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

FORM 10-Q

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

For the Quarterly Period Ended: June 30, 2008

OR

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

For the Transition Period from __________ to __________

Commission File Number 1-13759

REDWOOD TRUST, INC.

(Exact Name of Registrant as Specified in Its Charter)

Maryland	**68-0329422**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

One Belvedere Place, Suite 300
Mill Valley, California 94941

(Address of Principal Executive Offices) (Zip Code)

(415) 389-7373

(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(g) of the Act:

Title of Each Class:	Name of Exchange on Which Registered:
Common Stock, par value $0.01 per share	New York Stock Exchange

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ☒ Accelerated Filer ☐ Non-Accelerated Filer ☐

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

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

Common Stock, $0.01 par value per share	33,575,409 as of August 5, 2008

TABLE OF CONTENTS

REDWOOD TRUST, INC.

2008 FORM 10-Q REPORT

TABLE OF CONTENTS

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

REDWOOD TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Data) (Unaudited)	June 30, 2008	December 31, 2007
ASSETS		
Real estate loans	$ 6,376,718	$ 7,204,151
Real estate securities, at fair value:		
Trading securities	841,868	11,521
Available-for-sale securities	399,759	2,110,080
Total real estate securities	1,241,627	2,121,601
Other investments	78,583	79,125
Cash and cash equivalents	147,639	290,363
Total earning assets	7,844,567	9,695,240
Restricted cash	102,171	118,064
Accrued interest receivable	40,948	45,553
Derivative assets	4,914	5,598
Deferred tax asset	8,087	8,875
Deferred asset-backed securities issuance costs	14,339	39,909
Other assets	30,910	25,233
Total Assets	$ 8,045,936	$ 9,938,472
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Liabilities		
Short-term debt – Redwood	$ 9,326	$ 7,561
Asset-backed securities issued – Sequoia	6,174,571	6,946,166
Asset-backed securities issued – Acacia	935,072	3,383,113
Accrued interest payable	32,237	53,796
Derivative liabilities	100,396	81,385
Accrued expenses and other liabilities	8,866	10,441
Dividends payable	24,887	24,289
Long-term debt – Redwood	150,000	150,000
Total liabilities	7,435,355	10,656,751
Minority interest	46,583	—
Stockholders' Equity (Deficit)		
Common stock, par value $0.01 per share, 75,000,000 and 50,000,000 shares authorized; 33,184,317 and 32,385,073 issued and outstanding	334	324
Additional paid-in capital	1,139,666	1,108,148
Accumulated other comprehensive loss	(64,143)	(573,766)
Cumulative earnings (losses)	492,949	(299,626)
Cumulative distributions to stockholders	(1,004,808)	(953,359)
Total stockholders' equity (deficit)	563,998	(718,279)
Total Liabilities and Stockholders' Equity (Deficit)	$ 8,045,936	$ 9,938,472

REDWOOD TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF (LOSS) INCOME

(In Thousands, Except Share Data) (Unaudited)	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Interest Income				
Real estate loans	$ 62,702	$ 119,576	$ 150,267	$ 246,427
Real estate securities	61,529	95,862	138,057	181,785
Other investments	514	464	1,246	464
Cash and cash equivalents	2,196	3,756	5,377	6,088
Total interest income	126,941	219,658	294,947	434,764
Management fees	1,319	1,481	2,932	2,649
Interest Expense				
Short-term debt – Redwood	(68)	(22,700)	(250)	(53,794)
Asset-backed securities issued	(96,525)	(142,022)	(222,722)	(278,136)
Long-term debt – Redwood	(2,233)	(2,516)	(4,766)	(4,572)
Total interest expense	(98,826)	(167,238)	(227,738)	(336,502)
Net Interest Income Before Market Valuation Adjustments	29,434	53,901	70,141	100,911
Market valuation adjustments, net	(60,619)	(29,430)	(254,551)	(39,694)
Net Interest (Loss) Income	(31,185)	24,471	(184,410)	61,217
Operating expenses	(14,255)	(12,772)	(30,604)	(30,554)
Realized gains on sales and calls, net	2,837	2,738	2,879	3,884
Minority interest allocation	(2,369)	—	(2,624)	—
Net (loss) income before provision for income taxes	(44,972)	14,437	(214,759)	34,547
Provision for income taxes	(937)	(3,021)	(2,737)	(4,822)
Net (Loss) Income	$ (45,909)	$ 11,416	$ (217,496)	$ 29,725
Basic (loss) earnings per share:	$ (1.40)	$ 0.42	$ (6.65)	$ 1.10
Diluted (loss) earnings per share:	$ (1.40)	$ 0.41	$ (6.65)	$ 1.06
Total dividends declared per common share	$ 0.75	$ 0.75	$ 1.50	$ 1.50
Basic weighted average shares outstanding	32,871,442	27,405,284	32,691,444	27,132,001
Diluted weighted average shares outstanding	32,871,442	28,164,944	32,691,444	27,917,502

REDWOOD TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In Thousands) (Unaudited)	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Net (Loss) Income	$(45,909)	$ 11,416	$(217,496)	$ 29,725
Other Comprehensive Income (Loss)				
Net unrealized gains (losses) on available-for-sale securities	9,152	(101,745)	(43,120)	(194,430)
Reclassification adjustment for net losses included in net (loss) income	18,750	7,058	92,044	6,945
Unrealized gains on cash flow hedges, net	—	19,952	—	13,814
Reclassification of net realized cash flow hedge losses (gains) to interest expense on asset-backed securities issued and realized losses (gains) on sales and calls	1,246	5	2,492	(400)
Total Other Comprehensive Income (Loss)	29,148	(74,730)	51,416	(174,071)
Comprehensive Loss	$(16,761)	$ (63,314)	$(166,080)	$(144,346)

REDWOOD TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

For the Six Months Ended June 30, 2008

(In Thousands, Except Share Data) (Unaudited)	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive	Cumulative (Losses) Earnings	Cumulative Distributions to Stockholders	Total

	Shares	Amount		(Loss) Income			
December 31, 2007	32,385,073	$ 324	$ 1,108,148	$ (573,766)	$ (299,626)	$ (953,359)	$ (718,279)
Net loss	—	—	—	—	(217,496)	—	(217,496)
Adoption of SFAS No. 159	—	—	—	458,207	1,010,071	—	1,468,278
Net unrealized gain/reclassification on assets AFS	—	—	—	48,924	—	—	48,924
Net unrealized gain/reclassification on interest rate agreements	—	—	—	2,492	—	—	2,492
Issuance of common stock:							
Dividend reinvestment & stock purchase plans	722,431	10	23,505	—	—	—	23,515
Employee option & stock purchase plan	76,813	—	975	—	—	—	975
Non-cash equity award compensation			7,038	—	—	—	7,038
Common dividends declared				—	—	(51,449)	(51,449)
June 30, 2008	33,184,317	$ 334	$ 1,139,666	$ (64,143)	$ 492,949	$ (1,004,808)	$ 563,998

For the Six Months Ended June 30, 2007

(In Thousands, Except Share Data) (Unaudited)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive (Loss) Income	Cumulative Earnings	Cumulative Distributions to Stockholders	Total
December 31, 2006	26,733,460	$ 267	$ 903,808	$ 93,158	$ 809,011	$ (803,554)	$1,002,690
Net income	—	—	—	—	29,725	—	29,725
Net unrealized loss/reclassification on assets AFS	—	—	—	(187,485)	—	—	(187,485)
Net unrealized gain/reclassification on interest rate agreements	—	—	—	13,414	—	—	13,414
Issuance of common stock:							
Dividend reinvestment & stock purchase plans	1,004,165	10	52,054	—	—	—	52,064
Employee option & stock purchase plan	78,575	2	330	—	—	—	332
Non-cash equity award compensation	—	—	8,752	—	—	—	8,752
Common dividends declared	—	—	—	—	—	(43,408)	(43,408)
June 30, 2007	27,816,200	$ 279	$ 964,944	$ (80,913)	$ 838,736	$ (846,962)	$ 876,084

TABLE OF CONTENTS

REDWOOD TRUST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands) (Unaudited)	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Cash Flows from Operating Activities:		
Net (loss) income	$ (217,496)	$ 29,725
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Amortization of premiums, discounts, and debt issuance costs	(5,405)	(32,749)
Depreciation and amortization of non-financial assets	536	830
Provision for credit losses	18,119	6,329
Non-cash equity award compensation	7,038	8,752
Net recognized losses and valuation adjustments	254,551	39,694
Realized gains on sales and calls, net	(2,879)	(3,884)
Net change in:		
Accrued interest receivable	15,581	13,432
Deferred income taxes	788	568
Other assets	11,585	4,111
Accrued interest payable	(18,302)	(2,117)
Accrued expenses and other liabilities	(1,575)	38,683
Net cash provided by operating activities	62,541	103,374
Cash Flows from Investing Activities:		
Purchases of real estate loans held-for-investment	—	(1,091,496)
Proceeds from sales of real estate loans held-for-investment	—	2,191
Principal payments on real estate loans held-for-investment	765,293	2,025,662
Purchases of real estate securities available-for-sale	(244,252)	(1,011,181)
Proceeds from sales of real estate securities available-for-sale	7,300	175,559
Principal payments on real estate securities available-for-sale	41,098	160,737
Purchases of real estate securities trading	(3,341)	(40,818)
Proceeds from sales of real estate securities trading	454	2,237
Principal payments on real estate securities trading	100,504	7,431
Purchases of other investments	—	(80,000)
Principal payments on other investments	541	—
Net decrease (increase) in restricted cash	15,893	(94,497)
Net cash provided by investing activities	683,490	55,825
Cash Flows from Financing Activities:		
Net (repayments) borrowings on short-term Redwood debt	1,765	(1,007,546)
Proceeds from issuance of asset-backed securities	—	3,332,925
Deferred asset-backed security issuance costs	—	(19,147)

Repayments on asset-backed securities	(905,000)	(2,609,157)
Proceeds from issuance of long-term Redwood debt	—	50,000
Net purchases of interest rate agreements	(5,743)	(2,798)
Net proceeds from issuance of common stock	24,490	52,396
Dividends paid	(50,850)	(41,262)
Change in minority interests	46,583	—
Net cash used in financing activities	(888,755)	(244,589)
Net decrease in cash and cash equivalents	(142,724)	(85,390)
Cash and cash equivalents at beginning of period	290,363	168,016
Cash and cash equivalents at end of period	$ 147,639	$ 82,626
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest	$ 243,109	$ 335,970
Cash (received) paid for taxes	$ (1,442)	$ 8,480
Non-Cash Financing Activity:		
Dividends declared but not paid at end of period	$ 24,887	$ 20,862

TABLE OF CONTENTS

REDWOOD TRUST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)

Note 1. Redwood Trust

Redwood Trust, Inc., together with its subsidiaries (Redwood, we, or us), invests in, finances, and manages real estate assets. We invest in residential and commercial real estate loans and in asset-backed securities backed by real estate loans. Our primary focus is credit-enhancing residential and commercial real estate loans. We credit-enhance loans by acquiring and managing the first-loss and other credit-sensitive securities that bear the bulk of the credit risk of securitized loans.

We seek to invest in assets that have the potential to generate sufficient long-term cash flow returns to support our goal of distributing an attractive level of dividends per share to shareholders over time. For tax purposes, we are structured as a real estate investment trust (REIT).

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

Note 2. Basis of Presentation

The consolidated financial statements presented herein are at June 30, 2008 and December 31, 2007, and for the three and six months ended June 30, 2008 and 2007.

These consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the United States (GAAP) for interim financial information and with the Securities and Exchange Commission's (SEC) instructions to Form 10-Q and Article 10 of Regulation S-X. Results for the three and six months ended June 30, 2008, may not necessarily be indicative of the results for the year ending December 31, 2008. The unaudited interim consolidated financial statements as of June 30, 2008, should be read in conjunction with our audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2007.

Organization

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

We currently sponsor two securitization programs. Our Sequoia program is used for the securitization of residential mortgage loans. References to Sequoia refer collectively to all the Sequoia securitization entities. Our Acacia program is used for the securitization of mortgage-backed securities and other types of financial assets. References to Acacia refer collectively to all of the Acacia CDO securitization entities.

We are the asset manager and investor in an Opportunity Fund LP (the Fund) that we sponsor. The Fund primarily invests in mortgage securities.

Principles of Consolidation

Under the provisions of FASB Interpretation No. 46 (revised), *Consolidation of Variable Interest Entities* (FIN 46R), we are required to consolidate the assets, liabilities, and non-controlling interests of any variable interest entity (VIE) in which we are the primary beneficiary. Under this principle, the primary beneficiary is the party that absorbs the majority of the VIE's anticipated losses and/or the majority of the expected returns.

We consolidate the Acacia and Sequoia securitization entities that we sponsor, since we are the primary beneficiary in these entities and they are not considered qualifying special purpose entities under the provisions of Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 140). Accordingly, the underlying loans and

Note 2. Basis of Presentation – (continued)

securities owned by these entities are shown on our consolidated balance sheets under real estate loans and real estate securities and the asset-back securities (ABS) issued to third parties are shown on our consolidated balance sheets under ABS issued. In our consolidated statements of (loss) income, we record interest income on the loans and securities and interest expense on the ABS issued. All significant intercompany balances and transactions, including transfers or repurchases of Sequoia or Acacia ABS, have been eliminated in consolidation.

We consolidate the Fund that we sponsor, since we are the primary beneficiary in this entity. The portion of the Fund that represents the interest of third parties is shown as minority allocation on our consolidated balance sheets and the portion of income allocable to third parties is shown as other expense in our consolidated statements of (loss) income.

Note 3. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with GAAP requires us to make a significant number of estimates. These include estimates of fair value of certain assets and liabilities, amount and timing of credit losses, prepayment rates, the period of time during which we anticipate an increase in the fair values of real estate securities sufficient to recover unrealized losses in those securities, and other items that affect the reported amounts of certain assets and liabilities as of the date of the consolidated financial statements and the reported amounts of certain revenues and expenses during the reported period. It is likely that changes in these estimates (e.g., market values due to changes in supply and demand, credit performance, prepayments, interest rates, or other reasons; yields due to changes in credit outlook and loan prepayments) will occur in the near term. Our estimates are inherently subjective in nature and actual results could differ from our estimates and the differences may be material.

Our financial statements include assets and liabilities that are measured based on their estimated fair values and many of these assets and liabilities are illiquid in nature. Our fair value estimates reflect what we believe we could realize if we chose to sell our assets or pay if we chose to transfer liabilities in an orderly manner. Establishing fair values for illiquid assets and liabilities is inherently subjective and is dependent upon our estimates and modeling assumptions and indications of value obtained from brokers and dealers. There is currently a wide variance of opinion related to the assumptions underpinning our market valuation inputs. We expect that the market valuations will continue to be highly volatile. Nonetheless, we believe the fair values for our assets and liabilities and other estimates used in preparation of our financial statements are in conformity with GAAP principles.

Effective January 1, 2008, we adopted two pronouncements relating to fair value measurement: Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157) and Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115* (FAS 159).

See *Note 4* and *Note 5* for further discussion on fair value estimates and these accounting principles.

Real Estate Loans

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

Residential and commercial real estate loans classified as held-for-sale are those loans that we are marketing for sale to independent third parties. Loans held-for-sale are carried at the lower of their cost or fair value on a loan-by-loan basis. Any market valuation adjustments on these loans are recognized in market valuation adjustments, net, in our consolidated statements of (loss) income.

REDWOOD TRUST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)

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

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

Residential and commercial real estate loans classified as held-for-investment are carried at their unpaid principal balances adjusted for net unamortized premiums or discounts and net of any allowance for credit losses.

Coupon interest on loans is recognized as revenue when earned and deemed collectible. We accrue interest on loans until they are more than 90 days past due at which point they are placed on nonaccrual status. Loans are charged off upon foreclosure of the underlying collateral. Purchase discounts and premiums related to real estate loans are amortized into interest income over their estimated lives to generate an effective yield, which considers the actual and future estimated prepayments of the loans pursuant to the provisions discussed below. Gains or losses on the sale of real estate loans are based on the specific identification method.

Pursuant to Statement of Financial Accounting Standards No. 91,*Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Cost of Leases* (FAS 91), we use the interest method to determine an effective yield and amortize the premium or discount on real estate loans held-for-investment. For loans acquired prior to July 1, 2004, we use coupon interest rates as they change over time and anticipated principal payments to determine an effective yield to amortize the premium or discount. For loans acquired after July 1, 2004, we use the initial coupon interest rate of the loans (without regard to future changes in the underlying indices) and anticipated principal payments to calculate an effective yield to amortize the premium or discount.

We may exercise our right to call ABS issued by Sequoia and may subsequently sell the underlying loans to third parties. For balance sheet purposes, we reclassify held-for-investment loans to held-for-sale loans once we determine that loans will be sold to third parties.

Real Estate Loans — Reserve for Credit Losses

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

We follow the guidelines of SEC Staff Accounting Bulletin No. 102, *Selected Loan Loss Allowance Methodology and Documentation* (SAB 102), Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies* (FAS 5), Statement of Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan* (FAS 114), and Statement of Financial Accounting Standards No. 118, *Accounting by Creditors for Impairment of a Loan-Income Recognition and Disclosures* (FAS 118) in setting credit reserves for our real estate loans.

We consider the following factors in making such determinations:

- Ongoing analyses of loans, including, but not limited to, the age of loans, underwriting standards, business climate, economic conditions, geographical considerations, and other observable data;
- Historical loss rates and past performance of similar loans;
- Relevant environmental factors;
- Relevant market research and publicly available third-party reference loss rates;
- Trends in delinquencies and charge-offs;

TABLE OF CONTENTS

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

- Effects and changes in credit concentrations;
- Information supporting a borrower’s ability to meet obligations;
- Ongoing evaluations of fair values of collateral using current appraisals and other valuations; and,
- Discounted cash flow analyses.

Once we determine applicable default amounts, the timing of the defaults, and severity of losses upon defaults, we estimate expected losses for each individual loan or pool of loans over its expected life. We then estimate the timing of these losses and the losses probable to occur over an effective loss confirmation period. This period is defined as the range of time between the probable occurrence of a credit loss (such as the initial deterioration of the borrower’s financial condition) and the confirmation of that loss (the actual impairment or charge-off of the loan). The losses expected to occur within the estimated loss confirmation period are the basis of our credit reserves, because we believe those losses exist as of the reported date of the financial statements. We re-evaluate the level of our credit reserves on at least a quarterly basis, and we record provision, charge-offs, and recoveries monthly.

See *Note 7* for further discussion on reserves for credit losses.

Since we do not originate real estate loans, we do not currently maintain a loan repurchase reserve, as any risk of loss due to loan repurchases (i.e., due to breach of representations) is generally covered by recourse to the companies from whom we acquired the loans.

Real Estate Securities, at Fair Value

Trading Securities

Real estate securities classified as trading include residential, commercial, and CDO securities and are carried at their estimated fair values. Coupon interest is recognized as revenue when earned and deemed collectible and changes in fair value (gains and losses) are reported through our consolidated statements of (loss) income in market valuation adjustments, net. Trading securities are primarily those securities where we have adopted the fair value option under FAS 159.

Available-for-Sale Securities

Real estate securities classified as available-for-sale (AFS) include residential, commercial, and CDO securities and are carried at their estimated fair values. Cumulative unrealized gains and losses are reported as a component of accumulated other comprehensive income (loss) in our consolidated statements of stockholders’ equity (deficit). Upon sale or other-than-temporary impairment, this accumulated other comprehensive income (loss) is reclassified into earnings using the specific identification method.

Coupon interest is recognized as revenue when earned and deemed collectible. Purchase discounts and premiums related to the securities are amortized into interest income over their estimated lives to generate an effective yield, which considers the actual and future estimated prepayments of the securities pursuant to the provisions discussed below. Gains or losses on the sale of securities are based on the specific identification method.

When recognizing revenue on AFS securities where credit risk is not remote, we employ the interest method as prescribed under the Emerging Issues Task Force of the Financial Accounting Standards Board 99-20, *Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets* (EITF 99-20) to account for purchase premiums, discounts, and fees associated with these securities. The use of this method requires us to project cash flows over the remaining life of each asset. These projections include assumptions about interest rates, prepayment rates, the timing and amount of credit losses, and other factors. We review and make adjustments to our cash flow projections on an ongoing

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

basis and monitor these projections based on input and analyses received from external sources, internal models, and our own judgment and experience. Actual maturities of the AFS securities are affected by the contractual lives of the associated mortgage collateral, periodic payments of principal, and prepayments of principal. Actual maturities of AFS securities are generally shorter than stated contractual maturities. Stated contractual maturities are generally greater than ten years. There can be no assurance that our assumptions used to estimate future cash flows or the current period's yield for each asset would not change in the near term, and the change could be material.

Yields recognized for each security can vary as a function of credit results, prepayment rates, and interest rates. For the securities we acquire, if estimated future credit losses are less than our prior estimate, credit losses occur later than expected, or prepayment rates are faster than expected (meaning the present value of projected cash flows is greater than previously expected), the yield over the remaining life of the security may be adjusted upwards. If estimated future credit losses exceed our prior expectations, credit losses occur more quickly than expected, or prepayments occur more slowly than expected (meaning the present value of projected cash flows is less than previously expected), the yield over the remaining life of the security may be adjusted downward. In cases where the fair value of our securities is below our cost basis we may have an other-than-temporary impairment.

For determining other-than-temporary impairment on our real estate securities accounted for as AFS securities, we use the guidelines prescribed under EITF 99-20, Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (FAS 115), and SEC Staff Accounting Bulletin No. 5(m), *Other-Than-Temporary Impairment for Certain Investments in Debt and Equity Securities* (SAB 59). Other-than-temporary impairments are reported under market valuation adjustments, net in our consolidated statements of income (loss). We assess whether a drop in fair value below our cost of the AFS security should be deemed as other-than-temporary impairment. If there has been no adverse change in the projected future cash flows of the security, we have the ability and intent to hold the security, and we have determined that within a reasonable period of time there will likely be a recovery of fair value up to (or beyond) the amortized cost of the security, there is no other-than-temporary impairment.

Other Investments

Other investments include a guaranteed investment contract (GIC) entered into by an Acacia securitization entity that we consolidate for financial statements purposes. We elected the fair value option for this investment as of January 1, 2008. Other investments are recorded on our consolidated balance sheets at their estimated fair values. Changes in fair value are reported through our consolidated statements of (loss) income through market valuation adjustments, net.

See *Note 9* for further discussion on other investments.

Cash and Cash Equivalents

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

Restricted Cash

Restricted cash includes principal and interest payments from real estate loans and securities owned by consolidated securitization entities that are collateral for, or payable to, owners of ABS issued by those entities and cash pledged as collateral on interest rate agreements. Restricted cash may also include cash retained in Acacia or Sequoia securitization entities or in the Fund prior to the purchase of loans or securities, payments on or redemption of outstanding ABS issued, or distributions to limited partners.

REDWOOD TRUST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)

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

Accrued Interest Receivable

Accrued interest receivable represents interest that is due and payable to us. This is generally received within the next month.

Derivative Financial Instruments

Derivative financial instruments include contractual interest rate agreements and credit default swaps (CDS). All derivative financial instruments are reported at fair value on our consolidated balance sheets, in accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133). Derivatives with a positive value to us are reported as an asset and derivatives with a negative value to us are reported as a liability. The changes in fair value of derivatives accounted for as trading instruments are reported in the consolidated statements of (loss) income through market valuation adjustments, net. Net purchases and proceeds from interest rate agreements are classified as financing activities within our consolidated statements of cash flows.

We generally enter into interest rate agreements to help manage some of our interest rate risks. Prior to 2008, we accounted for derivatives used to hedge interest rate exposure in Acacia securitization entities as cash flow hedges under FAS 133. As of January 1, 2008, all derivatives designated as cash flow hedges were de-designated as cash flow hedges and accounted for as trading instruments. Since the associated hedged items continue to exist, the fair value of cash flow hedges at the time of de-designation remains in accumulated other comprehensive loss and is being amortized using the straight line method through interest expense over the remaining lives of the Acacia ABS issued.

We may enter into CDS contracts from time to time. A CDS is an agreement to provide (receive) credit event protection based on a financial index or specific security in exchange for receiving (paying) a fixed-rate fee or premium over the term of the contract. Prior to 2008, we accounted for CDS as trading instruments under FAS 133. As of January 1, 2008, we have accounted for CDS as trading instruments under FAS 159 as they were all owned by Acacia entities. In both cases, changes in fair value of CDS are reported in the consolidated statements of (loss) income through market valuation adjustments, net.

As of each period end, we may also have outstanding commitments to purchase real estate loans. These commitments are accounted for as derivatives under Statement of Financial Accounting Standards No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (FAS 149), and are classified as trading instruments.

See *Note 10* for further discussion on derivative financial instruments.

Deferred Tax Assets

Income recognition for GAAP and tax differ in material respects. As a result, we may recognize taxable income in periods prior to or later than when we recognize income for GAAP. When this occurs, we pay the tax liability and establish a deferred tax asset for GAAP. When the income is subsequently realized in future periods under GAAP, the deferred tax asset is recognized as an expense. Our deferred tax assets are generated by differences in GAAP and taxable income at our taxable subsidiaries. GAAP and tax differences at the REIT may create additional deferred tax assets or liabilities to the extent we do not distribute all of our taxable income.

See *Note 20* for further discussion of taxes.

Deferred Asset-Backed Securities Issuance Costs

Asset-backed securities (ABS) issuance costs are costs associated with the issuance of ABS from securitization entities we sponsor. These costs typically include underwriting, rating agency, legal, accounting,

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

and other fees. ABS issuance costs associated with liabilities accounted for under the fair value option are expensed as incurred. ABS issuance costs associated with liabilities reported at cost are deferred. Deferred ABS issuance costs are reported on our consolidated balance sheets as deferred charges and are amortized as an adjustment to interest expense using the interest method, based upon the actual and estimated repayment schedules of the related ABS issued under the principles prescribed in Accounting Practice Bulletin 21, *Interest on Receivables and Payables* (APB 21). Sequoia deferred ABS issuance costs are reporting in accordance with APB 21. As of January 1, 2008, the deferred issuance costs associated with Acacia were included in the fair value of ABS issued by Acacia and were accounted for under FAS 159. As a result, these costs were included in our one-time adjustment upon the adoption of FAS 159 and were reclassified into retained earnings.

See *Note 4* for further discussion on FAS 159.

Other Assets

Other assets on our consolidated balance sheets include real estate owned (REO), fixed assets, purchased interest, principal receivable, and other prepaid expenses. REO is reported at the lower of cost or fair value. All other assets are reported at cost.

Short-Term Debt — Redwood

Short-term debt includes our credit facilities at Redwood that mature within one year. Open facilities may be unsecured or collateralized by loans or securities. We report short-term Redwood debt at its unpaid principal balance.

Asset Backed Securities Issued — Sequoia and Acacia

The majority of the liabilities reported on our consolidated balance sheets represent ABS, as issued by bankruptcy-remote securitization entities sponsored by Redwood.

Sequoia and Acacia assets are held in the custody of trustees. Trustees collect principal and interest payments (less servicing and related fees) from the assets and make corresponding principal and interest payments to the ABS investors. ABS obligations are payable solely from the assets of these entities and are not obligations of Redwood.

Sequoia ABS Issued

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

Acacia ABS Issued

Effective January 1, 2008, Acacia ABS issued are accounted for under the fair value option under FAS 159 and carried at their fair values on our consolidated balance sheets. Changes in fair value (gains or losses) are reported in the consolidated statements of (loss) income through market valuation adjustments, net. Prior to January 1, 2008, Acacia ABS issued were accounted for under the same method as Sequoia ABS issued.

Long-Term Debt — Redwood

Long-term debt includes trust preferred securities and subordinated notes at Redwood. Both are unsecured debt, requiring quarterly interest payments at a floating rate equal to London Interbank Offered Rate (LIBOR) plus a margin until they are redeemed in whole or mature at a future date. These notes contain an earlier optional redemption date without penalty. Long-term Redwood debt is reported on our consolidated balance sheet at cost.

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

See *Note 14* for further discussion on long-term Redwood debt.

Minority Interest

Minority interest represents the aggregate limited partnership interests in the Opportunity Fund held by third parties.

See *Note 16* for further discussion on minority interest.

Earnings (Loss) Per Share

Basic (loss) earnings per share are computed by dividing net (loss) income by the weighted average number of common shares outstanding during the period. Diluted (loss) earnings per share are computed by dividing net (loss) income by the weighted average number of common shares and potential common shares outstanding during the period. Potential common shares outstanding are calculated using the treasury stock method, which assumes that all dilutive common stock equivalents are exercised and the funds generated by the exercises are used to buy back outstanding common stock at the average market price of the common stock during the reporting period. In accordance with Statement of Financial Accounting Standards No. 128, *Earnings per Share* (FAS 128), if there is a loss from continuing operations, the common stock equivalents are deemed antidilutive and diluted (loss) earnings per share is calculated in the same manner as basic (loss) earnings per share.

Other Comprehensive Income (Loss)

Current period net unrealized gains and losses on real estate securities available-for-sale and interest rate agreements previously designated as cash flow hedges under FAS 133 are reported as components of other comprehensive income (loss) on our consolidated statements of comprehensive income (loss). Net unrealized gains and losses on securities and interest rate agreements held by our taxable subsidiaries that are reported in other comprehensive income (loss) are adjusted for the effects of taxation and may create deferred tax assets or liabilities.

Stock-Based Compensation

As of June 30, 2008 and December 31, 2007, we had one stock-based employee compensation plan and one employee stock purchase plan.

We adopted Statement of Financial Accounting Standards No. 123R, *Share-Based Payment* (FAS 123R), on January 1, 2006. With the adoption of FAS 123R, the grant date fair values of all remaining unvested stock compensation awards (stock options, deferred stock units, and restricted stock) are expensed on the consolidated statements of (loss) income over their remaining vesting periods.

See *Note 18* for further discussion on stock based compensation.

Recent Accounting Pronouncements

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *The Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* (FAS 160). FAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. FAS 160 clarifies that a noncontrolling interest in a subsidiary should be reported as a component of equity in the consolidated financial statements and requires disclosure, on the face of the consolidated statement of (loss) income, of the amounts of consolidated net income attributable to the parent and to the noncontrolled interest. FAS 160 is effective beginning January 1, 2009, with early adoption not permitted. FAS 160 is to be applied prospectively, except for the presentation and disclosure requirements, which upon adoption will be applied retrospectively for all periods presented. We are currently evaluating the disclosure requirements of FAS 160.

TABLE OF CONTENTS

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

In February 2008, the FASB issued FASB Staff Position 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* (FSP 140-3). FSP 140-3 provides that a transferor and a transferee must account for a transfer of a financial asset and a repurchase financing with the same counterparty (or consolidated affiliates of either counterparty) as a linked transaction if the transfer and repurchase financing were entered into contemporaneously or in contemplation of each other unless certain specified criteria are met. Under FSP 140-3, a repurchase financing is a transaction in which the buyer (initial transferee) of a financial asset obtains financing from the seller (initial transferor) and transfers the financial asset back to the seller as collateral until the financing is repaid. FSP 140-3 is effective beginning January 1, 2009, with early adoption not permitted. FSP 140-3 is to be applied prospectively to initial transfers and repurchase financings for which the initial transfer is executed on or after the beginning of the fiscal year in which this FSP is initially applied.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133* (FAS 161). FAS 161 amends and expands the disclosure requirements of FAS 133 to provide greater transparency about how and why an entity uses derivative instruments, how derivative instruments and related hedge items are accounted for under FAS 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity's financial position, results of operations, and cash flows. To meet those objectives, FAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments, and disclosures about credit risk related contingent features in derivative agreements. FAS 161 is effective January 1, 2009, and early adoption is encouraged. We are currently evaluating the impact of FAS 161, although we do not expect a significant impact on our financial position, results of operations or cash flows.

In June 2008, the FASB issued Staff Position EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (EITF 03-6-1). EITF 03-6-1 states that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are "participating securities" as defined in EITF 03-6, *Participating Securities and the Two-Class Method under FASB Statement No. 128* (EITF 03-6), and therefore should be included in computing earnings per share using the two-class method. According to EITF 03-6-1, a share-based payment award is a participating security when the award includes nonforfeitable rights to dividends or dividend equivalents. The rights result in a noncontingent transfer of value each time an entity declares a dividend or dividend equivalent during the award's vesting period. However, the award would not be considered a participating security if the holder forfeits the right to receive dividends or dividend equivalents in the event that the award does not vest. EITF 03-6-1 is effective for financial statements issued in fiscal years beginning after December 15, 2008, and interim periods within those years. When adopted, its requirements are applied by recasting previously reported EPS. We are currently evaluating the requirements of EITF 03-6-1 and have not yet determined the impact of adoption.

Note 4. Adoption of FAS 159

On January 1, 2008, we elected to apply the fair value option under FAS 159 to the assets and liabilities of our consolidated Acacia securitization entities and the investment grade securities (IGS) at Redwood. FAS 159 gives us the option of electing to measure eligible financial assets, financial liabilities, and commitments, at fair value on an instrument-by-instrument basis. The election to use the fair value option is available when we first recognize a financial asset or financial liability or enter into a firm commitment, or upon the initial election of the fair value option on existing instruments on January 1, 2008. Subsequent changes in the fair value of assets, liabilities, and commitments valued under FAS 159 are recorded in the consolidated statements of (loss) income.

TABLE OF CONTENTS

REDWOOD TRUST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)

Note 4. Adoption of FAS 159 – (continued)

Prior to the application of FAS 159, we were required to mark-to-market the assets, but not the liabilities, of Acacia entities, even though the assets and liabilities were paired within the same legal structure and the ABS issued by each Acacia entity would be repaid directly and solely from the cash flows generated by the assets of that entity. Electing the fair value option for the assets and liabilities (including derivatives) of Acacia enabled us to mitigate the volatility in earnings and book value that results from the use of different measurement attributes, to correlate more closely the values of the assets and liabilities that are paired within the same securitization entity, and to reduce the complexity of accounting with regards to derivatives under FAS 133. We also elected the fair value option for certain investment grade securities (IGS) held at Redwood, since we expect to pair these investments with a future liability for which we will also elect the fair value option under FAS 159.

As a result of the one-time election of FAS 159 on January 1, 2008, we reclassified $459 million of net unrealized gains and losses on Acacia assets and IGS at Redwood from accumulated other comprehensive income (loss) to retained earnings. We also recorded to retained earnings the $1.5 billion aggregate difference between the reported values and fair values of Acacia liabilities. As part of the revaluation of the Acacia liabilities to fair value, we also reclassified to retained earnings the associated unamortized deferred ABS issuance costs of $21 million. Adjustments resulting from the one-time election at the adoption date of FAS 159 are reflected on the balance sheet as a cumulative effect adjustment to stockholders' equity (deficit).

We did not elect the fair value option for the assets and liabilities of Sequoia, as these assets and liabilities are currently accounted for using similar measurement attributes and do not generally create substantial volatility in our earnings. We also did not elect the fair value option for our credit enhancement securities (CES) at Redwood, which are funded with equity. There is no paired liability for these assets and our intent upon acquisition of these assets is to hold them to maturity and to generate long-term cash flows.

Our decision to adopt FAS 159 for new financial instruments is generally based upon our funding strategy for the specific financial asset acquired or financial liability incurred. Assets that we anticipate funding with equity will generally be accounted for as AFS securities under FAS 115. Assets that we anticipate financing with a combination of debt and equity will generally be accounted for as trading securities under FAS 159 along with the corresponding liabilities.

TABLE OF CONTENTS

Note 4. Adoption of FAS 159 – (continued)

The following table presents the transition adjustments and their effect on the Consolidated Total Assets and Total Liabilities and Stockholders' Equity at January 1, 2008, following the adoption of FAS 159.

Adoption of FAS 159

(In Millions)	December 31, 2007 Redwood Consolidated	Transition Adjustment	January 1, 2008 Redwood Consolidated
Real estate loans	$ 7,204	$ —	$ 7,204
Real estate securities and other investments	2,201	—	2,201
Cash and cash equivalents	290	—	290
Total earning assets	9,695	—	9,695
Restricted cash	118	—	118
Other assets	126	(21)	105
Total Assets	9,939	(21)	9,918
Redwood debt	8	—	8
Asset-backed securities issued	10,329	(1,490)	8,839
Subordinated notes	150	—	150
Other liabilities	170	—	170
Total liabilities	10,657	(1,490)	9,167
Common stock and additional paid-in capital	1,108	—	1,108
Accumulated other comprehensive (loss) income	(574)	459	(115)
Retained earnings	(1,252)	1,010	(242)
Total stockholders' (deficit) equity	(718)	1,469	751
Total Liabilities and Stockholders' Equity	$ 9,939	$ (21)	$ 9,918

Included in the $1 billion transition adjustment to retained earnings is an additional $1.5 million that was recorded during the second quarter of 2008. This amount relates to securities where we adopted FAS 159 on January 1, 2008, but was excluded in our original transition adjustment.

Note 5. Fair Value of Financial Instruments

In September 2006, the FASB issued FAS 157, which sought to consolidate and clarify the definition of "fair value" that is used throughout GAAP. FAS 157 defines fair value, establishes a methodology for measuring fair value, establishes a hierarchy of information used in measuring fair value, and enhances the disclosure of information about fair value measurements. FAS 157 provides that the "exit price," which is the price at which an asset could be sold or a liability could be transferred in an orderly process, should be used to value the asset or liability. FAS 157 also provides that market data, to the extent available, and not internally generated or entity specific information, should be used to determine fair value. We adopted FAS 157 on January 1, 2008. The financial impact on Redwood of the adoption of FAS 157 was not significant since our valuation methodology used in prior periods did not need to be revised to comply with FAS 157.

FAS 157 also provided a set of disclosures, the most significant being the requirements to disclose the valuations based on a framework that would group the valuations into a three-level hierarchy based on the ability to observe the significant inputs into the valuation:

Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

TABLE OF CONTENTS

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

Level 2: Inputs other than quoted prices included in Level 1 that are observable for the asset or liability either directly or through corroboration with observable market data.

Level 3: Unobservable inputs (e.g., an entity's own data or assumptions).

Level 3 inputs include situations where there is little, if any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment and considers factors specific to the asset or liability. FAS 157 also requires a roll forward of the items in Level 3 along with additional discussions on how these valuations are developed.

The following table presents information about financial assets and liabilities reported at fair value as of June 30, 2008, and indicates the fair value hierarchy of the valuation techniques used to measure fair value.

Assets and Liabilities Measured at Fair Value on a Recurring Basis as of June 30, 2008

(In Thousands)	Carrying Value	Fair Value Measurements Using: Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Real estate loans (held-for-sale)	$ 3,695	$ —	$ —	$ 3,695
Real estate loans (fair value)	18,800	—	—	18,800
Trading securities	841,868	—	—	841,868
Available-for-sale securities	399,759	—	—	399,759
Other investments	78,583	—	—	78,583
Derivative assets	4,914	—	4,635	279
Liabilities				
ABS issued – Acacia	935,072	—	—	935,072
Derivative liabilities	100,396	—	25,106	75,290

TABLE OF CONTENTS

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

The following table presents additional information about the assets and liabilities reported at fair value on our consolidated balance sheets on a recurring basis for which Level 3 inputs were used to determine fair value. These changes in fair value occurred after the adoption of FAS 159 on January 1, 2008.

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

Three Months Ended June 30, 2008 (In Thousands)	Beginning Balance 4/1/2008	Principal Paydowns	Total Realized and Unrealized Gains (Losses) Included in Income: Realized Gains or (Losses)	Unrealized Gains or (Losses)	Purchases, Sales, Other Settlements and Issuances, Net	Ending Balance 6/30/2008
Assets						
Real estate loans (held-for-sale)	$ 4,443	$ (626)	$ (81)	$ (41)	$ —	$ $3,695
Real estate loans (fair value)	18,801	(113)	112	—	—	18,800
Trading securities	952,576	(43,206)	(67,171)	—	(331)	841,868
Available-for-sale securities	242,030	(23,162)	(30,822)	27,901	183,812	399,759
Other investments	78,770	(187)	—	—	—	78,583
Derivative assets	72	—	207	—	—	279
Liabilities						
Acacia ABS issued	1,046,160	(109,881)	(4,464)	—	3,257	935,072
Derivative liabilities	72,501	—	2,789	—	—	75,290

Six Month Ended June 30, 2008 (In Thousands)	Beginning Balance 1/1/2008	Principal Paydowns	Total Realized and Unrealized Gains (Losses) Included in Income: Realized Gains or (Losses)	Unrealized Gains or (Losses)	Purchases, Sales, Other Settlements and Issuances, Net	Ending Balance 6/30/2008
Assets						
Real estate loans (held-for-sale)	$ 4,533	$ (642)	$ (155)	$ (41)	$ —	$ 3,695
Real estate loans (fair value)	25,426	(229)	(4,548)	(1,849)	—	18,800
Trading securities	1,804,511	(100,504)	(865,151)	—	3,012	841,868
Available-for-sale securities	317,090	(30,234)	(174,920)	49,094	238,729	399,759

Other investments	79,125	(542)	—	—	—	78,583
Derivative assets	114	—	165	—	—	279
Liabilities						
Acacia ABS issued	1,893,441	(140,046)	(814,305)	—	(4,018)	935,072
Derivative liabilities	57,397	—	17,893	—	—	75,290

TABLE OF CONTENTS

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

The following table presents information for total net interest income for assets and liabilities measured under the fair value option for the three and six months ended June 30, 2008.

Net Interest Income on Fair Value Option Assets and Liabilities

	Net Interest Income on FVO Assets and Liabilities Three Months Ended June 30, 2008			Net Interest Income on FVO Assets and Liabilities Six Months Ended June 30, 2008		
(In Thousands)	**Change in Market Value**	**Interest Income (Expense)**	**Total Effect On Net Interest Income**	**Change in Market Value**	**Interest Income (Expense)**	**Total Effect On Net Interest Income**
Assets						
Real estate loans (fair value)	$ 112	$ 373	$ 485	$ (4,548)	$ 744	$ (3,804)
Trading securities	(62,537)	37,858	(24,679)	(857,821)	84,004	(773,817)
Other investments	—	514	514	—	1,246	1,246
Derivative assets	989	—	989	792	—	792
Liabilities						
Acacia ABS issued	4,464	(30,306)	(25,842)	814,305	(74,826)	739,479
Derivative liabilities	27,769	—	27,769	(21,818)	—	(21,818)
Total	$ (29,203)	$ 8,439	$ (20,764)	$ (69,090)	$ 11,168	$ (57,922)

Market valuation adjustments include fair value adjustments as well as other valuation changes in assets and liabilities consolidated on our financial statements that are recorded through our consolidated statements of (loss) income. The following table presents the components of market valuation adjustments, net, recorded in our consolidated statements of (loss) income for the three and six months ended June 30, 2008.

Market Valuation Adjustments, Net

(In Thousands)	**Three Months Ended June 30, 2008**	**Six Months Ended June 30, 2008**
Total Market Valuations of Fair Value Assets and Liabilities	$ (29,203)	$ (69,090)
Other Market Valuation Adjustments		
Impairments on AFS securities	(28,970)	(173,067)
Derivative instruments	1,981	(4,411)
Other real estate investments (trading)	(3,362)	(6,058)
Real estate loans (held-for-sale)	(1,065)	(1,925)
Market Valuation Adjustments, Net	$ (60,619)	$ (254,551)

TABLE OF CONTENTS

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

Fair Value of Financial Instruments

The following table presents the carrying values and estimated fair values of our financial instruments as of June 30, 2008 and December 31, 2007.

	June 30, 2008		December 31, 2007	
(In Thousands)	**Carrying Value**	**Fair Value**	**Carrying Value**	**Fair Value**
Assets				
Real estate loans (held-for-investment)	$ 6,354,223	$ 5,666,056	$ 7,199,618	$ 6,860,574
Real estate loans (held-for-sale)	3,695	3,695	4,533	4,533
Real estate loans (fair value)	18,800	18,800	—	—
Trading securities	841,868	841,868	11,521	11,521
Available-for-sale securities	399,759	399,759	2,110,080	2,110,080

Other investments	78,583	78,583	79,125	79,125
Cash and equivalents	147,639	147,639	290,363	290,363
Derivative assets	4,914	4,914	5,598	5,598
Restricted cash	102,171	102,171	118,064	118,064
Accrued interest receivable	40,948	40,948	45,553	45,553
Liabilities				
Short-term debt – Redwood	9,326	9,326	7,561	7,561
ABS Issued				
ABS issued – Sequoia	6,174,571	5,425,929	6,946,166	6,693,087
ABS issued – Acacia(1)	935,072	935,072	3,383,113	1,893,441
Total ABS issued	7,109,643	6,361,001	10,329,279	8,586,528
Derivative liabilities	100,396	100,396	81,385	81,385
Accrued interest payable	32,237	32,237	53,796	53,796
Long-term debt – Redwood	150,000	72,000	150,000	94,000

(1) We elected the fair value option under FAS 159 for all Acacia ABS as of January 1, 2008. Acacia ABS were recorded at their amortized cost at and prior to December 31, 2007.

The following is a description of the instruments measured at fair value under FAS 157 as well as the general classification of such instruments pursuant to the valuation hierarchy described above under FAS 157.

- Real estate loans
  - Residential real estate loan fair values are determined by available market quotes and discounted cash flow analyses (Level 2 and 3).
  - Commercial real estate loan fair values are determined by available market quotes and discounted cash flow analyses (Level 2 and 3).
- Real estate securities
  - Real estate securities are residential, commercial, CDO, and other asset-backed securities that are illiquid in nature and trade infrequently. Fair values are determined by discounted cash flow analyses and other valuation techniques using market pricing assumptions that are confirmed by third party dealer/pricing indications, to the extent available. Significant inputs in the valuation

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

analysis are predominantly Level 3 in nature, due to the lack of readily available market quotes and related inputs. Relevant market indicators that are factored in the analyses include bid/ask spreads, credit losses, interest rates, and prepayment speeds. Estimated fair values are based on applying the market indicators to generate discounted cash flows.

- Other investments
  - Other investments currently include a GIC. Management currently considers the GIC’s fair value to approximate contract value, as the interest rate is variable at LIBOR less 5 basis points and resets on a monthly basis (Level 2).
- Derivative assets and liabilities
  - Our derivative instruments include interest rate agreements and credit default swaps. Fair values of derivative instruments are determined using valuation models and are verified by valuations provided by dealers active in derivative markets. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates, and correlations of such inputs. Model inputs for interest rate agreements can generally be verified and model selection does not involve significant management judgment (these are Level 2 inputs). For other derivatives, valuations are based on various factors such as liquidity, bid/offer spreads, and credit considerations for which we rely on available market evidence. In the absence of such evidence, management’s best estimate is used (these are Level 3 inputs).
- Cash and cash equivalents
  - Cash and cash equivalents include cash on hand and highly liquid investments with original maturities of three months or less. Fair values equal carrying values.
- Restricted cash
  - Restricted cash primarily includes interest-earning cash balances in ABS entities and the Fund for the purpose of distribution to bondholders or limited partners, and reinvestment. Due to the short-term nature of the restrictions, fair values approximate carrying values.
- Accrued interest receivable and payable
  - Accrued interest receivable and payable includes interest due on our assets and payable on our liabilities. Due to the short-term nature of when these interest payments will be received or paid, fair values approximate carrying values.

- Short-term debt — Redwood
  - Short-term Redwood debt includes our credit facilities that mature within one year. Short-term Redwood debt is set to an adjustable rate. Fair values approximate carrying values (Level 1 and 2).
- ABS issued
  - ABS issued includes asset-backed securities issued through our Sequoia and Acacia programs. These instruments are illiquid in nature and trade infrequently, if at all. Fair values are determined by discounted cash flow analyses and other valuation techniques using market pricing assumptions that are confirmed by third party dealer/pricing indications, to the extent available. Significant inputs in the valuation analysis are predominantly Level 3, due to the nature of these instruments and the lack of readily available market quotes. Relevant market

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

indicators factored into the analyses include dealer price indications to the extent available, bid/ask spreads, external spreads, collateral credit losses, interest rates and collateral prepayment speeds. Estimated fair values are based on applying the market indicators to generate discounted cash flows.

- Long-term debt — Redwood
  - Long-term Redwood debt includes our subordinated notes and trust preferred securities. Fair values are determined using comparable market indicators of current pricing. Significant inputs in the valuation analysis are predominantly Level 3 due to the nature of these instruments and the lack of readily available market quotes.

Note 6. Real Estate Loans

We acquire residential and commercial real estate loans from third party originators. The majority of these loans are sold to securitization entities sponsored by us under our Sequoia and Acacia programs which, in turn, issue ABS. The remainder of the loans we invest in are held and financed with short-term Redwood debt and equity.

The following table summarizes the carrying value of the residential and commercial real estate loans, as reported on our consolidated balance sheets at June 30, 2008 and December 31, 2007.

(In Thousands)	June 30, 2008	December 31, 2007
Residential real estate loans (held-for-sale)	$ 3,695	$ 4,533
Residential real estate loans (held-for-investment)	6,353,972	7,173,940
Total residential real estate loans	6,357,667	7,178,473
Commercial real estate loans (fair value)	18,800	—
Commercial real estate loans (held-for-investment)	251	25,678
Total Real Estate Loans	$ 6,376,718	$ 7,204,151

At June 30, 2008, we had $5 million in outstanding principal of residential loans held-for-sale with a lower of cost or fair value of $4 million. At December 31, 2007, there was $6 million in outstanding principal for these loans with a lower of cost or fair value of $5 million.

Real Estate Loans Held-for-Investment

The following table provides additional information on real estate loans classified as held-for-investment as of June 30, 2008 and December 31, 2007.

June 30, 2008 (In Thousands)	Residential Real Estate Loans	Commercial Real Estate Loans	Total
Current face	$ 6,318,090	$ 11,102	$ 6,329,192
Current premium (discount) – net, unamortized	68,479	(362)	68,117
Discount designated as credit reserve	—	(8,141)	(8,141)
Reserve for credit losses	(32,597)	(2,348)	(34,945)
Carrying Value	$ 6,353,972	$ 251	$ 6,354,223

Note 6. Real Estate Loans – (continued)

December 31, 2007 (In Thousands)	Residential Real Estate Loans	Commercial Real Estate Loans	Total
Current face	$ 7,106,018	$ 38,111	$ 7,144,129
Current premium (discount) – net, unamortized	86,204	(1,944)	84,260
Discount designated as credit reserve	—	(8,141)	(8,141)
Reserve for credit losses	(18,282)	(2,348)	(20,630)
Carrying Value	$ 7,173,940	$ 25,678	$ 7,199,618

Of the $6.3 billion of principal face and $68 million of unamortized premium on our residential real estate loans at June 30, 2008, $2.2 billion of principal face and $50 million of unamortized premium relates to residential loans acquired prior to July 1, 2004. For these residential loans, we determine an effective yield using coupon interest rates as they change over time and anticipated principal payments to amortize the premium into income. During the first half of 2008, 13% of these residential loans prepaid and we amortized 23% of the premium. Of the $7.1 billion of principal face and $86 million of unamortized premium on our residential real estate loans at December 31, 2007, $2.5 billion of principal face and $66 million of unamortized premium relates to residential loans acquired prior to July 1, 2004.

For residential loans acquired after July 1, 2004, the principal face and unamortized premium was $4.1 billion and $18 million at June 30, 2008, respectively, and $4.6 billion and $20 million at December 31, 2007, respectively. For these residential loans, we use the initial coupon interest rate of the loans (without regard to future changes in the underlying indices) and anticipated principal payments to calculate an effective yield to amortize the premium or discount. During the first half of 2008, 10% of these residential loans prepaid and we amortized 11% of the premium.

On January 1, 2008, we elected the fair value option under FAS 159 for commercial real estate loans owned by Acacia entities, and accordingly record these loans at their fair values. At June 30, 2008 we owned $26 million face of commercial loans that had a fair value of $19 million. Prior to 2008, these loans were classified as held-for-investment.

The following table presents information regarding real estate loans pledged and unpledged under our borrowing agreements at June 30, 2008 and December 31, 2007.

Real Estate Loans Pledged and Unpledged

(In Thousands)	June 30, 2008 Face Value	June 30, 2008 Carrying Value	December 31, 2007 Face Value	December 31, 2007 Carrying Value
Unpledged	$ 15,880	$ 3,946	$ 16,606	$ 4,785
Owned by securitization entities, financed through ABS issued	6,344,867	6,372,772	7,133,022	7,199,366
Total	$ 6,360,747	$ 6,376,718	$ 7,149,628	$ 7,204,151

Unpledged real estate loans at June 30, 2008 consist of residential loans held-for-sale with a face value of $5 million and a carrying value of $4 million and two commercial loans held-for-investment with a face value of $11 million and a carrying value of $0.2 million.

Note 7. Reserves for Credit Losses

We establish reserves for credit losses on our real estate loans held-for-investment based on our estimate of losses inherent in our loan portfolio. At both June 30, 2008 and December 31, 2007, all residential loans

TABLE OF CONTENTS

Note 7. Reserves for Credit Losses – (continued)

classified as held-for-investment were owned by Sequoia entities. At June 30, 2008, we had a reserve for credit losses of $33 million on these residential loans, an increase from the $18 million reserve at December 31, 2007.

The following table summarizes the activity in reserves for credit losses for our consolidated residential loans classified as held-for-investment for the three and six months ended June 30, 2008 and 2007.

Activity in Residential Real Estate Loan Reserves for Credit Losses

(In Thousands)	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Balance at beginning of period	$ 24,444	$ 19,954	$ 18,282	$ 20,119
Provision for credit losses	10,061	2,500	18,119	3,981
Charge-offs	(1,908)	(6,038)	(3,804)	(7,684)
Balance at End of Period	$ 32,597	$ 16,416	$ 32,597	$ 16,416

Delinquencies in our consolidated residential real estate loan portfolio were $118 million and $68 million as of June 30, 2008 and December 31, 2007, respectively. Delinquencies include loans delinquent more than 90 days and in foreclosure. As a percentage of our current residential real estate loan balances, delinquencies were 1.87% and 0.96% at June 30, 2008 and December 31, 2007, respectively. As a percentage of the original balances, delinquencies were 0.42% and 0.24% at June 30, 2008 and December 31, 2007, respectively.

Our residential loan servicers advance payment on delinquent loans to the extent they deem them recoverable. We accrue interest on loans until they are more than 90 days past due or deemed uncollectible at which point they are placed on nonaccrual status. When we pursue foreclosure in full satisfaction for a defaulted loan, we estimate the specific loan loss, if any, based on estimated net proceeds from the sale of the property (including accrued but unpaid interest), and charge this specific estimated loss (or recovery) against the reserve for credit losses. During the first half of 2008, there were $4 million of charge-offs that reduced our reserve for credit losses. These charge-offs arose from $24 million of defaulted loan principal. Foreclosed property is subsequently recorded as REO, a component of other assets (See *Note 11*). Subsequent changes in value of REO are recorded through market valuation adjustments, net, in our consolidated statements of (loss) income.

The following table summarizes the activity in reserves for credit losses for our commercial real estate loans held-for-investment, for the three and six months ended June 30, 2008 and 2007.

Activity in Commercial Real Estate Loan Reserves for Credit Losses

	Three Months Ended June 30,		Six Months Ended June 30,	
(In Thousands)	**2008**	**2007**	**2008**	**2007**
Balance at beginning of period	$ 2,348	$ 2,348	$ 2,348	$ —
Provision for credit losses	—	—	—	2,348
Charge-offs	—	—	—	—
Balance at End of Period	$ 2,348	$ 2,348	$ 2,348	$ 2,348

During the first quarter of 2007, we fully reserved for an anticipated loss on a mezzanine commercial loan, which was made to finance a condominium-conversion project. We do not expect to recover any outstanding principal upon completion of the conversion project and sale of the condominium units.

Note 8. Real Estate Securities

We invest in third party residential, commercial, and CDO securities. The following table presents our real estate securities by collateral type and entity, as of June 30, 2008 and December 31, 2007.

June 30, 2008 (In Thousands)	**Redwood**	**The Fund**	**Acacia**	**Total Securities**
Residential	$ 247,579	$ 45,750	$ 596,366	$ 889,695
Commercial	90,969	—	176,162	267,131
CDO	14,763	19,989	49,974	84,726
Other real estate investments	75	—	—	75
Total Real Estate Securities	$ 353,386	$ 65,739	$ 822,502	$ 1,241,627

December 31, 2007 (In Thousands)	**Redwood**	**The Fund**	**Acacia**	**Total Securities**
Residential	$ 163,235	$ 3,126	$ 1,393,048	$ 1,559,409
Commercial	148,508	—	278,003	426,511
CDO	20,822	12,075	91,263	124,160
Other real estate investments	11,521	—	—	11,521
Total Real Estate Securities	$ 344,086	$ 15,201	$ 1,762,314	$ 2,121,601

The following table presents our trading and available-for-sale (AFS) real estate securities by collateral type and entity, as of June 30, 2008 and December 31, 2007.

June 30, 2008	**Redwood**		**The Fund**	**Acacia**	**Total Securities**	
(In Thousands)	**Trading**	**AFS**	**AFS**	**Trading**	**Trading**	**AFS**
Residential IGS						
Prime	$ 1,319	$ 100,664	$ 1,220	$ 169,564	$ 170,883	$ 101,884
Non-prime	3,251	55,230	44,530	312,473	315,724	99,760
Total Residential IGS	4,570	155,894	45,750	482,037	486,607	201,644
Residential CES						
Prime	—	79,304	—	61,760	61,760	79,304
Non-prime	282	7,529	—	52,569	52,851	7,529
Total Residential CES	282	86,833	—	114,329	114,611	86,833
Commercial IGS	—	—	—	61,818	61,818	—
Commercial CES	—	90,969	—	114,344	114,344	90,969
CDO IGS	14,364	—	12,853	45,615	59,979	12,853
CDO CES	75	324	7,136	4,359	4,434	7,460
Other real estate investments	75	—	—	—	75	—
Total Real Estate Securities	$ 19,366	$ 334,020	$ 65,739	$ 822,502	$ 841,868	$ 399,759

Note 8. Real Estate Securities – (continued)

December 31, 2007 (In Thousands)	Redwood Trading	Redwood AFS	The Fund AFS	Acacia AFS	Total Securities Trading	Total Securities AFS
Residential IGS						
Prime	$ —	$ 1,360	$ —	$ 514,045	$ —	$ 515,405
Non-prime	—	10,865	3,126	628,068	—	642,059
Total Residential IGS	—	12,225	3,126	1,142,113	—	1,157,464
Residential CES						
Prime	—	127,612	—	193,676	—	321,288
Non-prime	—	23,398	—	57,259	—	80,657
Total Residential CES	—	151,010	—	250,935	—	401,945
Commercial IGS	—	—	—	89,676	—	89,676
Commercial CES	—	148,508	—	188,327	—	336,835
CDO IGS	—	18,450	12,075	83,094	—	113,619
CDO CES	—	2,372	—	8,169	—	10,541
Other real estate investments	11,521	—	—	—	11,521	—
Total Real Estate Securities	$ 11,521	$ 332,565	$ 15,201	$ 1,762,314	$ 11,521	$ 2,110,080

We finance securities through a combination of Redwood debt and equity as well as investments in the Fund and Acacia entities that we consolidate. Of the total securities owned at Redwood as of June 30, 2008 and December 31, 2007, $9 million and $8 million, respectively, were pledged for short-term Redwood debt.

Trading securities are recorded at fair value with changes in fair value recorded in market valuation adjustments, net, in the consolidated statements of (loss) income. We currently account for Redwood IGS, securities owned by Acacia entities, and other real estate investments (OREI), as trading securities. Prior to the adoption of FAS 159, Redwood IGS and securities owned by Acacia were recorded at fair value in accordance with FAS 115.

AFS Securities

AFS securities are measured at fair value, with unrealized gains and losses recorded as a component of other comprehensive income (loss), net of deferred taxes, in stockholders' equity (deficit). We currently account for most securities at Redwood and all securities at the Fund as AFS securities. Prior to the adoption of FAS 159 on January 1, 2008, all securities at Redwood and Acacia (except for OREI) were classified as AFS.

The following table presents the carrying value (which equals fair value) of AFS securities as of June 30, 2008 and December 31, 2007.

June 30, 2008 (In Thousands)	Residential	Commercial	CDO	Total
Current face	$ 1,019,761	$ 517,615	$ 99,089	$ 1,636,465
Current discount – designated credit reserve	(555,702)	(384,487)	(33,743)	(973,932)
Current discount – net unamortized	(154,465)	(31,871)	(42,415)	(228,751)
Amortized cost	309,594	101,257	22,931	433,782
Gross unrealized gains	14,995	2,820	625	18,440
Gross unrealized losses	(36,112)	(13,108)	(3,243)	(52,463)
Carrying Value	$ 288,477	$ 90,969	$ 20,313	$ 399,759

TABLE OF CONTENTS

Note 8. Real Estate Securities – (continued)

December 31, 2007 (In Thousands)	Residential	Commercial	CDO	Total
Current face	$ 3,553,064	$ 988,653	$ 393,010	$ 4,934,727
Current discount – designated credit reserve	(723,489)	(318,456)	(100,617)	(1,142,562)
Current discount – net unamortized	(886,118)	(98,509)	(156,305)	(1,140,932)
Amortized cost	1,943,457	571,688	136,088	2,651,233
Gross unrealized gains	14,074	4,965	822	19,861
Gross unrealized losses	(398,122)	(150,142)	(12,750)	(561,014)
Carrying Value	$ 1,559,409	$ 426,511	$ 124,160	$ 2,110,080

When we purchase a credit-sensitive AFS security at a significant discount to its face value, we often do not amortize into income a significant portion of this discount that we are entitled to earn but do not expect to collect due to the inherent credit risk of the security. The portion of the total discount that we do not amortize into income is designated as a credit reserve on the security, with the remaining portion amortized into income over time using the interest method in accordance with EITF 99-20. Our estimate of required credit reserves is based upon various factors, including economic conditions, characteristics of the underlying loans, delinquency status, past performance of similar securities, external credit enhancements or guarantees, and priority of cash flows and credit loss attribution within the securitization from which our security interest participates. We use a variety of internal and external credit risk cash flow modeling and portfolio analytical tools to assist in our assessments. We review our assessments at least quarterly and determine the appropriate level of credit reserve required for each security we own. The designated credit reserve is specific to each security.

The following table presents the detail investment activity affecting our gross purchase discount on AFS securities and the resulting net unamortized discount that we currently expect to recognize into income over the remaining lives of these securities.

Changes in Unamortized Discount and Designated Credit Reserves on AFS Securities

	Residential		Commercial		CDO	
Three Months Ended June 30, 2008 (In Thousands)	**Designated Credit Reserve**	**Unamortized Net Discount**	**Designated Credit Reserve**	**Unamortized Net Discount**	**Designated Credit Reserve**	**Unamortized Net Discount**
Beginning balance – March 31, 2008	$ 586,174	$ 83,714	$ 378,388	$ 36,955	$ 37,374	$ 47,472
Amortization of net discount	—	(7,925)	—	2,123	—	(456)
Realized credit losses	(60,507)	—	(5,502)	—	(4,150)	—
Acquisitions	4,773	71,774	—	—	—	—
Sales, calls, other	—	7,909	—	—	—	(4,402)
Impairments	24,255	—	4,394	—	320	—
Transfers/release of credit reserves	1,007	(1,007)	7,207	(7,207)	199	(199)
Ending balance – June 30, 2008	$ 555,702	$ 154,465	$ 384,487	$ 31,871	$ 33,743	$ 42,415

TABLE OF CONTENTS

Note 8. Real Estate Securities – (continued)

	Residential		Commercial		CDO	
Six Months Ended June 30, 2008 (In Thousands)	**Designated Credit Reserve**	**Unamortized Net Discount**	**Designated Credit Reserve**	**Unamortized Net Discount**	**Designated Credit Reserve**	**Unamortized Net Discount**
Beginning balance – December 31, 2007	$ 723,489	$ 886,118	$ 318,456	$ 98,509	$100,617	$ 156,305
Reclassification due to fair value option	(213,356)	(794,395)	—	(80,642)	(78,762)	(122,384)
Beginning balance – January 1, 2008	510,133	91,723	318,456	17,867	21,855	33,921
Amortization of net discount	—	(19,877)	—	3,646	—	(891)
Realized credit losses	(91,169)	—	(5,540)	—	(4,150)	—
Acquisitions	28,030	93,723	—	—	15,000	13,569
Sales, calls, other	—	7,866	—	—	—	(4,545)
Impairments	89,738	—	81,929	—	1,399	—
Transfers/release of credit reserves	18,970	(18,970)	(10,358)	10,358	(361)	361
Ending balance – June 30, 2008	$ 555,702	$ 154,465	$ 384,487	$ 31,871	$ 33,743	$ 42,415

The loans underlying our residential CES totaled $145 billion at June 30, 2008, and consist of $107 billion prime and $38 billion non-prime. These loans are located nationwide with a large concentration in California (49%). Serious delinquencies (90+ days, in foreclosure or REO) at June 30, 2008 were 4.23% of current principal balances and 1.93% of original principal balances. For loans in prime pools, delinquencies were 1.01% of current balances and 0.47% of original balances. Non-prime pools had delinquencies of 13.29% of current balances and 5.94% of original balances.

The loans underlying our commercial CES totaled $49 billion at June 30, 2008, and consist primarily of office (39%), retail (28%), and multifamily (16%) fixed rate commercial loans. These loans are located nationwide. Serious delinquencies (90+ days, in foreclosure or REO) at June 30, 2008 were 0.79% of current principal balances and 0.74% of original principal balances.

For the three and six months ended June 30, 2008, we recognized other-than-temporary impairments on AFS securities of $29 million and $173 million, respectively, through market valuation adjustments, net, in our consolidated statements of (loss) income. For the three and six months ended June 30, 2007, we recognized other-than-temporary impairments of $22 million and $24 million, respectively.

TABLE OF CONTENTS

Note 8. Real Estate Securities – (continued)

The following table presents the components comprising the carrying value of AFS securities that were in an unrealized loss position and not deemed to be other than temporarily impaired as of June 30, 2008, and December 31, 2007.

AFS Securities with Unrealized Losses

June 30, 2008 (In Thousands)	Less Than 12 Consecutive Months			12 Consecutive Months or Longer		
	Total Amortized Cost	Gross Unrealized Losses	Total Fair Value	Total Amortized Cost	Gross Unrealized Losses	Total Fair Value
Residential	$ 220,003	$ (35,665)	$ 184,338	$ 1,661	$ (447)	$ 1,214
Commercial	75,430	(10,987)	64,443	5,111	(2,122)	2,989
CDO	12,410	(3,242)	9,168	—	—	—
Total Securities	$ 307,843	$ (49,894)	$ 257,949	$ 6,772	$ (2,569)	$ 4,203

December 31, 2007 (In Thousands)	Less Than 12 Consecutive Months			12 Consecutive Months or Longer		
	Total Amortized Cost	Gross Unrealized Losses	Total Fair Value	Total Amortized Cost	Gross Unrealized Losses	Total Fair Value
Residential	$ 930,965	$ (303,546)	$ 627,419	$ 315,304	$ (94,576)	$ 220,728
Commercial	400,942	(112,769)	288,173	130,681	(37,373)	93,308
CDO	42,113	(12,750)	29,363	—	—	—
Total Securities	$ 1,374,020	$ (429,065)	$ 944,955	$ 445,985	$ (131,949)	$ 314,036

At June 30, 2008, we owned 601 AFS securities, of which, 198 were in an unrealized loss position and 8 were in a continuous unrealized loss position for twelve months or longer. At December 31, 2007, we owned 1,722 AFS securities, of which 855 were in an unrealized loss position and 188 were in a continuous loss position for twelve months or longer. The number of AFS securities reported on our consolidated balance sheets declined as a result of our adoption of FAS 159 on January 1, 2008.

Gross Realized Gains and Losses

Gains and losses from AFS securities are recorded to realized gains (losses) on sales and calls, net, in our consolidated statements of (loss) income. The following table presents the gross realized gains and losses on sales and calls of AFS securities for the six months ended June 30, 2008 and 2007.

(In Thousands)	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Gross realized gains – sales	$ 1,831	$ 2,746	$ 1,831	$ 3,415
Gross realized gains – calls	—	1,310	42	2,153
Gross realized losses – sales	—	(1,284)	—	(2,737)
Gross realized losses – calls	(43)	—	(43)	—
Total realized gains on sales and calls, net	$ 1,788	$ 2,772	$ 1,830	$ 2,831

Note 9. Other Investments

Other investments includes a GIC owned by an Acacia securitization entity that we consolidate for financial statements purposes. This GIC represents a deposit certificate issued by a rated investment bank. This GIC serves as the collateral to cover potential losses on CDS also entered into by this same Acacia entity. The

TABLE OF CONTENTS

Note 9. Other Investments – (continued)

CDS reference BBB and A-rated residential mortgage-backed securities issued in 2006. In the event that any of these referenced securities incurs a credit loss, the GIC can then be drawn upon by the CDS counterparty to cover the amount of such loss. Since the acquisition of this asset, it has been drawn down by $1 million as the notional amount of the related CDS has been reduced. This investment is recorded on our consolidated balance sheets at its estimated fair value. The fair value was $79 million as of June 30, 2008. Changes in fair value are reported through our consolidated statements of (loss) income through market valuation adjustments, net.

Note 10. Derivative Financial Instruments

We report our derivative financial instruments at fair value as determined using third-party models and confirmed by broker/dealers that make markets in these instruments. As of June 30, 2008 and December 31, 2007, the net fair value of our derivative financial instruments was negative $95 million and negative $76 million, respectively.

The following table shows the aggregate fair value and notional amount of our derivative financial instruments as of June 30, 2008 and December 31, 2007.

(In Thousands)	June 30, 2008 Fair Value	June 30, 2008 Notional Amount	December 31, 2007 Fair Value	December 31, 2007 Notional Amount
Trading Instruments				

Interest rate caps purchased	$ 4,246	$ 714,400	$ 3,788	$ 707,900
Interest rate caps sold	(1,160)	250,000	(1,061)	250,000
Interest rate corridors purchased	—	—	—	844,805
Interest rate swaps	(23,278)	1,091,652	(1,553)	186,733
Interest rate swaps designated as cash flow hedges	—	—	(19,564)	994,562
Credit default swaps	(75,290)	78,487	(57,397)	78,771
Total Derivative Financial Instruments	$ (95,482)	$ 2,134,539	$ (75,787)	$ 3,062,771

Of the negative $95 million value of derivative financial instruments at June 30, 2008, $5 million was recorded as derivative assets and $100 million was recorded as derivative liabilities on our consolidated balance sheet. Of the negative $76 million value of derivative financial instruments at December 31, 2007, $5 million was recorded as derivative assets and $81 million was recorded as derivative liabilities on our consolidated balance sheet.

Interest Rate Agreements

We maintain an overall interest rate risk management strategy that incorporates the use of interest rate agreements. We enter into interest rate agreements for a variety of reasons, including minimizing significant fluctuations in earnings or market values on certain assets or liabilities that may be caused by interest rate volatility. Interest rate agreements that we use as part of our interest rate risk management strategy may include interest rate options, swaps, options on swaps, futures contracts, options on futures contracts, and options on forward purchases.

We currently account for our interest rate agreements as trading instruments in accordance with FAS 133. Changes in the fair value of the interest rate agreement and all associated income and expenses are reported in our consolidated statements of (loss) income through market valuation adjustments, net. We had net valuation adjustments on interest rate agreements of positive $33 million and negative $5 million for the three and six months ended June 30, 2008, respectively, and positive $1 million and positive $2 million for the three and six months ended June 30, 2007, respectively.

TABLE OF CONTENTS

Note 10. Derivative Financial Instruments – (continued)

We did not have any interest rate agreements designated as cash flow hedges during the three and six months ended June 30, 2008. For interest rate agreements previously designated as cash flow hedges, our total unrealized gain or loss included in accumulated other comprehensive income (loss) was negative $30 million at June 30, 2008 and was negative $33 million at December 31, 2007.

The following table presents the interest income and expense of our interest rate agreements previously designated as cash flow hedges for the three months and six months ended June 30, 2008 and 2007.

Impact on Net Interest Income (Expense) of Our Interest Rate Agreements Accounted for as Cash Flow Hedges

	Three Months Ended June 30,		Six Months Ended June 30,	
(In Thousands)	**2008**	**2007**	**2008**	**2007**
Net interest income on cash flow interest rate agreements	$ —	$ 2,693	$ —	$ 5,092
Realized net income due to net ineffective portion of hedges	—	671	—	590
Realized net losses reclassified from other comprehensive (loss) income	(1,246)	(6)	(2,492)	(678)
Total	$ (1,246)	$ 3,358	$ (2,492)	$ 5,004

Credit Default Swaps

A credit default swap (CDS) is an agreement to provide (receive) credit event protection based on a financial index or specific security in exchange for receiving (paying) a fixed-rate fee or premium over the term of the contract. These instruments enable us to synthetically assume the credit risk of a reference security or index of securities. All of our existing CDS contracts were initiated during 2007 by an Acacia securitization entity that we have consolidated for financial reporting purposes.

Credit default swaps in Acacia are accounted for as trading instruments. These CDS are reported at fair value with the changes in fair value and any net receipts/payments recognized through market valuation adjustments, net on our consolidated statements of (loss) income. The values of these contracts fluctuate for a variety of reasons, such as the likelihood or occurrence of a specific credit event, the market perception of default risk and counterparty risk, and supply and demand changes. During the three and six months ended June 30, 2008, the fair value of these credit default swaps decreased $2 million and $20 million, respectively, as the result of higher market premiums required for these types of instruments.

Counterparty Credit Risk

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

As of June 30, 2008, Redwood and its affiliates had twenty International Swaps and Derivatives Association (ISDA) agreements with eleven different bank counterparties. For open derivative positions at June 30, 2008, we were in compliance with the requirements of our ISDA counterparties. For ISDA

Note 10. Derivative Financial Instruments – (continued)

agreements with no open derivative positions, we were in breach of nine agreements due to a decline in our total reported net worth and are currently in process of amending those agreements. This had no impact to our financial statements.

Note 11. Other Assets

Other assets as of June 30, 2008 and December 31, 2007, are summarized in the following table.

Other Assets

(In Thousands)	June 30, 2008	December 31, 2007
Real estate owned (REO)	$ 22,996	$ 15,118
Fixed assets and leasehold improvements	4,924	5,666
Principal receivable	1,910	2,819
Other	1,080	1,630
Total Other Assets	$ 30,910	$ 25,233

Real estate owned (REO) consists of foreclosed properties owned by Sequoia entities that were recovered in full satisfaction of real estate loans. The number of single-family properties owned by Sequoia entities was 87 at June 30, 2008, an increase from 78 owned at December 31, 2007. This 10% increase reflects the continued housing market downturn and inability of a growing number of borrowers to meet their repayment obligations. The states of Arizona, California, and Florida accounted for 31% of our REO balance at June 30, 2008. The Midwest region accounted for an additional 25% of this total.

The carrying value of REO as of June 30, 2008 was $23 million, of which $20 million related to transfers into REO in the first half of 2008, offset by $10 million of REO liquidations during the first half of 2008 and $2 million of negative valuation changes. The carrying value of REO as of December 31, 2007 was $15 million, of which $14 million related to transfers into REO in 2007 and $1 million from transfers in 2006.

Note 12. Short-term Debt — Redwood

We typically enter into master repurchase agreements (MRA), bank borrowings, and other forms of collateralized (and generally uncommitted) borrowings with various commercial banks and investment banks. We also issued commercial paper (CP) for financing residential real estate loans prior to 2008. We refer to these borrowings as short-term Redwood debt. We report short-term Redwood debt at its unpaid principal balance. Borrowings under short-term Redwood debt facilities generally bear interest rates of a specified margin over one-month LIBOR. They are uncommitted and mature within one year.

We are generally placing less reliance on short-term Redwood debt facilities and greater reliance on other types of recourse debt such as long-term Redwood debt (See *Note 14*). We closed our Madrona (CP) facility in December 2007 and have allowed other facilities to expire. We believe we could increase our borrowings on existing short-term facilities if necessary and we continue to explore alternative financing arrangements that we might pursue in the future.

As of June 30, 2008, we had 38 MRA's in place with 15 different counterparties. We also had two facilities open to finance the acquisition of real estate loans. These facilities had a combined borrowing limit of $1 billion and mature in October 2008. We also had one $10 million unsecured line of credit that matures each month. At June 30, 2008, our only use of short-term Redwood debt was to finance $9 million of

Note 12. Short-term Debt — Redwood – (continued)

securities under an existing MRA that matures every 35 days. At December 31, 2007, our only use of short-term Redwood debt was to finance $8 million of securities under an existing MRA that matured monthly.

The following table summarizes short-term Redwood debt outstanding by weighted average interest rates and by collateral type as of June 30, 2008 and December 31, 2007.

Short-term Debt — Redwood

June 30, 2008	December 31, 2007

(In Thousands)	Amount Borrowed	Weighted Average Interest Rate	Weighted Average Days Until Maturity	Amount Borrowed	Weighted Average Interest Rate	Weighted Average Days Until Maturity
Securities collateral	$ 9,326	2.82%	35	$ 7,561	5.25%	22
Total short-term Redwood debt	$ 9,326	2.82%	35	$ 7,561	5.25%	22

For the three and six months ended June 30, 2008, the average balance of short-term Redwood debt was $5 million and $13 million, respectively, with a weighted-average interest cost of 5.55% and 3.79%, respectively. For the three and six months ended June 30, 2007 the average balance of short-term Redwood debt was $1.5 billion and $1.9 billion, respectively, with a weighted-average interest cost of 5.99% and 5.82%, respectively. At June 30, 2008 and December 31, 2007, accrued interest payable on short-term Redwood debt was $16,000 and $12,000, respectively. All short-term Redwood debt as of June 30, 2008 and December 31, 2007, matured within 35 days of the financial reporting date.

The borrowing agreements under short-term Redwood debt facilities require compliance with various financial and organizational covenants on an ongoing basis. These covenants typically relate to our tangible net worth, liquidity reserves, and financial leverage. Although we generally comply with all of our covenants, the decline and volatility in our reported net worth has resulted in breaches and subsequent renegotiations of certain borrowing agreements. As of June 30, 2008, we were in compliance with the covenants under borrowing agreements for all drawn facilities. Of the undrawn facilities, we were in breach with one counterparty due to a decline in our tangible net worth and have requested a waiver from this counterparty. This had no impact on our financial statements.

Note 13. Asset-Backed Securities Issued

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

The maturity of each class of ABS issued is directly affected by the rate of principal prepayments on the assets of the issuing entity. Each series is also subject to redemption (call) according to the specific terms of the respective governing documents. As a result, the actual maturity of ABS issued will often occur earlier than its stated maturity.

TABLE OF CONTENTS

Note 13. Asset-Backed Securities Issued – (continued)

The carrying value components of the collateral for ABS issued and outstanding as of June 30, 2008 and December 31, 2007, are summarized in the following table.

Collateral for Asset-Backed Securities Issued

	June 30, 2008			December 31, 2007		
(In Thousands)	**Sequoia**	**Acacia**	**Total**	**Sequoia**	**Acacia**	**Total**
Real estate loans	$6,353,972	$ 18,800	$6,372,772	$7,173,940	$ 25,426	$7,199,366
Real estate securities	—	906,692	906,692	—	1,762,607	1,762,607
Other investments	—	78,583	78,583	—	79,125	79,125
Real estate owned (REO)	21,778	—	21,778	13,744	—	13,744
Restricted cash	313	71,616	71,929	337	112,793	113,130
Accrued interest receivable	26,662	8,486	35,148	37,907	9,928	47,835
Total Collateral for ABS Issued	$6,402,725	$1,084,177	$7,486,902	$7,225,928	$1,989,879	$9,215,807

The components of ABS issued by consolidated securitization entities as of June 30, 2008 and December 31, 2007, along with other selected information, are summarized in the following table.

Asset-Backed Securities Issued

	June 30, 2008			December 31, 2007		
(In Thousands)	**Sequoia**	**Acacia**	**Total**	**Sequoia**	**Acacia**	**Total**
ABS issued – certificates with principal value	$ 6,146,332	$ 3,231,253	$ 9,377,585	$ 6,904,937	$ 3,403,748	$10,308,685
ABS issued – interest-only certificates	26,367	—	26,367	35,220	—	35,220
Unamortized premium	1,872	—	1,872	6,009	—	6,009
Unamortized discount	—	—	—	—	(20,635)	(20,635)
Market value discount	—	(2,296,181)	(2,296,181)	—	—	—
Total ABS Issued	$ 6,174,571	$ 935,072	$ 7,109,643	$ 6,946,166	$ 3,383,113	$10,329,279
Range of weighted average interest rates, by series	2.64% to 5.89%	3.18% to 3.55%		4.42% to 6.14%	5.40% to 6.06%	
Stated maturities	2024 – 2047	2039 – 2052		2010 – 2047	2039 – 2052	
Number of series	38	10		39	10	

As of June 30, 2008, all of the total $7.1 billion reported value of ABS issued had contractual maturities of over five years.

On January 1, 2008, we elected to account for the ABS issued in Acacia at fair value under FAS 159. Prior to this election, Acacia ABS issued were carried at their unpaid principal balances, net of any unamortized discount or premium, and Acacia ABS deferred issuance costs were amortized as an adjustment to interest expense. Amortization of Sequoia deferred ABS issuance costs were $2 million and $4 million for the three and six months ended June 30, 2008. Amortization of Sequoia and Acacia deferred ABS issuance costs were $6 million and $13 million for the three and six months ended June 30, 2007.

Note 13. Asset-Backed Securities Issued – (continued)

The following table summarizes the accrued interest payable on ABS issued as of June 30, 2008 and December 31, 2007. Interest due on Sequoia ABS is settled monthly and interest due on Acacia ABS is settled quarterly.

Accrued Interest Payable on Asset-Backed Securities Issued

(In Thousands)	June 30, 2008	December 31, 2007
Sequoia	$ 15,139	$ 19,648
Acacia	15,751	32,237
Total Accrued Interest Payable on ABS Issued	$ 30,890	$ 51,885

Note 14. Long-term Debt — Redwood

In 2006, we issued $100 million of subordinated notes through Redwood Capital Trust I, a wholly-owned Delaware statutory trust, in a private placement transaction. These subordinated notes require quarterly distributions at a floating coupon rate equal to three-month LIBOR plus 2.25% until the notes are redeemed in whole, which will be no later than January 30, 2037. The earliest optional redemption date without penalty is January 30, 2012.

In 2007, we issued an additional $50 million of subordinated notes, which require quarterly distributions at a floating interest rate equal to three-month LIBOR plus 2.25% until the notes are redeemed in whole, which will be no later than July 30, 2037. The earliest optional redemption date without a penalty is July 30, 2012.

At June 30, 2008 and December 31, 2007, the accrued interest payable balance on long-term Redwood debt was $1 million and $2 million, respectively.

Note 15. Commitments and Contingencies

As of June 30, 2008, we were obligated under non-cancelable operating leases with expiration dates through 2018 for $15 million. The majority of the future lease obligations relates to a ten-year operating lease for our executive offices that expires in 2013 and a lease for additional space at our executive offices that expires in 2018. The total payments required under these leases are recognized as office rent expense on a straight-line basis over the lease terms. Operating lease expense was $0.5 million and $0.9 million for the three and six months ended June 30, 2008, respectively, and $0.3 million and $0.6 million for the three and six months ended June 30, 2007, respectively.

Leasehold improvements for our executive offices are amortized into expense over the ten-year lease term, expiring in 2013. The unamortized leasehold improvement balance at both June 30, 2008 and December 31, 2007 was $3 million.

The following table presents our future lease commitments as of June 30, 2008.

Future Lease Commitments by Year

(In Thousands)	June 30, 2008
2008 (six months)	$ 904
2009	1,688
2010	1,709
2011	1,831
2012	1,882
2013 and thereafter	6,692
Total	$ 14,706

Note 15. Commitments and Contingencies – (continued)

At June 30, 2008, to our knowledge there were no legal proceedings to which we were a party or to which any of our properties was subject.

Stock Repurchases

We announced a stock repurchase plan in November 2007 for the repurchase of up to a total of 5,000,000 common shares. This plan replaced all previous share repurchase plans and has no expiration date. There were no repurchases during the first half of 2008 and, as of June 30, 2008, there remained 5,000,000 shares available for repurchase under this plan.

Note 16. Minority Interest

Minority interest represents the aggregate limited partnership (LP) interests in the Fund held by third parties. As of June 30, 2008, the minority interest was $47 million, representing a 48% third party interest in the Fund. Income allocated to the minority interest is based on the third party LP's ownership percentage. The ownership percentage is determined by dividing the numbers of units held by third party LP's by the total units outstanding. Subsequent changes in our ownership percentage will be treated as capital transactions and result in a reallocation between shareholders' equity and minority interest in the consolidated balance sheets.

Note 17. Stockholders' Equity

The following table provides the basic and diluted (loss) earnings per share computations for the three and six months ended June 30, 2008 and 2007.

Basic and Diluted (Loss) Earnings per Share

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Denominators:				
Denominator for basic (loss) earnings per share is equal to the weighted average number of common shares outstanding during the period	32,871,442	27,405,284	32,691,444	27,132,001
Adjustments for diluted (loss) earnings per share are:				
Net effect of dilutive stock options	—	759,660	—	785,501
Denominator for diluted (loss) earnings per share	32,871,442	28,164,944	32,691,444	27,917,502
Basic (Loss) Earnings per Share:	$ (1.40)	$ 0.42	$ (6.65)	$ 1.10
Diluted (Loss) Earnings per Share:	$ (1.40)	$ 0.41	$ (6.65)	$ 1.06

Pursuant to EITF 03-6, we determined that there was no allocation of income for our outstanding stock options as they were antidilutive, as defined by this principle, for the three and six months ended June 30, 2008 and 2007. For the three months ended June 30, 2008 and 2007, the number of outstanding stock options that were antidilutive totaled 1,230,021 and 449,105, respectively. For the six months ended June 30, 2008 and 2007, the number of outstanding equity awards that were antidilutive totaled 1,351,533 and 252,109, respectively. There were no other participating securities, as defined by EITF 03-6, during the three and six months ended June 30, 2008 and 2007.

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive loss includes the difference between the fair value and amortized cost for real estate securities accounted for as AFS, in accordance with FAS 115, and any net gains or losses from interest rate agreements previously accounted for as cash flow hedges under FAS 133 that have been terminated or de-designated during prior reporting periods.

TABLE OF CONTENTS

Note 17. Stockholders' Equity – (continued)

The following table provides a summary of the components of accumulated other comprehensive loss as of June 30, 2008 and December 31, 2007.

(In Thousands)	June 30, 2008	December 31, 2007
Net unrealized losses on real estate securities	$ (34,023)	$ (541,153)
Net unrealized losses on interest rate agreements accounted for as cash flow hedges	(30,120)	(32,613)
Total Accumulated Other Comprehensive Loss	$ (64,143)	$ (573,766)

At June 30, 2008, the net unrealized loss on AFS securities was $34 million, as compared to a net unrealized loss of $541 million at December 31, 2007. Upon our adoption of FAS 159 (for all securities in Acacia and IGS at Redwood) on January 1, 2008, net unrealized losses of $459 million were reclassified from accumulated other comprehensive loss to retained earnings. During the second quarter of 2008, we recognized $29 million other-than-temporary impairments on securities and $4 million of fair value declines in AFS with unrealized losses that were not deemed to be other-than-temporary (See *Note 8*), which decreased accumulated other comprehensive loss during the quarter.

On January 1, 2008, the interest rate agreements in Acacia entities were de-designated as cash flow hedges upon our adoption of FAS 159. At June 30, 2008, these agreements had an unrealized loss of $30 million, which will be expensed through our consolidated statements of (loss) income over the remaining lives of designated Acacia ABS (See *Note 10*). During the three and six months ended June 30, 2008, we amortized $1 million and $2 million, respectively, into interest expense.

Note 18. Equity Compensation Plans

Stock-Based Compensation

At January 1, 2006, upon our adoption of FAS 123R, we had $19 million of unamortized costs related to unvested equity awards (stock options, restricted stock, and deferred stock units). Most of these awards have vested and the related costs have been expensed through the operating expenses line on the consolidated statements of (loss) income. Since then, additional awards have been granted and, at June 30, 2008, the unamortized costs totaled $13 million. This amount will be expensed over the next six years, of which over half will be expensed over the next twelve months.

Incentive Plan

In March 2008, we amended the previously amended 2002 Redwood Trust, Inc. Incentive Stock Plan (Incentive Plan) for executive officers, employees, and non-employee directors. This amendment was approved by our shareholders in May 2008. The Incentive Plan authorizes our Board of Directors (or a committee appointed by our Board of Directors) to grant incentive stock options (ISOs) as defined under Section 422 of the Code, non-qualifying stock options (NQSOs), deferred stock units, restricted stock, performance shares, stock appreciation rights, limited stock appreciation rights (awards), and dividend equivalent rights (DERs) to eligible recipients other than non-employee directors. ISOs and NQSOs awarded to employees and directors have a maximum term of ten years. Stock options, deferred stock units, and restricted stock granted to employees generally vest over a four-year period. Non-employee directors are automatically provided annual awards under the Incentive Plan that generally vest immediately. The Incentive Plan has been designed to permit the compensation committee of our Board of Directors to grant and certify awards that qualify as performance-based and otherwise satisfy the requirements of Section 162(m) of the Code. The amendment also increased the number of shares available for distribution through the Incentive Plan. As of June 30, 2008 and December 31, 2007, 1,670,328 and 493,646 shares of common stock, respectively, were available for grant.

TABLE OF CONTENTS

Note 18. Equity Compensation Plans – (continued)

A summary of stock option activity during the three and six months ended June 30, 2008 and 2007 is presented in the following table.

Stock Options Activity

	Three Months Ended June 30,				Six Months Ended June 30,			
	2008		2007		2008		2007	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Stock Options Outstanding								
Options outstanding at beginning of period	772,354	$ 37.48	1,032,462	$ 35.11	833,215	$ 37.60	1,072,622	$ 34.70
Options granted	—	—	219	53.50	—	—	15,934	55.73
Options exercised	(16,213)	34.34	(9,996)	34.09	(43,812)	32.34	(64,172)	32.52
Options forfeited	(7,818)	55.04	(14,836)	56.73	(41,080)	55.29	(16,535)	56.66
Options expired	—	—	—	—	—	—	—	—
Options Outstanding at Period-End	748,323	$ 37.67	1,007,849	$ 34.81	748,323	$ 37.67	1,007,849	$ 34.81
Options exercisable at period-end	732,671	$ 37.23	920,904	$ 32.83	732,671	$ 37.23	920,904	$ 32.83
Weighted average fair market value of options granted during the period		$ —		$ 4.93		$ —		$ 4.30

For the three and six months ended June 30, 2008, expenses related to stock options were $0.2 million and $0.4 million, respectively. For the three and six months ended June 30, 2007, expenses related to stock options were $0.5 million and $1.1 million, respectively. As of June 30, 2008, there was less than $1 million of unrecognized compensation cost related to unvested stock options. These costs will be expensed over a weighted-average period of less than one year.

The total intrinsic value or gain (fair market value less exercise price) for options exercised was $0.2 million and $0.5 million for the three and six months ended June 30, 2008, respectively. The total gain for options exercised was $0.2 million and $1.4 million for the three and six months ended June 30, 2007, respectively.

The net cash proceeds received from the exercise of stock options was $0.3 million and $0.9 million for the three and six months ended June 30, 2008, respectively. The net cash proceeds received from the exercise of stock options was $0.2 million and $1.2 million for the three and six months ended June 30, 2007, respectively.

In the first half of 2008, officers exercised 7,750 options and surrendered 6,050 shares to pay exercise costs and taxes totaling $0.2 million, within the guidelines of the Incentive Plan. The gains on these option exercises totaled $0.1 million. In the first half of 2007, officers exercised 23,487 options and surrendered 15,715 shares to pay exercise costs and taxes totaling $1 million, within the guidelines of the Incentive Plan.

The aggregate intrinsic value of the options outstanding and options currently exercisable was $3 million and $7 million at June 30, 2008 and December 31, 2007, respectively.

Restricted Stock

As of June 30, 2008 and December 31, 2007, 32,757 and 17,646 shares, respectively, of restricted stock were outstanding. Restrictions on these shares lapse through July 2012. There were 1,500 and 30,156 restricted stock awards granted during the three and six months ended June 30, 2008, respectively. There were

TABLE OF CONTENTS

Note 18. Equity Compensation Plans – (continued)

no restricted stock awards granted during the first six months of 2007. We generally grant restricted stock annually as part of total compensation at the end of the year. However, the 2007 annual grants were awarded in the first quarter of 2008. The cost of these grants is amortized over the vesting term using an accelerated method in accordance with FASB Interpretation No. 28 *Accounting for Stock Appreciation Rights and Other Variable Stock Options or Award Plans* (FIN 28) and FAS 123R.

For the three and six months ended June 30, 2008 the expenses related to restricted stock were $0.1 million and $0.3 million, respectively. For the three and six months ended June 30, 2007 the expenses related to restricted stock were $0.1 million and $0.2 million, respectively. As of June 30, 2008, there was less than $1 million of unrecognized compensation cost related to unvested restricted stock. This cost will be recognized over a weighted average period of one year.

Deferred Stock Units

Deferred stock units (DSUs) are granted or purchased by participants in the Executive Deferred Compensation Plan. Some of the DSUs awarded may have a vesting period associated with them and restrictions on these DSUs lapse through 2013.

For the three and six months ended June 30, 2008, expenses related to DSUs were $3 million and $6 million, respectively. For the three and six months ended June 30, 2007, expenses related to DSUs were $3 million and $7 million, respectively. As of June 30, 2008, there was $12 million of unrecognized compensation cost related to nonvested DSUs. This cost will be recognized over a weighted-average period of one year. As of June 30, 2008 and December 31, 2007, the number of outstanding DSUs that had vested was 413,817 and 301,406, respectively.

TABLE OF CONTENTS

Note 18. Equity Compensation Plans – (continued)

The following table provides a summary of DSU activity for the three and six months ended June 30, 2008 and 2007.

Deferred Stock Units Activity

	Three Months Ended June 30,					
	2008			2007		
(In Thousands, Except Unit Amounts)	**Units**	**Fair Market Value**	**Weighted Average Grant Date Fair Market Value**	**Units**	**Fair Market Value**	**Weighted Average Grant Date Fair Market Value**
Balance at beginning of period	977,144	$ 35,519	$ 36.35	703,270	$ 36,697	$ 49.60
Grants of DSUs	80,536	2,653	32.94	11,202	562	50.19
Distribution of DSUs	(7,198)	(412)	57.17	(3,531)	(107)	30.27
Change in valuation during period	—	(13,643)	—	—	(2,757)	—
Participant forfeitures	(7,941)	(361)	45.43	—	—	—
Net change in number/value of DSUs	65,397	(11,763)	—	7,671	(2,302)	—
Balance at End of Period	1,042,541	$ 23,756	$ 22.79	710,941	$ 34,395	$ 49.24

	Six Months Ended June 30,					
	2008			2007		
(In Thousands, Except Unit Amounts)	**Units**	**Fair Market Value**	**Weighted Average Grant Date Fair Market Value**	**Units**	**Fair Market Value**	**Weighted Average Grant Date Fair Market Value**
Balance at beginning of period	709,848	$ 24,305	$ 48.69	737,740	$ 42,848	$ 48.91
Grants of DSUs	348,863	11,231	32.19	24,633	1,343	54.54

Distribution of DSUs	(7,198)	(412)	57.17	(47,282)	(2,207)	46.67
Change in valuation during period	—	(10,953)	—	—	(7,377)	—
Participant forfeitures	(8,972)	(415)	46.23	(4,150)	(212)	51.20
Net change in number/value of DSUs	332,693	(549)	—	(26,799)	(8,453)	—
Balance at End of Period	1,042,541	$ 23,756	$ 22.79	710,941	$ 34,395	$ 49.24

We generally grant DSUs annually as part of compensation in the fourth quarter. However, the 2007 annual grants were awarded in the first quarter of 2008.

Executive Deferred Compensation Plan

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

TABLE OF CONTENTS

Note 18. Equity Compensation Plans – (continued)

crediting account is set forth in the EDCP. The accrual rate is based on 120% of the long-term applicable federal rate (AFR). Participants may also use their deferrals to acquire additional DSUs. Information on DSUs is provided above.

For the three months and six months ended June 30, 2008, deferrals made to EDCP totaled of $0.1 million and $2.4 million, respectively. For both the three and six months ended June 30, 2008, distributions from the EDCP were $4.4 million. For the three and six months ended June 30, 2007, distributions from the EDCP were $2.6 million and $3.4 million, respectively. The balance in the EDCP account was $7 million and $9 million at June 30, 2008 and December 31, 2007, respectively. For the three and six months ended June 30, 2007, deferrals of $0.3 million and $1.3 million, respectively, were made under the EDCP.

Employee Stock Purchase Plan

In May 2002, our stockholders approved the 2002 Redwood Trust, Inc. Employee Stock Purchase Plan (ESPP), effective July 1, 2002. The purpose of the ESPP is to give our employees an opportunity to acquire an equity interest in Redwood through the purchase of shares of common stock at a discount. The ESPP allows eligible employees to purchase common stock at 85% of its fair value, subject to limits. Fair value as defined under the ESPP is the lesser of the closing market price of the common stock on the first day of the calendar year or the first day of the calendar quarter of that year.

The ESPP allows a maximum of 100,000 shares of common stock to be purchased in aggregate for all employees. As of June 30, 2008 and December 31, 2007, 58,272 and 48,302 shares have been purchased, respectively, and there remained a negligible amount of uninvested employee contributions in the ESPP.

Note 19. Operating Expenses

Components of our operating expenses for the three and six months ended June 30, 2008 and 2007 are presented in the following table.

Operating Expenses

	Three Months Ended June 30,		Six Months Ended June 30,	
(In Thousands)	**2008**	**2007**	**2008**	**2007**
Fixed compensation expense	$ 4,648	$ 4,286	$ 10,322	$ 8,902
Variable compensation expense	330	198	2,187	2,449
Equity compensation expense	3,502	3,540	6,808	6,888
Severance expense	—	—	—	2,380
Total compensation expense	8,480	8,024	19,317	20,619
Systems	2,492	2,163	4,625	3,819
Due diligence	8	78	18	785
Office costs	1,629	1,265	3,151	2,445
Accounting and legal	1,495	284	2,596	1,139
Other operating expenses	151	958	897	1,747
Total Operating Expenses	$ 14,255	$ 12,772	$ 30,604	$ 30,554

Note 20. Taxes

We have elected to be taxed as a REIT under the Internal Revenue Code and the corresponding provisions of state law. In order to qualify as a REIT, we must distribute at least 90% of our annual REIT

REDWOOD TRUST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)

Note 20. Taxes – (continued)

taxable income (not including taxable income retained in our taxable subsidiaries) to shareholders within the time frame set forth in the tax code and we must meet certain other requirements.

Through the second quarter of 2008, we had elected to retain up to 10% of our REIT ordinary taxable income and had provisioned for corporate income taxes on the retained income while maintaining our REIT status. We recognized a total tax provision of $1 million and $3 million for the three months ended June 30, 2008 and 2007, respectively, and a total tax provision of $3 million and $5 million for the six months ended June 30, 2008 and 2007, respectively. During the third quarter of 2008, our Board of Directors decided to distribute 100% of our REIT taxable income from 2007 and 2008 to shareholders. This development is discussed in *Note 21*.

The tax provisions we record are determined by applying our expected annual effective tax rate to our GAAP pre-tax income (loss). The effective tax rate is determined as the ratio of our estimated current year tax liability to our estimated GAAP pre-tax income (loss). This annual estimate is based on our annualized actual GAAP results to date. The estimate of the annual effective tax rate used by annualizing year-to-date results may not be reflective of actual GAAP earnings. However, we believe that applying the effective tax rate to GAAP income is an appropriate estimate due to the inherent volatility of our GAAP earnings, in part due to significant market valuation adjustments on our investments that are recorded to our GAAP consolidated statements of (loss) income.

Differences between taxable income and GAAP income reflect differing accounting treatments for tax and GAAP, such as accounting for discount and premium amortization, credit losses, equity awards, and asset impairments. Differences between taxable income and GAAP (loss) may also reflect differing valuation estimates for certain assets, liabilities, and derivatives. Some of these differences create timing differences between when taxable income is earned and the tax is paid, and when the GAAP (loss) income is recognized and the tax provision is recorded. Some of these differences are permanent, since certain income (or expense) may be recorded for tax but not for GAAP (or vice-versa). One such significant permanent difference is our ability as a REIT to deduct dividends paid to shareholders for tax but not for GAAP.

The following is a reconciliation of the statutory federal and state rates to the effective rates as estimated for the six months ended June 30, 2008 and 2007.

Reconciliation of Statutory Tax Rate to Effective Tax Rate

	Six Months Ended, June 30,	
	2008	**2007**
Federal statutory rate	35.0 %	35.0 %
State statutory rate, net of Federal tax effect	7.0 %	7.0 %
Differences in taxable income from GAAP income	(54.8) %	35.8 %
Dividend paid deduction	11.6 %	(63.8) %
Effective Tax Rate	(1.2) %	14.0 %

Our taxable income before dividend distributions has historically been higher than our GAAP net (loss) income, primarily due to differences in the accounting for credit losses as well as significant market valuation adjustments taken on our investments for GAAP but not for tax. These differences resulted in net losses for GAAP during recent periods while taxable income had remained positive.

Our deferred tax assets before valuation allowance at our taxable subsidiaries increased from $9 million at December 31, 2007 to $17 million at June 30, 2008, primarily due to differences in the basis of our real estate assets. This increase in deferred tax assets was offset by a valuation allowance of $9 million, as we do not expect to realize a future tax benefit from this asset. Thus, there was little change in our deferred tax asset after valuation allowance during the first six months of 2008.

REDWOOD TRUST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)

Note 20. Taxes – (continued)

Our policy for interest and penalties on material uncertain tax positions recognized in our consolidated financial statements is to classify these as interest expense and operating expense, respectively. However, in accordance with Financial Accounting Standard Board Interpretation Number 48, *Accounting for Uncertainty in Income Taxes*, (FIN 48) we assessed our tax positions for all open tax years (Federal, years 2004 to 2007 and State, years 2003 to 2007) as of June 30, 2008 and December 31, 2007, and concluded that we have no material unrecognized FIN 48 liabilities.

Note 21. Recent Developments

In August 2008, our Board of Directors decided to distribute as dividends 100% of our REIT taxable income generated in 2007 and 2008. Previously, we had planned to distribute 90% of REIT taxable income (the minimum REIT requirement) and retain 10%. During 2007 and the first six months of 2008, we established GAAP income tax provisions of $9 million related to the planned 10% retention. As a result of the decision to distribute 100% of REIT taxable income, we expect to record a $9 million credit to our GAAP income tax provision in the third quarter of 2008.

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

You should read this Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) in conjunction with our unaudited consolidated financial statements and related notes, and the more detailed information contained in our Annual Report on Form 10-K for the year ended December 31, 2007. The results of operations presented in our interim financial statements and discussed in MD&A are not necessarily indicative of the results that may be expected for the full year.

Cautionary Statement

This Form 10-Q and the documents incorporated by reference herein contain forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve numerous risks and uncertainties. Our actual results may differ from our expectations, estimates, and projections and, consequently, you should not rely on these forward-looking statements as predictions of future events. Forward-looking statements are not historical in nature and can be identified by words such as "anticipate," "estimate," "will," "should," "expect," "believe," "intend," "seek," "plan" and similar expressions or their negative forms, or by references to strategy, plans, or intentions. These forward-looking statements are subject to risks and uncertainties, including, among other things, those described in our Annual Report on Form 10-K for the year ended December 31, 2007 under the caption "Risk Factors." Other risks, uncertainties, and factors that could cause actual results to differ materially from those projected are described below and may be described from time to time in reports we file with the Securities and Exchange Commission, including reports on Forms 10-K, 10-Q, and 8-K. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

Important factors, among others, that may affect our actual results include: changes in interest rates; changes in prepayment rates; general economic conditions, particularly as they affect the price of earning assets and the credit status of borrowers; legislative and regulatory actions affecting the mortgage industry; the availability of high quality assets for purchase at attractive prices; declines in home prices; increases in mortgage payment delinquencies; changes in the level of liquidity in the capital markets which may adversely affect our ability to finance our real estate asset portfolio; changes in liquidity in the market for real estate securities, the re-pricing of credit risk in the capital markets, rating agency downgrades of securities and increases in the supply of real estate securities available-for-sale, each of which may adversely affect the values of securities we own; the extent of changes in the values of securities we own and the impact of adjustments reflecting those changes on our income statement and balance sheet, including our stockholders' equity; our ability to maintain the positive stockholders' equity necessary to enable us to pay the dividends required to maintain our status as a real estate investment trust for tax purposes; and other factors not presently identified. This Quarterly Report on Form 10-Q may contain statistics and other data that in some cases have been obtained from or compiled from information made available by servicers and other third-party service providers.

Summary

Redwood Trust, Inc., together with its subsidiaries (Redwood, we, or us), is a financial institution focused on investing in, financing, and managing residential and commercial real estate loans and securities. We seek to invest in assets that have the potential to provide high cash flow returns over a long period of time to help support our goal of distributing attractive levels of dividends to our shareholders. For tax purposes, we are structured as a real estate investment trust (REIT). We are able to pass through substantially all of our earnings generated at our REIT to our shareholders without paying income tax at the corporate level. We pay income tax on the REIT taxable income we retain and on the income we earn at our taxable subsidiaries.

Our primary source of income is net interest income, which equals the interest income we earn from our investments in loans and securities less the interest expenses we incur from our borrowed funds and other liabilities. We assume a range of risks in our investments and the level of assumed risk dictates the manner in which we finance our purchase of and derive income from these investments. Our primary real estate investments include investments in real estate loans and securities, investments in the securitization entities that we sponsor, and investments in a private equity fund that we sponsor. We leverage our investment

platform through the asset management activities of our asset management subsidiary that generate fee income from the management of certain assets.

Our direct investments in residential, commercial, and collateralized debt obligation (CDO) securities are financed almost entirely with capital without the use of financial leverage. To date, our investment focus has been in credit enhancement securities (CES, or below investment-grade securities) backed by high-quality residential and commercial real estate loans. "High-quality" real estate loans are loans that typically have low loan-to-value ratios, borrowers with strong credit histories, and other indications of quality relative to the range of loans within U.S. real estate markets as a whole. These investments tend to have concentrated structural credit risk that is generally reflected in their credit ratings. Additionally, we acquire certain investment-grade securities (IGS) that generally have less concentrated credit risk than CES but still provide an attractive rate of return. Our recent investments have been more focused on IGS as the availability of attractive CES has been limited.

We also make investments in the securitization entities we sponsor — Sequoia and Acacia. The Sequoia entities hold residential real estate loans. The Acacia entities hold real estate securities (generally IGS) and some loans, CES, and other mortgage related investments. Our capital at risk in Sequoia and Acacia is limited to our investments in these entities, as each entity is independent of Redwood and of each other and the assets and liabilities are not owned by and are not obligations of Redwood. However, we are required under generally accepted accounting principles in the United States (GAAP) to consolidate the assets and liabilities of the Sequoia and Acacia entities for financial statement reporting purposes. The income we earn on our investment in the equity of these securitization entities is based upon the spread between the yield on the assets owned by each entity and the cost of funds borrowed by each entity to fund its assets. The cost of funds is the interest paid on the asset-backed securities (ABS) issued by each of these entities. Periodic interest costs on ABS issued are generally variable and are affected by the structural cash flow distribution requirements of each independent entity.

During the first quarter of 2008, we established the Opportunity Fund. The Fund primarily invests in non-prime residential IGS and CDO IGS securities. The offer and sale of interests in the Fund were not registered under the federal securities laws. We are required under GAAP to consolidate the assets, liabilities, and minority interest of the Fund for financial statement reporting purposes.

Results of Operations

Our reported GAAP loss for the second quarter of 2008 was $46 million ($1.40 per share) compared to GAAP net income of $11 million ($0.41 per share) for the second quarter of 2007. For the six months ended June 30, 2008, our GAAP loss was $217 million ($6.65 per share) compared to GAAP net income of $30 million ($1.06 per share) in the six months ended June 30, 2007. For the second quarter of 2008, we declared a regular dividend of $0.75 per share, the same dividend per share paid in the second quarter of 2007. The total dividends declared for both the first half of 2008 and 2007 were $1.50 per share.

The following table presents the components of our GAAP net (loss) income for the three and six months ended June 30, 2008 and 2007.

Table 1 Net Income

(In Thousands, Except Share Data)	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Interest income	$ 126,941	$ 219,658	$ 294,947	$ 434,764
Management fees	1,319	1,481	2,932	2,649
Interest expense	(98,826)	(167,238)	(227,738)	(336,502)
Net interest income before valuation adjustments	29,434	53,901	70,141	100,911
Market valuation adjustments, net	(60,619)	(29,430)	(254,551)	(39,694)
Net interest (loss) income	(31,185)	24,471	(184,410)	61,217
Operating expenses	(14,255)	(12,772)	(30,604)	(30,554)
Realized gains on sales and calls, net	2,837	2,738	2,879	3,884
Minority interest allocation	(2,369)	—	(2,624)	—
Provision for income taxes	(937)	(3,021)	(2,737)	(4,822)
Net (Loss) Income	$ (45,909)	$ 11,416	$ (217,496)	$ 29,725
Diluted weighted average common shares outstanding	32,871,442	28,164,944	32,691,444	27,917,502
Net (loss) income per share	$ (1.40)	$ 0.41	$ (6.65)	$ 1.06

The largest factor in the decline in net income in the second quarter of 2008 as compared to the second quarter of 2007 was a $31 million increase in negative market valuation adjustments (MVA). This increase is discussed in detail in the Market Valuation Adjustments section of this MD&A.

Another factor negatively affecting our net income was a $25 million decline in net interest income before MVA. This decline was due to an $11 million decrease in interest income from CES held at Redwood (excluding investments in Sequoia and Acacia) due to higher credit losses, slower prepayments, and lower interest rates. Comparable net interest income from loans held at Sequoia was lower by $11 million of which $8 million was due to higher credit loss provisions and $3 million was due to higher loan premium amortization. Another factor negatively impacting net interest income was a $5 million comparable decrease from Acacia entities due to the absence of any discount accretion as a result of our adoption of FAS 159. Finally, we generated $2 million in the second quarter of 2008 on our recent investment in the Fund.

Operating expenses rose during the quarter by $2 million, but were at the same level during the first half of 2008 as in 2007.

In August 2008, our Board of Directors decided to distribute as dividends 100% of our REIT taxable income generated in 2007 and 2008. Previously, we had planned to distribute 90% of REIT taxable income (the minimum REIT requirement) and retain 10%. During 2007 and the first six months of 2008, we established GAAP income tax provisions of $9 million related to the planned 10% retention. As a result of the decision to distribute 100% of REIT taxable income, we expect to record a $9 million credit to our GAAP income tax provision in the third quarter of 2008.

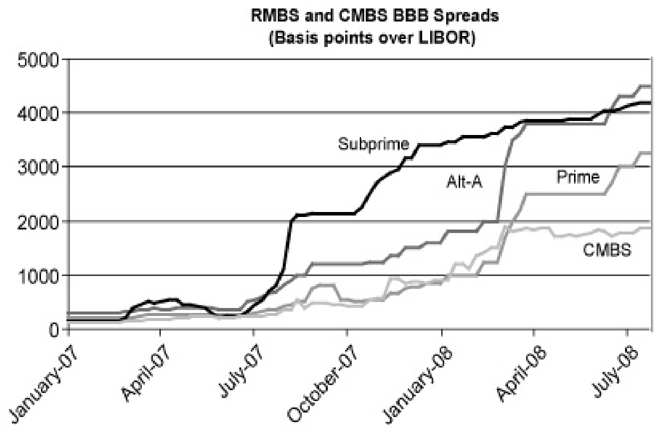
At June 30, 2008, there was $44 million ($1.32 per share) of estimated 2007 and 2008 undistributed estimated REIT taxable income available to distribute to our shareholders during 2008.

Market Conditions

During the second quarter, the challenges facing the mortgage industry grew larger and more complex. The same issues – rising credit costs, falling home prices, contracting credit availability, deteriorating balance sheet strength, and escalating rating agency downgrades – are still front and center. Fear and uncertainty continue to inhibit the normal functioning of the mortgage capital markets. As a consequence, residential non-agency and commercial securitizations backed by newly originated loans remain at the lowest levels in several years. Additionally, trading activity of existing securities remains light. Pricing for residential and commercial mortgage-backed securities and CDO securities remained under downward pressure during the

second quarter, although the rate of decline was significantly lower than the rate of decline in the prior three quarters. Prices continue to trend lower early into the third quarter.

The table below illustrates the additional interest rate spread that investors have required to compensate for the perceived credit risk of various types of residential mortgage backed securities (RMBS) and commercial mortgage-backed securities (CMBS).



Source: Credit Suisse, JPMorgan Chase, Redwood Trust

For some assets, declines in fair values reflect the near-certainty of serious credit losses being realized. For others, significant future losses may not occur, but there is a perceived increase in the risk of loss, resulting in a lower value. Finally, many assets are not at serious risk of loss but their declining value largely reflects a limited number of observed sales in the market.

Quarterly Activity

During the quarter, we invested $152 million of our excess capital in what we believe are safe and attractive assets, we generated $52 million of cash flow in excess of our operating and interest costs, and we continued to expand our asset management business. Furthermore, we maintained our strong balance sheet and liquidity position. At June 30, 2008, we had $148 million of available cash, of which $132 million was capital in excess of our operating requirements. We remain challenged, however, by rising credit costs, particularly for the 2006 and 2007 vintages. Additionally, we have materially reduced our future cash flow expectations from our Acacia equity investments due to a high level of rating agency downgrades of Acacia assets in June and July of 2008 that were more severe and more rapid than our expectations. During the second quarter, the cash flow received from our Acacia equity investments was $5 million, but we now expect this cash flow to diminish rapidly over the next few quarters.

We continue to actively, yet patiently, pursue residential credit investments. Credit investment opportunities that we find attractive, however, remain scarce. Additionally, our progress in completing other forms of credit risk transfers with large financial institutions has been impeded by the slow, deliberate pace of their balance sheet restructuring and capital reallocation process. As a result, we only invested $3 million in residential credit enhancement securities (CES) during the second quarter.

Our investing activity at Redwood during the quarter was limited almost entirely to the purchase of residential investment grade securities (IGS), securities that provide a greater certainty of the range of expected cash flows. We invested $147 million in residential IGS, $64 million of which was rated AAA and AA and backed by prime mortgage collateral, and $62 million of which was AAA-rated and backed by non-prime mortgage collateral. We also acquired $21 million of A and BBB-rated securities backed by prime mortgage collateral from 2003 and 2004. The majority (72%) of our acquisitions of IGS consisted of securities backed by 2005 and earlier mortgage collateral. The weighted average purchase price for our

acquisitions was 75% of face value. Our yield modeling expectations for these securities at the time of purchase ranged from 12% to 16%. Although we can provide no assurance as to the future credit performance of these securities, we currently do not expect to incur any material principal credit losses on these newly acquired IGS. We acquired these securities with safety in mind. In this regard, our recent non-prime IGS investments had on average over 30 points of external credit enhancement.

We did not make any new commercial or collateralized debt obligation (CDO) investments at Redwood during the quarter. We did acquire $2 million of previously issued Sequoia ABS.

The commercial real estate market is facing economic headwinds with a slowing economy, resulting in rising vacancies across property types. In general, we expect conditions to worsen. We have not purchased and do not own commercial assets with underlying loans originated in 2007 or 2008. So far, our seasoned portfolio continues to perform generally within our expectations. We believe there will be many attractive opportunities to expand our commercial business in the future.

The Fund closed at the end of the first quarter with $96 million of commitments ($46 million from third-party investors and $50 million from Redwood). The offer and sale of interests in this private fund were not registered under the federal securities laws. The Fund was formed to capitalize on dislocations in the non-prime residential mortgage-backed securities (RMBS) and CDO markets. As of June 30, 2008, the Fund had invested $82 million, mainly in seasoned residential non-prime IGS and CDOs. It is managed by Redwood Asset Management, one of our taxable subsidiaries. The expansion of our asset management business is an important part of our long-term business strategy.

Capital and Liquidity

Our excess capital position was $132 million at June 30, 2008, a decrease from $247 million at March 31, 2008. During the second quarter, our sources of capital were $52 million generated from portfolio cash flows in excess of operating costs and financing costs, $14 million raised from stock issuances under our direct stock purchase and dividend reinvestment plan, $1 million in asset management fees and $8 million from net changes in working capital. Our uses of capital were $152 million for new investments, $10 million for an additional capital investment in the Fund, and $25 million for dividend payments.

The vast majority of the investments made during the second quarter were financed with capital. We expect to continue financing most new investments with capital, either on our own or with third-party capital sourced through funds or other asset management vehicles.

Our quarter-end cash position remained strong at $148 million. Short-term Redwood debt was $9 million at June 30, 2008. We have no liquidity issues or need to sell assets.

We further discuss our excess capital and net liquidity in the Redwood Capital and Liquidity section later in this report.

Outlook

We expect that GAAP earnings will remain volatile in the near term due to mark-to-market (MTM) adjustments. We will likely encounter MTM volatility from our consolidation of the Acacia entities due to the technical valuation methodologies required under Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115* (FAS 159). This topic is more fully discussed in the Market Valuation Adjustments section of this MD&A. In addition, we may recognize additional GAAP impairment losses on residential, commercial, and CDO securities held at Redwood. Negative MTM balance sheet write-downs that have not yet been realized through our income statement totaled $52 million at June 30, 2008. Future income statement impairment charges related to these unrealized losses will not affect GAAP book value since these MTM losses were already deducted from stockholders' equity at June 30, 2008.

Our current rate of capital deployment has slowed significantly from the second quarter levels as we have not acquired any new assets thus far in the third quarter (through August 5, 2008). Our capital deployment plan is fluid at this time and may include acquiring or selling assets as well as issuing or repurchasing shares of our common stock. Our actions will depend on:

- The level and attractiveness of new investment opportunities;

- Our ability to raise capital at a price that is accretive to earnings;
- The relative attractiveness of investing in our assets through the repurchase of our shares; and,
- The amount of cash we believe we should hold in reserve to take advantage of potential extraordinary investment opportunities that may appear in the future.

As these considerations are in some respects competing, and as market conditions remain unclear and volatile, it is difficult to predict what actions we are likely to take. We are keeping our options open.

In the three and six months ended June 30, 2008, we earned an estimated $4 million and $26 million, of REIT taxable income, or $0.13 per share and $0.89 per share, respectively. In the three and six months ended June 30, 2007, we earned an estimated $46 million and $86 million of REIT taxable income, or $1.63 per share and $2.92 per share, respectively. REIT taxable income is that portion of our total taxable income that we earn at Redwood and its qualifying REIT subsidiaries and does not include taxable income earned in taxable subsidiaries. Our REIT taxable income determines the minimum amount of dividends we must distribute to shareholders in order to maintain our tax status as a REIT. We are and expect to remain in compliance with all REIT tests.

For the three and six months ended June 30, 2008, the decrease in REIT taxable income as compared to the same periods in 2007 was primarily due to an increase in realized credit losses. For tax purposes, we are not permitted to establish credit reserves on securities and do not record impairments or other changes in the fair value of financial assets or liabilities. Realized credit losses were $30 million and $44 million, or $0.92 and $1.33 per share, for the three and six months ended June 30, 2008, respectively. Realized credit losses were $2 million and $5 million, or $0.08 and $0.16 per share, for the three and six months ended June 30, 2007, respectively.

We expect that REIT taxable income for the remainder of 2008 and 2009 will continue to be pressured by tax deductions triggered by the realization of credit losses. Actual REIT taxable income will depend on the timing of the credit losses and the level of taxable income generated by our new and existing investments. Currently, our estimate is that the REIT taxable income generated in 2008, together with the undistributed taxable income carried over from 2007, may fall short of full-year distributions at our regular dividend rate. We caution that the timing of credit losses can be difficult to project in the current environment and that our estimates of taxable income could change.

In August 2008, our Board of Directors reaffirmed its intention to maintain the regular quarterly dividend rate of $0.75 per share for both the third and fourth quarters of 2008. We do not expect to pay a special dividend in 2008. Further, we expect that the amount of undistributed taxable income carried over into 2009, if any, will be minimal. The Board plans to review dividend policy for 2009 at its regularly scheduled November Board meeting.

Results of Operations – Consolidating

When analyzing our GAAP consolidated income statements, it can be difficult to ascertain how our investments in consolidated entities impact our overall financial results. As a supplement to our GAAP discussion, we present consolidating results for Redwood, the Opportunity Fund, Sequoia, and Acacia. This presentation highlights the impact of these consolidated entities on our overall results of operations. A detailed discussion of net interest income for the three and six months ended June 30, 2008, including a comparison to prior year periods, is provided for each of these consolidating entities in this section.

Table 2 Consolidating Income Statements

(In Thousands)	Redwood Parent Only	Opportunity Fund	Sequoia	Acacia	Intercompany Adjustments	Redwood Consolidated
	Three Months Ended June 30, 2008					
Interest Income						
Real estate loans	$ 76	$ —	$ 62,253	$ 373	$ —	$ 62,702
Real estate securities	23,163	2,348	—	37,924	(1,906)	61,529
Other investments	—	—	—	514	—	514
Cash and cash equivalents	1,428	72	18	678	—	2,196
Total interest income	24,667	2,420	62,271	39,489	(1,906)	126,941
Management fees	1,319	—	—	—	—	1,319
Interest Expense						
Short-term debt – Redwood	(68)	—	—	—	—	(68)
Asset-backed securities issued	—	—	(67,036)	(31,395)	1,906	(96,525)
Long-term debt – Redwood	(2,233)	—	—	—	—	(2,233)
Total interest expense	(2,301)	—	(67,036)	(31,395)	1,906	(98,826)
Net interest income before market valuation adjustments	23,685	2,420	(4,765)	8,094	—	29,434
Market valuation adjustments, net	(31,349)	—	(974)	(28,296)	—	(60,619)
Net Interest (Loss) Income	(7,664)	2,420	(5,739)	(20,202)	—	(31,185)
Operating expenses	(14,232)	—	(23)	—	—	(14,255)
Realized gains on sales and calls, net	883	1,831	—	123	—	2,837
Income from Opportunity Fund	1,882	—	—	—	(1,882)	—
Loss from Sequoia	(5,762)	—	—	—	5,762	—
Loss from Acacia	(20,079)	—	—	—	20,079	—
Minority interest allocation	—	(2,369)	—	—	—	(2,369)
Net (loss) income before provision for taxes	(44,972)	1,882	(5,762)	(20,079)	23,959	(44,972)
Provision for income taxes	(937)	—	—	—	—	(937)
Net (Loss) Income	$ (45,909)	$ 1,882	$ (5,762)	$ (20,079)	$ 23,959	$ (45,909)

(In Thousands)	Redwood	Opportunity Fund	Sequoia	Acacia	Intercompany Adjustments	Redwood Consolidated
	Three Months Ended June 30, 2007					
Interest Income						
Real estate loans	$ 21	$ —	$ 119,154	$ 401	$ —	$ 119,576
Real estate securities	35,608	—	—	62,227	(1,973)	95,862
Other investments	—	—	—	464	—	464
Cash and cash equivalents	1,801	—	—	1,955	—	3,756
Total interest income	37,430	—	119,154	65,047	(1,973)	219,658
Management fees	1,481	—	—	—	—	1,481
Interest Expense						
Short-term debt – Redwood	(1,527)	—	(13,271)	(7,902)	—	(22,700)
Asset-backed securities issued	—	—	(99,943)	(44,052)	1,973	(142,022)
Long-term debt – Redwood	(2,516)	—	—	—	—	(2,516)
Total interest expense	(4,043)	—	(113,214)	(51,954)	1,973	(167,238)
Net interest income before market valuation adjustments	34,868	—	5,940	13,093	—	53,901
Market valuation adjustments, net	(20,017)	—	—	(9,413)	—	(29,430)
Net interest income	14,851	—	5,940	3,680	—	24,471
Operating expenses	(12,772)	—	—	—	—	(12,772)
Realized gains on sales and calls, net	3,408	—	—	(670)	—	2,738
Income from Sequoia	5,940	—	—	—	(5,940)	—
Income from Acacia	3,010	—	—	—	(3,010)	—
Net income before provision for taxes	14,437	—	5,940	3,010	(8,950)	14,437
Provision for income taxes	(3,021)	—	—	—	—	(3,021)
Net (Loss) Income	$ 11,416	$ —	5,940	$ 3,010	$ (8,950)	$ 11,416

TABLE OF CONTENTS

Table 2 Consolidating Income Statements – **(continued)**

(In Thousands)	Redwood Parent Only	Opportunity Fund	Sequoia	Acacia	Intercompany Adjustments	Redwood Consolidated
	Six Months Ended June 30, 2008					
Interest Income						
Real estate loans	$ 175	$ —	$ 149,348	$ 744	$ —	$ 150,267
Real estate securities	54,618	4,106	—	83,386	(4,053)	138,057
Other investments	—	—	—	1,246	—	1,246
Cash and cash equivalents	3,663	87	47	1,580	—	5,377
Total interest income	58,456	4,193	149,395	86,956	(4,053)	294,947
Management fees	2,932	—	—	—	—	2,932
Interest Expense						
Short-term debt – Redwood	(250)	—	—	—	—	(250)
Asset-backed securities issued	—	—	(149,770)	(77,005)	4,053	(222,722)
Long-term debt – Redwood	(4,766)	—	—	—	—	(4,766)
Total interest expense	(5,016)	—	(149,770)	(77,005)	4,053	(227,738)

	Redwood	Opportunity Fund	Sequoia	Acacia	Intercompany Adjustments	Redwood Consolidated
Net interest income before market valuation adjustments	56,372	4,193	(375)	9,951	—	70,141
Market valuation adjustments, net	(198,010)	—	(1,392)	(55,149)	—	(254,551)
Net Interest (Loss) Income	(141,638)	4,193	(1,767)	(45,198)	—	(184,410)
Operating expenses	(30,539)	—	(65)	—	—	(30,604)
Realized gains on sales and calls, net	922	1,831	—	126	—	2,879
Income from Opportunity Fund	3,400	—	—	—	(3,400)	—
Loss from Sequoia	(1,832)	—	—	—	1,832	—
Loss from Acacia	(45,072)	—	—	—	45,072	—
Minority interest allocation	—	(2,624)	—	—	—	(2,624)
Net (loss) income before provision for taxes	(214,759)	3,400	(1,832)	(45,072)	43,504	(214,759)
Provision for income taxes	(2,737)	—	—	—	—	(2,737)
Net (Loss) Income	$(217,496)	$ 3,400	$ (1,832)	$ (45,072)	$ 43,504	$(217,496)

	Six Months Ended June 30, 2007					
(In Thousands)	**Redwood**	**Opportunity Fund**	**Sequoia**	**Acacia**	**Intercompany Adjustments**	**Redwood Consolidated**
Interest Income						
Real estate loans	$ (2,794)	$ —	$ 248,436	$ 785	$ —	$ 246,427
Real estate securities	66,000	—	—	120,440	(4,655)	181,785
Other investments	—	—	—	464	—	464
Cash and cash equivalents	3,113	—	—	2,975	—	6,088
Total interest income	66,319	—	248,436	124,664	(4,655)	434,764
Management fees	2,649	—	—	—	—	2,649
Interest Expense						
Short-term debt – Redwood	(1,609)	—	(35,344)	(16,841)	—	(53,794)
Asset-backed securities issued	—	—	(198,635)	(84,156)	4,655	(278,136)
Long-term debt – Redwood	(4,572)	—	—	—	—	(4,572)
Total interest expense	(6,181)	—	(233,979)	(100,997)	4,655	(336,502)
Net interest income before market valuation adjustments	62,787	—	14,457	23,667	—	100,911
Market valuation adjustments, net	(27,305)	—	—	(12,389)	—	(39,694)
Net interest (loss) income	35,482	—	14,457	11,278	—	61,217
Operating expenses	(30,554)	—	—	—	—	(30,554)
Realized gains on sales and calls, net	5,277	—	—	(1,393)	—	3,884
Income from Sequoia	14,457	—	—	—	(14,457)	—
Income from Acacia	9,885	—	—	—	(9,885)	—
Net income before provision for taxes	34,547	—	14,457	9,885	(24,342)	34,547
Provision for income taxes	(4,822)	—	—	—	—	(4,822)
Net Income	$ 29,725	$ —	$ 14,457	$ 9,885	$ (24,342)	$ 29,725

TABLE OF CONTENTS

Results of Operations – Redwood

The following table presents the net interest income (interest income less interest expense and after market valuation adjustments) earned at Redwood for the three and six months ended June 30, 2008 and 2007.

Table 3 Net Interest Income at Redwood

	Three Months Ended June 30,					
	2008			2007		
(Dollars in Thousands)	**Total Interest Income/(Expense)**	**Average Amortized Cost**	**Yield**	**Total Interest Income/(Expense)**	**Average Amortized Cost**	**Yield**
Interest Income						
Real estate loans	$ 76	$ 3,759	8.09%	$ 21	$ 1,286	6.53%
Trading securities	1,317	23,627	22.30%	618	44,061	5.61%
Available-for-sale securities	21,846	336,295	25.98%	34,990	586,373	23.87%
Cash and cash equivalents	1,428	200,781	2.84%	1,801	139,612	5.16%
Total Interest Income	24,667			37,430		
Management fees	1,319			1,481		
Interest Expense						
Interest expense on short-term Redwood debt	(68)	4,904	(5.55)%	(1,527)	89,702	(6.81)%
Interest expense on long-term Redwood debt	(2,233)	146,480	(6.10)%	(2,516)	117,934	(8.53)%
Total Interest Expense	(2,301)			(4,043)		
Net Interest Income Before MVA	23,685			34,868		
Market valuation adjustments	(31,349)			(20,017)		
Net Interest (Loss) Income at Redwood	$ (7,664)			$ 14,851		

	Six Months Ended June 30,					
	2008			2007		
(Dollars in Thousands)	**Total Interest Income/(Expense)**	**Average Amortized Cost**	**Yield**	**Total Interest Income/(Expense)**	**Average Amortized Cost**	**Yield**
Interest Income						
Real estate loans	$ 175	$ 4,013	8.72%	$ (2,794)	$ 2,603	(214.68)%
Trading securities	5,508	31,194	35.31%	2,954	4,082	144.75%

Available-for-sale securities	49,110	361,033	27.21%	63,046	577,540	21.83%
Cash and cash equivalents	3,663	222,119	3.30%	3,113	137,432	4.53%
Total Interest Income	58,456			66,319		
Management fees	2,932			2,649		
Interest Expense						
Interest expense on short-term Redwood debt	(250)	9,116	(5.49)%	(1,609)	94,607	(3.40)%
Interest expense on long-term Redwood debt	(4,766)	146,420	(6.51)%	(4,572)	107,531	(8.50)%
Total Interest Expense	(5,016)			(6,181)		
Net Interest Income Before MVA	56,372			62,787		
Market valuation adjustments	(198,010)			(27,305)		
Net Interest (Loss) Income at Redwood	$ (141,638)			$ 35,482		

Net interest (loss) income at Redwood was a loss of $8 million in the second quarter of 2008 compared to income of $15 million in the second quarter of 2007, a decline of $23 million. Net interest (loss) income was a loss of $142 million in the first half of 2008 compared to income of $35 million in the first half of 2007, a decline of $177 million. The primary reason for these declines was an increase in negative market valuation adjustments (MVA) of $11 million and $171 million over comparable periods. We detail these adjustments in the Market Valuation Adjustments section in this MD&A.

Net interest income before MVA was $24 million in the second quarter of 2008 compared to $35 million in the second quarter of 2007, a decline of $11 million. Net interest income before MVA was $56 million in the first half of 2008 compared to $63 million in the first half of 2007, a decline of $7 million. The primary reasons for these declines were lower benchmark LIBOR rates on adjustable rate securities and higher credit costs due to deteriorating credit performance and lower projected cash flows on most CES. We have reduced the cost basis of these securities through impairment charges over recent quarters and increased the amount of unamortized discount designated as credit reserves. The amount of discount that we record into income over time is net of the unamortized discount designated as credit reserves and is subject to change based upon the long term performance of our securities.

The two most significant economic factors affecting the performance of CES are the timing and amount of credit losses and the rate of principal repayments. In general, lower credit losses and higher prepayment speeds benefit CES that we buy at a significant discount to face value. Over the past two quarters, delinquencies have been rising and prepayments have been slowing. Serious delinquencies on prime residential CES (loans that are 90+ days delinquent) were 0.47% of original balances and 1.01% of current balances as of June 30, 2008. Serious delinquencies on commercial CES (loans that are 60+ days delinquent) were 0.74% of original balances and 0.79% of current balances. Average prepayment speeds on prime residential CES declined to 19% CPR in the second quarter of 2008, compared to 31% CPR in 2007. There were no prepayments on commercial CES.

The following table presents the components of interest income and yield for AFS securities for the three and six months ended June 30, 2008 and 2007.

Table 4 Interest Income — AFS Securities at Redwood

Three Months Ended June 30, 2008

(Dollars in Thousands)	Interest Income	Discount (Premium) Amortization	Total Interest Income	Average Amortized Cost	Yield as a Result of: Interest Income	Yield as a Result of: Discount (Premium) Amortization	Yield as a Result of: Total Interest Income
IGS							
Residential	$ 1,663	$ 1,499	$ 3,162	$ 107,193	6.21%	5.59%	11.80%
Commercial	—	—	—	—	—	—	—
CDO	—	—	—	—	—	—	—
Total IGS	1,663	1,499	3,162	107,193	6.21%	5.59%	11.80%
CES							
Residential	8,618	5,688	14,306	122,095	28.23%	18.63%	46.87%
Commercial	6,278	(2,123)	4,155	106,314	23.62%	(7.99)%	15.63%
CDO	223	—	223	693	128.72%	—	128.72%
Total CES	15,119	3,565	18,684	229,102	26.40%	6.22%	32.62%
Total AFS Real Estate Securities at Redwood	$ 16,782	$ 5,064	$ 21,846	$ 336,295	19.96%	6.02%	25.98%

Table 4 Interest Income — AFS Securities at Redwood – (continued)

Three Months Ended June 30, 2007

(Dollars in Thousands)	Interest	Discount	Total	Average	Yield as a Result of

	Income	(Premium) Amortization	Interest Income	Amortized Cost	Interest Income	Discount (Premium) Amortization	Total Interest Income
IGS							
Residential	$ 2,359	$ 1,019	$ 3,378	$ 156,171	6.04%	2.61%	8.65%
Commercial	118	(14)	104	7,985	5.91%	(0.70)%	5.21%
CDO	439	30	469	23,786	7.38%	0.50%	7.89%
Total IGS	2,916	1,035	3,951	187,943	6.21%	2.20%	8.41%
CES							
Residential	9,853	15,822	25,675	215,675	18.27%	29.34%	47.62 %
Commercial	6,258	(1,270)	4,988	180,687	13.85%	(2.81)%	11.04 %
CDO	376	—	376	2,068	72.73%	—	72.73%
Total CES	16,487	14,552	31,039	398,430	16.55%	14.61%	31.16 %
Total AFS Real Estate Securities at Redwood	$ 19,403	$ 15,587	$ 34,990	$ 586,373	13.24%	10.63%	23.87%

Six Months Ended June 30, 2008

(Dollars in Thousands)	Interest Income	Discount (Premium) Amortization	Total Interest Income	Average Amortized Cost	Yield as a Result of		
					Interest Income	Discount (Premium) Amortization	Total Interest Income
IGS							
Residential	$ 1,828	$ 1,562	$ 3,390	$ 58,775	6.22%	5.32%	11.54%
Commercial	—	—	—	—	—	—	—
CDO	—	—	—	—	—	—	—
Total IGS	1,828	1,562	3,390	58,775	6.22%	5.32%	11.54%
CES							
Residential	18,943	17,258	36,201	156,244	24.25%	22.09%	46.34%
Commercial	12,801	(3,646)	9,155	144,880	17.67%	(5.03)%	12.64%
CDO	364	—	364	1,134	64.20%	—	64.20%
Total CES	32,108	13,612	45,720	302,258	21.25%	9.01%	30.26%
Total AFS Real Estate Securities at Redwood	$ 33,936	$ 15,174	$ 49,110	$ 361,033	18.80%	8.41%	27.21%

Six Months Ended June 30, 2007

(Dollars in Thousands)	Interest Income	Discount (Premium) Amortization	Total Interest Income	Average Amortized Cost	Yield as a Result of		
					Interest Income	Discount (Premium) Amortization	Total Interest Income
IGS							
Residential	$ 3,103	$ 878	$ 3,981	$ 96,482	6.43%	1.82%	8.25%
Commercial	167	(14)	153	5,588	5.98%	(0.50)%	5.48%
CDO	730	30	760	20,577	7.10%	0.29%	7.39%
Total IGS	4,000	894	4,894	122,647	6.52%	1.46%	7.98%
CES							
Residential	19,142	29,002	48,144	266,441	14.37%	21.77%	36.14%
Commercial	12,107	(2,673)	9,434	183,763	13.18%	(2.91)%	10.27%
CDO	574	—	574	4,689	24.48%	—	24.48%
Total CES	31,823	26,329	58,152	454,893	13.99%	11.58%	25.57%
Total AFS Real Estate Securities at Redwood	$ 35,823	$ 27,223	$ 63,046	$ 577,540	12.41%	9.43%	21.83%

TABLE OF CONTENTS

The following table presents the components of operating expenses at Redwood for the three and six months ended June 30, 2008 and 2007.

Table 5 Operating Expenses

(In Thousands)	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Fixed compensation expense	$ 4,648	$ 4,286	$ 10,322	$ 8,902
Variable compensation expense	330	198	2,187	2,449
Equity compensation expense	3,502	3,540	6,808	6,888
Severance expense	—	—	—	2,380
Total compensation expense	8,480	8,024	19,317	20,619
Systems	2,492	2,163	4,625	3,819
Due diligence	8	78	18	785
Office costs	1,629	1,265	3,151	2,445
Accounting and legal	1,495	284	2,596	1,139
Other operating expenses	151	958	897	1,747
Total Operating Expenses	$ 14,255	$ 12,772	$ 30,604	$ 30,554

Operating expenses in 2008 are slightly higher than for the same period in 2007, after adjusting for the 2007 severance expense. We expect our level of operating expense in the second half of 2008 to increase slightly from the level in the first half of 2008.

The following table details the components of our net gains for the three and six months ended June 30, 2008 and 2007.

Table 6 Realized Gains on Sales and Calls, Net

(In Thousands)	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Realized gains (losses) on sales of:				
Real estate loans	$ —	$ (34)	$ (3)	$ (34)
Real estate securities	1,983	1,462	1,983	678
Interest rate agreements	—	—	—	1,087
Total gains on sales	1,983	1,428	1,980	1,731
Total gains on repurchase of Sequoia ABS	926	—	926	—
Total (losses) gains on calls	(72)	1,310	(27)	2,153
Total Realized Gains on Sales and Calls, Net	$ 2,837	$ 2,738	$ 2,879	$ 3,884

Results of Operations – Opportunity Fund

The Fund was established in 2008 to capitalize on the dislocation in the non-prime residential and CDO markets. The fund received $96 million in commitments from investors, including a $50 million commitment from Redwood. As the owner of a controlling interest in the Fund and manager of the Fund, we consolidate the Fund's assets, liabilities, and minority interest for financial reporting purposes.

Net interest income at the Fund was $2 million in the second quarter of 2008 and $4 million in the first half of 2008. These amounts were derived from interest income earned on AFS securities and were funded with equity. The Fund acquired $40 million of non-prime IGS and CDO securities at an average price of 69% of outstanding principal face during the second quarter of 2008.

TABLE OF CONTENTS

The following table presents the components of interest income and yield for AFS securities at the Fund for the three and six months ended June 30, 2008 and 2007.

Table 7 Interest Income — AFS Securities at the Fund

Three Months Ended June 30, 2008

(Dollars in Thousands)	Interest Income	Amortization	Total Interest Income	Average Amortized Cost	Yield as a Result of Interest Income	Yield as a Result of Discount Amortization	Yield as a Result of Total Interest Income
IGS							
Residential	$ 393	$ 738	$ 1,131	$ 30,957	5.08%	9.54%	14.62%
CDO	563	340	903	16,087	14.00%	8.45%	22.45%
Total IGS	956	1,078	2,034	47,044	8.13%	9.17%	17.30%
CES							
CDO	198	116	314	9,139	8.67%	5.08%	13.75%
Total CES	198	116	314	9,139	8.67%	5.08%	13.75 %
Total Real Estate Securities	$ 1,154	$ 1,194	$ 2,348	$ 56,183	8.22%	8.50%	16.72%

Six Months Ended June 30, 2008

(Dollars in Thousands)	Interest Income	Discount Amortization	Total Interest Income	Average Amortized Cost	Yield as a Result of Interest Income	Yield as a Result of Discount Amortization	Yield as a Result of Total Interest Income
IGS							
Residential	$ 475	$ 1,057	$ 1,532	$ 18,197	5.22%	11.62%	16.84%
CDO	1,486	774	2,260	21,915	13.56%	7.06%	20.62%
Total IGS	1,961	1,831	3,792	40,112	9.78%	9.13%	18.91%
CES							
CDO	198	116	314	4,570	8.67%	5.08%	13.75%
Total CES	198	116	314	4,570	8.67%	5.08%	13.75%
Total Real Estate Securities	$ 2,159	$ 1,947	$ 4,106	$ 44,682	9.66%	8.71%	18.37%

In addition to interest income on securities, the Fund realized gains of $2 million as a result of the sale of one asset during the second quarter.

TABLE OF CONTENTS

Results of Operations – Sequoia

Sequoia is our brand name for securitizations of residential real estate loans which we sponsor. Although our exposure to these loans is limited to our investments in each Sequoia securitization entity, we are required under GAAP to consolidate the assets and liabilities of Sequoia entities on our consolidated balance sheets. Sequoia loans and ABS issued are reported on an amortized cost basis. The net interest income reported represents the GAAP earnings we record on our investments in these entities and any net interest earned during the accumulation of residential real estate loans for securitization.

The following table presents the net interest income earned at Sequoia for the three and six months ended June 30, 2008 and 2007. It is followed by a discussion of the significant components of net interest income.

Table 8 Net Interest Income at Sequoia

Three Months Ended June 30, 2008

(Dollars in Thousands)	Interest Income	Net (Premium) Discount Amortization	Provision For Credit Losses	Total Interest Income	Average Amortized Cost	Yield
Interest Income						
Real estate loans	$ 82,529	$ (10,215)	$ (10,061)	$ 62,253	$6,483,477	3.84%
Cash and cash equivalents	18	—	—	18	2,651	2.72%
Total Interest Income	82,547	(10,215)	(10,061)	62,271		
Interest Expense						
Interest expense on ABS issued	(66,720)	(159)	—	(66,879)	6,349,662	(4.21)%
Interest rate agreement (expense) income	(157)	—	—	(157)		
Total Interest Expense	(66,877)	(159)	—	(67,036)		
Net Interest Income Before MVA	15,670	(10,374)	(10,061)	(4,765)		
Market valuation adjustments				(974)		
Net Interest (Loss) Income at Sequoia	$ 15,670	$ (10,374)	$ (10,061)	$ (5,739)		

Three Months Ended June 30, 2007

(Dollars in Thousands)	Interest Income	Net (Premium) Discount Amortization	Provision For Credit Losses	Total Interest Income	Average Amortized Cost	Yield
Interest Income						
Real estate loans	$ 132,543	$ (10,889)	$ (2,500)	$ 119,154	$8,232,476	5.79%
Total Interest Income	132,543	(10,889)	(2,500)	119,154		
Interest Expense						
Interest expense on ABS issued	(99,332)	(740)	—	(100,072)	7,105,117	(5.63)%
Interest expense on repo debt	(13,271)	—	—	(13,271)	936,025	(5.67)%
Interest rate agreement (expense) income	129	—	—	129		
Total Interest Expense	(112,474)	(740)	—	(113,214)		
Net Interest Income Before MVA	20,069	(11,629)	(2,500)	5,940		
Market valuation adjustments				—		
Net Interest (Loss) Income at Sequoia	$ 20,069	$ (11,629)	$ (2,500)	$ 5,940		

Table 8 Net Interest Income at Sequoia – **(continued)**

Six Months Ended June 30, 2008

(Dollars in Thousands)	Interest Income	Net (Premium) Discount Amortization	Provision For Credit Losses	Total Interest Income	Average Amortized Cost	Yield
Interest Income						
Real estate loans	$ 185,191	$ (17,724)	$ (18,119)	$ 149,348	$6,689,503	4.47%
Cash and cash equivalents	47	—	—	47	2,910	3.23%
Total Interest Income	185,238	(17,724)	(18,119)	149,395		
Interest Expense						
Interest expense on ABS issued	(149,388)	(69)	—	(149,457)	6,547,610	(4.57)%
Interest rate agreement (expense) income	(313)	—	—	(313)		
Total Interest Expense	(149,701)	(69)	—	(149,770)		
Net Interest Income Before MVA	35,537	(17,793)	(18,119)	(375)		
Market valuation adjustments				(1,392)		
Net Interest (Loss) Income at Sequoia	$ 35,537	$ (17,793)	$ (18,119)	$ (1,767)		

Six Months Ended June 30, 2007

(Dollars in Thousands)	Interest Income	Net (Premium) Discount Amortization	Provision For Credit Losses	Total Interest Income	Average Amortized Cost	Yield
Interest Income						
Real estate loans	$ 275,425	$ (23,010)	$ (3,981)	$ 248,436	$8,467,002	5.87%
Total Interest Income	275,425	(23,010)	(3,981)	248,436		
Interest Expense						
Interest expense on ABS issued	(195,917)	(2,207)	—	(198,124)	7,005,954	(5.66)%
Interest expense on repo debt	(35,344)	—	—	(35,344)	1,251,938	(5.65)%
Interest rate agreement (expense) income	(511)	—	—	(511)		

Total Interest Expense	(231,772)	(2,207)	—	(233,979)
Net Interest Income Before MVA	43,653	(25,217)	(3,981)	14,457
Market valuation adjustments				—
Net Interest (Loss) Income at Sequoia	$ 43,653	$ (25,217)	$ (3,981)	$ 14,457

Net interest (loss) income at Sequoia was a loss of $6 million in the second quarter of 2008 compared to income of $6 million in the second quarter of 2007, a decline of $12 million. Net interest (loss) income was a loss of $2 million in the second half of 2008 compared to income of $14 million in the second half of 2007, a decline of $16 million. The primary reasons for these declines included higher credit loss provisions, lower interest rates, and lower average loan balances.

The provision for credit losses on Sequoia loans reduced interest income by $10 million and $18 million for the three and six months ended June 30, 2008, respectively, and $3 million and $4 million in the three and six months ended June 30, 2007, respectively. On a percentage basis, our credit reserve increased to 0.77% of the residential loan balance at June 30, 2008 from 0.26% at December 31, 2007. Serious delinquencies (90+ days delinquent) increased to $118 million (1.87% of the current balances) at June 30, 2008, from $68 million (0.96% of the current balances) at December 31, 2007. As a percentage of original balances, serious delinquencies increased to 0.42% at June 30, 2008, from 0.24% at December 31, 2007.

Average loan balances decreased to $6.5 billion in the second quarter of 2008 and $6.6 billion in the first half of 2008, from $8.2 billion in the second quarter of 2007 and $8.5 billion in the first half of 2007, respectively. This reduced interest income and interest expense. The decreases in average balances resulted

from repayments on existing loans with no offsetting loan acquisitions during the last twelve months. The average prepayment rate for Sequoia loans during 2008 (annualized) was 23%, compared to 38% in 2007 and 46% in 2006.

At June 30, 2008, 66% of Sequoia loan principal outstanding consisted of one-month or six-month LIBOR ARMs and 34% consisted of hybrid ARM loans. Coupons on six-month LIBOR ARMs have reset lower over the past year due to a decline in short-term interest rates over this period.

The following table presents the cost of funds at Sequoia for the three and six months ended June 30, 2008 and 2007.

Table 9 Cost of Funds of Asset-Backed Securities Issued by Sequoia

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in Thousands)	**2008**	**2007**	**2008**	**2007**
ABS issued interest expense	$ 66,720	$ 99,332	$ 149,388	$ 195,917
ABS issued issuance expense amortization	2,114	3,674	4,207	6,895
Net ABS issued interest rate agreement income	157	(129)	313	511
Net ABS issued issuance premium income amortization	(1,955)	(2,934)	(4,138)	(4,688)
Total ABS Issued Interest Expense	$ 67,036	$ 99,943	$ 149,770	$ 198,635
Average balance of ABS issued	$6,349,662	$7,105,117	$6,547,610	$7,005,954
ABS issued interest expense	4.20%	5.59%	4.56%	5.59%
ABS issued issuance expense amortization	0.13%	0.21%	0.13%	0.20%
Net ABS issued interest rate agreement income	0.01%	(0.01)%	0.01%	0.01%
Net ABS issued issuance premium income amortization	(0.12)%	(0.17)%	(0.13)%	(0.13)%
Cost of Funds of ABS Issued	4.22%	5.62%	4.57%	5.67%

Sequoia ABS issued generally pays interest based on one-, three-, or six-month LIBOR, or in some instances, passes through the weighted average interest earned on the underlying assets. Interest expense declined due to lower average balances and lower interest rates. Some of the ABS issued was sold at a premium, which we amortize as a component of interest expense over time. We also amortize the costs of Sequoia ABS issued over time as a component of interest expense.

Results of Operations – Acacia

Acacia is our brand name for the collateralized debt obligation (CDO) securitizations which we sponsor. The pool of assets held by Acacia entities primarily consists of IGS and some CES. The securities are backed by prime and non-prime residential real estate loans and commercial real estate loans. Acacia also owns related assets such as real estate CDO securities, corporate debt issued by equity REITs, and synthetic assets derived from real estate assets. Our investment in each Acacia entity is separate and independent, thus diminished performance on one of our investments would have no effect on our investments in the other Acacia entities.

We are required to consolidate the assets and liabilities of Acacia on our GAAP financial statements, even though our investments in Acacia represent only a small portion of each Acacia securitization. Prior to 2008, we were required under GAAP to record most of the assets of Acacia at fair value, but we were required to record the paired liabilities at their amortized cost. As of January 1, 2008, we elected to adopt FAS 159 to value the assets and liabilities of the Acacia entities. This new GAAP standard significantly improved the disparity that existed between the carrying value of our Acacia equity investments and our estimate of their economic values.

The following table presents the net interest income earned at Acacia for the three and six months ended June 30, 2008 and 2007. It is followed by a discussion of the significant components of net interest income.

Table 10 Net Interest Income at Acacia

Three Months Ended June 30,

(Dollars in Thousands)	2008 Total Interest Income	2008 Average Balance	2008 Yield	2007 Interest Income	2007 Discount (Premium) Amortization	2007 Total Interest Income	2007 Average Amortized Cost	2007 Yield
Interest Income								
Commercial real estate loans	$ 373	$ 18,773	7.95%	$ 381	$ 20	$ 401	$ 24,560	6.53%
Trading securities	37,924	884,811	17.14%	54,028	8,199	62,227	3,083,256	8.07%
Other investments	514	78,584	2.62%	464	—	464	38,681	4.80 %
Cash and cash equivalents	678	96,207	2.82%	1,955	—	1,955	151,257	5.17 %
Total Interest Income	39,489			56,828	8,219	65,047		
Interest Expense								
Interest expense on ABS issued	(30,306)	986,915	(12.28)%	(44,634)	(2,647)	(47,281)	2,841,157	(6.66) %
Interest expense on repo debt	—			(7,902)	—	(7,902)	490,261	(6.45)%
Interest rate agreement (expense) income	(1,089)			3,229	—	3,229		
Total Interest Expense	(31,395)			(49,307)	(2,647)	(51,954)		
Net Interest Income Before MVA	8,094			7,521	5,572	13,093		
Market Valuation Adjustments	(28,296)			(9,413)	—	(9,413)		
Net Interest (Loss) Income	$(20,202)			$ (1,892)	$ 5,572	$ 3,680		

Six Months Ended June 30,

(Dollars in Thousands)	2008 Total Interest Income	2008 Average Balance	2008 Yield	2007 Interest Income	2007 Discount (Premium) Amortization	2007 Total Interest Income	2007 Average Amortized Cost	2007 Yield
Interest Income								
Commercial real estate loans	$ 744	$ 19,578	7.60%	$ 744	$ 41	$ 785	$ 24,413	6.43%
Trading securities	83,386	1,000,271	16.67%	104,498	15,942	120,440	3,109,728	7.84%
Other investments	1,246	78,632	3.17%	464	—	464	19,448	4.77%
Cash and cash equivalents	1,580	100,768	3.14%	2,975	—	2,975	131,347	4.53%
Total Interest Income	86,956			108,681	15,983	124,664		
Interest Expense								
Interest expense on ABS issued	(74,826)	1,106,237	(13.53)%	(83,672)	(5,999)	(89,671)	2,640,150	(6.79)%
Interest expense on repo debt	—			(16,841)	—	(16,841)	503,599	(6.69)%
Interest rate agreement (expense) income	(2,179)			5,515	—	5,515		
Total Interest Expense	(77,005)			(94,998)	(5,999)	(100,997)		
Net Interest Income Before MVA	9,951			13,683	9,984	23,667		
Market Valuation Adjustments	(55,149)			(12,389)	—	(12,389)		
Net Interest (Loss) Income	$(45,198)			$ 1,294	$ 9,984	$ 11,278		

Net interest (loss) income at Acacia was a loss of $20 million in the second quarter of 2008 compared to income of $4 million in the second quarter of 2007, a decline of $24 million. Net interest income was a loss of $45 million in the first six months of 2008 compared to income of $11 million in the first six months of 2007, a decline of $56 million. The primary reason for these declines was an increase in negative market

TABLE OF CONTENTS

valuation adjustments (MVA) of $19 million and $43 million over comparable periods, respectively. We detail these adjustments in the Market Valuation Adjustments section in this MD&A.

Net interest income before MVA was $8 million in the second quarter of 2008 compared to $13 million in the second quarter of 2007, a decline of $5 million. Net interest income before MVA was $10 million in the first half of 2008 compared to $24 million in the first half of 2007, a decline of $14 million. These declines were primarily due to an accounting change resulting from the adoption of FAS 159. Our Acacia assets and liabilities are now recorded as trading instruments, with only coupon interest included in interest income and interest expense and all other adjustments recorded through market valuation adjustments as a separate component of net interest income. This includes the impact of interest rate agreements used to hedge the interest rate exposure of Acacia liabilities, which is a significant component of net interest income.

We received $5 million of cash distributions from our Acacia equity investments during the second quarter, but expect these distributions to diminish rapidly over the next few quarters. During the first half of 2008, six of our Acacia equity investments stopped receiving cash distributions due to performance deficiencies (consisting primarily of rating agency downgrades of securities held by the Acacia entities), which significantly affected the yield we expect to earn on these investments. In total, four of our Acacia equity investments are currently receiving cash distributions and six are not receiving cash distributions as of June 30, 2008. There is a possibility that cash distributions from our equity investments in the remaining four Acacia entities will be disrupted for the same reason within a year, although it is difficult to predict the severity and timing of rating agency actions.

Market Valuation Adjustments – Consolidating

Negative market valuation adjustments were the most significant factor affecting our earnings for the second quarter and first half of 2008. Market valuation adjustments are changes in the fair values of financial assets and liabilities that flow through our consolidated statements of (loss) income under GAAP. The accounting rules that determine the measurement of fair values and the timing and amount of market valuation adjustments are complex and may not clearly reflect the timing, nature, and extent of changing economic or market conditions. That is, the amount of market valuation adjustments recorded to our income statement during any specific reporting period may not precisely mirror the timing and extent of economic changes impacting the fair values of our investments. These economic factors are discussed in the Market Conditions section of our report.

The following tables provide a breakout of market valuation adjustments that occurred in the three and six months ended June 30, 2008 and 2007, and their effect on our consolidating income statements and balance sheets.

Table 11 Market Valuation Adjustments Impact on Consolidating Income Statement and Balance Sheet

	Three Months Ended June 30, 2008				
(In Millions)	**Redwood**	**Opportunity Fund**	**Sequoia**	**Acacia**	**Total**
Income Statement Impact					
Changes in fair value assets	$ (2)	$ —	$ (1)	$ (33)	$ (36)
Changes in fair value liabilities	—	—	—	4	4
Impairment on AFS securities	(29)	—	—	—	(29)
Total income statement impact	(31)	—	(1)	(29)	(61)
Balance Sheet Impact					
Net change in OCI	27	—	—	—	27
Total Market Valuation Adjustments	$ (4)	$ —	$ (1)	$ (29)	$ (34)

TABLE OF CONTENTS

***Table 11 Market Valuation Adjustments Impact on Consolidating Income Statement and Balance Sheet* – (continued)**

	Three Months Ended June 30, 2007				
(In Millions)	**Redwood**	**Opportunity Fund**	**Sequoia**	**Acacia**	**Total**
Income Statement Impact					
Impairment on AFS securities	$ (12)	$ —	$ —	$ (10)	$ (22)
Changes in fair value assets	(8)	—	—	—	(8)
Total income statement impact	(20)	—	—	(10)	(30)
Balance Sheet Impact					
Net change in OCI	(19)	—	—	(55)	(74)
Total Market Valuation Adjustments	$ (39)	$ —	$ —	$ (65)	$ (104)

	Six Months Ended June 30, 2008				
(In Millions)	**Redwood**	**Opportunity Fund**	**Sequoia**	**Acacia**	**Total**
Income Statement Impact					
Changes in fair value assets	$ (25)	$ —	$ (1)	$ (870)	$ (896)
Changes in fair value liabilities	—	—	—	814	814
Impairment on AFS securities	(173)	—	—	—	(173)
Total income statement impact	(198)	—	(1)	(56)	(255)
Balance Sheet Impact					
Net change in OCI	48	—	$ —	—	48
Total Market Valuation Adjustments	$ (150)	$ —	$ (1)	$ (56)	$ (207)

	Six Months Ended June 30, 2007				
(In Millions)	**Redwood**	**Opportunity Fund**	**Sequoia**	**Acacia**	**Total**
Income Statement Impact					
Impairment on AFS securities	$ (13)	$ —	$ —	$ (11)	$ (24)
Changes in fair value assets	(14)	—	—	(2)	(16)
Total income statement impact	(27)	—	—	(13)	(40)
Balance Sheet Impact					
Net change in OCI	(39)	—	—	(134)	(173)
Total Market Valuation Adjustments	$ (66)	$ —	$ —	$ (147)	$ (213)

Market Valuation Adjustments at Redwood

At Redwood, we classify most securities (excluding our investments in Sequoia and Acacia) as AFS and report these securities at their fair values in accordance with Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (FAS 115). Net market valuation adjustments were negative $4 million and negative $150 million for the three and six months ended June 30, 2008, respectively, as compared to negative $39 million and $66 million for the three and six months ended June 30, 2007, respectively.

We recorded $29 million and $173 million of other-than-temporary impairments through our income statement in the three and six months ended June 30, 2008, respectively. Most of these impairments were the result of changes in the market's expectation of cash flows and credit and our assessment that the values of

TABLE OF CONTENTS

certain securities would not recover within a reasonable period of time. We recorded $12 million and $13 million of other-than-temporary impairments through our income statement in the three and six months ended June 30, 2007, respectively, primarily due to changes in the market's expectation of cash flows and credit. We continue to expect impairments to occur and the levels may vary significantly from quarter to quarter.

The following tables detail the market valuation adjustments on Redwood securities by underlying collateral type and by vintage.

Table 12 Market Valuation Adjustments by Underlying Collateral Type on Securities at Redwood

	Three Months Ended June 30, 2008				
(In Millions)	**IGS**	**CES**	**Loans, & Derivatives**	**Total**	**MTM Percent(1)**
Residential					
Prime	$ (2)	$ 13	$ —	$ 11	6%
Non-prime	(7)	(4)	—	(11)	(16)%
Residential total	(9)	9	—	—	
Commercial	—	(6)	—	(6)	(7)%
CDO	—	—	—	—	
Interest rate agreements & other derivatives	—	—	2	2	
Total Market Valuation Adjustments	$ (9)	$ 3	$ 2	$ (4)	

	Six Months Ended June 30, 2008				
(In Millions)	**IGS**	**CES**	**Loans, & Derivatives**	**Total**	**MTM Percent(1)**
Residential					
Prime	$ (13)	$ (43)	$ —	$ (56)	(26)%
Non-prime	(16)	(18)	—	(34)	(33)%
Residential total	(29)	(61)	—	(90)	
Commercial	—	(53)	—	(53)	(37)%
CDO	(1)	(2)	—	(3)	(15)%
Interest rate agreements & other derivatives	—	—	(4)	(4)	
Total Market Valuation Adjustments	$ (30)	$ (116)	$ (4)	$ (150)	

(1) This percentage represents the market valuation adjustments taken as a percentage of the reported market values at the beginning of the period, or the purchase price if acquired during the period. It illustrates the price declines by collateral type for the three and six months ended June 30, 2008. These price declines may not be indicative of price declines in the market in general.

Table 13 Market Valuation Adjustments by Vintage on Securities at Redwood

Three Months Ended June 30, 2008

	Vintage						
(In Millions)	**2004 & Earlier**	**2005**	**2006**	**2007**	**2008**	**Loans & Derivatives**	**Total**
Market Valuation Adjustments	$ 14	$ (9)	$ (7)	$ (5)	$ 1	$ 2	$ (4)

Six Months Ended June 30, 2008

	Vintage						
(In Millions)	**2004 & Earlier**	**2005**	**2006**	**2007**	**2008**	**Loans & Derivatives**	**Total**
Market Valuation Adjustments	$ (21)	$ (31)	$ (41)	$ (43)	$ (9)	$ (5)	$ (150)

TABLE OF CONTENTS

Market Valuation Adjustments at the Fund

At June 30, 2008, all of the investments held by the Fund were classified as AFS securities. We had no other-than-temporary impairments on these securities during the first half of 2008.

Market Valuation Adjustments at Acacia

On January 1, 2008, we adopted the fair value option under FAS 159 for the assets and liabilities owned by Acacia securitization entitles, which we consolidate for financial reporting purposes. In accordance with the standard, we decreased the carrying value of Acacia assets and liabilities by a net $1.5 billion, and recorded this fair value change as a one-time cumulative-effect adjustment to retained earnings, a component of stockholders equity. All future market valuation adjustments on Acacia are recorded through our consolidated income statements. Due to the illiquid nature of Acacia investments and continued market volatility, there is no way to anticipate periodic valuation changes in future quarters.

During the three and six months ended June 30, 2008, the fair values of Acacia assets and liabilities, net, declined by $28 million and $55 million, respectively. The following table details market valuation adjustments for Acacia entities during the three and six months ended June 30, 2008.

Table 14 Market Valuation Adjustments by Underlying Collateral Type on Securities held by Acacia Entities

Three Months Ended June 30, 2008

(In Millions)	IGS	CES	Loans, Liabilities & Derivatives	Total	MTM Percent[(1)]
Residential					
Prime	$ 12	$ 5	$ —	$ 17	8%
Non-prime	(19)	(53)	—	(72)	(17)%
Residential total	(7)	(48)	—	(55)	
Commercial	—	2	—	2	1%
CDO	(5)	(3)	—	(8)	(14)%
Interest rate agreements & other derivatives	—	—	29	29	
Liabilities	—	—	4	4	
Total Market Valuation Adjustments	$ (12)	$ (49)	$ 33	$ (28)	

	Six Months Ended June 30, 2008				
(In Millions)	IGS	CES	Loans, Liabilities & Derivatives	Total	MTM Percent[(1)]
Residential					
Prime	$ (254)	$ (102)	$ (5)	$ (361)	(67)%
Non-prime	(253)	(94)	—	(347)	(46)%
Residential total	(507)	(196)	(5)	(708)	
Commercial	(21)	(74)	—	(95)	(35)%
CDO	(39)	(6)	—	(45)	(48)%
Interest rate agreements & other derivatives	—	—	(21)	(21)	
Liabilities	—	—	814	814	
Total Market Valuation Adjustments	$ (567)	$ (276)	$ 788	$ (55)	

(1) This percentage represents the market valuation adjustments taken as a percentage of the reported market values at the beginning of the period, or the purchase price if acquired during the period. It illustrates the price declines by collateral type for the three and six months ended June 30, 2008. These price declines may not be indicative of price declines in the market in general.

TABLE OF CONTENTS

Changes in Volume and Yields on Consolidated Investments and Borrowings

The following table details how our GAAP interest income changed as a result of changes in investment balances ("volume") and yields ("rate") at Redwood and our consolidated entities for the three and six months ended June 30, 2008, as compared to the three and six months ended June 30, 2007.

Table 15 Volume and Rate Changes for Interest Income

	Change in Interest Income June 30, 2008 Versus June 30, 2007					
	Three Months Ended			Six Months Ended		
(In Thousands)	Volume	Rate	Total Change	Volume	Rate	Total Change
Real estate loans, net of provisions for credit losses	$(25,289)	$(31,585)	$(56,874)	$ (54,607)	$(41,551)	$ (96,158)
Real estate securities	(59,799)	25,465	(34,334)	(103,752)	60,022	(43,730)
Other investments	479	(428)	51	1,412	(630)	782
Cash and cash equivalents	776	(2,336)	(1,560)	3,085	(3,796)	(711)
Total Interest Income	$(83,833)	$ (8,884)	$(92,717)	$(153,862)	$ 14,045	$(139,817)

Our consolidated interest income decreased by $93 million, from $220 million for the three months ended June 30, 2007 to $127 million for the three months ended June 30, 2008. Similarly, interest income decreased by $140 million, from $435 million for the six months ended June 30, 2007 to $295 million for the six months ended June 30, 2008. Interest income declined primarily because of higher credit reserves on loans and securities and lower interest rates. Accounting changes related to the adoption of FAS 159 also contributed to the decrease in interest income as we no longer amortize purchase discounts into income on securities owned at Acacia. Balances on our loans were lower as a result of prepayments with no new acquisitions. Balances on securities were also lower due to impairments and the adoption of FAS 159, offset by new acquisitions during 2008.

The following table details how our GAAP interest expense changed, as a result of changes in borrowings ("volume") and yields ("rate") at Redwood and our consolidated entities for the three and six months ended June 30, 2008 as compared to the three and six months ended June 30, 2007.

Table 16 Volume and Rate Changes for Interest Expense

	Change in Interest Expense June 30, 2008 Versus June 30, 2007					
	Three Months Ended			Six Months Ended		
(In Thousands)	Volume	Rate	Total Change	Volume	Rate	Total Change
Interest expense on ABS – Sequoia	$(10,727)	$(22,113)	$(32,840)	$ (12,864)	$(35,399)	$ (48,263)
Interest expense on ABS – Acacia	(28,750)	16,093	(12,657)	(48,894)	41,743	(7,151)
Interest expense on short-term Redwood debt	(22,627)	(5)	(22,632)	(53,529)	(15)	(53,544)

Interest expense on long-term Redwood debt	609	(892)	(283)	1,654	(1,459)	195
Total Interest Expense on Total Obligation	$(61,495)	$ (6,917)	$(68,412)	$(113,633)	$ 4,870	$(108,763)

Our consolidated interest expense decreased by $68 million, from $167 million for the three months ended June 30, 2007 to $99 million for the three months ended June 30, 2008. Similarly, interest expense decreased by $109 million, from $337 million for the six months ended June 30, 2007 to $228 million for the six months ended June 30, 2008. Interest expense fell primarily as a result of lower average balances and lower short-term interest rates. The adoption of FAS 159 and paydowns on ABS issued with no new issuance led to the decline in average balances over the past twelve months.

Potential GAAP Earnings Volatility

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

Changes in Premium Amortization for Loans at Sequoia

The unamortized premium for loans owned by Sequoia was $68 million at June 30, 2008. The amount of periodic premium amortization expense we recognize is volatile and dependent on a number of factors, including credit performance of the underlying loans, changes in prepayment speeds, and changes in short-term interest rates. Loan premium amortization was $18 million in the first six months of 2008 and $23 million in the first six months of 2007.

Changes in Discount Amortization for Securities at Redwood and the Fund

The unamortized discount, net of designated credit reserves, for securities owned at Redwood and the Fund was $229 million at June 30, 2008. The amount of periodic discount amortization income we recognize is volatile and dependent on a number of factors, including credit performance of the underlying loans, changes in prepayment speeds, and changes in short-term interest rates. Discount amortization on securities was $17 million in the first six months of 2008 and $27 million in the first six months of 2007.

Changes in Fair Values of Consolidated Assets and Liabilities

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

For AFS securities, cumulative unrealized gains and losses are recorded as a component of accumulated other comprehensive (loss) income in our consolidated statements of stockholders' equity (deficit). Unrealized gains and losses are not charged against current earnings to the extent they are temporary in nature. Certain factors may require us however, to recognize these amounts as other-than-temporary impairments and record them through our current earnings. Factors that determine other than temporary impairment include a change in our ability or intent to hold assets, adverse changes to projected cash flows of assets, or the likelihood that declines in the fair values of assets would not return to their previous levels within a reasonable time. Impairments on securities are generally non-recurring and can lead to significant GAAP earnings volatility each quarter.

As of January 1, 2008, we elected to adopt a new accounting standard, FAS 159, to record the assets and liabilities in Acacia and certain other assets at Redwood at fair value. We may also elect the fair value option for certain new acquisitions in the future. Our FAS 159 elections significantly improved the disparity that existed between the GAAP carrying value of our Acacia equity investments and our estimate of their economic value. However, valuation changes in these financial instruments are inherently volatile and can lead to significant GAAP earnings volatility each quarter.

Changes in Fair Values of Derivative Financial Instruments

We currently account for consolidated derivative financial instruments as trading instruments in accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133). Derivative financial instruments are reported on our consolidated balance

sheets at fair value, with changes in fair value and all associated income and expense recorded as a component of net interest income in our consolidated statements of (loss) income. Previously, we had designated certain derivatives as cash flow hedges in accordance with FAS 133. We de-designated these hedging relationships in conjunction with our adoption of FAS 159 on January 1, 2008. The net unrealized loss (effective portions) from these hedging derivatives is currently being expensed into our consolidated statements of (loss) income over the expected remaining lives of the ABS that they were formerly designated to hedge under FAS 133.

We can experience significant earnings volatility from our use of derivatives. One source of significant volatility can be from timing differences of interest rate adjustments between adjustable rate assets and adjustable rate liabilities at Acacia. Most of the adjustable rate assets in Acacia pay interest at one-month LIBOR, while adjustable rate liabilities generally pay interest at three-month LIBOR. Our interest rate agreements are primarily benchmarked to swap rates. While we expect these interest rate agreements to be effective hedges over time, interest rate mismatches between reporting periods can significantly distort the effects of derivative market valuation adjustments on our reported earnings. In addition, our income statement presentation for Acacia has changed due to our de-

designation of cash flow hedge accounting relationships and our adoption of FAS 159. This may add significant volatility to reported net interest income before market valuation adjustments on our consolidated income statements.

Changes in Future Accounting Principles

In August 2008, the FASB will issue an exposure draft for comments on proposed amendments to FAS 140 and FIN 46(R). The FASB is proposing removal of the concept of a qualifying special-purpose entity (QSPE) from FAS 140 and the related scope exceptions from FIN 46(R). In addition, they propose to (1) make certain changes to the derecognition provisions in FAS 140 and (2) modify the consolidation model in FIN 46(R). As a result, if these decisions become final, enterprises involved with QSPEs will no longer be exempt from applying FIN 46(R), thus, previously unconsolidated entities may have to be consolidated. The FASB voted to modify the existing consolidation model by introducing a two-step approach into Interpretation 46(R). Step 1 in determining the primary beneficiary is a qualitative analysis that takes into account who has the explicit or implicit power to affect the VIE's activities. Step 2 is a quantitative analysis using a calculation of expected losses and expected residual returns that is only applied if the primary beneficiary cannot be determined in step 1. The FASB has proposed that the amendments be effective for all VIEs (except for certain existing QSPEs) and new transfers of financial assets for fiscal years beginning after January 1, 2010.

We are currently evaluating this exposure draft and its potential impact on our future financial statements and related disclosures.

Potential Tax Income Volatility

We expect quarter-to-quarter estimated taxable income volatility for a variety of reasons, such as the timing of credit losses and prepayments on our consolidated investments, and equity award taxation.

Differences between GAAP Net (Loss) Income and Total Taxable Income

Taxable income estimates are not calculated in accordance with GAAP, which can result in significant differences between GAAP (loss) income and taxable income estimates for the same reporting period. The following table reconciles GAAP (loss) income to total taxable income for the three and six months ended June 30, 2008 and 2007.

TABLE OF CONTENTS

Table 17 Differences between GAAP Net (Loss) Income and Total Taxable Income

	Three Months Ended June 30,	
(In Thousands, Except per Share Data)	**2008**	**2007**
GAAP net (loss) income	$ (45,909)	$ 11,416
Difference in taxable income calculations		
Amortization and credit losses	(7,377)	10,298
Operating expense differences	706	(2,921)
Realized gains on calls and sales	(5,834)	(3,589)
Market valuation adjustments, net	60,619	29,430
Income tax provisions	1,447	1,662
Total differences in GAAP/tax income	49,561	34,880
Taxable income	$ 3,652	$ 46,296
Shares used for taxable EPS calculations	33,184	27,816
Total taxable income per share	$ 0.11	$ 1.66

	Six Months Ended June 30,	
(In Thousands, Except per Share Data)	**2008**	**2007**
GAAP net (loss) income	$ (217,496)	$ 29,725
Difference in taxable income calculations		
Amortization and credit losses	(1,283)	20,715
Operating expense differences	2,197	(4,634)
Realized gains on calls and sales	(11,100)	(2,635)
Market valuation adjustments, net	254,551	39,694
Income tax provisions	2,605	3,462
Total differences in GAAP/tax income	246,970	56,602
Taxable income	$ 29,474	$ 86,327
Shares used for taxable EPS calculations	32,947	27,473
Total taxable income per share	$ 0.90	$ 3.14

Credit Losses on Securities at Redwood

To determine estimated taxable income we are not permitted to anticipate, or reserve for, credit losses on investments that we purchase at a discount (usually CES). For tax purposes, we accrete the entire purchase discount on a security into taxable income over the expected life of the security. Estimated taxable income is only reduced when actual credit losses occur. For GAAP purposes, we reserve for credit losses and only accrete a portion of the purchase discount, if any, into income. We are also required to write-down securities that become impaired. Our income recognition is therefore faster for tax as compared to GAAP, especially in the early years of owning a discount security (when there are generally few credit losses). At June 30, 2008, the cumulative difference between the GAAP and tax amortized costs basis of our residential, commercial, and CDO CES was $402 million. In addition, as of June 30, 2008, we had an allowance for loan losses (GAAP) of $35 million for our consolidated residential and commercial loans. As we have no credit reserves for tax, any future credit losses on securities would have a more significant impact on tax earnings than on GAAP earnings and may create significant taxable income volatility to the extent the level of credit losses fluctuates during reporting periods.

Income Recognition on Interest-Only Securities (IOs) at Sequoia

As part of our investment in Sequoia securitization entities, we often retain interest-only (IO) securities. Our current tax basis in these securities is $45 million. As a result of rapid prepayments (in recent years) on the loans underlying these securities, we continue to experience negative economic returns on some IO's. Since we are not permitted to recognize a negative yield under tax accounting rules, the periodic premium expense has been relatively low and the cost basis for these securities has not been significantly reduced. With many of our Sequoia securitizations callable or becoming callable over the next two years, our remaining IO

TABLE OF CONTENTS

tax basis may be written off during future periods. This would create ordinary losses for tax and potential taxable earnings volatility in future periods. We do not currently anticipate calling any Sequoia securitizations in 2008.

Compensation Expense at Redwood

The total tax expense for equity award compensation is dependent upon varying factors such as the timing of dividend equivalent rights payments, the exercise of stock options, the distribution of deferred stock units, and the deferrals to and withdrawals from our Executive Deferred Compensation Plan. For GAAP, the total expense associated with an equity award is determined at the award date and is generally recognized over the vesting period. For tax, the total expense is recognized at the date of distribution or exercise and not the award date. The amount of compensation expense could therefore be significantly different for tax than for GAAP, in addition to the differences in timing.

Financial Condition

The consolidating balance sheet presents our financial condition at Redwood, including our investments in the Opportunity Fund, Sequoia, and Acacia entities. We consolidate these entities for GAAP reporting purposes, but they are not separate business segments. This presentation highlights the impact from the consolidation of those entities on our overall financial condition. A discussion of significant balance sheet accounts is provided in the section that follows.

TABLE OF CONTENTS

Table 18 Consolidating Balance Sheet

June 30, 2008 (In Millions)	**Redwood Parent Only**	**Opportunity Fund**	**Sequoia**	**Acacia**	**Intercompany Adjustments**	**Redwood Consolidated**
Real estate loans	$ 4	$ —	$ 6,354	$ 19	$ —	$ 6,377
Real estate securities, at fair value:						
Trading securities	19	—	—	822	—	841
Available-for-sale securities	334	66	—	84	(84)	400
Other investments	—	—	—	79	—	79
Cash and cash equivalents	148	—	—	—	—	148
Total earning assets	505	66	6,354	1,004	(84)	7,845
Investment in Opportunity Fund	47	—	—	—	(47)	
Investment in Sequoia	140	—	—	—	(140)	—
Investment in Acacia	41	—	—	—	(41)	—
Restricted cash	2	29	—	72	—	103
Accrued interest receivable	5	—	27	8	—	40
Derivative assets	—	—	—	5	—	5
Deferred tax asset	8	—	—	—	—	8
Deferred asset-backed securities issuance costs	3	—	11	—	—	14
Other assets	8	—	22	1	—	31
Total Assets	$ 759	$ 95	$ 6,414	$ 1,090	$ (312)	$ 8,046
Short-term debt – Redwood	$ 9	$ —	$ —	$ —	$ —	$ 9
Asset-backed securities issued – Sequoia	—	—	6,259	—	(84)	6,175
Asset-backed securities issued – Acacia	—	—	—	935	—	935
Accrued interest payable	1	—	15	16	—	32
Derivative liabilities	2	—	—	98	—	100
Accrued expenses and other liabilities	8	1	—	—	—	9
Dividends payable	25	—	—	—	—	25
Long-term debt – Redwood	150	—	—	—	—	150
Total liabilities	195	1	6,274	1,049	(84)	7,435
Minority interest	—	47	—	—	—	47
Total stockholders' equity	564	47	140	41	(228)	564
Total Liabilities and Stockholders' Equity	$ 759	$ 95	$ 6,414	$ 1,090	$ (312)	$ 8,046

At June 30, 2008, our stockholders' equity totaled $564 million, we had unrestricted cash of $148 million, and we had short-term Redwood debt of $9 million.

TABLE OF CONTENTS

The following supplemental non-GAAP components of book value presents our assets and liabilities as reported under GAAP and as estimated by us using economic values for our investments. We show our investments in the Fund, Sequoia, and Acacia entities as separate line items similar to the equity method of accounting. This presentation highlights our specific ownership interest in these entities, as the underlying assets and liabilities owned by these entities are legally not ours.

Table 19 Components of Book Value

	June 30, 2008

(In Millions, Except per Share Data)	As Reported	Adjustments	Management's Estimate of Economic Value
Real estate securities (excluding Sequoia and Acacia)			
Residential	$ 247		$ 247
Commercial	91		91
CDO	15		15
Subtotal real estate securities	353		353
Cash and cash equivalents	148		148
Investments in Opportunity Fund	47		47
Investments in Sequoia	140	(65)[(a)]	75
Investments in Acacia	41	(22)[(b)]	19
Other assets/liabilities, net (d)	(15)		(15)
Long-term debt – Redwood	(150)	78[(c)]	(72)
Stockholders' Equity	**$564**		**$555**
Book Value Per Share	**$17.00**		**$16.72**

(a) Our actual Sequoia investments consist of CES, IGS, and IOs acquired by Redwood from the Sequoia entities. We calculated the $75 million estimate of economic value for these securities using the same valuation process that we followed to fair value all other real estate securities. In contrast, the $140 million of GAAP carrying value of these investments represents the difference between residential real estate loans owned by the Sequoia entities and the asset-backed securities (ABS) issued by those entities to third party investors. We account for these loans and ABS issued at cost, not at fair value.

(b) Our actual Acacia investments consist of equity interests, and to a lesser extent ABS issued, that we acquired from the Acacia entities. The $19 million estimate of economic value of our investment interests in the Acacia entities at June 30, 2008 represents the net present value of projected cash flows from our Acacia investments and management fees discounted at 45%, except for the CDO ABS that we have recently repurchased at substantial discounts from face which are valued at cost. We valued our equity interests at the amount of cash we received in July and expect to receive in August and September 2008. We are not valuing any future cash flows from equity distributions beyond the third quarter. The reason for the difference between economic and GAAP carrying values is complex and relates to a significant difference in valuation methodology.

(c) We issued $150 million of 30-year long-term Redwood debt at an interest rate of LIBOR plus 225 basis points. Under GAAP, these notes are carried at cost. Economic value is difficult to estimate with precision as the market for the notes is currently inactive. We estimated the $72 million economic value using the same valuation process used to fair value our other financial assets and liabilities. Estimated economic value is $78 million lower than our GAAP carrying value because given the significant overall contraction in credit availability and re-pricing of credit risk. If we had issued these notes at June 30, 2008, investors would have required a substantially higher interest rate.

(d) Other assets/liabilities, net are comprised of real estate loans of $4 million, restricted cash of $2 million, $8 million of deferred taxes, $5 million of accrued interest, and other assets of $11 million, less Redwood debt of $9 million, accruals of $8 million, dividends payable of $25 million, and other liabilities of $3 million.

In reviewing the non-GAAP supplemental components of book value, there are a number of important factors and limitations to consider. The estimated fair value of our stockholders' equity is calculated as of a particular point in time based on our existing assets and liabilities and does not incorporate other factors that may have a significant impact on that value, most notably the impact of future business activities. As a result,

the estimated economic value of our stockholders' equity does not necessarily represent an estimate of our net realizable value, liquidation value or our market value as a whole. Amounts we ultimately realize from the disposition of assets or settlement of liabilities may vary significantly from the estimated economic values presented in our non-GAAP supplemental components of book value. Because temporary changes in market conditions can substantially affect the economic value of our stockholders' equity, we do not believe that short-term fluctuations in the economic value of our assets and liabilities are necessarily representative of the effectiveness of our investment strategy or the long-term underlying value of our business. As discussed in "Note 5. Fair Value of Financial Instruments", when quoted market prices or observable market data are not available to estimate fair value, we rely on Level 3 inputs. Because assets and liabilities classified as Level 3 are generally based on unobservable inputs, the process of calculating economic value is generally more subjective and involves a high degree of management judgment and assumptions. These assumptions may have a significant effect on our estimates of economic value, and the use of different assumptions as well as changes in market conditions could have a material effect on our results of operations or financial condition.

Redwood Capital and Liquidity

During the second quarter, we maintained our strong balance sheet. At June 30, 2008, we had $148 million of unrestricted cash. We ended the second quarter with total capital of $714 million, which includes excess capital of $132 million available to make new investments. Our reported capital base consists of $564 million of common equity and $150 million of long-term Redwood debt due in 2037.

As a supplement to our Consolidated Statement of Cash Flows included in this Quarterly Report for the six months ended June 30, 2008 and 2007, we have included the non-GAAP table below that summarizes the sources and uses of our cash for the second quarter of 2008. This table excludes the gross cash flows that are not available to Redwood that are generated by our Sequoia and Acacia securitization entities and the Fund, but does include the cash flow generated by our investments in those entities.

The cash generated by our investments is one of the financial metrics on which we focus. In the second quarter, our investments generated cash from principal and interest of $65 million, compared to $70 million in the first quarter. We also received $1 million of asset management fees in the second quarter. The net investment cash flow after deducting long-term Redwood debt and short-term debt interest expense of $2 million and cash operating expenses of $12 million was $52 million, compared to $54 million in the first quarter.

Table 20 Redwood Sources and Uses of Cash

(In Millions)	Three Months Ended June 30, 2008
Sources:	
Cash from investments	$ 65
Equity raised	14
Management fees	1
Short-term borrowings	7
Changes in working capital	5
Total Sources	92
Uses:	
Acquisitions	(152)
Additional investment in Opportunity Fund	(10)
Dividends paid	(25)
Operating expenses paid	(12)
Interest expense	(2)
Total Uses	(201)
Net Uses of Cash	(109)
Beginning Cash Balance at 3/31/08	257
Ending Cash Balance at 6/30/08	$ 148

TABLE OF CONTENTS

The primary reason for the decline in net investment cash flow was lower interest income resulting from the decline in short-term interest rates during the recent quarters which has lowered coupon rates we earn on adjustable rate assets.

The $65 million of cash flow from investments includes $40 million of coupon interest and $25 million of principal. We caution readers that given the nature of our investments (deep discount credit-sensitive securities, IGS at discounts, IO's, equity investments in Acacia, and other types) it is difficult to draw conclusions in any one period about what portion of our cash flow represents "income" and what is a "return of capital". It is only at the end of the asset's life that we can accurately determine what portion of the cumulative cash received (whether principal or interest) was truly income and what was a return of capital.

Table 21 Cash Flow by Vintage

Three Months Ended June 30, 2008

	Vintage					
(In Millions)	2004 & Earlier	2005	2006	2007	2008	Total
Redwood	$ 17	$ 10	$ 6	$ 5	$ 1	$ 39
Opportunity Fund	1	1	—	—	—	2
Sequoia	14	1	—	4	—	19
Acacia	2	2	1	—	—	5
Total	$ 34	$ 14	$ 7	$ 9	$ 1	$ 65

We note that credit losses on securities have no immediate impact on our cash flow at the time a loss is realized, although they will result in a reduction in the principal balance of the security. Cash flow receipts will therefore be reduced in future periods since interest payments will be based on a reduced principal balance. Additionally, the ability to potentially recover the full purchase discount from face value will be reduced by the amount of the loss.

We caution that the amount of cash flow from existing investments could be volatile from quarter to quarter depending on prepayment patterns, changes in interest rates, and the level of credit losses. Overall, we expect cash flow from existing investments to trend lower over time. Future cash flows could be positively impacted by the timing and the success of our new investment activity.

Residential Real Estate Loans at Sequoia and Redwood

We did not acquire any residential real estate loans during the first half of 2008. We plan to resume acquiring high-quality residential real estate loans on a bulk or flow basis from originators once the economics for securitization improve. Prior to 2006, our loan purchases were predominately comprised of short reset LIBOR-indexed ARMs. In 2006 and 2007 we expanded our Sequoia's product offerings to include high-quality hybrid loans (loans with a fixed-rate coupon for a period of two to ten years before becoming adjustable).

TABLE OF CONTENTS

The following table provides details of our residential real estate loans activity for the six months ended June 30, 2008. Loans are predominantly owned by the Sequoia securitization entities and the reported activity is associated with those loans. The residential loans held outside of any securitization entity and owned by Redwood totaled $4 million at June 30, 2008.

Table 22 Residential Real Estate Loans at Sequoia and Redwood — Activity

(In Millions)	Three Months Ended June 30, 2008	Six Months Ended June 30, 2008

Balance at beginning of period	$ 6,756	7,178
Acquisitions	—	—
Sale proceeds	—	—
Principal repayments	(365)	(764)
Transfers to real estate owned	(13)	(20)
Changes in fair value, net	—	—
Premium amortization	(10)	(18)
Provision for credit losses	(10)	(18)
Balance at End of Period	$ 6,358	$ 6,358

Our residential real estate loan balance declined to $6.4 billion at June 30, 2008 from $7.2 billion at December 31, 2007. At June 30, 2008, 66% of residential loans (by unpaid principal balance) were one-month or six-month LIBOR ARMs and the remaining 34% were hybrid loans. Our residential loans are financed almost entirely through Sequoia securitization entities.

Real Estate Securities at Redwood

The following table provides details of our securities activity at Redwood for the three and six months ended June 30, 2008, at Redwood.

Table 23 Real Estate Securities Activity at Redwood

Three Months Ended June 30, 2008

(In Millions)	Residential CES	Residential IGS	Commercial CES	CDO CES	CDO IGS	OREI	Total
Balance at beginning of period	$ 88	$ 26	100	1	16	3	$ 234
Acquisitions	3	147	—	—	—	—	150
Principal repayments (including calls)	(16)	(4)	—	—	(2)	—	(22)
Recognized gains on calls, net	—	—	—	—	—	—	—
Discount amortization	6	1	(2)	—	—	—	5
Upgrades/downgrades	—	—	—	—	—	—	—
Transfer from (to) other portfolios	—	—	—	—	—	—	—
Change in fair value adjustments, net	6	(10)	(7)	(1)	1	(3)	(14)
Balance at End of Period	$ 87	$ 160	$ 91	$ —	$ 15	$ —	$ 353

Six Months Ended June 30, 2008

(In Millions)	Residential CES	Residential IGS	Commercial CES	CDO CES	CDO IGS	OREI	Total
Balance at beginning of period	$ 151	$ 12	$ 149	$ 2	$ 18	$ 12	$ 344
Acquisitions	13	175	—	—	—	—	188
Principal repayments (including calls)	(32)	(6)	—	—	(2)	(1)	(41)
Recognized gains on calls, net	—	—	—	—	—	—	—
Discount amortization	17	2	(4)	—	—	—	15
Upgrades/downgrades	1	(1)	—	—	—	—	—
Transfer from (to) other portfolios	—	4	—	—	—	(5)	(1)
Change in fair value adjustments, net	(63)	(26)	(54)	(2)	(1)	(6)	(152)
Balance at End of Period	$ 87	$ 160	$ 91	$ —	$ 15	$ —	$ 353

During the second quarter of 2008, we acquired $150 million securities, had principal payments of $22 million, discount amortization of $5 million, had negative market valuation adjustments of $14 million, resulting in a net $124 million increase in our securities portfolio to $353 million at June 20, 2008, from $234 million at March 31, 2008. We also acquired $2 million of previously issued Sequoia ABS during the quarter, which does not appear on our consolidated balance sheets. During the first half of 2008, we acquired $188 million securities, had principal payments of $41 million, discount amortization of $15 million, negative market valuation adjustments of $154 million, and net portfolio transfers of negative $1 million, resulting in a net $9 million increase in our securities portfolio to $353 million at June 30, 2008, from $344 million at June 30, 2007.

The following table provides product type and vintage information regarding the $353 million of securities owned by Redwood at June 30, 2008.

Table 24 Real Estate Securities at Redwood

June 30, 2008 (In Millions)	2004 & Earlier	2005	2006	2007	2008	Grand Total
Prime						
IGS	$ 43	$ 27	$ 21	$ 4	$ 7	$ 102
CES	56	12	4	6	1	79
OREI	—	—	—	—	—	—
Non-prime						
IGS	—	29	13	16	—	58
CES	3	2	1	2	—	8
OREI	—	—	—	—	—	—
Residential Subtotal	102	70	39	28	8	247
Commercial IGS	—	—	—	—	—	—
Commercial CES	15	18	45	13	—	91
CDO IGS	8	6	—	1	—	15
CDO CES	—	—	—	—	—	—
Totals	$ 125	$ 94	$ 84	$ 42	$ 8	$ 353

TABLE OF CONTENTS

The following table presents the carrying value (which equals fair value) as a percent of face value at June 30, 2008 for the securities at Redwood. In the aggregate, the fair value of these securities is 22% of face value.

Table 25 Fair Value as Percent of Principal Value for Real Estate Securities at Redwood

	2004 & Earlier		2005		2006		2007		2008		Total	
(Dollars in Millions)	**Value**	**%**	**Value**	**%**	**Value**	**%**	**Value**	**%**	**Value**	**%**	**Value**	**%**
Prime												
Resi – IGS												
AAA	$ 1	93%	$ 4	79%	$ 13	76%	$ —	—	$ —	—	$ 18	78%
AA	19	76%	21	69%	—	—	4	70%	4	70%	48	72%
A	13	59%	—	—%	8	50%	—	—	2	55%	23	55%
BBB	10	49%	2	30%	—	—	—	—	1	28%	13	42%
Resi – IGS Total	43	63%	27	64%	21	50%	4	—	7	44%	102	63%
Resi – CES												
BB	16	35%	8	27%	2	26%	3	19%	1	19%	30	29%
B	17	38%	1	8%	1	14%	2	8%	—	—	21	24%
NR	23	16%	3	4%	1	2%	1	3%	—	—	28	9%
Resi – CES Total	56	24%	12	10%	4	5%	6	7%	1	19%	79	20%
Total Prime	$ 99	33%	$ 39	23%	$ 25	26%	$ 10	12%	$ 8	32%	$ 181	27%
Non-prime												
Resi – IGS												
AAA	$ —	—	$ 29	62%	$ 13	67%	$ 15	58%	$ —	—	$ 57	62%
BBB	—	—	—	—	—	—	1	3%	—	—	1	3%
Resi – IGS Total	—	—	29	62%	13	66%	16	58%	—	—	58	62%
Resi – CES												
B	1	5%	—	—	—	—	1	3%	—	—	2	10%
NR	2	13%	2	6%	1	2%	1	2%	—	—	6	3%
Resi – CES Total	3	13%	2	7%	1	2%	2	2%	—	—	8	3%
OREI	—	—	—	—	2	1%	1	10%	—	—	3	1%
Total Non-prime	$ 3	13%	$ 31	44%	$ 14	21%	$ 18	13%	$ —	—	$ 66	22%
CMBS												
Comm – CES												
BB	$ 5	55%	$ —	—	$ 6	26%	$ 3	21%	$ —	—	$ 14	30%
B	—	—	—	—	7	21%	5	19%	—	—	12	20%
NR	10	23%	18	14%	32	16%	5	14%	—	—	65	16%
Comm – CES Total	15	29%	18	14%	45	17%	13	17%	—	—	91	18%
Total CMBS	$ 15	29%	$ 18	14%	$ 45	17%	$ 13	17%	$ —	—	$ 91	18%
CDO												
CDO – IGS												
AAA	$ —	—	$ 6	34%	$ —	—	$ —	—	$ —	—	$ 6	34%
AA	8	58%	—	—	—	—	—	—	—	—	8	58%
BBB	—	—	—	—	—	—	1	3%	—	—	1	4%
CDO – IGS Total	8	58%	6	34%	—	—	1	3%	—	—	15	26%
Total CDO	$ 8	58%	$ 6	34%	$ —	—	$ 1	3%	$ —	—	$ 15	26%

Approximately 51% of our investments in real estate securities at June 30, 2008 were residential and commercial credit enhancement securities (CES). We acquire CES at a significant discount to their principal value as credit losses could reduce or eliminate the principal value of these bonds. Our return on these investments is based on how much principal and interest we receive, and how quickly we receive it. In an ideal environment we would experience fast prepayments and low credit losses, allowing us to recover a substantial part of the discount as income. Conversely, the least beneficial environment would be slow prepayments and high credit losses.

TABLE OF CONTENTS

The following table presents the components of carrying value (which equals fair value) at June 30, 2008 for residential and commercial CES.

Table 26 Credit-Enhancement Securities at Redwood

June 30, 2008	**Residential**		
(In Millions)	**Prime**	**Non Prime**	**Commercial**
Current face	$ 390	$ 319	$ 518
Unamortized discount, net	(49)	(17)	(33)
Discount designated as credit reserve	(252)	(297)	(384)
Amortized cost	89	5	101
Gross unrealized market value gains	9	4	3

Gross unrealized market value losses	(19)	(1)	(13)
Carrying Value	$ 79	$ 8	$ 91
Carrying value as a percentage of face	20%	3%	18 %

Residential Credit-Enhancement Securities at Redwood

Our residential CES portfolio had a fair value of $87 million at June 30, 2008, a decrease of $64 million from the fair value of $151 million at December 31, 2007. The primary reason was a decline in fair values in these securities during this period. We acquired $3 million residential CES during the second quarter of 2008, which were all prime securities.

CES have credit ratings that are below investment-grade and have both the upside opportunities and downside risks that are assumed with concentrated credit investments. As a result, we are generally able to acquire these securities at a discount to their face (principal) value. At June 30, 2008, the difference between the principal value ($709 million) and carrying value ($87 million), which equals the fair value, was $622 million for residential CES. Of this difference, $549 million was designated as internal credit reserve (reflecting our estimate of credit losses on the underlying loans over the life of these securities), $66 million represented unamortized discount we are accreting into income over time, and $7 million represented net unrealized mark-to-market losses. Amortized cost on residential CES (principal value less internal credit reserve less amortized discount) decreased $108 million to $94 million at June 30, 2008 from $202 million at December 31, 2007, primarily as a result of declines in fair values and the effect of impairment charges. Net unrealized mark-to-market losses on residential CES fell by $44 million to $7 million at June 30, 2008, from $51 million at December 31, 2007.

The following table details our residential CES portfolios by the product type and collateral vintage at June 30, 2008.

Table 27 Residential Credit-Enhancement Securities at Redwood — Product and Vintage

June 30, 2008 (In Millions)	Vintage 2004 & Earlier	2005	2006	2007	2008	Total
Prime						
ARM	$ 5	$ —	$ —	$ —	$ —	$ 5
Hybrid	32	12	3	2	1	50
Fixed	19	—	1	4	—	24
Total prime	56	12	4	6	1	79
Non-prime						
Option ARM	2	2	1	2	—	7
Hybrid	1	—	—	—	—	1
Total non-prime	3	2	1	2	—	8
Total Residential CES	$ 59	$ 14	$ 5	$ 8	$ 1	$ 87

TABLE OF CONTENTS

Prime securities are residential mortgage-backed securities backed by high credit quality loans. Many of these loans are jumbo loans, with loan balances greater than existing conforming loan limits. Prime securities typically have relatively high weighted average FICO scores (700 or higher), low weighted average loan-to-value ratios (75% LTV or less), and limited concentrations of investor properties.

Non-prime securities are residential mortgage-backed securities that are not backed by high credit quality loans. Most of the borrowers backing non-prime loans have lower FICO scores or impaired credit histories, but exhibit the ability to repay the loan. To compensate for the greater risks and higher costs to service non-prime loans, borrowers often pay higher interest rates, and possibly higher origination fees. We use loss assumptions that are significantly higher when acquiring CES backed by non-prime loans than we use when acquiring CES backed by prime loans.

The loans underlying all of our residential CES totaled $145 billion at June 30, 2008, and consist of $107 billion prime and $38 billion non-prime. These loans are located nationwide with a large concentration in California (49%). During the second quarter of 2008, realized residential credit losses were $67 million of principal value, a rate that equals 18 basis points (0.18%) of current loan balances on an annualized basis. Serious delinquencies (90+ days, in foreclosure or REO) at June 30, 2008 were 4.23% of current balances and 1.93% of original balances. For loans in prime pools, delinquencies were 1.01% of current balances and 0.47% of original balances. Non-prime pools had had delinquencies of 13.29% of current balances and 5.94% of original balances.

Commercial Credit-Enhancement Securities at Redwood

Our commercial CES totaled $91 million at June 30, 2008, a decrease from $149 million at December 31, 2007. This decrease was primarily to declines in the fair value of these securities. At June 30, 2008, commercial CES provided credit-enhancement on $49 billion of underlying loans on office, retail, multifamily, industrial, and other income-producing properties nationwide. Of our total commercial CES, $65 million were non-rated, $12 million were B-rated, and $14 million were BB-rated.

As a result of the concentrated credit risk associated with commercial CES, we are generally able to acquire these securities at a discount to their face (principal) value. The difference between the principal value ($518 million) and carrying value ($91 million) of our commercial CES at June 30, 2008 was $427 million. Of this difference, $384 million was designated as internal credit reserve (reflecting our estimate of likely credit losses on the underlying loans over the life of these securities), $33 million was unamortized discount that we are accreting into income over time, and $10 million was net unrealized market valuation adjustments.

Seriously delinquent loans underlying commercial CES at June 30, 2008 were $390 million, an increase of $207 million from the beginning of the year. Most of the delinquencies are concentrated within a few securities for which we have increased our credit reserves and impaired through our income statement. We consider our credit reserve of $384 million to be adequate as of June 30, 2008.

There were no acquisitions of commercial CES during the quarter. We may begin acquiring these securities during future quarters if and when pricing for these securities becomes attractive to us relative to the risks incurred.

Residential Investment-Grade Securities at Redwood

We invest in IGS backed by prime and non-prime residential loans. Our residential IGS portfolio totaled $160 million at June 30, 2008, an increase from the $12 million at December 31, 2007. The increase in this portfolio was the result of net acquisitions of $175 million, partially offset by decreases in the fair values of these securities. Of the $175 million of IGS acquired in the first half of 2008, 64% were prime securities and 36% were non-prime securities.

TABLE OF CONTENTS

The following table details our residential IGS portfolio by the product type and collateral vintage at June 30, 2008.

Table 28 Residential Investment Grade Securities at Redwood — Product and Vintage

June 30, 2008 (In Millions)	Vintage 2004 & Earlier	2005	2006	2007	2008	Total
Prime						
Hybrid	$ 41	$ 27	$ 13	$ —	$ 4	$ 85
Fixed	2	—	8	4	3	17
Total prime	43	27	21	4	7	102
Non-prime						
Option ARM	—	29	13	—	—	42
Hybrid	—	—	—	16	—	16
Fixed	—	—	—	—	—	—
Total non-prime	—	29	13	16	—	58
Total Residential IGS	$ 43	$ 56	$ 34	$ 20	$ 7	$ 160

Securities at the Opportunity Fund

We began acquiring assets for the Fund in the fourth quarter of 2007. We acquired $60 million of assets during the first half of 2008, bringing the total capital deployed to date to $81 million. The fair value of securities held in the Fund at June 30, 2008 was $66 million, which includes a $15 million unrealized loss due to declining fair values of securities in the Fund. The following table provides information on the activity in this Fund for three and six months ended June 30, 2008.

Table 29 Securities at the Opportunity Fund — Activity

Three Months Ended June 30, 2008 (In Millions)	Residential IGS	CDO CES	CDO IGS	Total
Balance at beginning of period	$ 9	$ —	$ 27	$ 36
Acquisitions	40	—	(7)	33
Recognized gains on sales, net	—	—	2	2
Principal repayments (including calls)	(3)	—	(3)	(6)
Recognized gains on calls, net	—	—	—	—
Discount amortization	1	—	—	1
Upgrades/downgrades	—	7	(7)	—
Change in fair value adjustments, net	(1)	—	1	—
Balance at End of Period	$ 46	$ 7	$ 13	$ 66

Six Months Ended June 30, 2008 (In Millions)	Residential IGS	CDO CES	CDO IGS	Total
Balance at beginning of period	$ 3	$ —	$ 12	$ 15
Acquisitions	47	—	5	52
Recognized gains on sales, net	—	—	2	2
Principal repayments (including calls)	(3)	—	(3)	(6)
Recognized gains on calls, net	—	—	—	—
Discount amortization	1	—	1	2
Upgrades/downgrades	—	7	(7)	—
Change in fair value adjustments, net	(2)	—	3	1
Balance at End of Period	$ 46	$ 7	$ 13	$ 66

TABLE OF CONTENTS

At June 30, 2008, securities at the Fund consisted of $46 million of residential subprime IGS issued prior to 2005, $4 million of CDO IGS issued in 2004, and $9 million of CDO IGS issued in 2005. We did not recognize any other-than-temporary impairments on these securities, as they continue to perform in line with our expectations. We anticipate acquiring additional securities and fully investing the $96 million in Fund capital commitments within the next quarter.

The following table presents the carrying value (which equals fair value) as a percent of face value at June 30, 2008 for the securities at the Fund. In the aggregate, the fair value of these securities is 46% of face value.

Table 30 Fair Value as Percent of Principal Value for Real Estate Securities at the Opportunity Fund

(Dollars in Millions)	2004 & Earlier Value	2004 & Earlier %	2005 Value	2005 %	2006 Value	2006 %	Total Value	Total %
Prime								
Resi – IGS								
AAA	$ 1	85%	$ —	—	$ —	—	$ 1	85%

Resi – IGS Total	1	85%	—	—	—	—	1	85%
Total Prime	$ 1	85%	$ —	—	$ —	—	$ 1	85%
Non-prime								
Resi – IGS								
AAA	$ 12	68%	$ 15	64%	$ 4	60%	$ 31	65%
AA	8	84%	1	50%	—	—	9	82%
A	5	62%	—	—	—	—	5	62%
Resi – IGS Total	25	71%	16	64%	4	60%	45	67%
Total Non-prime	$ 25	71%	$ 16	64%	$ 4	60%	$ 45	67%
CDO								
CDO – IGS								
AA	$ 2	58%	$ 9	27%	$ —	—	$ 11	30%
BBB	2	11%	—	—	—	—	2	11%
CDO – IGS Total	4	19%	9	27%	—	—	13	24%
CDO – CES								
B	7	32%	—	—	—	—	7	32%
CDO – CES Total	7	32%	—	—	—	—	7	32%
Total CDO	$ 11	25%	$ 9	27%	$ —	—	$ 20	26%

Securities at Acacia

The following table provides detail on the activity for securities owned by Acacia entities for the three and six months ended June 30, 2008.

Table 31 Real Estate Securities at Acacia — Activity

Three Months Ended June 30, 2008 (In Millions)	**Residential CES**	**Residential IGS**	**Commercial CES**	**Commercial IGS**	**CDO CES**	**CDO IGS**	**Total**
Balance at beginning of period	$ 103	$ 589	$ 113	$ 63	$ 6	$ 53	$ 927
Acquisitions	—	—	—	—	—	—	—
Recognized gains on sales, net	—	—	—	—	—	—	—
Principal repayments	(14)	(25)	—	(1)	—	(1)	(41)
Recognized gains on calls, net	—	—	—	—	—	—	—
Discount amortization	—	—	—	—	—	—	—
Upgrades/downgrades	76	(76)	—	—	1	(1)	
Transfer from (to) other portfolios	—	—	—	—	—	—	—
Change in fair value adjustments, net	(50)	(7)	1	—	(3)	(5)	(64)
Balance at End of Period	$ 115	$ 481	$ 114	$ 62	$ 4	$ 46	$ 822

***Table 31 Real Estate Securities at Acacia — Activity* – (continued)**

Six Months Ended June 30, 2008 (In Millions)	**Residential CES**	**Residential IGS**	**Commercial CES**	**Commercial IGS**	**CDO CES**	**CDO IGS**	**Total**
Balance at beginning of period	$ 251	$ 1,142	$ 188	$ 90	$ 8	$ 83	$ 1,762
Acquisitions	—	—	—	—	—	—	—
Recognized gains on sales, net	—	—	—	—	—	—	—
Principal repayments	(30)	(62)	—	(2)	—	(1)	(95)
Recognized gains on calls, net	—	—	—	—	—	—	—
Discount amortization	—	—	—	—	—	—	—
Upgrades/downgrades	93	(93)	—	—	3	(3)	
Transfer from (to) other portfolios	—	—	—	(5)	—	5	—
Change in fair value adjustments, net	(199)	(506)	(74)	(21)	(7)	(38)	(845)
Balance at End of Period	$ 115	$ 481	$ 114	$ 62	$ 4	$ 46	$ 822

In addition to the $822 million of real estate securities included in the table above, Acacia owned $84 million of ABS issued by Sequoia, $79 million in non-real estate securities, and $19 million in commercial loans.

The following table presents the total securities owned by Acacia entities, by product type, as of June 30, 2008 and December 31, 2007.

Table 32 Securities at Acacia

(In Millions)	**June 30, 2008**	**December 31, 2007**
Residential IGS		
Prime		
Sequoia	$ 67	$ 75
Other	170	514
Non-prime		
Alt-a	171	417
Subprime	140	211
Residential CES		
Prime		

Sequoia	17	18
Other	62	194
Non-prime		
Alt-a	41	48
Subprime	12	9
Commercial IGS	62	90
Commercial CES	114	189
CDO: IGS	46	83
CDO: CES	4	8
Total Securities at Acacia	$ 906	$ 1,856

TABLE OF CONTENTS

The following table presents the carrying value (which equals fair value) as a percent of face value at June 30, 2008 for securities owned by Acacia entities. In the aggregate, the fair value of these securities is 28% of face value.

Table 33 Fair Value as Percent of Principal Value for Securities at Acacia

(Dollars in Millions)	2004 & Earlier		2005		2006		2007		2008		Total	
	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%
Prime												
Resi – IGS												
AAA	$ 8	89%	$ 7	75%	$ 3	60%	$ —	—	$ —	—	$ 18	77%
AA	37	73%	7	36%	7	65%	1	35%	—	—	52	57%
A	19	51%	17	44%	10	43%	2	30%	—	—	48	45%
BBB	10	44%	23	26%	4	26%	15	35%	—	—	52	39%
Resi – IGS Total	74	64%	54	46%	24	45%	18	34%	—	—	170	52%
Resi – CES												
BB	29	36%	15	29%	6	24%	2	22%	—	—	52	31%
B	4	30%	1	3%	3	10%	—	—	—	—	8	10%
NR	—	—	—	—	2	4%	—	—	—	—	2	4%
Resi – CES Total	33	35%	16	18%	11	11%	2	22%	—	—	62	20%
Total Prime	$ 107	51%	$ 70	35%	$ 35	23%	$ 20	31%	$ —	—	$ 232	37%
Alt-A												
Resi – IGS												
AAA	$ 7	68%	$ 7	77%	$ 68	54%	$ 41	49%	$ —	—	$ 123	54%
AA	7	32%	9	14%	8	16%	2	6%	—	—	26	16%
A	4	23%	2	3%	4	9%	1	6%	—	—	11	7%
BBB	2	19%	6	4%	1	4%	2	4%	—	—	11	5%
Resi – IGS Total	20	33%	24	8%	81	33%	46	26%	—	—	171	22%
Resi – CES												
BB	4	11%	3	6%	2	4%	3	5%	—	—	12	6%
B	1	9%	4	6%	5	4%	3	4%	—	—	13	5%
NR	—	—	1	5%	10	4%	5	7%	—	—	16	4%
Resi – CES Total	5	9%	8	6%	17	4%	11	6%	—	—	41	5%
Total Alt-A	$ 25	22%	$ 32	7%	$ 98	14%	$ 57	15%	$ —	—	$ 212	13%
Subprime												
Resi – IGS												
AAA	$ —	—	$ —	—	$ —	—	$ 7	77%	$ —	—	$ 7	77%
AA	28	67%	39	82%	2	31%	1	11%	—	—	70	68%
A	24	63%	6	40%	—	—	—	—	—	—	30	56%
BBB	25	65%	7	64%	1	7%	—	—	—	—	33	54%
Resi – IGS Total	77	65%	52	70%	3	17%	8	54%	—	—	140	62%
Resi – CES												
BB	6	50%	—	—	—	—	—	—	—	—	6	50%
B	1	9%	—	—	1	6%	—	—	—	—	2	6%
NR	—	—	—	—	2	3%	2	4%	—	—	4	3%
Resi – CES Total	7	44%	—	—	3	3%	2	4%	—	—	12	9%
Total Subprime	$ 84	63%	$ 52	70%	$ 6	6%	$ 10	16%	$ —	—	$ 152	42%

TABLE OF CONTENTS

Table 33 Fair Value as Percent of Principal Value for Securities at Acacia **– (continued)**

(Dollars in Millions)	2004 & Earlier		2005		2006		2007		2008		Total	
	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%
CMBS												
Comm – IGS												
AAA	$ —	—	$ 8	87%	$ 2	88%	$ —	—	$ —	—	$ 10	87%
AA	1	65%	—	—	—	—	—	—	—	—	1	65%

A	11	68%	2	46%	—	—	—	—	—	—	13	64%
BBB	14	70%	23	47%	1	41%	—	—	—	—	38	53%
Comm – IGS Total	26	69%	33	50%	3	55%	—	—	—	—	62	56%
Comm – CES												
BB	19	44%	28	36%	29	29%	2	22%	—	—	78	34%
B	3	37%	13	34%	13	27%	—	—	—	—	29	31%
NR	—	—	2	41%	5	22%	—	—	—	—	7	25%
Comm – CES Total	22	42%	43	36%	47	28%	2	22%	—	—	114	33%
Total CMBS	$ 48	53%	$ 76	42%	$ 50	28%	$ 2	22%	$ —	—	$ 176	39%
CDO												
CDO – IGS												
AAA	$ 3	41%	$ 2	22%	$ —	—	$ —	—	$ —	—	$ 5	32%
AA	3	17%	1	9%	—	—	1	40%	—	—	5	18%
A	11	36%	2	50%	1	11%	1	20%	—	—	15	30%
BBB	12	39%	2	12%	5	24%	2	24%	—	—	21	28%
CDO – IGS Total	29	35%	7	16%	6	19%	4	27%	—	—	46	27%
CDO – CES												
BB	—	—	2	13%	1	20%	—	—	—	—	3	13%
B	1	11%	—	—	—	—	—	—	—	—	1	11%
CDO – CES Total	1	11%	2	13%	1	20%	—	—	—	—	4	12%
Total CDO	$ 30	29%	$ 9	16%	$ 7	19%	$ 4	27%	$ —	—	$ 50	21%

Derivative Financial Instruments

We enter into interest rate agreements to help manage some of our interest rate risks. We enter into these agreements with highly rated counterparties and maintain certain risk management policies limiting our exposure concentrations to any counterparty. At June 30, 2008, Redwood was party to interest rate agreements with an aggregate notional value of $264 million and a net fair value of negative $2 million. At June 30, 2008 the Acacia entities were party to interest rate agreements with an aggregate notional value of $1.8 billion and a net negative fair value of $18 million. These are all accounted for as trading instruments and all changes in value and any net payments and receipts are recognized through our consolidated statements of (loss) income through market valuation adjustments, net.

One Acacia entity entered into credit default swaps (CDS) in the first quarter of 2007. At June 30, 2008, these CDS had a $78 million notional balance and a fair value of negative $75 million. At December 31, 2007, these CDS had a notional balance of $79 million and a fair value of negative $57 million. The decrease in fair value on CDS is included in market valuation adjustments, net, in our consolidated statements of (loss) income.

Asset-Backed Securities Issued at Sequoia and Acacia

Through our sponsored securitization entities, we have securitized the majority of the assets shown on our consolidated balance sheets. These entities acquire assets and issue asset-backed securities (ABS) in order to fund these acquisitions. The residential whole loan securitization entities we sponsor are called Sequoia and the CDO securitization entities we sponsor are called Acacia. These securitization entities are bankruptcy-remote from us, so that our liabilities cannot become liabilities of the securitization entities, and

the ABS issued by the securitization entities cannot become obligations of ours. Nevertheless, GAAP requires us to consolidate the assets and liabilities from Sequoia and Acacia entities for financial statement reporting purposes.

At June 30, 2008, there was $6.4 billion of loans owned by Sequoia securitization entities and reported at cost, which were funded with $6.2 billion Sequoia ABS issued that is also reported at cost. At June 30, 2008, there was $822 million of securities owned by Acacia securitization entities and reported at fair value, which were funded with $935 million Acacia ABS issued that is also reported at fair value. In total, the assets of these two programs represent 94% of our total consolidated assets and the liabilities of these programs (ABS issued) represent 99% of our total consolidated liabilities.

The following table provides detail on the activity for asset-backed securities for the three and six months ended June 30, 2008.

Table 34 ABS Issued at Sequoia and Acacia — Activity

		Three Months Ended June 30, 2008					
(In Millions)	**March 31, 2008**	**Paydowns**	**FAS 159 Adjustments**	**Market Valuation Adjustments**	**Gain on ABS Payoff**	**Amortization**	**June 30, 2008**
Sequoia ABS issued with principal value, net	$ 6,515	$ (364)	$ —	$ —	$ (1)	$ (2)	$ 6,148
Sequoia ABS interest only issued	30	—	—	—	—	(3)	27
Total Sequoia ABS Issued	6,545	(364)	—	—	(1)	(5)	6,175
Acacia issued ABS with principal value, net	1,046	(110)	—	(1)	—	—	935
Acacia ABS CES issued	—	—	—	—	—	—	—
Total Acacia ABS Issued	1,046	(110)	—	(1)	—	—	935
Total ABS Issued	$ 7,591	$ (474)	$ —	$ (1)	$ (1)	$ (5)	$ 7,110

		Six Months Ended June 30, 2008					
(In Millions)	**December 31, 2007**	**Paydowns**	**FAS 159 Adjustments**	**Market Valuation Adjustments**	**Gain on ABS Payoff**	**Amortization**	**June 30, 2008**

Sequoia ABS issued with principal value, net	$ 6,911	$ (758)	$ —	$ —	$ (1)	$ (4)	$ 6,148
Sequoia ABS interest only issued	35	—	—	—	—	(8)	27
Total Sequoia ABS Issued	6,946	(758)	—	—	(1)	(12)	6,175
Acacia issued ABS with principal value, net	3,359	(147)	(1,468)	(809)	—	—	935
Acacia ABS CES issued	24	—	(22)	(2)	—	—	—
Total Acacia ABS Issued	3,383	(147)	(1,490)	(811)	—	—	935
Total ABS Issued	$ 10,329	$ (905)	$ (1,490)	$ (811)	$ (1)	$ (12)	$ 7,110

Long-term Debt — Redwood

In 2006, we issued $100 million of long-term Redwood debt in the form of long-term Redwood debt notes (trust preferred securities) through Redwood Capital Trust I, a wholly-owned Delaware statutory trust, in a private placement transaction. These trust preferred securities require quarterly distributions at a floating rate equal to three-month LIBOR plus 2.25% until the notes are redeemed in whole, which will be no later than January 30, 2037. The earliest optional redemption date without a penalty is January 30, 2012.

TABLE OF CONTENTS

In May 2007, we issued $50 million of long-term Redwood debt notes which require quarterly distributions at a floating rate equal to three-month LIBOR plus 2.25% until the notes are redeemed in whole, which will be no later than July 30, 2037. The earliest optional redemption date without a penalty is July 30, 2012.

In our internal risk-adjusted capital calculations we include long-term Redwood debt in our capital base.

Contractual Obligations and Commitments

The following table presents our contractual obligations and commitments as of June 30, 2008, as well as the obligations of the securitization entities that we sponsor and consolidate for financial reporting purposes.

Table 35 Contractual Obligations and Commitments as of June 30, 2008

(In Millions)	Payments Due or Commitment Expiration by Period				
	Total	Less Than 1 Year	1 to 3 Years	3 to 5 Years	After 5 Years
Redwood Obligations:					
Short-term debt – Redwood	$ 9	$ 9	$ —	$ —	$ —
Long-term debt – Redwood	150	—	—	—	150
Anticipated interest payments on long-term Redwood debt	316	7	19	22	268
Accrued interest payable	1	1	—	—	—
Operating leases	15	2	3	4	6
Purchase commitments	—	—	—	—	—
Total Redwood Obligations and Commitments	$ 491	$ 19	$ 22	$ 26	$ 424
Obligations of Securitization Entities:					
Consolidated ABS(1)	$ 7,110	$ —	$ —	$ —	$ 7,110
Anticipated interest payments on ABS(2)	6,803	187	1,340	965	4,311
Accrued interest payable	31	31	—	—	—
Total obligations of securitization entities	$ 13,944	$ 218	$ 1,340	$ 965	$ 11,421
Total Consolidated Obligations and Commitments	$ 14,435	$ 237	$ 1,362	$ 991	$ 11,845

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

(2) The anticipated interest payments on consolidated ABS issued is calculated based on the contractual maturity of the ABS and therefore assumes no prepayments of the principal outstanding as of June 30, 2008.

Accumulated Other Comprehensive (Loss) Income

As of December 31, 2007, most of our real estate securities were accounted for as AFS and were reported on our consolidated balance sheets at fair value. Additionally, most of the derivative instruments owned by Acacia entitles were accounted for as cash flow hedges and reported on our consolidated balance sheets at fair value. The differences between the value of these assets and their amortized costs were shown as a component of stockholders' equity (deficit) as accumulated other comprehensive (loss) income. Periodic changes in the fair value of these assets relative to amortized cost were included in other comprehensive income.

On January 1, 2008 we elected the fair value option under FAS 159 for the assets and liabilities of Acacia entities and certain other assets at Redwood. The effect of this election was a reclassification of $459 million from accumulated other comprehensive income to retained earnings. This one time adjustment had no impact on our reported earnings. Subsequent changes to the values of FAS 159 assets and liabilities flow through our consolidated statements of (loss) income not through other comprehensive income.

The following table provides cumulative balances of unrealized gains and losses and carrying value by type and rating of real estate securities at June 30, 2008 and December 31, 2007. It also reflects the change in balances of cumulative unrealized (loss) gains during the first six months of 2008.

Table 36 Other Comprehensive Income (Loss) — Real Estate Securities

	Cumulative (Loss) Gain	Adoption of FAS 159	Change in (Loss) Gain	Cumulative (Loss) Gain	Carrying Value	
(In Millions)	**December 31, 2007**	**January 1, 2008**	**Six Months Ended June 30, 2008**	**June 30, 2008**	**June 30, 2008**	**December 31, 2007**
Investment-Grade Securities						
Residential	$ (241)	$ 241	$ (15)	$ (15)	$ 202	$ 1,157
Commercial	(20)	20	—	—	—	90
CDO	(13)	7	5	(1)	13	114
Total IGS	(274)	268	(10)	(16)	215	1,361
Credit-Enhancement Securities						
Residential	(143)	103	34	(6)	87	402
Commercial	(125)	87	28	(10)	91	337
CDO	1	—	(3)	(2)	7	10
Total CES	(267)	190	59	(18)	185	749
Total Real Estate Securities	$ (541)	$ 458	$ 49	$ (34)	$ 400	$ 2,110

Market Risks

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

Credit Risk

Integral to our core business is assuming the credit risk of real estate loans primarily through the ownership of residential and commercial real estate loans and securities. Much of our capital base is employed in owning credit-enhancement securities that have below investment-grade credit ratings due to their concentrated credit risks with respect to underlying real estate loans. We believe that many of the loans underlying these securities are above-average in credit quality as compared to U.S. real estate loans in general, but the balance and percentage of loans with special risk factors (higher risk commercial loans, interest-only and negative amortization residential loan types, and alt-a and subprime residential loans) has increased and continues to increase. We also own $4 million residential real estate loans that are not securitized.

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

With respect to most of the loans securitized by securitization entities sponsored by us and for a portion of the loans underlying residential loan CES we have acquired from securitizations sponsored by others, the

interest rate is adjustable. Accordingly, when short-term interest rates rise, required monthly payments from homeowners may rise under the terms of these ARMs, and this may increase borrowers' delinquencies and defaults.

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

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

We will experience credit losses on residential and commercial loans and CES, and to the extent the losses are consistent with the amount and timing of our assumptions, we expect to earn attractive returns on our investments. We manage our credit risks by understanding the extent of the risk we are taking and insuring the appropriate underwriting criteria are met, and we utilize systems and staff to continually monitor the ongoing credit performance of each loan and security. To the extent we find the credit risks on specific assets are changing adversely, we will take actions (including selling the assets) to mitigate potential losses. However, we may not always be successful in foreseeing adverse changes in credit performance or in effectively mitigating future credit losses.

In addition to residential and commercial CES, Redwood, the Fund, and Acacia own investment-grade and other securities issued by securitization entities that are sponsored by others. These securities are typically rated AAA through BBB-, and are in a second-loss or better position or are otherwise effectively more senior in the credit structure in comparison to first-loss CES or their equivalent. A risk we face with respect to these securities is that we do not generally control or influence the underwriting, servicing, management, or loss mitigation with respect to these underlying loans.

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

In addition to the foregoing, the Acacia entities own certain investment-grade, BB-rated, and B-rated residential loan securities purchased from the Sequoia securitization entities we sponsor.

These securities are generally less likely to suffer credit losses than other securities since credit losses ordinarily would not occur until cumulative credit losses within the pool of securitized loans exceed the principal value of the subordinated CES underneath and other credit protections have been exhausted. However, if the pools of residential and commercial loans underlying these securities were to experience poor credit results, these securities could have their credit ratings downgraded, could suffer decreases in fair value, or could experience principal losses. If any of these events occurs, it would likely reduce our returns from these investments.

Interest Rate Risk

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

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

Prepayment Risk

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

Prepayments affect GAAP earnings in the near-term primarily through the timing of the amortization of purchase premium and discount and through triggering market valuation adjustments. For example, amortization income from discount assets may not necessarily offset amortization expense from premium assets, and vice-versa. In addition, variations in current and projected prepayment rates for individual assets and changes in interest rates (as they affect projected coupons on ARMs and other assets and thus change effective yield calculations) may cause net premium amortization expense or net discount amortization income to vary substantially from quarter to quarter. Moreover, the timing of premium amortization on assets may not always match the timing of the premium amortization on liabilities even when the underlying assets and liabilities are in the same securitization and pay down at the same rate.

With respect to securities backed by residential mortgage loans (and in particular, IO securities), changes in prepayment forecasts by market participants could affect the market prices of those securities sold by securitization entities, and thus could affect the profits we earn from securitized assets.

Prepayment risks also exist in the assets and associated liabilities consolidated on our balance sheets. In general, discount securities (such as CES) benefit from faster prepayment rates on the underlying real estate loans while premium securities (such as IO securities) benefit from slower prepayments on the underlying loans. Our largest current potential exposure to changes in prepayment rates is on short-term residential ARM loans. We are currently biased in favor of faster prepayment speeds with respect to the long-term economic effect of ARM prepayments. However, in the short-term, increases in ARM prepayment rates could result in GAAP earnings volatility.

Through our ownership of discount residential loan CES backed by fixed-rate and hybrid residential loans, we generally benefit from faster prepayments on those underlying loans. Prepayment rates for those loans typically accelerate as medium-and-long-term interest rates decline.

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

We caution that prepayment rates are difficult to predict or anticipate, and variations in prepayment rates can materially affect our earnings and dividends. ARM prepayment rates, for example, are driven by many factors, one of which is the steepness of the yield curve. As the yield curve flattens (short-term interest rates rise relative to longer-term interest rates), ARM prepayments typically increase.

We do not believe it is possible or desirable to control the effects of prepayments in the short-term. Consequently, our general approach is to seek to balance overall characteristics of our balance sheet so that the net present values of cash flows generated over the life of the assets and liabilities in our consolidated portfolios do not materially change as prepayment rates change.

Fair Value and Liquidity Risks

Most of the CES that we own is fully funded with equity with no associated recourse or non-recourse debt that might affect our liquidity position. Additionally, we consolidate many securities (primarily IGS) owned by Acacia entities. On January 1, 2008 we elected the fair value option under FAS 159 for Acacia assets and liabilities, with all changes in market values now being recorded through our income statement. Though this adds to our potential earnings volatility, the securities and ABS issued by Acacia entities have no

recourse to us that would otherwise affect our liquidity position. Changes in the fair values (or ratings downgrades) of assets owned by an Acacia entity may also create differences between our reported GAAP and taxable income. However, we do not currently believe this will create liquidity issues for us.

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

Our consolidated obligations consist primarily of ABS issued. Generally, changes in fair value of ABS issued have no impact on our liquidity. ABS issued by Sequoia are reported at amortized cost as our the residential loans collateralizing these ABS. Beginning January 1, 2008, we report at fair value the ABS issued by Acacia and also report the underlying securities collateralizing the ABS issued at fair value. In either case, the resulting net equity (assets less liabilities) may not necessarily be reflective of the economic value of our interests in these securitization entities. However, since the ABS issued can only look to the cash flows generated by the assets within that securitization for payments of interest and repayments of the face value of the ABS, the changes in fair value do not have an effect on Redwood. Only to the extent that changes in fair values affect the timing of the cash flows we might receive on our investments in the Acacia entities, is there an effect to Redwood from changes in fair values of these securities. There are no such considerations in the Sequoia securitization entities.

We hold some assets funded with short-term debt (generally prior to securitization) that is recourse to Redwood. At some point, this may increase our fair value and liquidity risks. We manage these risks by maintaining what we believe to be conservative capital levels under our internal risk-adjusted capital and risk management policies and by ensuring we have a variety of financing facilities available to fund each of our assets.

Mark-to-Market Valuation Process

The fair values we use for our assets and liabilities reflect what we believe we would realize if we chose to sell our securities or would have to pay if we chose to buy back our asset-backed securities (ABS) issued (liabilities). Establishing fair values is inherently subjective and is dependent upon many market-based inputs, including observable trades, information on offered inventories, bid lists, and indications of value obtained from dealers. Obtaining fair values for securities is especially difficult for more illiquid securities (such as ours), and is made more difficult when there is limited trading visibility, as has been the case in recent quarters. Where there are observable sales, many of them are from distressed sellers, and their sales tend to further depress asset prices. For these reasons, we expect market valuations to continue to be highly volatile.

Fair values for our securities and ABS issued are dependent upon a number of market-based assumptions including future interest rates, prepayment rates, discount rates, credit loss rates, and the timing of credit losses. We use these assumptions to generate cash flow estimates and internal values for each individual security. Our valuation process relied on our internal values to estimate the fair values of our securities at June 30, 2008. We also request indications of value (marks) from dealers every quarter to assist in the valuation process for all of our assets and liabilities. For June 30, 2008, we received dealer marks on 81% of our assets and 91% of our liabilities on our consolidated balance sheet. One major dealer that we have used in prior periods provided no marks. In the aggregate, our internal valuations of the securities on which we received dealer marks were 17% lower than the aggregate dealer marks at June 30, 2008. Our internal valuations of our ABS issued on which we received dealer marks were 1% lower than the aggregate dealer marks at June 30, 2008.

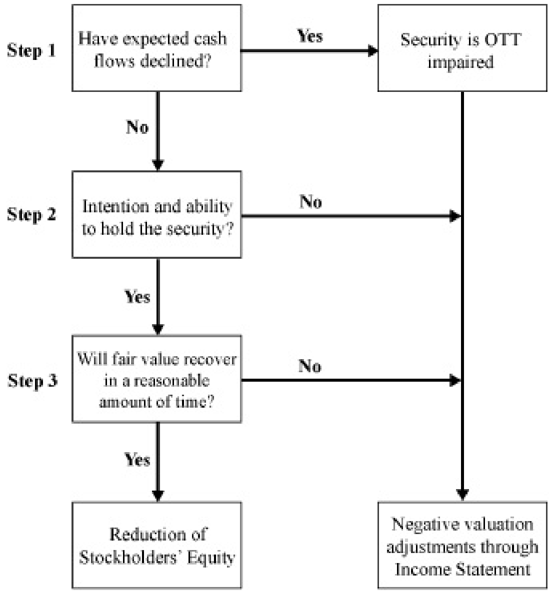
One of the factors we consider in our valuation process is our assessment of the quality of the dealer marks we receive. Dealers remain inundated with requests for quarter-end marks, and there continues to be limited observable trading information for them to rely upon. Thus, their marks were most likely generated by their own pricing models for which they did not share their inputs and we had little insight into their assumptions. Furthermore, the dealers continue to heavily qualify the information they send to us. The

qualifications include statements that the markets are very volatile and are characterized by limited trading volume and poor price transparency, and in many cases, an increasing number of valuations are model-based due to a lack of observable trades.

Mark-to-Market Adjustments

The rules regarding mark-to-market (MTM) accounting are complex and may not clearly reflect the underlying economics. This accounting and economic discussion is intended to provide investors with a better understanding of the impact of MTM adjustments on our reported financial results.

All changes in fair value for securities or derivatives accounted for as trading instruments or under the fair value option of FAS 159 flow through the income statement. These adjustments can be either positive or negative from period to period. Positive changes in the fair value of AFS securities from period to period are accounted for as increases to stockholders' equity and do not flow through our income statement. Accounting for negative changes in the fair value of AFS securities from period to period requires a three-step process involving a combination of quantitative and judgmental evaluations. The diagram and discussion that follows details the three-step process for evaluating impairments on AFS securities.



AFS securities are deemed impaired if the fair value is below amortized cost. An assessment is then required as to whether the impairment is temporary and is reflected as unrealized losses in the balance sheet, or is other-than-temporary (OTT) and realized through the income statement as market valuation adjustments.

The first step in this assessment is to determine whether there has been an adverse change in the underlying cash flows generated by the security. It is difficult to separate with precision how much of the change in fair value is driven by changes in expected cash flows versus changes in market discount rates, but during periods of market illiquidity and uncertainty (as we encountered since late 2007), the market discount rate impact can be significant. The second step is to determine whether we have the ability and intention to hold the security. The third step requires us to evaluate whether an impaired security will recover in value within a reasonable period of time. This step is very subjective, particularly when there is turmoil and uncertainty in the capital markets.

If, based on our assessment, we have an other-than-temporary impairment, then the basis of the security is written down to its fair value through our income statement. Market valuation adjustments of this type

could be substantial, reducing GAAP income and causing a loss. However, for securitized assets, reductions in fair values may not affect our cash flows or investment returns at all, or may not affect them to the degree implied by the accounting write-down.

A security can be considered OTT impaired even if the change in projected cash flows is small relative to the resulting MTM adjustment. So while OTT impaired securities cannot be written back up through MTM adjustments in our income statement, this does not mean the underlying security could not recover in value. If the cash flows generated by the security perform better than the decline in fair value might indicate, we could recognize this benefit through higher interest yields over time.

Inflation Risk

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

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Information concerning market risk is incorporated herein by reference to Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2007, as supplemented by the information under "Management's Discussion and Analysis of Financial Condition and Results of Operations — Market Risks" above. With the exception of developments described under Management's Discussion and Analysis of Financial Condition and Results of Operations above, including changes in the fair values of our assets, there have been no material changes in our quantitative or qualitative exposure to market risk since December 31, 2007.

Item 4. Controls and Procedures

In connection with the completion of the audited financial statements for December 31, 2007, we concluded that a material weakness in our internal control over financial reporting resulted from the fact that we were unable to obtain the necessary evidence under Staff Accounting Bulletin 59, *"Accounting for Noncurrent Marketable Equity Securities"* (SAB 59) to support our initial conclusion that a material portion of unrealized losses were recoverable as of December 31, 2007.

To address this material weakness we completed the additional analysis required under SAB 59 and implemented enhancements in our internal control over financial reporting that are designed to ensure that we continue to perform the requisite analysis on a quarterly basis.

Other than the enhancements and remediation steps described above, there have been no changes in our internal control over financial reporting during the quarter ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

TABLE OF CONTENTS

PART II

Item 1. Legal Proceedings

There is no material pending legal proceedings to which we or any of our subsidiaries is a party or of which our property is the subject.

Item 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed under Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2007.

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

For the three months ended June 30, 2008, we did not sell any equity securities that were not registered under the Securities Act of 1935, as amended, or repurchase any shares of our common stock.

Item 3. Defaults Upon Senior Securities

None.

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

We held our Annual Meeting of Stockholders on May 22, 2008, at which our stockholders voted to elect Douglas B. Hansen, Greg H. Kubicek, and Charles J. Toeniskoetter as Class II directors to serve on our Board of Directors until the Annual Meeting of Stockholders in 2011 and until their successors are duly elected and qualified. The stockholders' votes with respect to the election of directors were as follows:

	Votes	
Nominee	**For**	**Withheld**
Douglas B. Hansen	30,987,377	186,589
Greg H. Kubicek	30,690,027	483,938
Charles J. Toeniskoetter	30,940,760	233,205

The following directors' terms in office continue following the Annual Meeting of Stockholders:

George E. Bull, III
Richard D. Baum
Thomas C. Brown
Mariann Byerwalter
Georganne C. Proctor
David L. Tyler

At our Annual Meeting of Stockholders on May 22, 2008, our stockholders ratified the appointment of Grant Thornton LLP as our independent registered public accounting firm for 2008. The stockholders' votes with respect to the ratification of Grant Thornton LLP as our independent registered public accounting firm were as follows:

For	Against	Abstentions	Broker Non-Votes
28,952,930	2,160,832	60,203	—

At our Annual Meeting of Stockholders on May 22, 2008, our stockholders approved an amendment to our 2002 Incentive Plan. The stockholders' votes with respect to the approval were as follows:

For	Against	Abstentions	Broker Non-Votes
20,161,056	6,205,963	70,123	4,736,823

TABLE OF CONTENTS

At our Annual Meeting of Stockholders on May 22, 2008, our stockholders approved an amendment to our Charter. The stockholders' votes with respect to the approval were as follows:

For	Against	Abstentions	Broker Non-Votes
25,857,739	523,447	55,956	4,736,823

At our Annual Meeting of Stockholders on May 22, 2008, our stockholders did not approve a stockholder proposal concerning our classified Board of Directors. The stockholders' votes with respect to the proposal were as follows:

For	Against	Abstentions	Broker Non-Votes
12,416,766	13,794,318	226,057	4,736,823

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Exhibit
3.1	Articles of Amendment and Restatement of the Registrant, effective July 6, 1994 (filed herewith)
3.1.1	Articles Supplementary of the Registrant, effective August 11, 1994
3.1.2	Articles Supplementary of the Registrant, effective August 14, 1995
3.1.3	Articles Supplementary of the Registrant, effective August 9, 1996

3.1.4	Certificate of Amendment of the Registrant, effective June 30, 1998
3.1.5	Articles Supplementary of the Registrant, effective April 10, 2003
3.1.6	Articles of Amendment of the Registrant, effective June 12, 2008
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

TABLE OF CONTENTS

SIGNATURES

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

REDWOOD TRUST, INC.

Date: August 5, 2008	By: /s/ Douglas B. Hansen Douglas B. Hansen President (authorized officer of registrant)
Date: August 5, 2008	By: /s/ Martin S. Hughes Martin S. Hughes Chief Financial Officer and Secretary (principal financial officer)
Date: August 5, 2008	By: /s/ Harold F. Zagunis Harold F. Zagunis Managing Director and Controller (principal accounting officer)

TABLE OF CONTENTS

INDEX TO EXHIBITS

Exhibit Number	Exhibit
3.1	Articles of Amendment and Restatement of the Registrant, effective July 6, 1994 (filed herewith)
3.1.1	Articles Supplementary of the Registrant, effective August 11, 1994
3.1.2	Articles Supplementary of the Registrant, effective August 14, 1995
3.1.3	Articles Supplementary of the Registrant, effective August 9, 1996
3.1.4	Certificate of Amendment of the Registrant, effective June 30, 1998
3.1.5	Articles Supplementary of the Registrant, effective April 10, 2003
3.1.6	Articles of Amendment of the Registrant, effective June 12, 2008
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

ARTICLES OF AMENDMENT AND RESTATEMENT

OF

REDWOOD TRUST, INC.

REDWOOD TRUST, INC., a Maryland corporation, having its principal office at The Corporation Trust Incorporated, 32 South Street, Baltimore, Maryland 21202 (hereinafter referred to as the "Corporation"), hereby certifies to the State Department of Assessments and Taxation of Maryland that:

FIRST: The Corporation desires to amend and restate its charter as currently in effect and as hereinafter amended.

SECOND: The following provisions are all the provisions of the charter currently in effect and as hereinafter amended:

ARTICLE I

The undersigned, Billie Swoboda, whose address is 32 South Street, Baltimore, Maryland, 21202, being at least eighteen (18) years of age, does hereby act as an incorporator, under and by virtue of the General Laws of the State of Maryland, authorizing the formation of corporations and with the intention of forming a corporation.

ARTICLE II

The name of the corporation (which is hereinafter called the "Corporation") is:

REDWOOD TRUST, INC.

ARTICLE III

The purpose for which the Corporation is formed is to transact any or all lawful business, not required to be specifically stated in these Articles, for which corporations may be incorporated under the Corporations and Associations Article of the Annotated Code of Maryland as amended from time to time.

ARTICLE IV

The present address of the principal office of the Corporation in this State is:

The Corporation Trust Incorporated
32 South Street
Baltimore, Maryland 21202

ARTICLE V

The name and address of the resident agent of the Corporation are:

The Corporation Trust Incorporated
32 South Street
Baltimore, Maryland 21202

Said resident agent is a Maryland corporation actually residing in the State.

ARTICLE VI

A. The total number of shares of stock of all classes which the Corporation has authority to issue is fifty million (50,000,000) shares of capital stock, par value one cent ($0.01) per share, amounting in aggregate par value to Five Hundred Thousand Dollars ($500,000.00). All of such shares are initially classified as "Common Stock." The Board of Directors may classify and reclassify and unissued shares of Common Stock by setting or changing in any one or more respects the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends, qualifications or terms or conditions of redemption of such shares of stock.

B. The following is a description of the preferences, conversion and other rights, voting powers, restrictions limitations as to dividends, qualifications and terms and conditions of redemption of the Common Stock of the Corporation.

(1) Each share of Common stock shall have one vote, and, except as otherwise provided in respect of any class of capital stock hereafter classified or reclassified, the exclusive voting power for all purposes shall be vested in the holders of the Common Stock.

(2) Subject to the provisions of law and any preferences of any class of capital stock hereafter classified or reclassified, dividends, including dividends payable in shares of the Corporation's stock, may be paid on the Common Stock of the Corporation at such time and in such amounts as the Board of Directors may deem advisable.

(3) In the event of any liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, the holders of the Common Stock shall be entitled, after payment or provision for payment of the debts and other liabilities of the Corporation and the amount to which the holders of any class of capital stock hereafter classified or reclassified having a preference or distributions in the liquidation, dissolution or winding up of the Corporation shall be entitled, together with the holders of any other class of capital stock hereafter classified or reclassified not having a preference on distributions in the liquidation, dissolution or winding up of the Corporation, to share ratably in the remaining net assets of the Corporation.

C. Subject to the foregoing, the power of the Board of Directors to classify and reclassify any of the shares of capital stock shall include, without limitation, subject to the provisions of the charter, authority to classify or reclassify any unissued shares of such capital stock into a class or classes of preferred stock, preference stock, special stock, or other stock, and to divide and classify shares of any class into one or more series of such class, by determining, fixing or altering ore or more of the following:

(1) The distinctive designation of such class or series and the number of shares to constitute such class or series; provided that, unless otherwise prohibited by the terms of such or any other class or series, the number of shares of any class or series may be decreased by the Board of Directors in connection with any classification or reclassification of unissued shares and the number of shares of such class or series may be increased by the Board of Directors in connection with any such classification or reclassification, and any shares of any class or series which have been redeemed, purchased, otherwise acquired or converted into shares of Common Stock or any other class or series shall become part of the authorized capital stock and be subject to classification and reclassification as provided in this subparagraph.

(2) Whether or not and, if so, the rates, amounts and times at which, and the conditions under which, dividends shall be payable on shares of such class or series, whether any such dividends shall rank senior or junior to or on a parity with the dividends payable or any other class or series of capital stock, and the status of any such dividends as cumulative to a limited extent or noncumulative and as participating or nonparticipating.

(3) Whether or not shares of such class or series shall have voting rights in addition to any voting rights provided by law and, if so, the terms of such voting rights.

(4) Whether or not shares of such class or series shall have conversion or exchange privileges and, if so, the terms and conditions thereof, including provision for adjustment of the conversion or exchange rate in such events or at such times as the Board of Directors shall determine.

(5) Whether or not shares of such class or series shall be subject to redemption and, if so, the terms and conditions of such redemption, including the date or dates upon or after which they shall be redeemable and the amount per share payable in case of redemption, which amount may vary under different conditions and at different redemption dates; and whether or not there shall be any sinking fund or purchase account in respect thereof, and if so, the terms thereof.

(6) The rights of the holders of shares of such class or series upon the liquidation, dissolution or winding up of the affairs of, or upon any distribution of the assets of, the Corporation, which rights may vary depending upon whether such liquidation, dissolution or winding up is voluntary or involuntary and, if voluntary, may vary at different dates, and whether such rights shall rank senior or junior to or on a parity with such rights of any other class or series of capital stock.

(7) Whether or not there shall be any limitations applicable, while shares of such class or series are outstanding, upon the payment of dividends or making of distributions on, or the acquisition of, or the use of moneys for purchase or redemption of, any capital stock of the Corporation, or upon any other action of the Corporation, including action under this subparagraph, and, if so, the terms and conditions thereof.

(8) Any other preferences, rights, restrictions, including restrictions on transferability, and qualifications of shares of such class or series, not inconsistent with law and the Charter.

D. For the purposes hereof and of any Articles supplementary hereto providing for the classification or reclassification of any shares of capital stock or of any other charter document of the Corporation (unless otherwise provided in any such Articles or document), any class or series of capital stock of the Corporation shall be deemed to rank:

(1) prior to another class or series either as to dividends or upon liquidation, if the holders of such class or series shall be entitled to the receipt of dividends or of amounts distributable on liquidation, dissolution or winding up, as the case may be, in preference or priority to holders of such other class or series;

(2) on a parity with another class or series either as to dividends or upon liquidations, whether or not the dividend rates, dividend payment dates or redemption or liquidations price per share thereof be different from those of such others, if the holders of such class or series of stock shall be entitled to receipt of dividends or amounts distributable upon liquidations, dissolution or winding up, as the case may be, in proportion to their respective dividend rates or redemption or liquidations prices, without preference or priority over the holders of such other class or series; and

(3) junior to another class or series either as to dividends or upon liquidations, if the rights of the holders of such class or series shall be subject or subordinate to the rights of the holders of such other class or series in respect of the receipt of dividends or the amounts distributable upon liquidation, dissolution or winding up, as the case may be.

ARTICLE VII

The number of Directors of the Corporation shall be three (3), which number may be increased or decreased pursuant to the by-laws of the Corporation, but shall never be less than the minimum number permitted by the General Laws of the State of Maryland now or hereafter in force. The directors shall be divided into three Classes, designated Class I, Class II and Class III. Each class shall consist, as nearly as may be possible, of one-third of the total number of directors constituting the entire Board of Directors. The terms of the initial Class I directors shall terminate on the date of the annual meeting of stockholders held in 1995; the terms of the initial Class II directors shall terminate on the date of the annual meeting of stockholders held in 1996; and the term of the initial Class III directors shall terminate on the date of the annual meeting of stockholders held in 1997. At each annual meeting of stockholders beginning in 1995, successors to the class of directors whose term expires at the annual meeting shall be elected for a three-year term. If the number of directors is changed, any increase or decrease shall be apportioned among the classes so as to maintain the number of directors in each class as nearly equal as possible and any additional directors of any class elected to fill a vacancy resulting from an increase in such class shall hold office for a term that shall coincide with the remaining term of that class, but in no case will a decrease in the number of directors shorten the term of any incumbent director. A director shall hold office until the annual meeting for the year in which his or her term expires and until his or her successor shall be elected and shall qualify, subject, however, to prior death, resignation, retirement, disqualification or removal from office.

The names and Classes of the directors who shall act until their terms expire or until their successors are duly chosen and qualified are:

Director	Class
Frederick H. Borden	Class I
Douglas B. Hansen	Class II
George E. Bull, III	Class III

ARTICLE VIII

Except as may otherwise be provided by the Board of Directors of the Corporation, no holder of any shares of the stock of the Corporation shall have any pre-emptive or preferential right to purchase, subscribe for, or otherwise acquire any shares of stock of the Corporation of any class now or hereafter authorized, or any securities exchangeable for or convertible into such shares, or any warrants or other instruments evidencing rights or options to subscribe for, purchase or otherwise acquire such shares.

ARTICLE IX

The Corporation shall indemnify (A) its directors and officers, whether serving the Corporation or at its request any other entity, to the full extent required or permitted by the General Laws of the State of Maryland now or hereafter in force, including the advance of expenses under the procedures and to the full extent permitted by law and (B) other employees and agents to such extent as shall be authorized by the Board of Directors or the Corporation's By-Laws, and be permitted by law. The foregoing rights of indemnification shall not be exclusive of any other rights to which those seeking indemnification may be entitled. The Board of Directors may take such action as is necessary to carry out these indemnification provisions and is expressly empowered to adopt, approve and amend from time to time such By-Laws, resolutions or contracts implementing such provisions or such further indemnification arrangement as may be permitted by law. No amendment of the charter of the Corporation or repeal of any of its provisions shall limit or eliminate the right to indemnification provided hereunder with respect to acts or missions occurring prior to such amendment or repeal.

ARTICLE X

To the fullest extent permitted by Maryland statutory or decisional law, as amended or interpreted, no director or officer of this Corporation shall be personally liable to the Corporation or its stockholders for money damages. No amendment of the Charter of the Corporation or repeal of any of its provisions shall limit or eliminate the benefits provided to directors and officers under this provision with respect to any act or omission which occurred prior to such amendment or repeal.

ARTICLE XI

Section 1. Definitions. For the purpose of this Article XI, the following terms shall have the following meanings:

"Beneficial Ownership" shall mean ownership of Capital Stock by a Person either directly or constructively through the application of section 544 of the Code, as modified by sections 856(h)(l)(B) and 856(h)(3)(A) of the Code and determined without respect to whether such ownership has the effect of meeting the stock ownership requirement of section 542(a)(2) of the Code. The terms "Beneficial Owner," "Beneficially Owning," "Beneficially Own" and "Beneficially Owned" shall have the correlative meanings.

"Beneficiary" shall mean the beneficiary of the Trust as determined pursuant to Section 9 of this Article XI.

"Code" shall mean the Internal Revenue Code of 1986, as amended.

"Capital Stock" shall mean stock that is either Common Stock, Preferred Stock or any other class of capital stock of the Corporation classified or reclassified pursuant to Article VI or this Article XI.

"Excess Securities" shall have the meaning set forth in Section 4 of this Article XI.

"Initial Public Offering" shall mean the sale of shares of Common Stock pursuant to the Corporation's first effective registration statement for such Common Stock filed under the Securities Act of 1933, as amended.

"Market Price" for any class of Capital Stock or Warrants shall mean the last reported sales price reported on the New York Stock Exchange of such Capital Stock or Warrants, on the trading day immediately preceding the relevant date, or if not then traded on the New York Stock Exchange, the last reported sales price of such Capital Stock or Warrants on the trading day immediately preceding the relevant date as reported on any exchange or quotation system over which such Capital Stock or Warrants may be traded, or if not then traded any exchange or quotation system, then the market price of the Capital Stock or Warrants on the relevant date as determined in good faith by the Board of Directors of the Corporation.

"NYSE" shall mean the New York Stock Exchange.

"Ownership Limit" shall mean the Beneficial Ownership of 9.8%, in number of shares or value, of each class of outstanding Capital Stock of the Corporation, and after adjustment as set forth in Section 12 of this Article XI, shall mean such greater percentage of the outstanding Capital Stock as so adjusted. The number and value of shares of the outstanding Capital Stock of the Corporation shall be determined by the Board of Directors in good faith, which determination shall be conclusive for all purposes hereof.

"Person" shall mean an individual, corporation, partnership, estate, trust (including a trust qualified under section 401(a) or 501(c)(17) of the Code), a portion of a trust permanently set aside for or to be used exclusively for the purposes described in section 642(c) of the Code, association, private foundation within the meaning of section 509(a) of the Code, joint stock company or other entity; but does not include an underwriter which participated in a public offering or private placement of Capital Stock or Warrants for a period of 90 days following the purchase by such underwriter of such Capital Stock or Warrants.

“Purported Transferee” shall mean, with respect to any purported Transfer which results in Excess Securities, the purported transferee who would have acquired shares of Capital Stock or Warrants, if such Transfer had been valid under Section 2 of this Article XI.

“REIT” shall mean a real estate investment trust as defined under section 856 of the Code.

“Restriction Termination Date” shall mean the first day on which the Board of Directors of the Corporation determines that it is no longer in the best interest of the Corporation to attempt to, or continue to, qualify as a REIT.

“Transfer” shall mean any sale, transfer, gift, assignment, devise, or other disposition of Capital Stock or Warrants (including (a) the granting of any option of entering into any agreement for the sale, transfer or other disposition of Capital Stock or Warrants, (b) the sale, transfer, assignment or other disposition of Warrants or any other securities or rights convertible into or exchangeable for Capital Stock, but excluding the actual conversion or exchange of such securities or rights into Capital Stock and (c) any transfer or other disposition of any interest in Capital Stock or Warrants as a result of a change in the marital status of the holder thereof), whether voluntary or involuntary, whether of record or beneficially and whether by operation of law or otherwise. The terms “Transfers” and Transferred” shall have the correlative meanings.

“Trust” shall mean the trust created pursuant to Section 6 of this Article XI.

“Trustee” shall mean the Corporation as trustee for the Trust, and any successor trustee appointed by the Corporation.

“Warrants” shall mean warrants to acquire shares of Capital Stock of the Corporation.

Section 2. <u>Ownership Limitation</u>.

(A) Except as provided in Section 13 of this Article XI, from the earlier of (x) the date of the Initial Public Offering or (y) January 1, 1995, and until the Restriction Termination Date, no Personal shall Beneficially Own any class of shares of the outstanding Capital Stock in excess of the Ownership Limit.

(B) Except as provided in Section 13 of this Article XI, from the earlier of (x) the date of the Initial Public Offering or (y) January 1, 1995, and until the Restriction Termination Date, any Transfer that, if effective would result in any Person Beneficially Owning any class of Capital Stock in excess of the Ownership Limit shall be void ab initio as to the Transfer of such shares of Capital Stock or Warrants representing Beneficial Ownership of Shares of any class of Capital Stock in excess of the Ownership Limit; and the intended transferee shall acquire no rights in such shares of Capital Stock or Warrants.

(C) Except as provided in Section 13 of this Article XI, from the earlier of (x) the date of the Initial Public Offering or (y) January 1, 1995, and until the Restriction Termination Date, any Transfer that, if effective, would result in the Capital Stock being beneficially owned (as provided in section 856(a) of the Code) by less than 100 Persons (determined without reference to any rules of attribution shall be void ab initio as to the Transfer of such shares of Capital Stock which would be otherwise beneficially owned (as provided in section 856(a) of the Code) by the intended transferee; and the intended transferee shall acquire no rights in such shares of Capital Stock.

(D) From the date of the earlier of (x) the date of the Initial Public Offering or (y) January 1, 1995, and until the Restriction Termination Date, any transfer that, if effective, would result in the Corporation being "closely held" within the meaning of section 856(h) of the Code shall be void ab initio as to the Transfer of such shares of Capital Stock or Warrants which would cause the Corporation to be "closely held" within the meaning of section 856(h) of the Code; and the intended transferee shall acquire no rights in such shares of Capital Stock or Warrants.

(E) Until the Restriction Termination Date, any Transfer that, if effective, would result in disqualification of the Corporation as a REIT shall be void ab initio as to the Transfer of such shares of Capital Stock or Warrants; and the intended transferee shall acquire no rights in such shares of Capital Stock or Warrants.

(F) Nothing contained herein shall impair the settlement of transactions entered into on the facilities of the NYSE or any other exchange on which shares of Capital Stock or Warrants are traded.

Section 3. Prevention of Transfer. If the Board of Directors or its designee shall at any time determine in good faith that a purported Transfer has taken place in violation of Section 2 of this Article XI (whether or not such Transfer is a result of a transaction entered into through the facilities of the NYSE or any other exchange that shares of Capital Stock or Warrants are traded) or that a Person intends to acquire or Transfer or has attempted to acquire or Transfer Beneficial Ownership of Capital Stock of the Corporation in violation of Section 2, the Board of Directors or its designee shall take such action as it deems advisable to refuse to give effect to or to prevent such Transfer, including, but not limited to, refusing to give effect to such Transfer on the books of the Corporation or instituting proceedings to enjoin such Transfer; provided, however, that any purported Transfers in violation of this Article XI shall automatically result in the designation and treatment described in this Article XI, irrespective of any action (or non-action) by the Board of Directors.

Section 4. Excess Securities. If at any time after the earlier of (x) the date of the Initial Public offering and (y) January 1, 1995 and before the Restriction Termination Date there is a purported Transfer or other change in the capital structure of the Corporation such that (x) any Person would Beneficially Own Capital Stock in excess of the applicable Ownership Limit and (y) any provision of Section 2 of this Article XI or any application of such provision is determined to be void, invalid, or unenforceable by any court having jurisdiction over the issue, then, except as otherwise provided in Section 13 of this Article XI, such share of Capital Stock or Warrants representing Beneficial Ownership of shares of Capital Stock in excess of such Ownership Limit (rounded up to the nearest whole share) shall constitute "Excess Securities" and be treated as provided this Article XI. Such designation and treatment shall be effective as of the close of business on the business day prior to the date of the purported Transfer or change in capital structure; provided, however subject to the provisions of Section 13, shares of Capital Stock or Warrants held by an underwriter in a public offering or private placement of shares or warrants, or in a transaction involving the issuance of shares by the Corporation in which the Board of Directors determines that the underwriter or other person or party initially acquiring such shares or warrants will make a timely distribution of such shares or warrants to or among other holders such that, following such distribution, none of such securities will be Excess Securities, shall not constitute Excess Securities.

Section 5. Notice to Corporation. Any Person who acquires shares of Capital Stock or Warrants in violation of Section 2 of this Article XI, or any Person who is a Purported Transferee such that Excess Securities results under Section 4 of this Article XI, shall immediately give written notice or, in the event of a proposed or attempted Transfer that would violate Section 2 of this Article XI, give at least 15 days prior written notice to the Corporation of such event and shall provide to the Corporation such other information as the Corporation may request in order to determine the effect, if any, of such Transfer on the Corporation's status as a REIT.

Section 6. Trust for Excess Securities. Upon any purported Transfer of Capital Stock that results in Excess Securities, such Excess Securities shall be deemed automatically to have been converted into a class separate and distinct from the class or series from which converted and from any other shares of Capital Stock. All Excess Securities shall be transferred by operation of law to the Corporation, as Trustee of a Trust for the benefit of such Beneficiary or Beneficiaries to whom an interest in such Excess Securities may later be transferred pursuant to Section 9 of this Article XI. Excess Securities that constitute Capital Stock so held in trust shall be issued and outstanding stock of the Corporation. The Purported Transferee shall have no rights in any Excess Securities except the right to designate a transferee of such Excess Securities upon the terms specified in Section 9 of this Article XI.

Section 7. No Distribution for Excess Securities. The Trustee, as holder of Excess Securities, shall not be entitled to any distribution (including dividends or distributions upon liquidation, dissolution or winding up.) Any dividend or distribution paid prior to the discovery by the Corporation that the shares of Capital Stock or Warrants have been purportedly Transferred so as to be deemed Excess Securities shall be rapid to the Corporation upon demand.

Section 8. No Voting or Exercise Rights for Excess Securities. The Trustee, as holder of Excess Securities, shall not be entitled to vote on any matter and shall not be entitled to exercise or convert any such securities into shares of Capital Stock.

Section 9. Transfer of Excess Securities. The Purported Transferee may freely designate a beneficiary (a "Beneficiary") of an interest in the Trust (representing the number of shares or warrants (as the case may be) of Excess Securities held by the Trust attributable to a purported Transfer that resulted in the Excess Securities), if (a) the Excess Securities held in the Trust would not be Excess Securities in the hands of such Beneficiary and (b) the Purported Transferee does not receive a price for designating such Beneficiary that reflects a price per share or per warrant for such Excess Securities that exceeds (i) the price per share or per warrant such Purported Transferee paid for the Capital Stock or Warrants in the purported Transfer that resulted in the Excess Securities, or (ii) if the Purported Transferee did not give value for such Excess Securities (through a gift, devise or other transaction), a price per share or per warrant equal to the Market Price for the shares or warrants of the Excess Securities on the date of the purported Transfer that resulted in the Excess Securities. Upon such transfer of an interest in the Trust, the corresponding shares or warrants of Excess Securities in the Trust shall be automatically exchanged for an equal number of shares of Capital Stock or Warrants and such shares of Capital Stock or Warrants shall be transferred of record to the transferee of the interest in the Trust if such shares of Capital Stock or Warrants would not be Excess Securities in the hands of such transferee. Prior to any transfer of any interest in the Trust, the Purported Transferee must give advance notice to the Corporation of the intended transfer and the Corporation must have waived in writing its purchase rights under Section 10 of this Article XI.

Notwithstanding the foregoing, if a Purported Transferee receives a price for designating a Beneficiary of an interest in the Trust that exceeds the amounts allowable under this Section 9 of this Article XI, such Purported Transferee receives a price for designating a Beneficiary of an interest in the Trust that exceeds the amounts allowable under this Section 9 of this Article XI, such Purported Transferee shall pay, or cause such Beneficiary to pay, such excess to the Corporation.

If any of the foregoing restrictions or transfer of Excess Securities are determined to be void, invalid or unenforceable by any court of competent jurisdiction, then the Purported Transferee may be deemed, at the option of the Company, to have acted as an agent of the Company in acquiring such Excess Securities and to hold such Excess Securities on behalf of the Company.

Section 10. Call by Corporation on Excess Securities. Excess Securities shall be deemed to have been offered for sale to the Corporation, or its designee, at a price per share or per warrant equal to the lesser of (a) the price per share in the transaction that created such Excess Securities (or, in the case of a devise or gift, the Market Price at the time of such device or gift), reduced by the amount of any distributions received in violation of Section 7 that have not been repaid to the Corporation, and (b) the Market Price of the Capital Stock or Warrants to which such Excess Securities related on the date the Corporation, or its designee, accepts such offer, reduced by the amount of any distributions received in violation of Section 7 that have not been repaid to the Corporation. The Corporation shall have the right to accept such offer for a period of ninety days after the later of (x) the date of the purported Transfer which resulted in such Excess Securities and (x) the date of the purported Transfer which resulted in such Excess Securities and (y) the date the Board of Directors determines in good faith that a purported Transfer resulting in Excess Securities has occurred, if the Corporation does not receive notice of such Transfer pursuant to Section 5 of this Article XI but in no event later than a permitted transfer pursuant to and in compliance with the terms of Section 9 of this Article XI.

Section 11. Information for Corporation. Until the Restriction Termination Date:

(A) Every record owner of more than 5.0% (during any period in which the number of stockholders of record is 2000 or more) or 1% (during any period in which the number of stockholders of records is greater than 200 but less than 2000) or 1/2% (during any period in which the number of stockholder is 200 or less) of the number or value of the outstanding shares of Capital Stock of the Corporation shall, within 30 days after January 1 of each year, give written notice to the Corporation stating the name and address of such record owner, the number of shares Beneficially Owned, and a description of how such shares are held. Each such record owner shall also provide to the Corporation such additional information as the Corporation may reasonably request in order to determine the effect, if any, of such Beneficial Ownership on the Corporation's status as a REIT.

(B) Each Person who is a Beneficial Owner of Capital Stock and each Person (including the stockholder of record) who is holding Capital Stock for a Beneficial Owner shall provide to the Corporation such information that the Corporation may reasonably request in order to determine the Corporation's status as a REIT, to comply with the requirements of any taxing authority or government agency, or to determine any such compliance.

Section 12. Increase in Ownership Limit. The Board of Directors may from time to time increase or decrease the Ownership Limit; provided, however, that:

(A) Any decrease may be made prospectively as to subsequent holders (other than a decrease as a result of a retroactive change in existing law, in which case such decrease shall be effective immediately);

(B) The Ownership Limit may not be increased if, after giving effect to such increase, five Beneficial Owners of Common Stock could Beneficially Own, in the aggregate, more than 50.0% in value of the shares of Capital Stock then outstanding; and

(C) Prior to the modification of the Ownership Limit the Board of Directors of the Corporation may require such opinions of counsel, affidavits, undertakings or agreements as it may deem necessary or advisable in order to determine or ensure the Corporation's status as a REIT.

Section 13. Waivers by Board. The Board of Directors, upon receipt of a ruling from the Internal Revenue Service or an opinion of counsel or other evidence satisfactory to the Board of Directors and upon at least 15 days written notice from a transferee prior to the proposed Transfer which, if consummated, would result in the intended transferee owning shares in excess of the Ownership Limit and upon such other conditions as the Board of Directors may direct, may waive the ownership Limit with respect to such transferee.

Section 14. Legend. All certificates for shares of Capital Stock and Warrants shall bear a legend referencing the restrictions on ownership and transfer as set forth in these Articles of Incorporation.

Section 15. Other Action by Board. Subject to Section 2(F) of this Article XI, nothing contained in this Article XI shall limit the authority of the Board of Directors to take such other action as it deems necessary or advisable to preserve the Corporation's status as a REIT.

Section 16. Ambiguities. Subject to Section 2(F) of this Article XI, in the case of an ambiguity in the application of any of the provisions of this Article XI, including any definition contained in Section 1, the Board of Directors shall have the power to determine the application of the provisions of this Article XI with respect to any situation based on the facts known to it.

Section 17. Severability. If any provisions of this Article XI or any application of any such provision is determined to be void, invalid or unenforceable by any court having jurisdiction over the issue, the validity and enforceability of the remaining provisions shall be affected only to the extent necessary to comply with the determination of such court.

ARTICLE XII

With respect to any proposed merger, acquisition, business combination or other transaction or proposal, a director of the Corporation, in determining what is in the best interests of the Corporation, shall consider the interest of the stockholders of the Corporation and, in his or her discretion, may consider (i) the interests of the Corporation's employees, suppliers, creditors and customers, (ii) the economy of the nation, (iii) community and society interests and (iv) the long-term as well as short-term interests of the Corporation and its stockholders, including the possibility that these interests may be best served by the continued independence of the Corporation. Pursuant to this provision, the Board of Directors may consider numerous judgmental or subjective factors affecting a proposal, including certain nonfinancial matters, and on the basis of these considerations may oppose a business combination or other transaction which, as an exclusively financial matter, might be attractive to some, or a majority, of the Corporation's stockholders.

ARTICLE XIII

The Corporation hereby expressly elects not to be governed by the provisions of Title 3, Subtitle 6 of the Maryland General Corporation Law.

ARTICLE XIV

Notwithstanding any provision of law requiring the authorization of any action by a greater proportion than a majority of the total number of shares of all classes of capital stock or of the total number of shares of any class of capital stock, such action shall be valid and effective if authorized by the affirmative vote of the holders of a majority of the total number of shares of all classes outstanding and entitled to vote thereon, except as otherwise provided in the charter.

ARTICLE XV

The Board of Directors is hereby empowered to authorize the issuance from time to time of shares of its stock of any class, whether now or hereafter authorized, or securities convertible into shares of its stock of any class or classes, whether now or hereafter authorized, for such consideration as may be deemed advisable by the Board of Directors and without any action by the stockholders.

ARTICLE XVI

The Corporation reserves the right from time to time to make any amendments of this charter which may now or hereafter be authorized by law, including any amendments changing the terms or contract rights, as expressly set forth in its charter, or any of its outstanding stock by classification, reclassification or otherwise.

ARTICLE XVII

The enumeration and definition of particular powers of the Board of Directors included in the foregoing Articles shall in no way be limited or restricted by reference to or inference from the terms of any other Article of the charter of the Corporation, or construed as or deemed by inference or otherwise in any manner to exclude or limit any powers conferred upon the Board of Directors under the General Laws of the State of Maryland now or hereafter in force.

ARTICLE XVIII

The duration of the Corporation shall be perpetual.

THIRD: The amendment to and restatement of the charter of the Corporation as hereinabove set forth has been duly advised by the Board of Directors and approved by the stockholders of the Corporation as required by law.

FOURTH: The amendment and restatement of the charter of the Corporation does not increase the authorized stock of the Corporation.

FIFTH: The undersigned President acknowledges these Articles of Amendment and Restatement to be the corporate act of the Corporation and as to all matters or facts required to be verified under oath, the undersigned President acknowledges that to the best of his knowledge, information and belief, these matters and facts are true in all material respects and that this statement is made under the penalties for perjury.

IN WITNESS WHEREOF, the Corporation has caused these Articles to be signed in its name and on its behalf by its President and attested by its Secretary on this ______ day of June, 1994.

ATTEST	REDWOOD TRUST, INC.
/s/ Frederick H. Borden	By: /s/ Douglas B. Hansen (SEAL)
Frederick H. Borden	Douglas B. Hansen
Secretary	President

EXHIBIT 3.1.1

ARTICLES SUPPLEMENTARY

REDWOOD TRUST, INC.

Class A Convertible Preferred Stock
(Par Value $.01 Per Share)

Redwood Trust, Inc., a Maryland corporation (hereinafter called the "Corporation"), having its principal office at The Corporation Trust Incorporated. Baltimore City, Maryland, hereby certifies to the Department of Assessments and Taxation of the State of Maryland that:

FIRST: Pursuant to authority expressly vested in the Board of Directors of the Corporation by Article VI of the Charter of the Corporation, the Board of Directors has duly divided and classified 12,000,000 shares of the capital stock of the Corporation into a series designated Class A Convertible Preferred Stock and has provided for the issuance of such series.

SECOND: The terms of the Class A Convertible Preferred Stock as set by the Board of Directors are as follows:

1. *Designation and Amount; Fractional Shares; Par Value.* There shall be a series of Preferred Stock of the Corporation designated as "Class A Convertible Preferred Stock" and the number of shares constituting such series shall be 12,000,000. The Class A Convertible Preferred Stock is issuable solely in whole shares that shall entitle the holder thereof to exercise the voting rights, to participate in the distributions and to have the benefit of all other rights of holders of Class A Convertible Preferred Stock as set forth herein and in the Articles of Incorporation. The par value of each share of Class A Convertible Preferred Stock shall be $.01. Certain Shares of Class A Convertible Preferred Stock together with Warrants therefor are being offered for sale as Units in a private placement through Montgomery Securities (the "Offering").

2. *Dividends.* The holders of the Class A Convertible Preferred Stock shall be entitled to receive, when and as declared by the Board of Directors out of funds legally available for such purpose, cash dividends in such amounts as the Board of Directors may determine in order to satisfy the dividend distribution requirements applicable to "real estate investment trusts" under the provisions of the Internal Revenue Code of 1986, as it may be amended, or for such other purpose as the Board of Directors may deem appropriate.

In no event, so long as any Class A Convertible Preferred Stock shall remain outstanding, shall any dividend whatsoever be declared or paid upon, nor shall any distribution be made upon, any Common Stock, other than a dividend or distribution payable in shares of Common Stock, nor (without the written consent of the holders of 66-2/3% of the outstanding Class A Convertible Preferred Stock or as otherwise provided pursuant to Article XI of the Articles of Incorporation) shall any shares of Common Stock be purchased or redeemed by the Corporation, nor shall any moneys be paid to or made available for a sinking fund for the purchase or redemption of any Common Stock, unless in each instance the price paid for such purchase or redemption does not exceed $.01 per share (adjusted for any subsequent dividends or distributions payable in Common Stock or any subdivision or combination or reclassification of Common Stock).

3. *Liquidation Preference.* Subject to the prior payment in full of the preferential amounts to which shares of any other series or class of stock of the Corporation ranking, as to distributions upon any liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary (any such event, a "Liquidation"), senior to the Class A Convertible Preferred Stock, are entitled in the event of any Liquidation, each holder of a share of Class A Convertible Preferred Stock shall be entitled to receive, and be paid out of the assets of the Corporation available for distribution to its stockholders, a liquidation preference in the amount of $15.00 per share, plus all declared and unpaid dividends on such share (the "Liquidation Preference"). If upon any Liquidation the amounts payable with respect to the liquidation preference of the Class A Convertible Preferred Stock and any shares of a class or series of the Corporation's stock ranking on a parity with the Class A Convertible Preferred Stock as to distributions upon such Liquidation ("Parity Stock") are not paid in full, the holders of Class A Convertible Preferred Stock and of such shares of Parity Stock will share *pro rata* in the amounts payable and other property distributable with respect to such Liquidation so that the per share amounts to which holders of Class A Convertible Preferred Stock and the holders of such shares of Parity Stock are entitled will in all cases bear to each other the same ratio that the liquidation preferences of the Class A Convertible Preferred Stock and such shares of Parity Stock bear to each other. Following the payment of all of the Liquidation Preference, the shares of all capital stock junior to the Class A Convertible Preferred Stock shall have a right to receive a liquidation per share equivalent to (a) in the case of Common Stock, $15.00 divided by the Conversion Ratio (as defined in Section 4(a)(i)) (the "Common Stock Liquidation"), (b) in the case of any other capital stock with a specified liquidation preference, the amount of such preference and (c) in the case of all other capital stock junior to the Class A Convertible Preferred Stock, the Common Stock Liquidation multiplied by the number of shares of Common Stock which are equivalent to one share of such other capital stock (collectively, the "Junior Stock Liquidation"). Upon the payment of the Junior Stock Liquidation, the holders of the Class A Convertible Preferred Stock and any shares of a class or series of the Corporation's stock ranking on a parity or junior to the Class A Convertible Preferred Stock will share *pro rata* in the amounts payable and other property distributable with respect to such Liquidation so that the per share amounts to which holders of Class A Convertible Preferred Stock and the holders of such shares of Parity Stock and junior stock are entitled will in all cases bear to each other the same ratio that the liquidation amounts received prior to the payment of such amounts bear to each other. Neither a consolidation or merger of the Corporation with or into another corporation, nor a merger of any other corporation with or into the Corporation, nor the sale of all or substantially all of the Corporation's property or business (other than in connection with a winding up of its business) will be considered a Liquidation for purposes of this Section.

4. *Conversion Privileges.*

(a) *Rights of Conversion.*

(i) Optional Conversion. Each holder of shares of Class A Convertible Preferred Stock shall have the right, at such holder's option, to convert all or a portion of the shares held, at any time or from time to time following the date occurring six months after the last offer or sale of Units under the Offering (the "Start Date") into that number of fully paid and nonassessable shares of Common Stock, or such other securities and property as hereinafter provided (calculated as to each conversion to the nearest 1/100th of a share, with .5/100 rounded upwards), determined by multiplying the aggregate number of shares of Class A Convertible Preferred Stock being convened at such time by such holder, by the ratio (the "Conversion Ratio") of (i) $15.00 (the issue price per share of Class A Convertible Preferred Stock), divided by (ii) the Conversion Price. For purposes of this Articles Supplementary, "Conversion Price" shall initially mean $15.00 until such Conversion Price is adjusted in accordance with the provisions of Section 4(d) hereof and thereafter shall mean the Conversion Price in effect from time to time as adjusted. Except as specifically provided in Section 4(d) hereof, there shall be no adjustment of the Conversion Price in case of the issuance of any securities of the Corporation. All adjustments in the Conversion Price shall be rounded to the nearest whole cent, with one-half cent rounded upwards.

(ii) Automatic Conversion. Notwithstanding anything to the contrary contained in this Section, each share of Class A Convertible Preferred Stock shall automatically be converted into shares of Common Stock at the then effective Conversion Ratio but in no event prior to the Start Date (a) at the close of business on the date there shall be received the written consent to conversion of the Class A Convertible Preferred Stock into Common Stock from the holders of a majority in interest of the then issued and outstanding shares of Class A Convertible Preferred Stock, (b) at the close of business on the date of the closing of an underwritten public offering ("Public Offering") pursuant to an effective registration statement under the Securities Act of 1933, as amended, covering the offer and sale of Common Stock for the account of the Corporation to the public resulting in gross proceeds to the Corporation of at least $15 million, or (c) at the close of business on the date which is fifth anniversary of the last closing under the Offering.

(b) *Conversion Procedures.* Any holder of shares of Class A Convertible Preferred Stock desiring to convert such shares pursuant hereto shall surrender the certificate or certificates evidencing such shares to the Corporation at its principal office (or such other office or agency of the Corporation as the Corporation may designate by notice in writing to the holder or holders of the Class A Convertible Preferred Stock) at any time during its usual business hours which certificate or certificates, if the Corporation shall so require, shall be duly endorsed to the Corporation or in blank, or accompanied by proper instruments of transfer to the Corporation or in blank, accompanied by (i) an irrevocable written notice to the Corporation that the holder elects to convert such shares and specifying the name or names (with address or addresses) in which a certificate or certificates evidencing shares of Common Stock are to be issued and (ii) if required pursuant to Section 4(f), an amount sufficient to pay any transfer or similar tax (or evidence reasonably satisfactory to the Corporation demonstrating that such taxes have been paid).

The holder of a share of Class A Convertible Preferred Stock at the close of business on a record date shall be entitled to receive the dividend payable thereon on the corresponding dividend payment date notwithstanding the conversion thereof during the period between the record date with respect to such dividend and the corresponding dividend payment date or the Corporation's default in the payment of the dividend due on such dividend payment date. Except as provided in the preceding sentence, no payments or adjustments in respect of dividends on shares of Class A Convertible Preferred Stock surrendered for conversion or on account of any dividend on the Common Stock issued upon conversion shall be made upon the conversion of any shares of Class A Convertible Preferred Stock.

The Corporation shall, as soon as practicable after effectiveness of conversion of shares of Class A Convertible Preferred Stock and compliance with the other conditions herein contained, deliver to the holder whose shares of Class A Convertible Preferred Stock are so converted, or to the nominee or nominees of such person, certificates evidencing the number of full shares of Common Stock to which such person shall be entitled, together with a cash payment in respect of any fraction of a share of Common Stock as hereinafter provided. Subject to the following provisions of this paragraph, each conversion pursuant to Section 4(a)(i) shall be deemed to have been effected immediately prior to the close of business on the date on which the certificates for shares of Class A Convertible Preferred Stock to be converted shall have been surrendered together with the irrevocable written notice and the payment of taxes (if applicable), all as provided in this Section 4(b), and, the person or persons entitled to receive the Common Stock deliverable upon conversion of such Class A Convertible Preferred Stock shall be treated for all purposes as the record holder or holders of such Common Stock at such time on such date, unless the stock transfer books of the Corporation shall be closed on such date, in which event such person or persons shall be deemed to have become such holder or holders of record at the close of business on the next succeeding day on which such stock transfer books are open, but such conversion shall be at the Conversion Ratio in effect on the date on which such shares shall have been surrendered and the other conditions specified above have been satisfied. Notwithstanding the preceding sentence, in the event that at the time of surrender of shares of Class A Convertible Preferred Stock for conversion pursuant to Section 4(a)(i) the Corporation has an effective registration statement covering such conversion to Common Stock, the holder so surrendering shares for conversion shall have the right to rescind such election to convert (by delivering a written notice to that effect to the Corporation at the office at which such shares were surrendered) for a period ending at the close of business on the fifth business day after the Corporation shall have mailed (for overnight delivery if possible) to such holder at its last address as it shall appear upon the stock transfer books of the Corporation a copy of the Prospectus covering such conversion. Each conversion pursuant to Section 4(a)(ii) shall be deemed to have been effected at the time and on the date therein specified. No holder of Class A Convertible Preferred Stock shall have any rights as a holder of Common Stock (or any other securities into which the Class A Convertible Preferred Stock may become convertible) unless and until such conversion has been effected.

(c) *No Fractional Shares.* No fractional shares or scrip representing fractional shares of Common Stock shall be issued upon conversion of Class A Convertible Preferred Stock. If a certificate or certificates representing more than one share of Class A Convertible Preferred Stock shall be surrendered for conversion at one time by the same record holder, the number of full shares of Common Stock issuable upon conversion thereof shall be computed on the basis of the aggregate number of shares of Class A Convertible Preferred Stock so surrendered by such record holder as provided in Section 4(b). In lieu of any fractional share of Common Stock that would otherwise be issuable upon conversion of any shares of Class A Convertible Preferred Stock, the Corporation shall pay a cash adjustment in respect of such fractional share in an amount equal to the same fraction of the current fair market value of the Common Stock on the day immediately preceding the date of conversion, as determined by the Board of Directors.

(d) *Adjustment for Change in Capital Stock; Reorganization of the Corporation.* If, after the issuance of any shares of Class A Convertible Preferred Stock, the Corporation:

(i) subdivides its outstanding shares of Common Stock into a greater number of shares;

(ii) combines its outstanding shares of Common Stock into a smaller number of shares; or

(iii) issues by any dividend or distribution to the holders of Common Stock, shares of Common Stock; or

(iv) issues by reclassification of its Common Stock any shares of its capital stock.

then the conversion rights and the Conversion Price in effect immediately prior to such action shall be adjusted so that the holder of shares of Class A Convertible Preferred Stock thereafter converted may receive the number of shares of capital stock of the Corporation which such holder would have owned immediately following such action if such holder had converted the shares of Class A Convertible Preferred Stock immediately prior to such action. The adjustment shall become effective immediately after the effective date of the subdivision, combination, issuance or reclassification.

If after an adjustment a holder of shares of Class A Convertible Preferred Stock upon conversion of such shares may receive shares of two or more classes of capital stock of the Corporation, the Conversion Price shall thereafter be subject to adjustment upon the occurrence of an action taken with respect to any such class of capital stock as is contemplated by this Section 4(d) with respect to the Common Stock, on terms comparable to those applicable to Common Stock in this Section 4(d).

If the amount of any adjustment of the Conversion Price required pursuant to this Section 4(d) would be less than one percent (1%) of the Conversion Price in effect at the time such adjustment is otherwise so required to be made, no adjustment to the Conversion Price shall be made and such amount shall be carried forward and an adjustment with respect thereto made at the time of and together with any subsequent adjustment which, together with such amount and any other amount or amounts so carried forward, shall aggregate at least one percent (1%) of such Conversion Price. This paragraph shall not apply to any adjustment to the Conversion Price pursuant to Section 4(h).

If the Corporation is a party to a consolidation or a merger which reclassifies or changes its outstanding Common Stock, the person obligated to deliver securities, cash or other assets upon conversion of shares of Class A Convertible Preferred Stock shall make provisions in its certificate or articles of incorporation or other constituent document to establish that the holder of shares of Class A Convertible Preferred Stock may convert such shares into the kind and amount of securities, cash or other assets which such holder would have received immediately after the consolidation or merger if such holder had converted such shares immediately before the effective date of the transaction. Such certificate or articles of incorporation or other constituent document shall provide for adjustments which shall be as nearly equivalent as may be practical to the adjustments provided for in this Section 4(d).

(e) *Adjustment Report.* Whenever any adjustment is required in the shares into which any share of Class A Convertible Preferred Stock is convertible, the Corporation shall cause a notice of such adjustment, setting forth the adjusted Conversion Price and the calculation thereof to be mailed to the holders of record of shares of Class A Convertible Preferred Stock at their respective addresses as shown on the stock transfer books of the Corporation.

(f) *Reservation of Shares; Transfer Taxes, Etc.* The Corporation shall at all times reserve and keep available, out of its authorized and unissued stock, solely for the purpose of effecting the conversion of the Class A Convertible Preferred Stock, such number of shares of its Common Stock free of preemptive rights as shall from time to time be sufficient to effect the conversion of all shares of Class A Convertible Preferred Stock from time to time outstanding. The Corporation shall from time to time, in accordance with the laws of the State of Maryland, increase the authorized number of shares of Common Stock if at any time the number of shares of authorized and unissued Common Stock shall not be sufficient to permit the conversion of all the then outstanding shares of Class A Convertible Preferred Stock.

The Corporation shall pay any and all issue or other taxes that may be payable in respect of any issue or delivery of shares of Common Stock upon conversion of the Class A Convertible Preferred Stock. The Corporation shall not, however, be required to pay any tax which may be payable in respect of any transfer involved in the issue or delivery of Common Stock (or other securities or assets) in a name other than that in which the shares of Class A Convertible Preferred Stock so converted were registered, and no such issue or delivery shall be made unless and until the person requesting such issue has paid to the Corporation the amount of such tax or has established, to the satisfaction of the Corporation, that such tax has been paid.

(g) *Prior Notice of Certain Events.* In case:

(i) the Corporation shall take any action that would require an adjustment pursuant to Section 4(d) hereof; or

(ii) the Corporation shall take any action that would require any person to make provisions in a certificate or articles of incorporation or other constituent document as contemplated by Section 4(d) hereof; or

(iii) of a Liquidation;

then the Corporation shall cause to be mailed to the holders of record of the Class A Convertible Preferred Stock at their last addresses as they shall appear upon the stock transfer books of the Corporation, at least twenty days prior to the applicable date, a notice stating the date on which the subdivision, consolidation, dividend, distribution, reclassification, merger or Liquidation is expected to become effective (but no failure to mail such notice or any defect therein or in the mailing thereof shall affect the validity of the corporate action required to be specified in such notice).

(h) Notwithstanding any other provision of this Section 4, if (i) the Shelf Registration Statement (as such term is defined in the Registration Rights Agreement (the “Rights Agreement”) between the Corporation and Montgomery Securities which in part relates to the Class A Convertible Preferred Stock) is not filed with the Securities and Exchange Commission on or prior to May 22, 1995, or (ii) the Shelf Registration Statement has not been declared effective by the Securities and Exchange Commission within 60 days after the date of the initial filing thereof (each such event referred to in clause (i) and (ii), a “Registration Default”), the Conversion Price will be reduced (subject to adjustments in the event of stock splits, stock recombinations, stock dividends and the like) by an amount each week equal to (A) during the first 90-day period immediately following the occurrence of such Registration Default, $.01; (B) during each 90-day period subsequent to the initial 90-day period, by an additional $.01 per week for each additional 90-day period (i.e., during the second 90-day period, the decrease will be $.02 per week and during the third 90-day period, the decrease will be $.03 per week); *provided, however,* that in no event will the Conversion Price be decreased below $14.50 (subject to adjustments as set forth above) and the price will not be decreased by any additional amount pursuant to this paragraph upon the cure of all Registration Defaults. No decrease in the Conversion Price will be effected with respect to any week commencing after such time as all of the Class A Convertible Preferred Stock ceases to be Registrable Securities (as such term is defined in the Rights Agreement).

5. *Voting Rights.*

(a) The holders of Class A Convertible Preferred Stock and Common Stock shall vote together as a class for the election of all the directors of the Corporation and, except as otherwise provided by law and the Articles of Incorporation or these Articles Supplementary, on all other matters to be voted on by the stockholders of the Corporation on the following basis: (1) each holder of Class A Convertible Preferred Stock shall be entitled to one vote for each share of Common Stock which would be issuable to such holder upon the conversion of all the shares of Class A Convertible Preferred Stock so held on the record date for the determination of stockholders entitled to vote, and (2) each holder of Common Stock shall be entitled to one vote per share; *provided, however,* that:

(i) the holders of Class A Convertible Preferred Stock and the holders of Common Stock will be entitled to vote as separate classes for any proposed merger, consolidation or sale of the assets of the Company as an entirety;

(ii) the holders of Class A Convertible Preferred Stock will be entitled to vote separately as a class on the matters described under Section 6 below; and

(iii) the holders of Class A Convertible Preferred Stock and the holders of Common Stock will be entitled to vote as separate classes for any stock splits, reverse stock splits, or other amendments to the Articles of Incorporation which in any way adversely affects the respective preferences, qualifications, special or relative rights or privileges of the Common Stock.

(b) The holders of Class A Convertible Preferred Stock will also be entitled to designate one person to attend all Board of Directors meetings as a non-voting observer.

6. *Restrictions.* At any time when shares of Class A Convertible Preferred Stock are outstanding, except where the vote or written consent of the holders of a greater number of shares of the Corporation is required by law or by the Articles of Incorporation or these Articles Supplementary, and in addition to any other vote required by law, without the prior consent of the holders of a majority in interest of the outstanding Class A Convertible Preferred Stock, given in person or by proxy, either in writing or at a special meeting called for that purpose, at which meeting the holders of the shares of such Class A Convertible Preferred Stock shall vote together as a class:

(a) The Corporation will not create or issue any additional class or series of capital stock unless the same ranks junior to the Class A Convertible Preferred Stock both as to dividends and as to the distribution of the assets on Liquidation or increase the authorized amount of the Class A Convertible Preferred Stock or increase the authorized amount of any additional class or series of capital stock unless the same ranks junior to the Class A Convertible Preferred Stock both as to dividends and as to the distribution or assets on Liquidation, whether any such creation or authorization or increase shall be by means of amendment of the Articles of Incorporation or these Articles Supplementary, merger, consolidation or otherwise; *provided, however,* that the Corporation is authorized to create and issue up to $50 million in additional Class A Convertible Preferred Stock or in one or more new classes or series of capital stock ranking *pari passu* with Class A Convertible Preferred Stock as to dividends and as to the distribution of assets on Liquidation, at a per share price not less than the then current Conversion Price.

(b) The Corporation will not amend, alter or repeal the terms of the Class A Convertible Preferred Stock in any way which adversely affects the respective preferences, qualifications, special or relative rights or privileges of the Class A Convertible Preferred Stock, except for the effects of any additional issuances of Class A Convertible Preferred Stock or other class or series of capital stock permitted under Section 6(a).

7. *Ranking Upon Liquidation.* Any class or series of capital stock of the Corporation shall be deemed to rank:

(i) senior to the Class A Convertible Preferred Stock, as to dividends or upon Liquidation, if the holders of such class or series shall be entitled to the receipt of dividends or of amounts distributable upon Liquidation, as the case may be, in preference or priority to the holders of Class A Convertible Preferred Stock;

(ii) on a parity with the Class A Convertible Preferred Stock, as to dividends or upon Liquidation, whether or not the dividend rates, dividend payment dates or redemption or Liquidation prices per share thereof are different from those of the Class A Convertible Preferred Stock, if the holders of such class or series of stock and the Class A Convertible Preferred Stock shall be entitled to the receipt of dividends or of amounts distributable upon Liquidation, as the case may be, in proportion to their respective amounts of accumulated and unpaid dividends per share or Liquidation prices, as the case may be, without preferences or priority one over the other; and

(iii) junior to the Class A Convertible Preferred Stock, as to dividends or upon Liquidation, if such stock shall be Common Stock or any other class or series of capital stock of the Corporation if the holders of Class A Convertible Preferred Stock shall be entitled to receipt of dividends or of amounts distributable upon Liquidation, as the case may be, in preference or priority to the holders of shares of such other stock.

8. *Outstanding Shares.* For purposes of these Articles Supplementary, all shares of Class A Convertible Preferred Stock issued by the Corporation shall be deemed outstanding except (i) from the date specified in these Articles Supplementary upon the conversion of any shares of Class A Convertible Preferred Stock into Common Stock and (ii) from the date of registration of transfer to the Corporation of any direct or indirect majority-owned subsidiary of the Corporation, all shares of Class A Convertible Preferred Stock held of record by the Corporation or any such direct or indirect majority-owned subsidiary of the Corporation.

9. *Status of Acquired Shares.* Shares of Class A Convertible Preferred Stock received by the Corporation upon conversion pursuant to Section 4 or otherwise acquired by the Corporation will be restored to the status of authorized but unissued shares of capital stock, without designation as to class, and may thereafter be issued, but not as shares of Class A Convertible Preferred Stock except as otherwise permitted herein.

10. *No Redemption.* The shares of Class A Convertible Preferred Stock shall not be subject to redemption, either mandatorily or at the option of the Corporation or the holder thereof, except as otherwise provided pursuant to Article Xl of the Articles of Incorporation.

11. *Severability of Provisions.* Whenever possible, each provision hereof shall be interpreted in a manner as to be effective and valid under applicable law, but if any provision hereof is held to be prohibited by or invalid under applicable law, such provision shall be ineffective only to the extent of such prohibition or invalidity, without invalidating or otherwise adversely affecting the remaining provisions hereof.

12. *Time and Business Days.* Wherever in these Articles Supplementary there are references to "at the close of business" such references shall mean 5:00 P.M. Pacific Standard or Daylight Time, as the case may be, on a business day. References to "business days" shall mean days other than (i) a Saturday or Sunday, (ii) a legal holiday in the State of California, or (iii) a day on which banking institutions in the City and County of San Francisco are authorized or obligated by law or executive order to be closed.

IN WITNESS WHEREOF, the Corporation has caused these presents to be signed in its name and on its behalf by its President and witnessed by its Secretary on August 10, 1994.

WITNESS:	REDWOOD TRUST, INC.
/s/ Frederick H. Borden	/s/ Douglas B. Hansen
Frederick H. Borden	Douglas B. Hansen
Secretary	President

THE UNDERSIGNED, President of Redwood Trust, Inc., who executed on behalf of the Corporation Articles Supplementary of which this Certificate is made a part, hereby acknowledges in the name and on behalf of said Corporation the foregoing Articles Supplementary to be the corporate act of said Corporation and hereby certifies that the matters and facts set forth herein with respect to the authorization and approval thereof are true in all material respects under the penalties of perjury.

/s/ Douglas B. Hansen
Douglas B. Hansen
President

EXHIBIT 3.1.2

ARTICLES SUPPLEMENTARY

REDWOOD TRUST, INC.

Redwood Trust, Inc., a Maryland corporation (hereinafter called the "Corporation"), having its principal office at The Corporation Trust Incorporated, Baltimore City, Maryland, hereby certifies to the Department of Assessments and Taxation of the State of Maryland that:

FIRST: Pursuant to the authority expressly vested in the Board of Directors of the Corporation by Article VI of the Charter of the Corporation, the Board of Directors duly divided and classified 12,000,000 shares of the Common Stock of the Corporation ("Common Stock") into a series designated Class A Convertible Preferred Stock (the "Convertible Preferred Stock") and provided for the issuance of such Convertible Preferred Stock.

SECOND: The Corporation filed Articles Supplementary on August 11, 1994 with the Maryland State Department of Assessments and Taxation, which Articles Supplementary set forth a description of the Convertible Preferred Stock.

THIRD: All of the issued and outstanding shares of Convertible Preferred Stock have been converted to Common Stock of the Corporation in accordance with the terms of Article SECOND, Section 4(a)(ii) of the Articles Supplementary.

FOURTH: All of the shares of Convertible Preferred Stock received by the Corporation upon such conversion have been restored to the status of authorized but unissued capital stock of the Corporation without designation as to class pursuant to Section 9 of Article SECOND of the Articles Supplementary.

FIFTH: Pursuant to the authority expressly vested in the Board of Directors of the Corporation by Article VI of the Charter of the Corporation, the shares of Convertible Preferred Stock currently authorized but unissued are hereby reclassified as Common Stock.

SIXTH: Pursuant to the authority expressly vested in the Board of Directors of the Corporation by Article VI of the Charter of the Corporation, the shares of capital stock of the Corporation without designation as to class are hereby reclassified as Common Stock.

IN WITNESS WHEREOF, the Corporation has caused these presents to be signed in its name and on its behalf by its President and witnessed by its Secretary on this 11th day of August, 1995.

WITNESS:	REDWOOD TRUST, INC.
/s/ Frederick H. Borden	/s/ Douglas B. Hansen
Frederick H. Borden	Douglas B. Hansen
Secretary	President

THE UNDERSIGNED, President of Redwood Trust, Inc., who executed on behalf of the Corporation Articles Supplementary of which this Certificate is made a part, hereby acknowledges in the name and on behalf of said Corporation the foregoing Articles Supplementary to be the corporate act of said Corporation and hereby certifies that the matters and facts set forth herein with respect to the authorization and approval thereof are true in all material respects under the penalties of perjury.

/s/ Douglas B. Hansen
Douglas B. Hansen
President

ARTICLES SUPPLEMENTARY

REDWOOD TRUST, INC.

Class B 9.74% Cumulative Convertible Preferred Stock
(Par Value $.01 Per Share)

Redwood Trust, Inc., a Maryland corporation (hereinafter called the “Corporation”), having its principal office at The Corporation Trust, Incorporated, Baltimore City, Maryland, hereby certifies to the Department of Assessments and Taxation of the State of Maryland that:

FIRST: Pursuant to authority expressly vested in the Board of Directors of the Corporation by Article VI of the Charter of the Corporation, the Board of Directors has duly divided and classified One Million Six Thousand Two Hundred Fifty (1,006,250) authorized but unissued shares of the capital stock of the Corporation into a class designated as Class B 9.74% Cumulative Convertible Preferred Stock and has provided for the issuance of such class.

SECOND: The reclassification increases the number of shares classified as Class B 9.74% Cumulative Convertible Preferred Stock, par value $.01 per share, from no shares immediately prior to the reclassification to 1,006,250 shares immediately after the reclassification. The reclassification decreases the number of shares classified as Common Stock, par value $.01 per share, from 50,000,000 shares immediately prior to the reclassification to 48,993,750 shares immediately after the reclassification. The number of shares classified as Class B 9.74% Cumulative Convertible Preferred Stock may be decreased pursuant to paragraph 6 of Article Third of these Articles Supplementary upon reacquisition thereof in any manner, or by retirement thereof, by the Corporation.

THIRD: The terms of the Class B 9.74% Cumulative Convertible Preferred Stock (including the preferences, conversions or other rights, voting powers, restrictions, limitations as to dividends and other distributions, qualifications, or terms or conditions of redemption) as set by the Board of Directors are as follows:

1. *Number of Shares and Designation.*

This class of Preferred Stock shall be designated as Class B 9.74% Cumulative Convertible Preferred Stock (the “Class B Preferred Stock”) and One Million Six Thousand Two Hundred Fifty (1,006,250) shall be the authorized number of shares of such Class B Preferred Stock constituting such class.

2. *Definitions.*

For purposes of the Class B Preferred Stock, the following terms shall have the meanings indicated:

“Act” shall mean the Securities Act of 1933, as amended.

"affiliate" of a Person means a Person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the Person specified.

"Board of Directors" shall mean the Board of Directors of the Corporation or any committee authorized by such Board of Directors to perform any of its responsibilities with respect to the Class B Preferred Stock.

"Business Day" shall mean any day other than a Saturday, Sunday or a day on which state or federally chartered banking institutions in New York, New York are not required to be open.

"Call Date" shall have the meaning set forth in paragraph (b) of Section 5 hereof.

"Class B Preferred Stock" shall have the meaning set forth in Section 1 hereof

"Common Stock" shall mean the common stock, $.01 par value per share, of the Corporation or such shares of the Corporation's Capital Stock into which outstanding shares of Common Stock shall be reclassified.

"Conversion Price" shall mean the conversion price per share of Common Stock for which each share of Class B Preferred Stock is convertible, as such Conversion Price may be adjusted pursuant to paragraph (d) of Section 7. The initial Conversion Price shall be $31.00 (equivalent to an initial conversion rate of one share of Common Stock for each share of Class B Preferred Stock).

"Current Market Price" of publicly traded shares of Common Stock or any other class or series of Capital Stock or other security of the Corporation or of any similar security of any other issuer for any day shall mean the closing price, regular way on such day, or, if no sale takes place on such day, the average of the reported closing bid and asked prices regular way on such day, in either case as reported on the National Market of the National Association of Securities Dealers, Inc. Automated Quotations System ("NASDAQ") or, if such security is not quoted on such National Market, on the principal national securities exchange on which such securities are listed or admitted for trading, or if not so quoted, listed or admitted, the average of the closing bid and asked prices on such day in the over-the-counter market as reported by NASDAQ or, if bid and asked prices for such security on such day shall not have been reported through NASDAQ, the average of the bid and asked prices on such day as furnished by any New York Stock Exchange or National Association of Securities Dealers, Inc. member firm regularly making a market in such security selected for such purpose by the Chief Executive Officer or the Board of Directors or if any class or series of securities are not publicly traded, the fair value of the shares of such class as determined reasonably and in good faith by the Board of Directors of the Corporation.

"Distribution" shall have the meaning set forth in paragraph (d)(iii) of Section 7 hereof.

"Dividend Payment Date" shall mean, with respect to each Dividend Period, the twenty-first (21st) day of January, April, July and October, in each year, commencing on October 21, 1996 with respect to the period commencing on the Issue Date and ending September 30, 1996; provided, however, that if any Dividend Payment Date falls on any day other than a Business Day, the dividend payment payable on such Dividend Payment Date shall be paid on the Business Day immediately following such Dividend Payment Date.

"Dividend Periods" shall mean quarterly dividend periods commencing on January 1, April 1, July 1 and October 1 of each year and ending on and including the day preceding the first day of the next succeeding Dividend Period (other than the initial Dividend Period, which shall commence on the Issue Date and end on and include September 30, 1996).

"Fair Market Value" shall mean the average of the daily Current Market Prices of a share of Common Stock during five (5) consecutive Trading Days selected by the Corporation commencing not more than twenty (20) Trading Days before, and ending not later than, the earlier of the day in question and the day before the "ex" date with respect to the issuance or distribution requiring such computation. The term "'ex' date," when used with respect to any issuance or distribution, means the first day on which the share of Common Stock trades regular way, without the right to receive such issuance or distribution, on the exchange or in the market, as the case may be, used to determine that day's Current Market Price.

"Issue Date" shall mean August 14, 1996.

"Junior Stock" shall mean the Common Stock and any other class or series of Capital Stock of the Corporation over which the shares of Class B Preferred Stock have preference or priority in the payment of dividends or in the distribution of assets on any liquidation, dissolution or winding up of the Corporation.

"Parity Stock" shall have the meaning set forth in paragraph (b) of Section 8 hereof.

"Person" shall mean any individual, firm, partnership, corporation or other entity and shall include any successor (by merger or otherwise) of such entity.

"Press Release" shall have the meaning set forth in paragraph (a)(i) of Section 5 hereof.

"set apart for payment" shall be deemed to include, without any action other than the following, the recording by the Corporation in its accounting ledgers of any accounting or bookkeeping entry which indicates, pursuant to a declaration of dividends or other distribution by the Board of Directors, the allocation of funds to be so paid on any series or class of Capital Stock of the Corporation; provided, however, that if any funds for any class or series of Junior Stock or any class or series of Parity Stock are placed in a separate account of the Corporation or delivered to a disbursing, paying or other similar agent, then "set apart for payment" with respect to the Class B Preferred Stock shall mean placing such funds in a separate account or delivering such funds to a disbursing, paying or other similar agent.

"Trading Day", as to any securities, shall mean any day on which such securities are traded on the National Market of Nasdaq or, if such securities are not listed or admitted for trading on the National Market of Nasdaq, on the principal national securities exchange on which such securities are listed or admitted or, if such securities are not listed or admitted for trading on any national securities exchange, in the securities market in which such securities are traded.

"Transaction" shall have the meaning set forth in paragraph (e) of Section 7 hereof.

"Transfer Agent" means Chase Mellon Shareholder Services, L.L.C., or such other transfer agent as may be designated by the Board of Directors or their designee as the transfer agent for the Class B Preferred Stock.

"Voting Preferred Stock" shall have the meaning set forth in Section 9 hereof.

3. *Dividends.*

(a) The holders of Class B Preferred Stock shall be entitled to receive, when and as declared by the Board of Directors out of funds legally available for that purpose, cumulative dividends payable in cash in an amount per share of Class B Preferred Stock equal to the greater of (i) the base dividend of $0.755 per quarter (the "Base Rate") or (ii) the cash dividends declared on the number of shares of Common Stock, or portion thereof, into which a share of Class B Preferred Stock is convertible. The initial Dividend Period shall commence on the Issue Date and end on September 30, 1996. The dividends payable with respect to the portion of the initial Dividend Period commencing on the Issue Date and ending on September 30, 1996, shall be determined solely by reference to the Base Rate. The amount referred to in clause (ii) of this paragraph (a) with respect to each succeeding Dividend Period shall be determined as of the applicable Dividend Payment Date by multiplying the number of shares of Common Stock, or portion thereof calculated to the fourth decimal point, into which a share of Class B Preferred Stock would be convertible at the opening of business on such Dividend Payment Date (based on the Conversion Price then in effect) by the aggregate cash dividends payable or paid for such Dividend Period in respect of a share of Common Stock outstanding as of the record date for the payment of dividends on the Common Stock with respect to such Dividend Period or, if different, with respect to the most recent quarterly period for which dividends with respect to the Common Stock have been declared. Such dividends shall be cumulative from the Issue Date, whether or not in any Dividend Period or Periods such dividends shall be declared or there shall be funds of the Corporation legally available for the payment of such dividends, and shall be payable quarterly in arrears on the Dividend Payment Dates, commencing on the first Dividend Payment Date after the Issue Date. Each such dividend shall be payable in arrears to the holders of record of the Class B Preferred Stock, as they appear on the stock records of the Corporation at the close of business on a record date fixed by the Board of Directors which shall be not more than 60 days prior to the applicable Dividend Payment Date and, within such 60 day period, shall be the same date as the record date for the regular quarterly dividend payable with respect to the Common Stock for the Dividend Period to which such Dividend Payment Date relates (or, if there is no such record date for Common Stock, then such date as the Board of Directors may fix). Accumulated, accrued and unpaid dividends for any past Dividend Periods may be declared and paid at any time, without reference to any regular Dividend Payment Date, to holders of record on such date, which date shall not precede by more than 45 days the payment date thereof, as may be fixed by the Board of Directors.

Upon a final administrative determination by the Internal Revenue Service that the Corporation does not qualify as a real estate investment trust in accordance with Section 856 of the Internal Revenue Code of 1986 (the "Code"), the Base Rate set forth in (a)(i) will be increased to $0.794 until such time as the Corporation regains its status as a real estate investment trust; provided, however, that if the Corporation contests its loss of real estate investment trust status in Federal Court, following its receipt of an opinion of nationally recognized tax counsel to the effect that there is a reasonable basis to contest such loss of status, the Base Rate shall not be increased during the pendency of such judicial proceeding; provided further, however, that upon a final judicial determination in Federal Tax Court, Federal District Court or the Federal Claims Court that the Corporation does not qualify as a real estate investment trust, the Base Rate will be increased as stated above.

(b) The amount of dividends payable per share of Class B Preferred Stock for the portion of the initial Dividend Period commencing on the Issue Date and ending and including September 30, 1996, or any other period shorter than a full Dividend Period, shall be computed ratably on the basis of twelve 30-day months and a 360-day year. Holders of Class B Preferred Stock shall not be entitled to any dividends, whether payable in cash, property or stock, in excess of cumulative dividends, as herein provided, on the Class B Preferred Stock. No interest, or sum of money in lieu of interest, shall be payable in respect of any dividend payment or payments on the Class B Preferred Stock that may be in arrears.

(c) So long as any of the shares of Class B Preferred Stock are outstanding, except as described in the immediately following sentence, no dividends shall be declared or paid or set apart for payment by the Corporation and no other distribution of cash or other property shall be declared or made directly or indirectly by the Corporation with respect to any class or series of Parity Stock for any period unless dividends equal to the full amount of accumulated, accrued and unpaid dividends have been or contemporaneously are declared and paid or declared and a sum sufficient for the payment thereof has been or contemporaneously is set apart for such payment on the Class B Preferred Stock for all Dividend Periods terminating on or prior to the Dividend Payment Date with respect to such class or series of Parity Stock. When dividends are not paid in full or a sum sufficient for such payment is not set apart, as aforesaid, all dividends declared upon the Class B Preferred Stock and all dividends declared upon any other class or series of Parity Stock shall be declared ratably in proportion to the respective amounts of dividends accumulated, accrued and unpaid on the Class B Preferred Stock and accumulated, accrued and unpaid on such Parity Stock.

(d) So long as any of the shares of Class B Preferred Stock are outstanding, no dividends (other than dividends or distributions paid in shares of or options, warrants or rights to subscribe for or purchase shares of Junior Stock) shall be declared or paid or set apart for payment by the Corporation and no other distribution of cash or other property shall be declared or made directly or indirectly by the Corporation with respect to any shares of Junior Stock, nor shall any shares of Junior Stock be redeemed, purchased or otherwise acquired (other than a redemption, purchase or other acquisition of Common Stock made for purposes of an employee incentive or benefit plan of the Corporation or any subsidiary) for any consideration (or any moneys be paid to or made available for a sinking fund for the redemption of any shares of any such stock) directly or indirectly by the Corporation (except by conversion into or exchange for Junior Stock), nor shall any other cash or other property otherwise be paid or distributed to or for the benefit of any holder of shares of Junior Stock in respect thereof, directly or indirectly, by the Corporation unless in each case (i) the full cumulative dividends (including all accumulated, accrued and unpaid dividends) on all outstanding shares of Class B Preferred Stock and any other Parity Stock of the Corporation shall have been paid or such dividends have been declared and set apart for payment for all past Dividend Periods with respect to the Class B Preferred Stock and all past dividend periods with respect to such Parity Stock and (ii) sufficient funds shall have been paid or set apart for the payment of the full dividend for the current Dividend Period with respect to the Class B Preferred Stock and the current dividend period with respect to such Parity Stock.

4. *Liquidation Preference.*

(a) In the event of any liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, before any payment or distribution of the Corporation (whether capital or surplus) shall be made to or set apart for the holders of Junior Stock, the holders of shares of Class B Preferred Stock shall be entitled to receive Thirty-One Dollars ($31.00) per share of Class B Preferred Stock (the "Liquidation Preference"), plus an amount equal to all dividends (whether or not earned or declared) accumulated, accrued and unpaid thereon to the date of final distribution to such holders; but such holders shall not be entitled to any further payment. Until the holders of the Class B Preferred Stock have been paid the Liquidation Preference in full, plus an amount equal to all dividends (whether or not earned or declared) accumulated, accrued and unpaid thereon to the date of final distribution to such holders, no payment will be made to any holder of Junior Stock upon the liquidation, dissolution or winding up of the Corporation. If, upon any liquidation, dissolution or winding up of the Corporation, the assets of the Corporation, or proceeds thereof, distributable among the holders of Class B Preferred Stock shall be insufficient to pay in full the preferential amount aforesaid and liquidating payments on any other shares of any class or series of Parity Stock, then such assets, or the proceeds thereof, shall be distributed among the holders of Class B Preferred Stock and any such other Parity Stock ratably in the same proportion as the respective amounts that would be payable on such Class B Preferred Stock and any such other Parity Stock if all amounts payable thereon were paid in full. For the purposes of this Section 4, (i) a consolidation or merger of the Corporation with one or more corporations, (ii) a sale or transfer of all or substantially all of the Corporation's assets, or (iii) a statutory share exchange shall not be deemed to be a liquidation, dissolution or winding up, voluntary or involuntary, of the Corporation.

(b) Subject to the rights of the holders of any shares of Parity Stock, upon any liquidation, dissolution or winding up of the Corporation, after payment shall have been made in full to the holders of Class B Preferred Stock and any Parity Stock, as provided in this Section 4, any other series or class or classes of Junior Stock shall, subject to the respective terms thereof, be entitled to receive any and all assets remaining to be paid or distributed, and the holders of the Class B Preferred Stock and any Parity Stock shall not be entitled to share therein.

5. *Redemption at the Option of the Corporation.*

(a) Shares of Class B Preferred Stock shall not be redeemable by the Corporation prior to October 1, 1999. On and after October 1, 1999, the Corporation, at its option, may redeem shares of Class B Preferred Stock, in whole or from time to time in part, as set forth herein, subject to the provisions described below:

(i) Shares of Class B Preferred Stock may be redeemed, in whole or in part, at the option of the Corporation, at any time on or after October 1, 1999 by issuing and delivering to each holder for each share of Class B Preferred Stock to be redeemed such number of authorized but previously unissued shares of Common Stock as equals the Liquidation Preference (excluding any accumulated, accrued and unpaid dividends which are to be paid in cash as provided below) per share of Class B Preferred Stock divided by the Conversion Price as in effect as of the opening of business on the Call Date (as defined in paragraph (b) below); provided, however, that the Corporation may redeem shares of Class B Preferred Stock pursuant to this paragraph (a)(i) only if for twenty (20) Trading Days, within any period of thirty (30) consecutive Trading Days, including the last Trading Day of such 30-Trading Day period, the Current Market Price of the Common Stock on each of such 20 Trading Days equals or exceeds the Conversion Price in effect on such Trading Day. In order to exercise its redemption option pursuant to this paragraph (a)(i), the Corporation must issue a press release announcing the redemption (the "Press Release") prior to the opening of business on the second Trading Day after the condition in the preceding sentence has, from time to time, been satisfied. The Corporation may not issue a Press Release prior to August 31, 1999. The Press Release shall announce the redemption and set forth the number of shares of Class B Preferred Stock that the Corporation intends to redeem; or

(ii) Shares of Class B Preferred Stock may be redeemed, in whole or in part, at the option of the Corporation at any time on or after October 1, 1999 out of funds legally available therefor at a redemption price payable in cash equal to $31.00 per share of Class B Preferred Stock (plus all accumulated, accrued and unpaid dividends as provided below).

(iii) In the event of a redemption pursuant to Section 5(a)(i), the Corporation shall pay in cash all accumulated, accrued and unpaid dividends for all Dividend Periods ending prior to the Dividend Period in which the redemption occurs; but no dividend shall accrue or be payable on the Class B Preferred Stock to be redeemed for the Dividend Period in which the redemption occurs unless the Call Date is after the record date for the dividend payable on the Common Stock for such Dividend Period in which event each holder of Class B Preferred Stock at the close of business on such dividend record date shall be entitled to the dividend payable on such shares on the corresponding Dividend Payment Date notwithstanding the redemption of such shares prior to such Dividend Payment Date. In the event of a redemption pursuant to Section 5(a)(ii), the Corporation shall pay in cash all cumulative, accrued and unpaid dividends for all Dividend Periods ending prior to the Dividend Period in which the redemption occurs, plus the dividend (determined by reference to the Base Rate if the Call Date precedes the date on which the dividend on the Common Stock is declared for such Dividend Period) accrued from the beginning of the Dividend Period in which the redemption occurs and ending on the Call Date, provided, however, that if such Call Date is after the record date for such Dividend Period, each holder of Class B Preferred Stock at the close of business on such dividend record date shall be entitled to the dividend payable on such shares on the corresponding Dividend Payment Date notwithstanding the redemption of such shares prior to such Dividend Payment Date. Except as provided above, the Corporation shall make no payment or allowance for accumulated or accrued dividends on shares of Class B Preferred Stock called for redemption or on the shares of Common Stock issued upon such redemption.

(b) Shares of Class B Preferred Stock shall be redeemed by the Corporation on the date specified in the notice to holders required under paragraph (d) of this Section 5 (the "Call Date"). The Call Date shall be selected by the Corporation, shall be specified in the notice of redemption and shall be not less than 30 days nor more than 60 days after (i) the date on which the Corporation issues the Press Release, if such redemption is pursuant to paragraph (a)(i) of this Section 5 , and (ii) the date notice of redemption is sent by the Corporation, if such redemption is pursuant to paragraph (a)(ii) of this Section 5.

(c) If full cumulative dividends on all outstanding shares of Class B Preferred Stock and any other class or series of Parity Stock of the Corporation have not been paid or declared and set apart for payment, no shares of Class B Preferred Stock may be redeemed unless all outstanding shares of Class B Preferred Stock are simultaneously redeemed and neither the Corporation nor any affiliate of the Corporation may purchase or acquire shares of Class B Preferred Stock, otherwise than pursuant to a purchase or exchange offer made on the same terms to all holders of shares of Class B Preferred Stock.

(d) If the Corporation shall redeem shares of Class B Preferred Stock pursuant to paragraph (a) of this Section 5, notice of such redemption shall be given to each holder of record of the shares to be redeemed and, if such redemption is pursuant to paragraph (a)(i) of this Section 5, such notice shall be given not more than ten (10) Business Days after the date on which the Corporation issues the Press Release. Such notice shall be provided by first class mail, postage prepaid, at such holder's address as the same appears on the stock records of the Corporation, or by publication in The Wall Street Journal or The New York Times, or if neither such newspaper is then being published, any other daily newspaper of national circulation not less than 30 nor more than 60 days prior to the Call Date. If the Corporation elects to provide such notice by publication, it shall also promptly mail notice of such redemption to the holders of the shares of Class B Preferred Stock to be redeemed. Neither the failure to mail any notice required by this paragraph (d), nor any defect therein or in the mailing thereof to any particular holder, shall affect the sufficiency of the notice or the validity of the proceedings for redemption with respect to the other holders. Any notice which was mailed in the manner herein provided shall be conclusively presumed to have been duly given on the date mailed whether or not the holder receives the notice. Each such mailed or published notice shall state, as appropriate: (1) the Call Date; (2) the number of shares of Class B Preferred Stock to be redeemed and, if fewer than all such shares held by such holder are to be redeemed, the number of such shares to be redeemed from such holder; (3) whether redemption will be for shares of Common Stock pursuant to paragraph (a)(i) of this Section 5 or for cash pursuant to paragraph (a)(ii) of this Section 5, and, if redemption will be for Common Stock, the number of shares of Common Stock to be issued with respect to each share of Class B Preferred Stock to be redeemed; (4) the place or places at which certificates for such shares are to be surrendered for certificates representing shares of Common Stock; and (5) the then-current Conversion Price. Notice having been published or mailed as aforesaid, from and after the Call Date (unless the Corporation shall fail to issue and make available the number of shares of Common Stock and/or amount of cash necessary to effect such redemption), (i) except as otherwise provided herein, dividends on the shares of Class B Preferred Stock so called for redemption shall cease to accumulate or accrue on the shares of Class B Preferred Stock called for redemption (except that, in the case of a Call Date after a dividend record date and prior to the related Dividend Payment Date, holders of Class B Preferred Stock on the dividend record date will be entitled on such Dividend Payment Date to receive the dividend payable on such shares), (ii) said shares shall no longer be deemed to be outstanding, and (iii) all rights of the holders thereof as holders of Class B Preferred Stock of the Corporation shall cease (except the rights to receive the shares of Common Stock and/or cash payable upon such redemption, without interest thereon, upon surrender and endorsement of their certificates if so required and to receive any dividends payable thereon). The Corporation's obligation to provide shares of Common Stock and/or cash in accordance with the preceding sentence shall be deemed fulfilled if, on or before the Call Date, the Corporation shall deposit with a bank or trust company (which may be an affiliate of the Corporation) that has, or is an affiliate of a bank or trust company that has, a capital and surplus of at least $50,000,000, such number of shares of Common Stock and such amount of cash as is necessary for such redemption, in trust, with irrevocable instructions that such shares of Common Stock and/or cash be applied to the redemption of the shares of Class B Preferred Stock so called for redemption. In the case of any redemption pursuant to paragraph (a)(i) of this Section 5, at the close of business on the Call Date, each holder of shares of Class B Preferred Stock to be redeemed (unless the Corporation defaults in the delivery of the shares of Common Stock or cash payable on such Call Date) shall be deemed to be the record holder of the number of shares of Common Stock into which such shares of Class B Preferred Stock are to be converted at redemption, regardless of whether such holder has surrendered the certificates representing the shares of Class B Preferred Stock to be so redeemed. No interest shall accrue for the benefit of the holders of shares of Class B Preferred Stock to be redeemed on any cash so set aside by the Corporation. Subject to applicable escheat laws, any such cash unclaimed at the end of two years from the Call Date shall revert to the general funds of the Corporation, after which reversion the holders of shares of Class B Preferred Stock so called for redemption shall look only to the general funds of the Corporation for the payment of such cash.

As promptly as practicable after the surrender in accordance with said notice of the certificates for any such shares so redeemed (properly endorsed or assigned for transfer, if the Corporation shall so require and if the notice shall so state), such certificates shall be exchanged for certificates representing shares of Common Stock and/or any cash (without interest thereon) for which such shares have been redeemed in accordance with such notice. If fewer than all the outstanding shares of Class B Preferred Stock are to be redeemed, shares to be redeemed shall be selected by the Corporation from outstanding shares of Class B Preferred Stock not previously called for redemption by lot or, with respect to the number of shares of Class B Preferred Stock held of record by each holder of such shares, pro rata (as nearly as may be) or by any other method as may be determined by the Board of Directors in its discretion to be equitable. If fewer than all the shares of Class B Preferred Stock represented by any certificate are redeemed, then a new certificate representing the unredeemed shares shall be issued without cost to the holders thereof.

(e) In the case of any redemption pursuant to paragraph (a)(i) of this Section 5, no fractional shares of Common Stock or scrip representing fractions of shares of Common Stock shall be issued upon redemption of the shares of Class B Preferred Stock. Instead of any fractional interest in a share of Common Stock that would otherwise be deliverable upon redemption of shares of Class B Preferred Stock, the Corporation shall pay to the holder of such share an amount in cash (rounded to the nearest cent) based upon the Current Market Price of the Common Stock on the Trading Day immediately preceding the Call Date. If more than one share shall be surrendered for redemption at one time by the same holder, the number of full shares of Common Stock issuable upon redemption thereof shall be computed on the basis of the aggregate number of shares of Class B Preferred Stock so surrendered.

(f) In the case of any redemption pursuant to paragraph (a)(i) of this Section 5, the Corporation covenants that any shares of Common Stock issued upon redemption of shares of Class B Preferred Stock shall be validly issued, fully paid and non-assessable. The Corporation shall list, subject to official notice of issuance, the shares of Common Stock required to be delivered upon any such redemption of shares of Class B Preferred Stock, prior to such redemption, upon the National Market of NASDAQ or each national securities exchange, if any, upon which the outstanding shares of Common Stock are listed at the time of such delivery.

The Corporation shall take any action necessary to ensure that any shares of Common Stock issued upon the redemption of Class B Preferred Stock are freely transferable and not subject to any resale restrictions under the Act, or any applicable state securities or blue sky laws (other than any shares of Common Stock issued upon redemption of any Class B Preferred Stock which are held by an “affiliate” (as defined in Rule 144 under the Act) of the Corporation).

6. *Stock To Be Retired.*

All shares of Class B Preferred Stock which shall have been issued and reacquired in any manner by the Corporation shall be restored to the status of authorized, but unissued shares of Common Stock, par value $.01 per share. The Corporation may also retire any unissued shares of Class B Preferred Stock, and such shares shall then be restored to the status of authorized but unissued shares of Common Stock, par value $.01 per share.

7. *Conversion.*

Holders of shares of Class B Preferred Stock shall have the right to convert all or a portion of such shares into shares of Common Stock, as follows:

(a) Subject to and upon compliance with the provisions of this Section 7, a holder of shares of Class B Preferred Stock shall have the right, at such holder's option, at any time to convert such shares, in whole or in part, into the number of fully paid and non-assessable shares of authorized but previously unissued shares of Common Stock per each share of Class B Preferred Stock obtained by dividing the Liquidation Preference (excluding any accumulated, accrued and unpaid dividends) per share of Class B Preferred Stock by the Conversion Price (as in effect at the time and on the date provided for in the last subparagraph of paragraph (b) of this Section 7) and by surrendering such shares to be converted, such surrender to be made in the manner provided in paragraph (b) of this Section 7; provided, however, that the right to convert shares of Class B Preferred Stock called for redemption pursuant to Section 5 shall terminate at the close of business on the Call Date fixed for such redemption, unless the Corporation shall default in making payment of shares of Common Stock and/or cash payable upon such redemption under Section 5 hereof.

(b) In order to exercise the conversion right, the holder of each share of Class B Preferred Stock to be converted shall surrender the certificate representing such share, duly endorsed or assigned to the Corporation or in blank, at the office of the Transfer Agent, accompanied by written notice to the Corporation that the holder thereof elects to convert such share of Class B Preferred Stock. Unless the shares issuable on conversion are to be issued in the same name as the name in which such share of Class B Preferred Stock is registered, each share surrendered for conversion shall be accompanied by instruments of transfer, in form satisfactory to the Corporation, duly executed by the holder or such holder's duly authorized attorney and an amount sufficient to pay any transfer or similar tax (or evidence reasonably satisfactory to the Corporation demonstrating that such taxes have been paid).

Holders of shares of Class B Preferred Stock at the close of business on a dividend payment record date shall be entitled to receive the dividend payable on such shares on the corresponding Dividend Payment Date notwithstanding the conversion thereof following such dividend payment record date and prior to such Dividend Payment Date. Except as provided above, the Corporation shall make no payment or allowance for unpaid dividends, whether or not in arrears, on converted shares or for dividends on the shares of Common Stock issued upon such conversion.

As promptly as practicable after the surrender of certificates for shares of Class B Preferred Stock as aforesaid, the Corporation shall issue and shall deliver at such office to such holder, or send on such holder's written order, a certificate or certificates for the number of full shares of Common Stock issuable upon the conversion of such shares of Class B Preferred Stock in accordance with provisions of this Section 7, and any fractional interest in respect of a share of Common Stock arising upon such conversion shall be settled as provided in paragraph (c) of this Section 7.

Each conversion shall be deemed to have been effected immediately prior to the close of business on the date on which the certificates for shares of Class B Preferred Stock shall have been surrendered and such notice received by the Corporation as aforesaid, and the Person or Persons in whose name or names any certificate or certificates for shares of Common Stock shall be issuable upon such conversion shall be deemed to have become the holder or holders of record of the shares represented thereby at such time on such date and such conversion shall be at the Conversion Price in effect at such time on such date unless the stock transfer books of the Corporation shall be closed on that date, in which event such Person or Persons shall be deemed to have become such holder or holders of record at the close of business on the next succeeding day on which such stock transfer books are open, but such conversion shall be at the Conversion Price in effect on the date on which such shares shall have been surrendered and such notice received by the Corporation. If the dividend payment record date for the Class B Preferred Stock and Common Stock do not coincide, and the preceding sentence does not operate to ensure that a holder of shares of Class B Preferred Stock whose shares are converted into Common Stock does not receive dividends on both the shares of Class B Preferred Stock and the Common Stock into which such shares are converted for the same Dividend Period, then notwithstanding anything herein to the contrary, it is the intent, and the Transfer Agent is authorized to ensure that no conversion after the earlier of such record dates will be accepted until after the latter of such record dates.

(c) No fractional share of Common Stock or scrip representing fractions of a share of Common Stock shall be issued upon conversion of the shares of Class B Preferred Stock. Instead of any fractional interest in a share of Common Stock that would otherwise be deliverable upon the conversion of shares of Class B Preferred Stock, the Corporation shall pay to the holder of such share an amount in cash based upon the Current Market Price of the Common Stock on the Trading Day immediately preceding the date of conversion. If more than one share shall be surrendered for conversion at one time by the same holder, the number of full shares of Common Stock issuable upon conversion thereof shall be computed on the basis of the aggregate number of shares of Class B Preferred Stock so surrendered.

(d) The Conversion Price shall be adjusted from time to time as follows:

(i) If the Corporation shall after the Issue Date (A) pay a dividend or make a distribution on its Capital Stock in shares of Common Stock, (B) subdivide its outstanding Common Stock into a greater number of shares, (C) combine its outstanding Common Stock into a smaller number of shares or (D) issue any shares of Capital Stock by reclassification of its outstanding Common Stock, the Conversion Price in effect at the opening of business on the day following the date fixed for the determination of stockholders entitled to receive such dividend or distribution or at the opening of business on the day following the day on which such subdivision, combination or reclassification becomes effective, as the case may be, shall be adjusted so that the holder of any share of Class B Preferred Stock thereafter surrendered for conversion shall be entitled to receive the number of shares of Common Stock (or fraction of a share of Common Stock) that such holder would have owned or have been entitled to receive after the happening of any of the events described above had such share of Class B Preferred Stock been converted immediately prior to the record date in the case of a dividend or distribution or the effective date in the case of a subdivision, combination or reclassification. An adjustment made pursuant to this paragraph (d)(i) of this Section 7 shall become effective immediately after the opening of business on the day next following the record date (except as provided in paragraph (h) below) in the case of a dividend or distribution and shall become effective immediately after the opening of business on the day next following the effective date in the case of a subdivision, combination or reclassification.

(ii) If the Corporation shall issue after the Issue Date rights, options or warrants to all holders of Common Stock entitling them (for a period expiring within 45 days after the record date described below in this paragraph (d)(ii) of this Section 7) to subscribe for or purchase Common Stock at a price per share less than the Fair Market Value per share of the Common Stock on the record date for the determination of stockholders entitled to receive such rights, options or warrants, then the Conversion Price in effect at the opening of business on the day next following such record date shall be adjusted to equal the price determined by multiplying (A) the Conversion Price in effect immediately prior to the opening of business on the day following the date fixed for such determination by (B) a fraction, the numerator of which shall be the sum of (X) the number of shares of Common Stock outstanding on the close of business on the date fixed for such determination and (Y) the number of shares that could be purchased at such Fair Market Value from the aggregate proceeds to the Corporation from the exercise of such rights, options or warrants for Common Stock, and the denominator of which shall be the sum of (XX) the number of shares of Common Stock outstanding on the close of business on the date fixed for such determination and (YY) the number of additional shares of Common Stock offered for subscription or purchase pursuant to such rights, options or warrants. Such adjustment shall become effective immediately after the opening of business on the day next following such record date (except as provided in paragraph (h) below). In determining whether any rights, options or warrants entitle the holders of Common Stock to subscribe for or purchase Common Stock at less than such Fair Market Value, there shall be taken into account any consideration received by the Corporation upon issuance and upon exercise of such rights, options or warrants, the value of such consideration, if other than cash, to be determined in good faith by the Board of Directors.

(iii) If the Corporation shall after the Issue Date make a distribution on its Common Stock other than in cash or shares of Common Stock (including any distribution in securities other than rights, options or warrants as set forth below) (each of the foregoing being referred to herein as a "distribution"), then the Conversion Price in effect at the opening of business on the next day following the record date for determination of stockholders entitled to receive such distribution shall be adjusted to equal the price determined by multiplying (A) the Conversion Price in effect immediately prior to the opening of business on the day following the record date by (B) a fraction, the numerator of which shall be the difference between (X) the number of shares of Common Stock outstanding on the close of business on the record date and (Y) the number of shares determined by dividing (aa) the aggregate value of the property being distributed by (bb) the Fair Market Value per share of Common Stock on the record date, and the denominator of which shall be the number of shares of Common Stock outstanding on the close of business on the record date. Such adjustment shall become effective immediately after the opening of business on the day next following such record date (except as provided below). The value of the property being distributed shall be as determined in good faith by the Board of Directors. Neither the issuance by the Corporation of rights, options or warrants to subscribe for or purchase securities of the Corporation nor the exercise thereof shall be deemed a distribution under this paragraph. Notwithstanding the foregoing provisions of this paragraph, the Corporation will not make any distribution that, when taken together with all prior distributions after the Issue Date, would result in an aggregate adjustment constituting 50% or more of the Conversion Price on the Issue Date without obtaining prior consent by the affirmative vote of at least 66 2/3% of the votes entitled to be cast by the holders of Preferred Stock and any other class or series of preferred stock at the time outstanding that constitutes Parity Stock, voting together as a single class, given in Person or by proxy, either in writing without a meeting or by vote at any meeting called for the purpose.

(iv) No adjustment in the Conversion Price shall be required unless such adjustment would require a cumulative increase or decrease of at least 1% in such price; provided, however, that any adjustments that by reason of this paragraph (d)(iv) are not required to be made shall be carried forward and taken into account in any subsequent adjustment until made; and provided, further, that any adjustment shall be required and made in accordance with the provisions of this Section 7 (other than this paragraph (d)(iv)) not later than such time as may be required in order to preserve the tax-free nature of a distribution to the holders of shares of Common Stock. Notwithstanding any other provisions of this Section 7, the Corporation shall not be required to make any adjustment of the Conversion Price for the issuance of (A) any shares of Common Stock pursuant to any plan providing for the reinvestment of dividends or interest payable on securities of the Corporation and the investment of optional amounts in shares of Common Stock under such plan or (B) any options, rights or shares of Common Stock pursuant to any stock option, stock purchase or other stock-based plan maintained by the Corporation. All calculations under this Section 7 shall be made to the nearest cent (with $.005 being rounded upward) or to the nearest one-tenth of a share (with .05 of a share being rounded upward), as the case may be. Anything in this paragraph (d) of this Section 7 to the contrary notwithstanding, the Corporation shall be entitled, to the extent permitted by law, to make such reductions in the Conversion Price, in addition to those required by this paragraph (d), as it in its discretion shall determine to be advisable in order that any stock dividends, subdivision of shares, reclassification or combination of shares, distribution of rights or warrants to purchase stock or securities, or a distribution of other assets (other than cash dividends) hereafter made by the Corporation to its stockholders shall not be taxable, or if that is not possible, to diminish any income taxes that are otherwise payable because of such event.

(e) If the Corporation shall be a party to any transaction (including without limitation a merger, consolidation, statutory share exchange, issuer or self tender offer for all or a substantial portion of the shares of Common Stock outstanding, sale of all or substantially all of the Corporation's assets or recapitalization of the Common Stock, but excluding any transaction as to which paragraph (d)(i) of this Section 7 applies) (each of the foregoing being referred to herein as a "Transaction"), in each case as a result of which shares of Common Stock shall be converted into the right to receive stock, securities or other property (including cash or any combination thereof), each share of Class B Preferred Stock which is not converted into the right to receive stock, securities or other property in connection with such Transaction shall thereupon be convertible into the kind and amount of shares of stock, securities and other property (including cash or any combination thereof) receivable upon such consummation by a holder of that number of shares of Common Stock into which one share of Class B Preferred Stock was convertible immediately prior to such Transaction. The Corporation shall not be a party to any Transaction unless the terms of such Transaction are consistent with the provisions of this paragraph (e), and it shall not consent or agree to the occurrence of any Transaction until the Corporation has entered into an agreement with the successor or purchasing entity, as the case may be, for the benefit of the holders of the Class B Preferred Stock that will contain provisions enabling the holders of the Class B Preferred Stock that remain outstanding after such Transaction to convert into the consideration received by holders of Common Stock at the Conversion Price in effect immediately prior to such Transaction. The provisions of this paragraph (e) shall similarly apply to successive Transactions.

(f) If:

(i) the Corporation shall declare a dividend (or any other distribution) on the Common Stock (other than cash dividends and cash distributions); or

(ii) the Corporation shall authorize the granting to all holders of the Common Stock of rights or warrants to subscribe for or purchase any shares of any class or series of Capital Stock or any other rights or warrants; or

(iii) there shall be any reclassification of the outstanding Common Stock or any consolidation or merger to which the Corporation is a party and for which approval of any stockholders of the Corporation is required, or a statutory share exchange, or an issuer or self tender offer by the Corporation for all or a substantial portion of its outstanding shares of Common Stock (or an amendment thereto changing the maximum number of shares sought or the amount or type of consideration being offered therefor) or the sale or transfer of all or substantially all of the assets of the Corporation as an entirety; or

(iv) there shall occur the voluntary or involuntary liquidation, dissolution or winding up of the Corporation,

then the Corporation shall cause to be filed with the Transfer Agent and shall cause to be mailed to each holder of shares of Class B Preferred Stock at such holder's address as shown on the stock records of the Corporation, as promptly as possible, but at least 15 days prior to the applicable date hereinafter specified, a notice stating (A) the record date for the payment of such dividend, distribution or rights or warrants, or, if a record date is not established, the date as of which the holders of Common Stock of record to be entitled to such dividend, distribution or rights or warrants are to be determined or (B) the date on which such reclassification, consolidation, merger, statutory share exchange, sale, transfer, liquidation, dissolution or winding up is expected to become effective, and the date as of which it is expected that holders of Common Stock of record shall be entitled to exchange their shares of Common Stock for securities or other property, if any, deliverable upon such reclassification, consolidation, merger, statutory share exchange, sale, transfer, liquidation, dissolution or winding up or (C) the date on which such tender offer commenced, the date on which such tender offer is scheduled to expire unless extended, the consideration offered and the other material terms thereof (or the material terms of any amendment thereto). Failure to give or receive such notice or any defect therein shall not affect the legality or validity of the proceedings described in this Section 7.

(g) Whenever the Conversion Price is adjusted as herein provided, the Corporation shall promptly file with the Transfer Agent an officer's certificate setting forth the Conversion Price after such adjustment and setting forth a brief statement of the facts requiring such adjustment which certificate shall be conclusive evidence of the correctness of such adjustment absent manifest error. Promptly after delivery of such certificate, the Corporation shall prepare a notice of such adjustment of the Conversion Price setting forth the adjusted Conversion Price and the effective date such adjustment becomes effective and shall mail such notice of such adjustment of the Conversion Price to each holder of shares of Class B Preferred Stock at such holder's last address as shown on the stock records of the Corporation.

(h) In any case in which paragraph (d) of this Section 7 provides that an adjustment shall become effective on the day next following the record date for an event, the Corporation may defer until the occurrence of such event (A) issuing to the holder of any share of Class B Preferred Stock converted after such record date and before the occurrence of such event the additional Common Stock issuable upon such conversion by reason of the adjustment required by such event over and above the Common Stock issuable upon such conversion before giving effect to such adjustment and (B) paying to such holder any amount of cash in lieu of any fraction pursuant to paragraph (c) of this Section 7.

(i) There shall be no adjustment of the Conversion Price in case of the issuance of any Capital Stock of the Corporation in a reorganization, acquisition or other similar transaction except as specifically set forth in this Section 7.

(j) If the Corporation shall take any action affecting the Common Stock, other than action described in this Section 7, that in the opinion of the Board of Directors would materially adversely affect the conversion rights of the holders of Class B Preferred Stock, the Conversion Price for the Class B Preferred Stock may be adjusted, to the extent permitted by law, in such manner, if any, and at such time as the Board of Directors, in its sole discretion, may determine to be equitable under the circumstances.

(k) The Corporation shall at all times reserve and keep available, free from preemptive rights, out of the aggregate of its authorized but unissued Common Stock solely for the purpose of effecting conversion of the Class B Preferred Stock, the full number of shares of Common Stock deliverable upon the conversion of all outstanding shares of Class B Preferred Stock not theretofore converted into Common Stock. For purposes of this paragraph (k), the number of shares of Common Stock that shall be deliverable upon the conversion of all outstanding shares of Class B Preferred Stock shall be computed as if at the time of computation all such outstanding shares were held by a single holder (and without regard to the Ownership Limit set forth in the Charter of the Corporation).

The Corporation covenants that any shares of Common Stock issued upon conversion of the shares of Class B Preferred Stock shall be validly issued, fully paid and nonassessable.

The Corporation shall use its best efforts to list the shares of Common Stock required to be delivered upon conversion of the shares of Class B Preferred Stock, prior to such delivery, upon each national securities exchange, if any, upon which the outstanding shares of Common Stock are listed at the time of such delivery.

The Corporation shall take any action necessary to ensure that any shares of Common Stock issued upon conversion of shares of Class B Preferred Stock are freely transferable and not subject to any resale restrictions under the Act, or any applicable state securities or blue sky laws (other than any shares of Common Stock which are held by an “affiliate” (as defined in Rule 144 under the Act)).

(l) The Corporation will pay any and all documentary stamp or similar issue or transfer taxes payable in respect of the issue or delivery of shares of Common Stock or other securities or property on conversion or redemption of shares of Class B Preferred Stock pursuant hereto; provided, however, that the Corporation shall not be required to pay any tax that may be payable in respect of any transfer involved in the issue or delivery of shares of Common Stock or other securities or property in a name other than that of the holder of the shares of Class B Preferred Stock to be converted or redeemed, and no such issue or delivery shall be made unless and until the Person requesting such issue or delivery has paid to the Corporation the amount of any such tax or established, to the reasonable satisfaction of the Corporation, that such tax has been paid.

8. *Ranking.*

Any class or series of Capital Stock of the Corporation shall be deemed to rank:

(a) prior or senior to the Class B Preferred Stock, as to the payment of dividends and as to distribution of assets upon liquidation, dissolution or winding up, if the holders of such class or series shall be entitled to the receipt of dividends or of amounts distributable upon liquidation, dissolution or winding up, as the case may be, in preference or priority to the holders of Class B Preferred Stock;

(b) on a parity with the Class B Preferred Stock, as to the payment of dividends and as to distribution of assets upon liquidation, dissolution or winding up, whether or not the dividend rates, dividend payment dates or redemption or liquidation prices per share thereof be different from those of the Class B Preferred Stock, if the holders of such class of stock or series and the Class B Preferred Stock shall be entitled to the receipt of dividends and of amounts distributable upon liquidation, dissolution or winding up in proportion to their respective amounts of accrued and unpaid dividends per share or liquidation preferences, without preference or priority one over the other ("Parity Stock"); and

(c) junior to the Class B Preferred Stock, as to the payment of dividends or as to the distribution of assets upon liquidation, dissolution or winding up, if such stock or series shall be Common Stock or if the holders of Class B Preferred Stock shall be entitled to receipt of dividends or of amounts distributable upon liquidation, dissolution or winding up, as the case may be, in preference or priority to the holders of shares of such class or series ("Junior Stock").

9. *Voting.*

(a) If and whenever (i) six quarterly dividends (whether or not consecutive) payable on the Class B Preferred Stock or any series or class of Parity Stock shall be in arrears (which shall, with respect to any such quarterly dividend, mean that any such dividend has not been paid in full), whether or not earned or declared, or (ii) the consolidated shareholders' equity of the Corporation (determined in accordance with generally accepted accounting principles and giving effect to any adjustment for the net unrealized gain or loss on assets available for sale) at the end of any calendar quarter is less than 150% of the aggregate Liquidation Preference (excluding any accumulated, accrued and unpaid dividends) of the then outstanding Class B Preferred Stock and the aggregate liquidation preference (excluding any accumulated, accrued and unpaid dividends) of any then outstanding Parity Stock, the number of directors then constituting the Board of Directors shall be increased by two (if not already increased by reason of similar types of provisions with respect to Voting Preferred Stock (as defined below)) and the holders of shares of Class B Preferred Stock, together with the holders of shares of every other series or class of Parity Stock (any other such series, the "Voting Preferred Stock"), voting as a single class regardless of series, shall be entitled to elect the two additional directors to serve on the Board of Directors at any annual meeting of stockholders or special meeting held in place thereof, or at a special meeting of the holders of the Class B Preferred Stock and the Voting Preferred Stock called as hereinafter provided. Notwithstanding anything herein to the contrary, if any class or series of Voting Preferred Stock (with which the Class B Preferred Stock is entitled to vote as a single class) is entitled to elect two directors as a result of a failure to maintain a specified level of consolidated shareholders' equity required by the terms of such Voting Preferred Stock, then when such entitlement is triggered, the separate entitlement to elect two directors pursuant to Section 9(a)(ii) hereof shall be suspended. Whenever the entitlement pursuant to Section 9(a)(ii) of the Class B Preferred Stock (together with holders of Voting Preferred Stock voting as a single class regardless of series) to vote is suspended as described in the preceding sentence, the terms of office of all Persons elected as directors pursuant to Section 9(a)(ii) shall terminate upon the election of the two directors elected pursuant to a vote of the Class B Preferred Stock and Voting Preferred Stock voting as a single class as a result of a failure to maintain a specified level of consolidated shareholders' equity required by the terms of such class or series of Voting Preferred Stock. Whenever (1) in the case of an arrearage in dividends described in clause (i), all arrears in dividends on the Class B Preferred Stock and the Voting Preferred Stock then outstanding shall have been paid and dividends thereon for the current quarterly dividend period shall have been paid or declared and set apart for payment, or (2) in the case of a shortfall in the Corporation's consolidated shareholders' equity described in clause (ii), the consolidated shareholders' equity of the Corporation (determined in accordance with generally accepted accounting principles and giving effect to any adjustment for the net unrealized gain or loss on assets available for sale) at the end of any subsequent calendar quarter equals or exceeds 150% of the aggregate Liquidation Preference (excluding any accumulated, accrued and unpaid dividends) of the then outstanding Class B Preferred Stock and the aggregate liquidation preference (excluding any accumulated, accrued and unpaid dividends) of the then outstanding Parity Stock, then the right of the holders of the Class B Preferred Stock and the Voting Preferred Stock to elect such additional two directors shall cease (but subject always to the same provision for the vesting of such voting rights in the case of any similar future arrearages in six quarterly dividends or shortfall in consolidated shareholders' equity), and the terms of office of all Persons elected as directors by the holders of the Class B Preferred Stock and the Voting Preferred Stock shall forthwith terminate and the number of directors constituting the Board of Directors shall be reduced accordingly. At any time after such voting power shall have been so vested in the holders of Class B Preferred Stock and the Voting Preferred Stock, if applicable, the Secretary of the Corporation may, and upon the written request of any holder of Class B Preferred Stock (addressed to the Secretary at the principal office of the Corporation) shall, call a special meeting of the holders of the Class B Preferred Stock and of the Voting Preferred Stock for the election of the two Directors to be elected by them as herein provided, such call to be made by notice similar to that provided in the Bylaws of the Corporation for a special meeting of the stockholders or as required by law. If any such special meeting required to be called as above provided shall not be called by the Secretary within 20 days after receipt of any such request, then any holder of Class B Preferred Stock may call such meeting, upon the notice above provided, and for that purpose shall have access to the stock books of the Corporation. The Directors elected at any such special meeting shall hold office until the next annual meeting of the stockholders or special meeting held in lieu thereof if such office shall not have previously terminated as above provided. If any vacancy shall occur among the Directors elected by the holders of the Class B Preferred Stock and the Voting Preferred Stock, a successor shall be elected by the Board of Directors, upon the nomination of the then-remaining Director elected by the holders of the Class B Preferred Stock and the Voting Preferred Stock or the successor of such remaining Director, to serve until the next annual meeting of the stockholders or special meeting held in place thereof if such office shall not have previously terminated as provided above.

(b) So long as any shares of Class B Preferred Stock are outstanding, in addition to any other vote or consent of stockholders required by law or by the Articles of Incorporation, as amended, the affirmative vote of at least 66 2/3% of the votes entitled to be cast by the holders of the Class B Preferred Stock, given in Person or by proxy, either in writing without a meeting or by vote at any meeting called for the purpose, shall be necessary for effecting or validating:

(i) Any amendment, alteration or repeal of any of the provisions of these Articles Supplementary to the Articles of Incorporation, the Articles of Incorporation or the Bylaws of the Corporation that materially adversely affects the voting powers, rights or preferences of the holders of the Class B Preferred Stock; provided, however, that the amendment of the provisions of the Articles of Incorporation so as to authorize or create, or to increase the authorized amount of, any Junior Stock or any shares of any class ranking on a parity with the Class B Preferred Stock shall not be deemed to materially adversely affect the voting powers, rights or preferences of the holders of Class B Preferred Stock; or

(ii) The authorization or creation of, or the increase in the authorized amount of, any shares of any class or any security convertible into shares of any class ranking prior or senior to the Class B Preferred Stock in the distribution of assets on any liquidation, dissolution or winding up of the Corporation or in the payment of dividends; provided, however, that no such vote of the holders of Class B Preferred Stock shall be required if, at or prior to the time when such amendment, alteration or repeal is to take effect, or when the issuance of any such prior shares or convertible security is to be made, as the case may be, provision is made for the redemption of all shares of Class B Preferred Stock at the time outstanding.

For purposes of the foregoing provisions and all other voting rights under these Articles Supplementary, each share of Class B Preferred Stock shall have one (1) vote per share, except that when any other class or series of preferred stock shall have the right to vote with the Class B Preferred Stock as a single class on any matter, then the Class B Preferred Stock and such other class or series shall have with respect to such matters one (1) vote per $31.00 of stated liquidation preference. Except as otherwise required by applicable law or as set forth herein, the Class B Preferred Stock shall not have any relative, participating, optional or other special voting rights and powers other than as set forth herein, and the consent of the holders thereof shall not be required for the taking of any corporate action.

10. *Record Holders.*

The Corporation and the Transfer Agent may deem and treat the record holder of any share of Class B Preferred Stock as the true and lawful owner thereof for all purposes, and neither the Corporation nor the Transfer Agent shall be affected by any notice to the contrary.

IN WITNESS WHEREOF, the Corporation has caused these presents to be signed in its name and on its behalf by its President and witnessed by its Secretary on August 9, 1996.

WITNESS:

/s/ Frederick H. Borden
Frederick H. Borden
Secretary

REDWOOD TRUST, INC.

By: /s/ Douglas B. Hansen
Douglas B. Hansen
President

THE UNDERSIGNED, President of Redwood Trust, Inc., who executed on behalf of the Corporation the Articles Supplementary of which this Certificate is made a part, hereby acknowledges in the name and on behalf of said Corporation the foregoing Articles Supplementary to be the corporate act of said Corporation and hereby certifies that the matters and facts set forth herein with respect to the authorization and approval thereof are true in all material respects under the penalties of perjury.

/s/ Douglas B. Hansen
Douglas B. Hansen
President

EXHIBIT 3.1.4

REDWOOD TRUST, INC.

CERTIFICATE OF AMENDMENT

REDWOOD TRUST, INC., a Maryland corporation (which is hereinafter called the "Corporation"), hereby certifies to the State Department of Assessments and Taxation of Maryland that:

FIRST: The Charter of the Corporation is hereby amended as follows:

(a) Section 3 of Article XI of this Corporation's Charter is amended to read in its entirety as follows:

Section 3. Prevention of Transfer. If the Board of Directors or its designee shall at any time determine in good faith that a purported Transfer has taken place in violation of Section 2 of this Article XI or that a Person intends to acquire or Transfer or has attempted to acquire or Transfer Beneficial Ownership of Capital Stock of the Corporation in violation of Section 2, the Board of Directors or its designee shall take such action as it deems advisable to refuse to give effect to or prevent such Transfer, including, but not limited to, refusing to give effect to such Transfer on the books of the Corporation or instituting proceedings to enjoin such Transfer; provided however, that any purported Transfers in violation of this Article XI shall automatically result in the designation and treatment described in this Article XI, irrespective of any actions (or non-action) by the Board of Directors.

(b) The definition of "Beneficial Ownership" contained in Section 1 of Article XI of this Corporation's Charter is amended to read as follows:

Beneficial Ownership. "Beneficial Ownership" shall mean beneficial ownership as determined under Rule 13d-3, as amended from time to time, adopted pursuant to the Securities Exchange Act of 1934, as amended, of Capital Stock by a Person, either directly or constructively, including through the application of Section 544 of the Code, as modified by Sections 856(h)(1)(B) and 856(h)(3)(A) of the Code and determined without respect to whether such ownership has the effect of meeting the stock ownership requirement of Section 542(a)(2) of the Code. The terms "Beneficial Owner," "Beneficially Owning," "Beneficially Own" and "Beneficially Owned" shall have the correlative meanings.

SECOND: The amendment does not increase the authorized stock of the Corporation.

THIRD: The foregoing amendment to the Charter of the Corporation has been advised by the Board of Directors and approved by the stockholders of the Corporation.

WITNESS:	REDWOOD TRUST, INC.
By: /s/ Vickie L. Rath	By: /s/ Douglas B. Hansen
Vickie L. Rath, Secretary	Douglas B. Hansen, President

THE UNDERSIGNED, President of Redwood Trust, Inc., who executed on behalf of the Corporation the foregoing Articles of Amendment of which this certificate is made a part, hereby acknowledges in the name and on behalf of said Corporation the foregoing Articles of Amendment to be the corporate act of said Corporation and hereby certifies that to the best of his knowledge, information and belief the matters and facts set forth therein with respect to the authorization and approval thereof are true in all material respects under the penalties of perjury.

/s/ Douglas B. Hansen
Douglas B. Hansen, President

[filed 6/30/98]

EXHIBIT 3.1.5

REDWOOD TRUST, INC.

ARTICLES SUPPLEMENTARY TO THE CHARTER

Election to Subtitle 8 of Title 3 of Maryland General Corporation Law Director Vacancy

Redwood Trust, Inc., a Maryland corporation (hereinafter called the "Corporation"), having its principal office at The Corporation Trust, Incorporated, Baltimore City, Maryland, hereby certifies to the State Department of Assessments and Taxation of Maryland, that:

FIRST: Pursuant to Section 3-802 of the Maryland General Corporation Law ("GCL"), the Corporation has elected to be subject to Section 3-804(c) of the Maryland GCL by resolution of its Board of Directors on March 20, 2003.

SECOND: Such Section 3-804(c) of the Maryland GCL provides that:

"(1) Notwithstanding any provision in the charter or bylaws, this subsection applies to a vacancy that results from:

(i) an increase in the size of the board of directors; or

(ii) the death, resignation, or removal of a director.

(2) Each vacancy on the board of directors of a corporation may be filled only by the affirmative vote of a majority of the remaining directors in office, even if the remaining directors do not constitute a quorum.

(3) Any director elected to fill a vacancy shall hold office:

(i) For the remainder of the full term of the class of directors in which the vacancy occurred; and

(ii) Until a successor is elected and qualifies."

IN WITNESS WHEREOF, the Corporation has caused these presents to be signed in its name and on its behalf by its President and witnessed by its Secretary on April 7, 2003.

WITNESS:	REDWOOD TRUST, INC.
/s/ Harold F. Zagunis	/s/ Douglas B. Hansen
Harold F. Zagunis Secretary	Douglas B. Hansen President

THE UNDERSIGNED, President of Redwood Trust, Inc., who executed on behalf of the Corporation the Articles Supplementary of which this Certificate is made a part, hereby acknowledges in the name and on behalf of said Corporation that the matters and facts set forth herein with respect to the authorization and approval thereof are true in all material respects under the penalties of perjury.

/s/ Douglas B. Hansen
Douglas B. Hansen
President

EXHIBIT 3.1.6

REDWOOD TRUST, INC.

ARTICLES OF AMENDMENT

Redwood Trust, Inc., a Maryland corporation (the "Corporation"), hereby certifies to the State Department of Assessments and Taxation of Maryland that:

FIRST: The first sentence of Section (A) of Article VI of the charter of the Corporation (the "Charter") is hereby deleted in its entirety and the following is substituted in lieu thereof:

> The total number of shares of stock of all classes which the Corporation has authority to issue is seventy five million (75,000,000) shares of capital stock, par value one cent ($0.01) per share, amounting in aggregate par value of Seven Hundred Fifty Thousand Dollars ($750,000).

SECOND: The total number of shares of stock which the Corporation had authority to issue immediately prior to the foregoing amendment of the Charter was 50,000,000 shares of capital stock, all of which is classified as common stock, par value $0.01 per share. The aggregate par value of all shares of stock having par value was $500,000.00.

THIRD: The total number of shares of stock which the Corporation has authority to issue pursuant to the foregoing amendment of the Charter is 75,000,000 shares of capital stock, all of which is classified as common stock, par value $0.01 per share. The aggregate par value of all authorized shares of stock having par value is $750,000.00.

FOURTH: The amendment of the Charter as hereinabove set forth has been duly advised by the Board of Directors and approved by the stockholders of the Corporation as required by law.

FIFTH: The undersigned officer of the Corporation acknowledges these Articles of Amendment to be the corporate act of the Corporation and, as to all matters or facts required to be verified under oath, the undersigned officer acknowledges that, to the best of his knowledge, information and belief, these matters and facts are true in all material respects and that this statement is made under the penalties for perjury.

- Signature Page Follows -

IN WITNESS WHEREOF, the Corporation has caused these Articles of Amendment to be executed in its name and on its behalf by the undersigned President and attested by its Secretary this 12th day of June, 2008.

ATTEST:	REDWOOD TRUST, INC.
/s/ Martin S. Hughes	By: /s/ Douglas B. Hansen
Name: Martin S. Hughes	Name: Douglas B. Hansen
Title: Chief Financial Officer and Secretary	Title: President

EXHIBIT 31.1

CHIEF EXECUTIVE OFFICER CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, George E. Bull, III certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Redwood Trust, Inc.

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over the financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's control over financial reporting.

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 5, 2008

/s/ GEORGE E. BULL, III

George E. Bull, III
Chairman of the Board and Chief Executive Officer

EXHIBIT 31.2

CHIEF FINANCIAL OFFICER CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Martin S. Hughes, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Redwood Trust, Inc.

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over the financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's control over financial reporting.

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 5, 2008

/s/ MARTIN S. HUGHES
Martin S. Hughes
Chief Financial Officer and Secretary

EXHIBIT 32.1

Certification of Chief Executive Officer Regarding Quarterly Report On Form 10-Q
Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report of Redwood Trust, Inc. (the "Company") on Form 10-Q, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, George E. Bull, III, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company for the periods indicated.

Date: August 5, 2008

/s/ GEORGE E. BULL, III
George E. Bull, III
Chairman of the Board and Chief Executive Officer

EXHIBIT 32.2

Certification of Chief Financial Officer Regarding Quarterly Report on Form 10-Q
Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report of Redwood Trust, Inc. (the "Company") on Form 10-Q, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Martin S. Hughes, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company for the periods indicated.

Date: August 5, 2008

/s/ MARTIN S. HUGHES
Martin S. Hughes
Chief Financial Officer and Secretary