998.

RISK MANAGEMENT

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

At September 30, 1999, we owned mortgage securities and loans totaling $1.0 billion that we account for on a mark-to-market basis or, in the case of mortgage loans, on a lower-of-cost-or-market basis. Of these assets, 97% had adjustable-rate coupons and 3% had fixed-rate coupons.

Our interest rate agreement hedging program may offset some asset market value fluctuations due to interest rate changes. All of our $3 billion in notional amounts of interest rate agreements are marked-to-market for income statement purposes.

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

INTEREST RATE RISK
At September 30, 1999, we, including Sequoia, owned $2.1 billion of assets and had $1.9 billion of liabilities. The majority of the assets were adjustable-rate, as were a majority of the liabilities.

Fixed-rate mortgage assets and hybrid mortgage assets (with fixed-rate coupons for 3 to 7 years and adjustable-rate coupons thereafter) totaled $0.4 billion, or 23% of total assets. We had debt with interest rate reset characteristics matched to these hybrid mortgages totaling $0.4 billion.

We owned interest rate agreements with a notional face of $3 billion.

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

Our net income may vary somewhat as the yield curve between one-month interest rates and six- and twelve-month interest rates vary. At September 30, 1999, we effectively owned $0.6 billion of adjustable-rate mortgage assets with interest rates that adjust every six or twelve months off of interest rates of the same maturity funded with $0.6 billion of debt that has an interest rate that adjusts monthly off of one-month LIBOR interest rates.

At September 30, 1999, we owned $0.4 billion of adjustable-rate mortgage assets that adjust monthly off of one-month interest rates, funded with $0.4 million of debt that also adjusts monthly off of one-month LIBOR interest rates. However, the date on which the assets reset may differ from that date on which the liabilities reset, so in times of rapid changes in one-month LIBOR interest rates, our net spread may not be constant on these assets and liabilities.

Adjustable-rate assets with earnings rates dependent on U.S. Treasury rates totaled $0.5 billion at September 30, 1999. Liabilities with a cost of funds dependent on U.S. Treasury rates totaled $0.4 billion at that time. As part of our hedging program, we also had $0.3 billion notional amount of basis swaps that, in effect, increased our U.S. Treasury-based liabilities to $0.7 billion. Thus, at September 30, 1999, we had an excess of U.S. Treasury-based liabilities over U.S. Treasury-based assets.

Changes in interest rates affect prepayment rates (see below) and influence other factors that may affect our results.

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

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

At September 30, 1999, we had $78 million of highly liquid assets which were unpledged and available to meet margin calls on short-term debt that could be caused by asset value declines or changes in lender over-collateralization requirements. These assets consisted of unrestricted cash and unpledged "AAA"

rated mortgage securities. Total available liquidity, including unrestricted cash, equaled 9% of our short-term debt balances.

We paid fees in the third quarter of 1999 to secure two committed lines of short-term financing for a one-year term. There are certain restrictions regarding the collateral for which these lines can be used, but they generally allow us to fund whole loan acquisitions for the term of the commitments. There is no assurance that we will be able to renew such lines upon expiration.

We have entered into borrowings with maturities beyond December 31, 1999 to fund the substantial majority of our assets in order to avoid the need to rollover debt in advance of the beginning of the Year 2000. Nevertheless, year-end market fluctuations could negatively effect our liquidity position and our earnings.

PREPAYMENT RISK

As we receive repayments of mortgage principal, we amortize into income our mortgage premium balances as an expense and our mortgage discount balances as income. Mortgage premium balances arise when we acquire mortgage assets at a price in excess of the principal value of the mortgages. Premium balances are also created when an asset appreciates and is marked-to-market at a price above par. Mortgage discount balances arise when we acquire mortgage assets at a price below the principal value of the mortgages, or when an asset depreciates in market value and is marked-to-market at a price below par. At September 30, 1999, mortgage premium balances were $24 million and mortgage discount balances were $16 million. Net mortgage premium was $8 million.

Sequoia's long-term debt has associated deferred bond issuance costs. These capitalized costs are amortized as an expense as the bonds are paid off with mortgage principal receipts. These deferred costs totaled $3 million at September 30, 1999. In addition, premium received from the issuance of bonds at prices over principal value is amortized as income as the bond issues pay down. These balances totaled $4 million at September 30, 1999. The combined effect of these two items was to reduce our effective mortgage-related premium by $1 million.

Our net premium at September 30, 1999 for assets and liabilities affected by the rate of mortgage principal receipts was $7 million. This net premium equaled 3.6% of total common equity. Amortization expense and income will vary as prepayment rates on mortgage assets vary. In addition, changes in prepayment rates will effect the market value of our assets and our earnings. Changes in the value of our assets, to the extent they are incorporated into the basis of our assets, will also affect future amortization expense.

CREDIT RISK

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

Not including Sequoia, we owned $21 million in residential mortgage loans at September 30, 1999. Of these, $0.5 million were seriously delinquent (delinquent over 90 days, in foreclosure, in bankruptcy, or real estate owned). We also owned $18 million in commercial mortgage loans. These commercial mortgage loans were all current at September 30, 1999.

The three Sequoia trusts owned $1.0 billion in residential mortgage loans at September 30, 1999. Our total credit risk from these trusts is limited to our equity investment in these trusts. These equity investments had a reported value of $33 million at September 30, 1999. At that time, $3.4 million of the underlying loans, or 0.33%, were seriously delinquent.

At September 30, 1999, we had $4.9 million of credit reserves to provide for potential future credit losses from our mortgage loans. Total seriously delinquent loans had a loan balance of $3.9 million. To date, our realized credit losses from defaulted residential mortgage loans have averaged 9% of the loan balance of the defaulted loans. Loss severity may increase in the future, however, particularly if real estate values decline.

We believe our current level of reserve and credit provision policy is reasonable. We will continue to increase our credit reserve over time in anticipation of future potential losses.

At September 30, 1999, we also had $0.9 million credit reserves for our SMFC 97-A re-REMIC securities. Our total potential credit exposure from these securities (after this credit reserve) was $7 million. We believe this reserve is likely to be sufficient to cover currently foreseen credit losses from this asset.

CAPITAL RISK

Our capital levels, and thus our access to borrowings and liquidity, may be

tested, particularly if the market value of our assets securing short-term borrowings declines.

Through our risk-adjusted capital policy, we assign a guideline capital adequacy amount, expressed as a guideline equity-to-assets ratio, to each of our mortgage assets. For short-term funded assets, this ratio will fluctuate over time, based on changes in that asset's credit quality, liquidity characteristics, potential for market value fluctuation, interest rate risk, prepayment risk, and the over-collateralization requirements for that asset set by our collateralized short-term lenders. Capital requirements for equity interests in Sequoia trusts and for lower-rated mortgage securities generally equal our net investment. The sum of the capital adequacy amounts for all of our mortgage assets is our aggregate guideline capital adequacy amount.

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

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

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

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

INFLATION RISK

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

Our financial statements are prepared in accordance with Generally Accepted Accounting Principles and our dividends are generally determined based on our REIT net income as calculated for tax purposes. In each case, our activities and balance sheet are measured with reference to historical cost or fair market value without considering inflation.

YEAR 2000 READINESS DISCLOSURE

In 1998, we established a Year 2000 Project. The goal of this on-going project is to ensure that our communications, data, and information systems are ready for the Year 2000 and to employ prudent management to minimize any potential negative impact of the Year 2000 on our business partners and our investors. Senior management has taken an active role in the Year 2000 Project and provides updates to the Board of Directors as necessary.

Our definition of "Readiness for the Year 2000" includes testing 100% of our internal systems (hardware and software) to ensure that Year 2000 dates are retained and correctly roll from December 31, 1999 to January 1, 2000 and from February 28, to February 29, to March 1, 2000. It also includes having an enterprise-wide contingency and disaster recovery plan for any known Year 2000 issues (and to the extent possible, other unforeseeable circumstances).

Our project management strategies include system risk assessment, system upgrades or workarounds, and contingency planning. We believe we are devoting the necessary resources to address all appropriate Year 2000 issues. We do not currently anticipate incurring costs related to the Year 2000 issue that would be material to our financial position, results of operations, or cash flows in future periods.

We commenced operations within the past five years and have built our internal systems on a client-server model. Thus, we are not aware of any internal "legacy" computer systems or software issues.

Existing internal computer systems have been successfully tested and any additions to the existing systems and new systems are tested upon installation. Hardware testing included forward date testing of the December 31, 1999 to January 1, 2000 rollover and leap year 2000. Critical software applications used to manage our businesses were also successfully tested.

As systems are modified or new hardware or software systems are implemented in the normal course of business, our policy is to receive certification of Year 2000 compliance and to test for Year 2000 compliance upon installation.

We continue to gather and assess information regarding our business partners' Year 2000 readiness. We solicited Year 2000 disclosures directly through our own questionnaire and initiated direct discussions with certain key business partners. A majority of questionnaire responses was received prior to July 1999. No significant year 2000 issues have been identified through this process. We will continue to monitor public disclosures by key business partners into the Year 2000.

Business partners that provide information or services through externally controlled or externally coordinated systems have been identified. Joint testing of certain systems has been substantially completed. No material Year 2000 issues were discovered during these tests.

We, together with our affiliates, are continuing to develop contingency plans and workaround systems for critical systems. Workarounds may include substituting compliant business partners for those who are non-compliant. The benefit of this contingency plan is likely to be limited due to our lack of control on external vendors and inability to replace certain business partners efficiently.

We believe we are devoting the necessary technical and management resources to address the Year 2000 issues over which we have control and to plan for contingencies where we lack control. At this time we believe we have successfully achieved the goals of Year 2000 Readiness. However, it is inherently difficult to assess the impact our vendors and their vendors may have on us in the event they are unable to successfully manage their own Year 2000 issues. Thus, there can be no certainty that, in spite of our efforts, we will not face any Year 2000 issues and that such issues will not materially affect our operations.

RWT HOLDINGS, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS

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

Holdings originates commercial mortgage loans for sale to institutional investors through its Redwood Commercial Funding, Inc. ("RCF") subsidiary. RCF originated $22 million of commercial mortgage loans in the third quarter of 1999 and has originated $42 million of commercial loans in the first nine months of 1999. At September 30, 1999, commercial mortgage loans originated or acquired by RCF totaled $47 million, of which $18 million were held by Redwood Trust and $29 million were held at Holdings. These loans which had not yet been sold are all held for future sale.

RCF recorded net revenue in the third quarter of 1999 of $0.1 million. Loan sales were minimal, and net interest income at RCF was low as most of the commercial loans originated by RCF were held by Redwood Trust for most of the period. Direct RCF operating expenses were $0.4 million and operating expenses paid by Redwood Trust and reimbursable by Holdings were $0.4 million. The loss recorded at RCF for the third quarter was $0.7 million. RCF will recognize sale revenues upon the sale of the commercial loan portfolio.

Holdings also has a start-up mortgage technology services venture called Redwood Residential Funding, Inc. ("RRF"). RRF is seeking to generate fee income by matching the needs of residential mortgage investors with the needs of residential mortgage originators using ELWOOD, a new business-to-business Internet-based process and technology system. ELWOOD is designed to improve the process and significantly reduce the operational costs of linking mortgage investors to mortgage originators.

RRF commenced market operations in August of 1999 by opening its Internet site on a beta-test basis to a small number of mortgage loan sellers. The initial product is fixed-rate jumbo "A" quality mortgages.

Shareholders can view the public portion of RRF's Web site by visiting http://www.SellLoans.com.

RRF's efforts during the third quarter of 1999 focused on testing and implementation of the system, qualifying sellers, training sellers to use our system and processes, designing system enhancements, and utilizing the system in beta-test mode. In the fourth quarter, RRF efforts will focus on recruiting investors for the system, adding sellers, expanding product lines, and increasing system functionality.

In the third quarter of 1999, RRF had direct operating expenses of $1.8 million and operating expenses paid by Redwood Trust and reimbursable by Holdings totaling $0.5 million. Net revenue at RRF was negative $0.3 million as loans acquired on a beta-test basis were sold at a small loss. The net loss at RRF for the quarter was $2.5 million.

Holdings had a third operating business, Redwood Financial Services, Inc. ("RFS"). In the third quarter of 1999, RFS' operations were combined with Holdings' other operations. This resulted in a $2.2 million restructuring charge in the third quarter of 1999. This restructuring resulted in a significant reduction in the headcount and ongoing operating expenses at Holdings.

In the fourth quarter of 1999, we will continue to develop Holdings' operations and seek to increase their value as businesses. At the same time, we will continue to evaluate ways to allow both the value of Redwood Trust's core business and the value of Holdings' ventures to be reflected in Redwood Trust's stock price.

The following is a summary of the significant components of Holdings' earnings for the three and nine months ending September 30, 1999, for the three months ending September 30, 1998 and for the period from April 1, 1998 (commencement of operations) to September 30, 1998.

<TABLE>
<CAPTION>

RESULTS OF OPERATIONS	THREE MONTHS ENDED		NINE MONTHS ENDED	
(IN THOUSANDS, EXCEPT SHARE DATE)	SEPT. 30, 1999	SEPT. 30, 1998	SEPT. 30, 1999	SEPT. 30, 1998
<S>	<C>	<C>	<C>	<C>
RCF Operating Results	$ (671)	$ (104)	$ (1,542)	$ (104)
RRF Operating Results	(2,555)	(525)	(5,994)	(1,113)
RFS Operating Results	(978)	(961)	(2,972)	(961)
RFS Restructuring Charge	(2,210)	0	(2,210)	0
Net Income (Loss)	$ (6,414)	$ (1,590)	$(12,718)	$ (2,178)

</TABLE>

On a consolidated basis, at September 30, 1999, Holdings owned $20 million of residential mortgage loans and $29 million of commercial mortgage loans. Holdings also had $1 million in cash and $4 million in other assets, for total assets of $54 million. Holdings had commitments to acquire $22 million of commercial loans and $4 million of residential mortgage loans from Redwood Trust.

The loans owned by Holdings were funded with short-term borrowings and equity. Short-term debt was $19 million, loans from Redwood Trust were $20 million, and other liabilities totaled $2 million. Total equity at September 30, 1999 was $13 million.

At December 31, 1998, Holdings owned $12 million of residential mortgage loans, $10 million in cash, and $1 million in other assets, for total assets of $23 million. Loans from Redwood Trust totaled $7 million and other liabilities were $1 million. Equity at this time totaled $15 million.

In the third quarter of 1999, net interest income on a consolidated basis was $0.3 million, including interest income of $1.2 million and interest expenses of $0.9 million. Holdings also had net losses upon the sale of assets and mark-to-market adjustments of $0.5 million in the third quarter of 1999, resulting in net revenues of negative $0.2 million. Operating expenses at Holdings totaled $4.0 million in the third quarter of 1999. Restructuring charges related to the combining of RFS' operations with other Holding's operations totaled $2.2 million. Holdings' net loss in the third quarter of 1999 was $6.4 million.

In the second quarter of 1999, net interest income totaled $0.3 million, including interest income of $1.0 million and interest expenses of $0.7 million. Gain on sale totaled $0.1 million, resulting in net revenues of $0.4 million. In the second quarter of 1999, operating expenses at Holdings totaled $4.2 million and Holdings' net loss was $3.8 million.

In the third quarter of 1998, revenues totaled $0.1 million, including interest income of $0.1 million. In the third quarter of 1998, operating expenses at Holdings totaled $1.7 million and Holdings' net loss was $1.6 million.

In the first nine months of 1999, net interest income totaled $0.9 million, including interest income of $2.8 million, and interest expenses of $1.9 million. Gain on sale and other income totaled $0.1 million, resulting in net revenues of $1.0 million. Operating expenses at Holdings totaled $11.5 million in the first nine months of 1999. Including the restructuring charge of $2.2 million, Holdings' net loss during this nine-month period was $12.7 million.

For the period from April 1, 1998 (commencement of operations) through September 30, 1998, net operating revenue totaled $0.3 million, including interest income of $3.0 million, interest expenses of $2.7 million, and minimal net asset appreciation income. During this period operating expenses at Holdings totaled $2.5 million and Holdings' net loss was $2.2 million.

Holdings pre-tax loss as reported for GAAP currently approximates its after-tax loss. Due to the start-up nature of its operations, Holdings is not able to accrue a tax benefit relating to its operating losses for GAAP at this time.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

At September 30, 1999, 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

Not applicable

Item 3. Defaults Upon Senior Securities

Not applicable

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

Not applicable

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit 11.1 to Part I - Computation of Earnings Per Share for the three and nine months ended September 30, 1999 and September 30, 1998.

Exhibit 27 - Financial Data Schedule

(b) Reports

None

SIGNATURES

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

REDWOOD TRUST, INC.

Dated: November 10, 1999 By: /s/ Douglas B. Hansen

Douglas B. Hansen

President
(authorized officer of registrant)

Dated: November 10, 1999 By: /s/ Martin S. Hughes

Martin S. Hughes
Chief Financial Officer
(principal accounting officer)

REDWOOD TRUST, INC.
INDEX TO EXHIBIT

Exhibit Number		Sequentially Numbered Page
11.1	Computations of Earnings per Share......................................	52
27	Financial Data Schedule..	54

EXHIBIT 11.1

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

<TABLE>
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	Three Months Ended September 30, 1999	Nine Months Ended September 30, 1999
Average common shares outstanding	$ 9,481,418	$10,090,305
Total	9,481,418	10,090,305
Net Income	$(3,738,178)	$ 4,625,047
Per Share Amount	$ (0.39)	$ 0.46
Average common shares outstanding	9,481,418	10,090,305
Net effect of dilutive stock options outstanding during the period -- based on the treasury stock method	89,513	99,320
Total	9,570,931	10,189,625
Net Income	$(3,738,178)	$ 4,625,047
Per Share Amount	$ (0.39)	$ 0.45

</TABLE>

EXHIBIT 11.1

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

<TABLE>
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	Three Months Ended September 30, 1998	Nine Months Ended September 30, 1998
BASIC:		
Average common shares outstanding	13,247,908	13,823,020
Total	13,247,908	13,823,020
Net Income	$(47,866,200)	$(45,907,029)
Per Share Amount	$ (3.61)	$ (3.32)

DILUTED:		
Average common shares outstanding	13,247,908	13,823,020
Net effect of dilutive stock options outstanding during the period -- based on the treasury stock method	63,620	92,624
Total	13,311,528	13,915,644
Net Income	$(47,866,200)	$(45,907,029)
Per Share Amount	$ (3.60)	$ (3.30)

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM SEPTEMBER
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